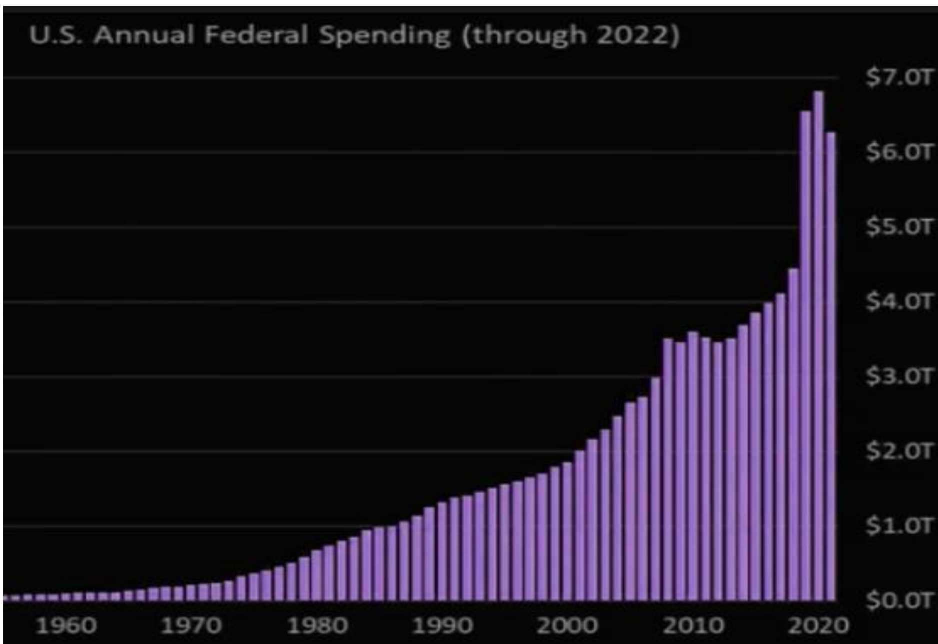
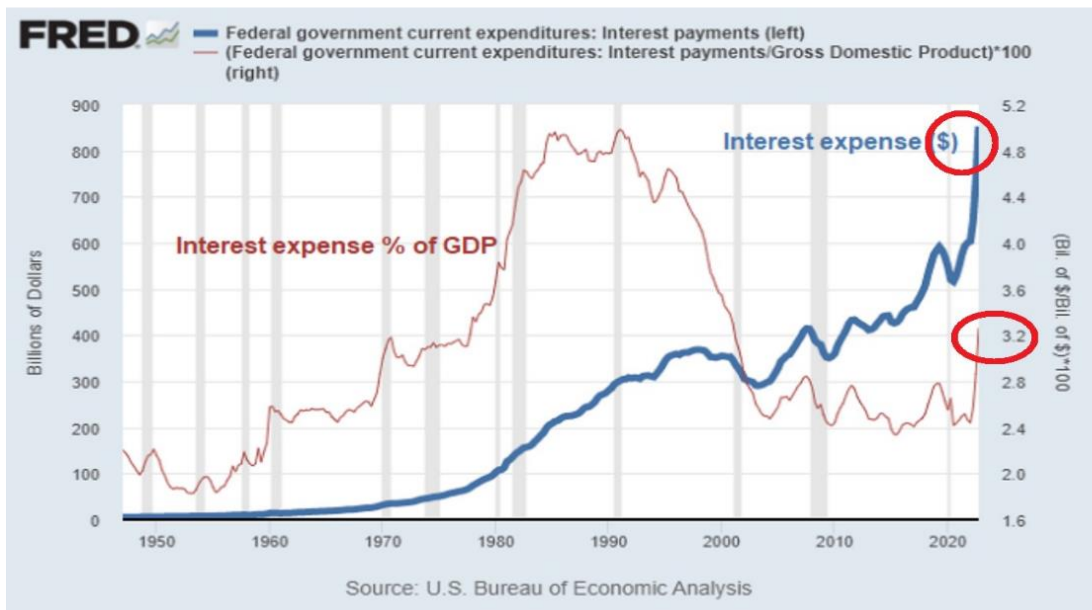
Trudenomics 10/30/2023

As I wrote in my last note, the stock market tenor has changed over the past 3 months, with lots of up and (most recently) down action as investors are wondering if the huge interest rate increases by the Fed are going to kill the market or whether the "artificial stimulus" of the federal government or the "Artificial intelligence" boom will save the day. In Q3 2023, the major stock and bond indexes were down between -3.5% and -4.0%. Was not a pretty quarter and the trouble is persisting. At one point the S&P 500 Index was plus 19% for the year and it is now about +9% (10.30.2023) and is below its 200-day moving average. 6 of the 11 subsectors of the index are in a "bear" market, meaning they are down 20% or more from their 52-week high.* The bond indexes are down for the 3rd straight year. As I type, the Dow Jones Index, the mid-cap index, the small-cap index, the European Index are all flat to negative for the 2nd year in a row.** This is a huge change from just a couple of months ago when they were all nicely positive. Our managed accounts at Nationwide are positive for the year and we remain cautious with a lots of short-term bonds and money market funds, although in the past week or so we have started buying some government long bond funds due to their high yield. We have reduced allocations of stocks while keeping a solid allocation to commodities, which has served us well the last couple of months (although not today). This doesn't mean markets won't zoom upward for a bit. At this moment, most "sentiment" is negative and the indexes have been down 10 of the last 12 days, which is often a trigger for markets to rebound. Additionally, the last 2 months of the year have "traditionally" been positive. Since 1953, there have been 53 up periods and 17 down periods.^ With this in mind, I have started the process of getting more aggressive. Of course, positions may change at any time.

