Depression Baby

Article by: Nick Stenger, *Chief Executive Officer, Financial Advisor*
Phone: (630) 912-8295 | Email: nick.stenger@stengerfamilyoffice.com

My grandmother was 3 years old when the Great Depression struck in 1929, sending a shockwave through the global economy. Unemployment peaked at 30% in 1932, not dropping below double-digit levels until the early 1940's. U.S. economic output dropped 53% and the Dow plummeted over 89%. Just 16 years before the crash, the Federal Reserve Act of 1913 was signed into law, establishing a central banking system in the United States. The goal of the Fed was to create a "stable monetary system." If the Fed were graded on its performance against its stated goal, it would have received an "F."

Grandma immigrated to the United States as a first generation American from Hungary as a young woman, entering through Ellis Island. She remembered children playing in the streets with stacks of worthless inflated cash. Growing up, she told me to be careful with money and save for a rainy day, of which she had lived through plenty. If you've ever met a depression baby, you know their philosophy on money was deeply rooted in conservation, and a passionate distaste for communism and socialism. Like millions of immigrants, Grandma came to America in search of freedom.

While our Founders set us up with checks and balances, the rule of law and personal property rights, one authoritarian downfall they missed was centralization of the banking system. As the founder of the Rothschild banking dynasty said in the late 1700's, "Permit me to issue and control the money of a nation, and I care not who makes its laws." Since the Fed was created, our currency has lost 97% of its purchasing power and all the while, politicians have kept us distracted by dividing us against our fellow citizens. The true enemy of the American people is not the left nor the right, but rather a shadow banking system that has caused every correction, panic, recession and depression in modern history. While we don't think we'll enter another depression any time soon, we do believe some investors are improperly prepared for the potential of more pain ahead in the economy.

One core similarity between today's environment and the years leading up to the Great Depression was a mass reduction in M2 money supply. In just 3 years, money supply shrank by 30%. At the same time, the Fed hiked rates from near 3% to over 6% in a few months. Liquidity was rapidly sucked out of the system while higher rates slowed down the overall economy. Today, M2 is down 6.25% since its all time high and headed lower. Like other panics in the past, short term interest rates are now above 5%, their highest level since 2007. We don't want to be the voice of doom and gloom, but our warning to clients is, we're not out of the woods yet.

So far in 2023, tech stocks have rallied significantly in the hopes of no more rate hikes and potentially even a few cuts in 2024. We think this idea is largely based on a fantasy, and that many high-flying tech companies have risen to levels unsupported by their earnings. While earnings aren't in bad shape, many large S&P 500 Index companies are now priced for perfection. Again, this doesn't mean the world will come crashing down any time soon, it just means, buyer beware.

As the allocators of your capital, we want to buy great companies and hold them for the long run. At the same time though, we don't want to overpay for their earnings. Plenty of stock market bubbles have happened the past 200 years, we don't want our clients left holding the bag of overpriced companies no matter how great they may appear. Rather, we want to own companies with business models that make sense, have plenty of cash on their balance sheets, and have a high degree of operating leverage in the case of a downturn. We expect more volatility the rest of the summer and possibly into 2024. Don't panic or get tossed overboard your long-term plan. Again, we don't think the sky is falling any time soon, but investors should be prepared for some choppiness until we burn off bad monetary policy the past three years.

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