Rodney’s Take

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The ONE Mitigating Factor: Cash

In the book *Shōgun* (James Clavell, 1975), the main character, Englishman John Blackthorne, is shipwrecked in Japan around 1600. He is captured and, through a series of adventures, learns some of the language and comes to appreciate the Japanese culture. I remember an exchange in the book where a Japanese leader asks his prisoner Blackthorne if there is ever a mitigating factor for a revolution. Blackthorne’s reply is something along the line of, “Yes… If you win.”

The economy strikes me that way. I can name a dozen reasons why we should be headed into a recession, including an inverted yield curve, the Fed draining liquidity from the economy, and higher rates dampening credit sales while making some debt-financed projects unprofitable. But, just like Blackthorne’s answer in the book, there is one, huge mitigating factor: more money.

For more than a decade, I’ve been surprised that central banks have printed money, seemingly with no repercussions. The bankers sterilized the cash, which fed gobs of liquidity into financial assets instead of the normal economy. This meant eye-watering gains for stock and bond investors, with just crumbs left over for people living off paychecks. The 2010s were a lost decade of economic growth: GDP and median hourly earnings merely crept higher while equity and bond values soared. Just as economic reality began to catch up to the markets in 2019 and early 2020, the pandemic hit, bringing a government bailout measuring in the trillions of dollars. Not to be outdone, the Fed restarted the printing press and created another $4.5 trillion dollars.

The reckoning was postponed at least until March 2022, when the Fed made inflation Public Enemy No. 1.

But while the Fed was draining fuel from the economy, another source came to the rescue. Through a number of initiatives, including the Inflation Reduction Act, the federal government pledged to spend at least $1 trillion to fund our transition to green energy. Whether it be to EV buyers, carmakers, transmission line companies, or some other group, all that money has to go somewhere. Last week, the U.S. Bureau of Economic Analysis reported that second-quarter GDP increased 2.4% on an annualized basis, pushed higher by moderate consumer spending, solid government spending, and unexpectedly high business spending. Since many businesses stand to gain from government subsidies, this makes sense.

As for investors, they're doing their best McDonald's imitation (I'm loving it!), as they watch equities soar while they get paid 5% on overnight money.

To be sure, there's a price to be paid. The debt will come due, and government spending will crowd out private investment, which depresses productivity. We saw some of this during the 2010s, but most people didn't pay attention or perhaps didn't care. They will. Or rather, their kids and grandkids will. Even if Keynes is proved right yet again (the markets can remain irrational for longer than you can remain solvent), the economic price of declining productivity will grind away at the standard of living of those who earn paychecks. Grandma and Grandpa might have a nice house and an investment portfolio, but the Millennials and Gen Z are struggling just to buy used cars for less than $40,000, much less a home. Let's hope the grandparents are generous when they make out their wills.

For now, government largesse has won the day and probably at least the next year. Our expected deficit spending, at $1.2 trillion to $1.6 trillion, likely will keep the wheels from coming off the economy and keep financial assets on a roll. If your situation allows you to profit from it, great. If you're still working for a living, consider sending better Christmas gifts to your grandparents.

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Got a question or comment? You can contact us at info@hsdent.com.