*Sentiment Trader 10.23.2023 ** Source: Yahoo Finance ^Sentiment Trader 10.30.2023 ** Source: Yahoo Finance



I call our current economy "Trudenomics," the philosophy of which is to spend as much as you can, as fast as you can, for as long as you can. It represents, by the two presidents (Trump and Biden), the largest fiscal (government) spending spree in the history of the world. In 2019, total federal spending was about $4.5 trillion. The last 3 years it has averaged about $6.5 trillion with cumulative deficits of a "lotta" trillions (see graph). A few short years ago, the yearly interest paid on the national debt was in the $400 billion range. Now it is rising to the $1 trillion range (see "FRED" graph below) with no end in sight and now surpasses defense as the largest non-"entitlement" expenditure. It really is crazy that we used to fight about $300- or $400 billion-dollar deficits and now hardly anyone in the two major political parties is willing to tackle the current madness of $1.7+ trillion deficits.



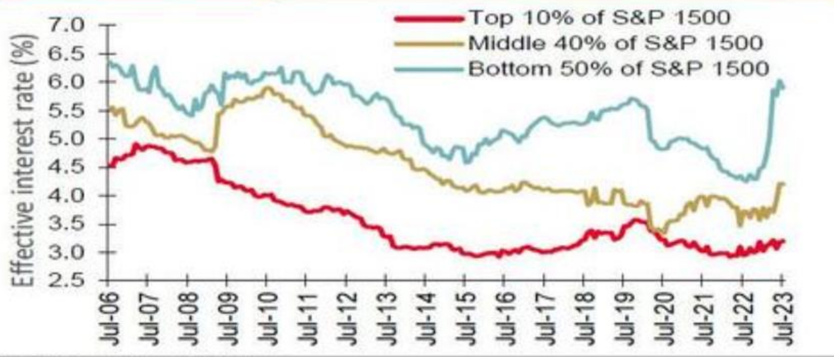
Imagine you took out the ol' credit card and used it to buy TVs for every room in your house, world vacations for the whole family, 2 luxury cars, and a partridge in a pear tree. Your family would love you. Your neighbors would be envious. Jobs would be plentiful. Your GDP would skyrocket. However, it's all because of debt and not because of increasing productivity. Eventually your interest payments would skyrocket as well, causing you to have a deflationary shock on the other end. I believe it was Herb Stein who said, "if something can't go on forever, it won't." My favorite 5 economic words are, "there is no free lunch." It is my belief; the excesses of the past 3 years (and 50 years) will be paid by reductions in the years ahead. Anything less would, in my opinion, require us to believe in fairies.

I'm reading a book by one of my favorite historical fiction authors, Gore Vidal, titled "The Golden Age," which is what he calls the era prior to WWII to a few years after. Vidal discusses the machinations of FDR to drive the US into a war that 80% of the populace didn't want prior to the Pearl Harbor bombing. According to the book, and in other history books I've read, the US created a situation whereby Japan was virtually forced to attack us, allowing FDR to declare war on Japan and, since they were an ally of Germany, to allow us to declare war on Germany. FDR ran and won the 1940 campaign by saying he wouldn't get the US into war, but there was small print in the statement that said, "unless we are attacked."

Reading the book, I was struck at the numerous parallels, including the political divisiveness at home and abroad, between the late '30s and today, especially involving discussions about war (we always think "nothing like this has happened before" and it has all happened before). I don't have room to go into all the similarities but I do want to touch on the "war" aspect. War increases the power and needs of the state, especially the need to spend money on stuff that blows up and then needs to be replaced. War is initially, inherently, inflationary. With much of the western world already in a "command" economy mandating a move from oil to electricity, although I suspect that will change, I believe the outcomes to be longer periods of inflation, higher interest rates, and higher commodity prices, at least until something in the financial system blows up. In my last note, I discussed the rotating 15 year cycles between stocks and commodities (https://tacticaladvisoryservices.com/market-updates). What's going on the world today fits that

"prediction" perfectly. We are moving to a separated world where we don't trust others to supply us our wants so we are changing our supply lines and/or locating them in the USA/North America (for more on this subject go to www.zeihan.com.) These changes are costly. Expect to pay more for your daily living. This creates a vicious circle whereby the Fed raises rates thereby increasing the cost of making these changes, which causes wages to go up, which causes prices to go up. I just stopped at Micky D's for 2 biscuit and egg b'fast sandwiches. What used to be under $5 is now over $10. Normally, the rapid interest rate increases by the Fed would have already caused a slowdown, however, massive fiscal (government) spending^ to fund the electrical revolution, the war, social security benefit increases, and much larger government interest payments which go to investors and corporations (as mentioned above), has allowed the party to continue, at least for the time being.

