



Third Quarter 2021 Commentary

October 21, 2021

If you multiply 2021 years by 365 days, then by 24 hours, and again by 60, you find that there have been about a billion minutes since the birth of Jesus Christ. That number requiring a thought exercise to comprehend has become quaint in our federal budgeting process. Now our politicians deal in trillions, which requires a reference back two million years to the early Stone Age. So, if you had a dollar for every minute since cave men and women were inventing rudimentary tools, you would only scratch the surface of President Biden's Build Back Better plan.

The New York Times describes the \$3.5 trillion to be spent throughout the next ten years as "a cradle-to-grave reweaving of a social safety net." It increases medical leave, child care, and educational benefits up to college. Housing, food, and medical benefits are also expanded for everyone living in the country, including all the illegal immigrants coming across our "closed border." The bill also includes whatever components of the Green New Deal that can survive the partisan budget reconciliation process.

Analysts put the true cost closer to \$5 trillion when considering programs that will probably last throughout the budget term. It comes after \$1 trillion already passed in a bipartisan Senate infrastructure bill. The scale of the proposals looks like a bridge too far for some Democrats, so Congressional leadership has called for further budget gimmicks to bring the price tag down. They are confident that once people get used to monthly "universal basic income" deposits into their bank accounts, the political weight to cancel them will be too great. They know Milton Friedman's rule that nothing is as permanent as a temporary government program.

President Biden says the plan will have "zero cost" because taxes on corporations and the rich will pay for it. The energy industry will bear a heavy burden with a complete rewriting of their accounting schedules. When asked about consumers ultimately paying those taxes through price increases, the White House press secretary said that would be "unfair and absurd." The plan is most likely to be paid for by Modern Monetary Theory, the greatest monetary innovation since the Stone Age, where the Federal Reserve prints money to buy the bonds to finance history's largest government expansion.

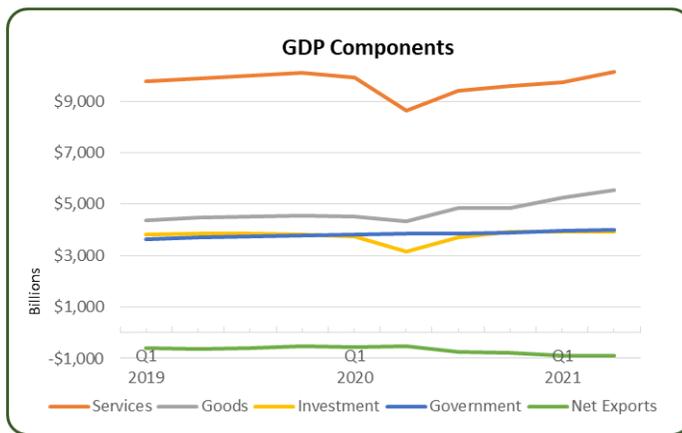
The stock market cheered the plan by building on its historic rally, but gave back most of the quarterly gains in September as Fed officials signaled the tapering of their \$120 billion monthly expansions. By the end of the third quarter, the S&P500 had barely broken even while the Dow Jones and NASDAQ averages finished slightly negative.

Trading the Fed

Everyone loves a bull market, especially some Fed governors who took on aggressive stock positions prior to announcements of monetary expansions. Their very profitable trades appeared on financial disclosure statements highlighting their privileged status in our economic ecosystem. The scrutiny sent

two governors into early retirement and put a cloud over a third. Replacements will need to be confirmed by Sen. Elizabeth Warren’s Senate Finance Committee, so don’t expect a hawkish tilt. Chairman Jerome Powell has also reached the end of his four-year term and saw his private trading records released. He was a seller into the rally, not a buyer in front of Fed action. Although not incriminating, the release of his personal information highlights the political ramifications of his renomination.

Chairman Powell not only finds himself at the end of his term but also at the end of the Fed’s monumental monetary expansions during the past twelve years, including his “nuclear” response to Covid. With inflation running above their heightened expectations, more printing has become harder to justify. Milton Friedman, history’s most respected monetary economist, defined inflation as too much money chasing too few goods. The Fed says today’s “transitory” inflation is from bottlenecks preventing goods from getting to markets, as seen at California’s ports, which should improve with the economy.



The nearby chart shows the components of Gross Domestic Product have all surpassed their pre-pandemic levels as of June, with further improvement in the third quarter. Except for imports coming from Asia, it doesn’t seem like the economy is suffering from a shortage of goods, which have been the strongest component of GDP. Instead, we have monetary growth far exceeding any historic precedent, leaving Fed policy as the prime culprit for the highest inflation rates in thirty years.

With the economy fully recovered from last year’s shutdowns, the unemployment rate registering below the inflation rate clearly says the historic monetary injections are no longer needed. Powell has projected a tapering of the Fed’s monthly expansions to begin in November and wind down to zero “sometime around the middle of next year.” Then, interest rates would be gradually raised from their zero bound. Markets seem to accept the plan, but politicians are another story.

