DIVIDENDS
Investment Planning Enewsletter

The Fed will mess it up again

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When I say the "Fed", what am I referring too?
The Federal Reserve Bank of the United States is called the "Fed". They are like our Bank of Canada except they have a much greater impact due to the economic size of the USA. They also have global impact that touches all major economies of the world. I will combine the two, Canada and the US, into this singular discussion.

The Cost of Money
If you are paying a floating rate of interest these days, you know your cost of money has doubled in the last year.
If yours or someone you know, whose mortgage is up for renewal, the payments will basically double what they were before.
Upon these renewals, banks will propose to extend the amortization period to some how make the payments not double...but that is truly not going to cost less interest in the long run.
If you are buying GIC's you know that they are finally paying a reasonable rate of return in the 5% range for 1 thru 5 year GIC's.
Money is worth less because each dollar can buy less than what it could a year ago. Not worthless but worth less.

What has the Fed been up to?
The Fed in concert with the countries they represent printed massive amounts of money to pay out during COVID. They increased what is called the "Money Supply". They have been reducing the money supply this year which is a good thing for that can help reduce inflation. Taking dollars away from those chasing the purchase of goods.
They also have been ramping up interest rates to try and slowdown the economy.
The North American governments, like most nations, have been issuing new debt to cover their increased spending and that costs all of us more. This is why, when governments only spend, and not save, it has the effect of creating more inflation.

What else is causing Inflation

Population growth rates (babies being born) in developed economies is below the rate of replacement. Japan has been the poster child of this for decades. However it is, and has been for some time, a global problem. Yes a problem, not just an issue.

For as those who are highly productive in the workforce say, "I'm done, and retire" it leaves a smaller pool of capable workers to take their place. This smaller pool wants more and demands higher pay. This does not mean they are any more productive. In fact, global productivity rates, are going negative and not positive.

Chart below courtesy of the US Bureau of Labor Statistics

NEWS RELEASES

Productivity decreases 2.1% in Q1 2023; unit labor costs increase 4.2% (annual rates)

06/01/2023

Productivity falls in 30 of 46 wholesale and retail trade industries in 2022

05/25/2023

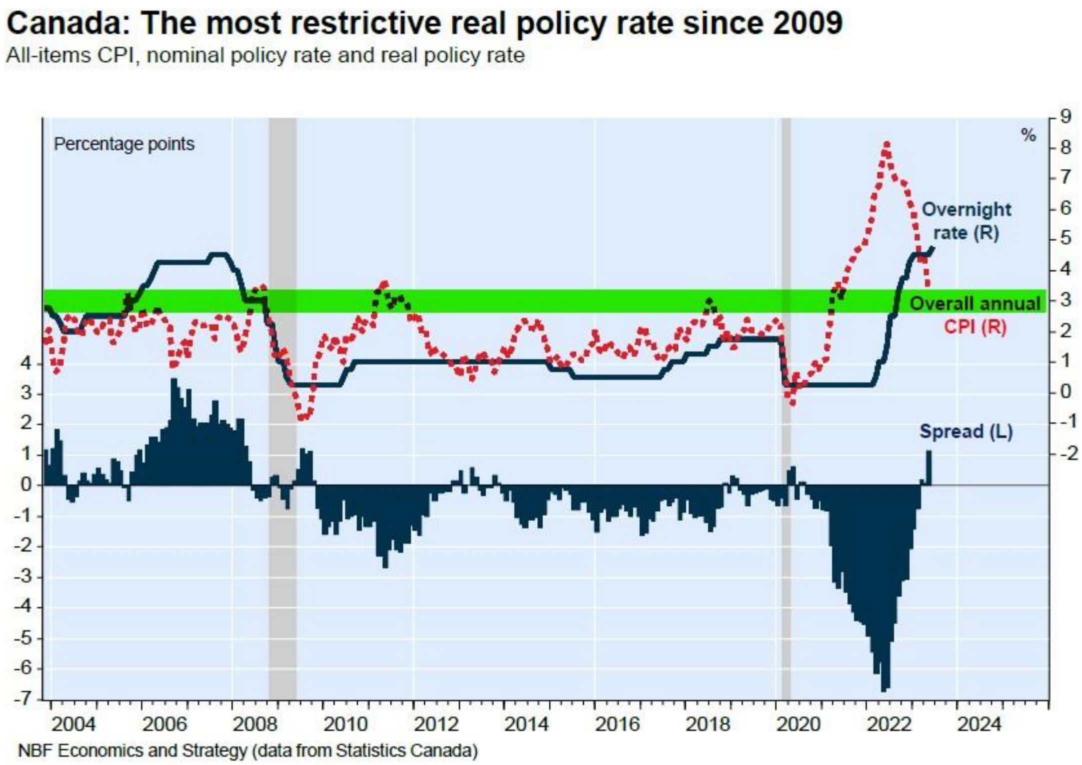
Total factor productivity decreases 1.2% in 2022, following a 4.0% increase in 2021

03/23/2023

Those that retire have more money to spend. Those that remain and receive these higher wages have more money to spend. And spend all shall continue to do. More money chasing goods. And I do not see that changing for decades for it takes decades to reverse negative population growth in the developed world.

Many countries after the world wars invited mass population growth by immigration. Can that work today? Yes, however they need places to live and that remains a North American problem due to the lack of real growth in housing. More people chasing the existing housing supply...that is inflationary.

Check out the chart below showing that inflation was below 3% (green line) for nearly 2 decades. Also note that CPI inflation has been declining since the start of the year.



They will mess it up...like they always do

The Fed feels that by ramping up interest rates on its own will bring down inflation. For it has worked in the past. Jennifer and I still remember our first mortgage at 14%+. Many of you have shared similar memories. Unfortunately raising interest rates alone does not take into consideration the points I have made above. Higher interest rates don't make workers more productive. Increased mortgage payments don't push folks to have babies.

So the Fed has to do more. They need to stop printing money. This tells governments to stop spending and start saving. Do you know who are the biggest buyers of government debt? The US Fed, The Bank of Canada, that's who. They need to stop buying this debt and let it go "unbought" and leave it to the market to buy it. Leave it to you and me to buy it.

If I said to you, I can buy a 30 year Government of Canada bond that is paying 3.25% for the 30 year duration would you buy it? Would I recommend you buy it? NO.
Why would you when you can buy a GIC paying 5%?
Why would you buy it when we can own a company from my Dividend Growth list that is paying a 4% to 6% annual dividend rate, and...grows their dividend, so you get a higher rate over time?
You would not. So why do we permit the "Fed" to continue to buy more of this lower returning money. Let it go unbought and governments must curtail spending increases and that will help to reduce inflation.

I said they will continue to mess it up, like they always do. The Fed always starts an interest rate increase too late and always reduces it too late. They did the front end of this, started too late in raising interest rates, and will do the same on bringing them down.
I believe that interest rates have risen far enough to have an impact. At a bare minimum they should let them be as they are now.

Used Automobile sales are falling
AutoCanada Inc. this week announced a -$12,400,000 write down in their used car inventories value. Additionally, with higher interest rates they have seen an increase of +$13,300,000 to their costs of financing their existing floorplan inventory. That is a double whammy for sure.

Simply, it is an example of the anticipation that COVID's spending over-exuberance would not end. Perhaps some good deals in cars are out there or coming to your local used car lot. New cars still have some limited availability but it is getting better as well.

Happy to speak with you or your friends at 905-309-9990 or email vwarrington@alignedcp.com

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