The Bill is Due

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Spending money on a credit card is all fun and games…until the bill comes due. Politicians the past three years have had the spending spree of a lifetime, from President Trump's $2.3 trillion pandemic spending package to President Biden's $1.2 trillion so-called "Inflation Reduction Act," and $1.9 trillion "American Rescue Plan." Collectively, these spending package cost more on an inflation adjusted basis than the Marshall Plan, TARP, and the Great Society combined. Since 2020, we've added 40% in total federal debt, one of the sharpest increases in history. Worse yet, we didn't raise bonds or pass tax hikes to pay for the increased spending, rather the Federal Reserve printed the cash out of thin air. $100,000 in a bank account in 2019 is now worth $71,400 thanks to the central bank's devaluation of our currency.

Thomas Sowell wrote in a 2005 op-ed entitled, The Lure of the Free Lunch, "Costs don't go away because you refuse to pay them, any more than gravity goes away if you refuse to acknowledge it. You usually pay more in different ways, through taxes as well as prices, and by deterioration in quality when political processes replace economic process." At some point, the bill for our ridiculous print and spend mentality will come due, it's just a matter of when and where. While we haven't turned bearish and still believe market math favors patient long run optimism, we do think there could be some pain ahead as we burn off bad economic policy. In our view, there are 3 key areas where we will continue paying off the bill.

#1 – Currency Devaluation: Like we stated earlier, our currency is worth roughly 40% less today than in 2019. Housing is still in high demand at a time of low supply. Families with sub 4% rates are unlikely to move unless rates and prices drop back down to parity, improbable unless the Fed aggressively cuts rates. Used car prices are up 44% and new cars are up 22% the past 3 years, an area of consumer spending that should drop over time, not increase. Food prices are up 23% since 2020, double the long run average annual increase. The same goes for energy prices – although lower than peak 2022 levels, are still up double the long run average annual rate of increase. Printing money isn't the magic solution politicians and central bankers wish it were. The cost of funny money is that each incremental dollar becomes worth less.

#2 – Gutting of the Middle Class: While critics of capitalism say the rich are getting richer and the poor are getting poorer, the U.S. model of wealth creation has minted more millionaires than anywhere else on earth and lifted more people out of abject poverty than any other economic system that's ever been tried. The true culprit of the wealth divide is government intervention that imposes excessive rules and regulation that stalls innovation and creates unintentional monopolies. The middle and lower classes bear the brunt of a big government that works hand in glove with big business and a big Fed. Like the Orwellian 1984 novel describes, big government is the boot stamping out the face of individuals.

#3 – Small Cap Abyss: When the Fed whipsaws interest rates, small and medium sized businesses can get hurt in a big way. Not only is the cost of capital higher in general for smaller businesses, but many financed equipment, machinery, real estate and a variety of other assets during 2020 and 2021 at rock bottom interest rates. Many of those loans are made on 3 or 5-year basis, placing their maturity dates between 2023 and 2026. Unless rates are substantially lowered soon, small and mid-caps will have to make tough choices on future expansion plans vs. paying down debt.

None of this means you should panic out of strong, U.S. blue chip stocks, but rather be aware of the short-term market risk and plan accordingly. We continue advising clients to remain conservative with spending, deferring unnecessary spending and maintaining a short-term treasury portfolio to finance upcoming expenses. The silver lining of the current economic environment is that consumer spending and corporate profits are still strong. While we could see some short-term pain, we think long run the U.S. economy is still in great shape and the best place to allocate capital.

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