If the proposed spending gets signed into law, the Fed will need to buy the bonds and prevent interest rates from spiking up. The Bank of China has become a consistent seller of United States Treasury debt, so their days of funding our deficits are over. With all the recent turnover, The Federal Reserve is at an important juncture, whether or not Jerome Powell continues as its Chairman.

Voices from the left are calling for Fed Governor Lael Brainard to replace Powell and usher in a new age of Modern Monetary Theory. The nomination usually comes around this time of year, so they may have delayed the taper to get past it. Whether Powell continues on his path back to normalization, or an alternative directs a new course along the current trajectory, is likely to become a marker of world economic history.

The stock market prefers to look at trees rather than the forest, even when both are showing age. Valuation improved slightly over the flat third quarter as freely floating monetary policy kept prices near highs while earnings improved. Gradual weakness after the Fed’s tapering signals was widespread across sectors, even hitting the inflation hedges in the Stepping Stones fully invested equity ETF strategy. Our staples position, whose products are disappearing from shelves before being replaced by higher priced and smaller packages declined by more than 1%, and the basic materials position, enjoying rising prices for their products, lost almost 4%. The gold miners did worse, declining by 13%. Even the

semiconductors fund couldn't benefit from a historic supply demand imbalance keeping prices high. Smaller companies are generally price takers, explaining weakness in that position while our European and dividend positions reflected the broadness of the late quarter weakness. Our utilities and currency hedged Japan funds were winners while our energy position gained slightly as prices rise with plummeting domestic production. For all the talk about sticking it to the oil companies, they have been the greatest beneficiaries of the Administration's policies, as we can all see when we fill up our cars. The overall strategy declined by -2.92% on a price basis in the third quarter, compared to the S&P500 returning 0.23% and the MSCI All World index dropping by -1.26%.

Emergency Measures

There are factors suppressing the economy beyond the waves of covid still rolling through the world. Having promised that nobody would ever be mandated to take a newly developed vaccine, President Biden issued a September decree doing just that. The vaccine mandate is currently taking effect and eliminating high value workers from the economy, which is already struggling to fill open positions that exceed the number of unemployed workers. Although enhanced federal unemployment benefits ended in September, other government transfer programs have lessened the need for many workers to return to the workforce.

The worker shortage explains some of the supply chain bottlenecks, while policies addressing climate change and social justice are causing other effects. Recent state laws have banned trucks built prior to 2011, and not union operated, from picking up goods at California ports. Those two laws have eliminated half of the nation's cross-country trucking fleet, especially the owner operators who have traditionally served those ports. That's the main reason for the California container ship backlog.

Our leaders have done nothing to eradicate the pandemic, while they continue to expand policies that inflict further harm. They seem to need a constant crisis to justify their everlasting emergency measures. It's not science driving a mandate for a vaccine whose effectiveness is underscored by the need for boosters. Nor is it good politics to enrage so many voters by preventing them from working or socializing. We are living under policies dictated by pride, the deadliest of sins.

Much of our politics have taken on a nihilistic aim to destroy America's traditional institutions, while dissention is silenced and canceled. Our post-truth era sees weakening economic numbers touted as continued progress. The military debacle in Afghanistan is called an "outstanding success." Our border is declared closed as waves of illegal immigrants cross freely and get shuttled through the country under darkness. Energy prices are spiking up as America's newfound independence has been cast aside. All the while, the White House press secretary echoes Groucho Marx saying "who you gonna believe, me or your lying eyes." George Orwell would be impressed with 21st century America, where newspeak and doublespeak confound logic, and some people are more equal than others.

Looking locally, we are thrilled to welcome the rise of Broadway's curtain, signaling New York City's return to normalcy. Social life is coming back to restaurants and events, even though the unvaccinated are excluded. The city is awakening from its slumber as the terror of last year's pandemic has been tempered by treatments and vaccines. It's high time for our politicians to surrender their emergency decrees and let everyone get on with our lives. New York City will soon have a new mayor and both leading candidates' rejection of wokeism is encouraging.

We can only hope the rest of America rejects the socialist siren song, and we can enjoy the return of a free market economy someday. Washington DC is working hard to prevent that, and all those executive orders that President Biden signed in his first week are having their effects. Clean natural gas has been sidelined

for surging coal production, independent workers are sidelined for union members, and low wages are being depressed by massive immigration. The highest inflation in generations is bringing back hoarding and empty shelves as The Washington Post editorializes about lowering our expectations.

We will always have high expectations for America, but are maintaining our cash balances in expectations of tighter monetary policy or sustained inflation. Neither scenario has been discounted in current valuations, as a new direction for the Fed will make one of them inevitable. We are at a historic turning point. Either Jerome Powell follows through on his pledge to end history's greatest monetary expansion, or the Fed fully embraces Modern Monetary Theory to fund the expansion of government. We should know which path they choose by the end of the fourth quarter.

As we approach the holidays, we are thankful for the gradual return to normalcy as the pandemic comes under control, and wish you a happy and blessed holiday season. Until then and as always, thank you for your trust and thank you for your business.

Yours truly,

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