^https://www.zerohedge.com/economics/here-1-trillion-stealth-stimulus-behind-bidenomics



This year has seen an almost a record bifurcation in returns between the large tech stock indexes and the rest of the stock market world.^ The gap in returns between small stocks and the S&P 500 Index has not been seen since 1930*. Essentially, if one hasn't been heavily weighted in mega size tech stocks that sport massive price to earnings ratios, one has made little to nothing. Curiously, one of the reasons for this anomaly, in my opinion, is increasing rates, which is contrary to what all the investing textbooks say. Large companies borrowed billions of dollars (issued bonds) during the low rates of 2020 and 2021, and now have that cash stashed in money markets paying 5% and are making profits on the borrowed money.* Small companies that couldn't issue bonds have seen their borrowing rates skyrocket and their ability to pay interest from their cash flow has declined (see the graph – smaller companies (blue line) have seen their net interest rates go from 4.5% to 6.5% while the largest companies (red line) have seen little change, so far).

^https://users.sentimentrader.com/users/sentimentedge/the-first-year-of-this-bull-market-has-been-unlike-any-other
*https://www.zerohedge.com/markets/something-very-strange-has-happened-albert-edwards-stunned-maddest-macro-chart-i-have-seen

For many years we've been conditioned to believe that "stock markets always go up" and that the returns of the past 100 years will be duplicated in the next 100 years if we just wait. What if the conditions that created the returns of the past 100 years are no longer in place?* People forget stock markets returned nothing on a "buy and hold" basis from 1929-1945, 1969-1982, and from 2000-2013. From Sept 1981 through July 2020, bonds were in a bull market, meaning interest rates were declining and values were increasing. As such, they were a great hedge against stock losses. That has not been the case for 3 years now. As I type, we remain about -13% below the all-time highs on 1/3/2022 for the S&P 500 Index. I believe there's a much greater than 0% chance we may be in for a long stretch of "nothing" starting from the 1/3/2022 date for many reasons including:

1) Excess debt that reduces investment and consumption.
2) Demographics whereby baby boomers are spending their children's inheritance rather than investing.
3) Reduced population growth worldwide, especially in developed countries and China.
4) The work ethic/productivity of the past 100 years has declined and, due to changing habits, will most likely continue that path.

We all know stock markets may do anything at any time. It's possible, we go up 10% from here into the year end for no reason other than it's the "pain trade," meaning that would be the direction no one is expecting. That doesn't necessarily negate my "prediction." *https://www.mauldineconomics.com/the-10th-man/the-next-100-years

I'm discussing this "doom and gloom" vision because, if what I believe comes to pass, there are investing ideas that may create profitable returns. When we invest in stocks, bonds, real estate, and commodities, there are an unlimited number of outcomes. Some very good, and some very bad. While we like the "very good," the "very bad" is not something any of us want as an option. The past few years, companies have created solutions that I call "structured outcome" investments. These investments link gains to major stock market indexes while reducing or eliminating potential stock market losses.* The trade-off is in some scenarios potential gains are capped while in others, they are not. With these types of investments, you truly can "have your cake and eat it too."

*Based on the claims paying ability of the insuring company.

I have spoken w/ many of you already about "structured outcome" investments such as "RILAs" and "FIAs." If I have not, please go to my webpages https://tacticaladvisoryservices.com/structured-outcomes and https://tacticaladvisoryservices.com/buffered-securities. There are short explanations along w/ short videos that explain how these work. I am using these in my own investing and have been quite happy with them.

If you want to see what else I'm reading and researching, here are a few links.

https://www.zerohedge.com/economics/hedge-fund-cio-inflation-still-most-likely-path-government-takes-alternative-depression
https://www.zerohedge.com/markets/elevator-pitch-bonds
https://www.zerohedge.com/markets/more-battle-rare-earths-and-critical-minerals
https://www.zerohedge.com/economics/complete-paralysis-just-1-us-homes-have-changed-hands-2023-lowest-share-record
https://wolfstreet.com/2023/07/21/entire-housing-market-buyers-and-sellers-may-have-shrunk-by-20-25-because-of-the-3-mortgages/

Thank you for allowing us to be of service. Please let us know if you need anything.

Enjoy,

Thomas B. Paine
Paine Financial Services
www.tacticaladvisoryservices.com
Centaurus Financial Inc.
6627-A Bay Laurel Pl
Avila Beach, CA 93424
805-473-6679
805-258-5476 (fax)
Supervisory Branch Office: 1186 E. Grand Ave., Arroyo Grande CA 93420; 805-473-6670 California License #0703852

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