

# Ivory's Economic Outlook

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*"It's hard running for office when people can't say your name".*

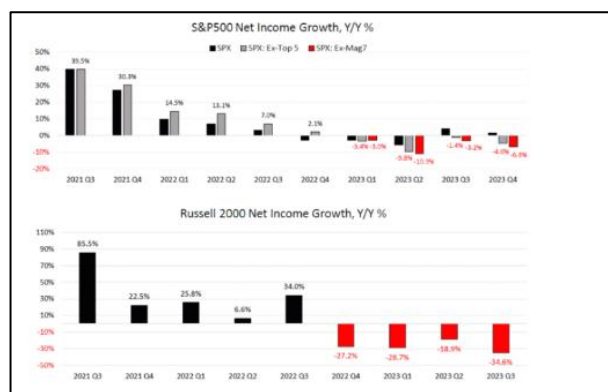
John Boehner, Former Speaker of the United States House of Representatives

Contrary to popular belief, New York City has beaches for residence willing to travel through Brooklyn on the subway, at times a Lord of the Rings style adventure. On a regular basis my 12-year-old cohorts and I would catch the D train from Grand Street with our towels rolled up and head to Brighton or Manhattan Beach. Our parents had already taken us to Coney Island to ride the cyclone; at this point in our illustrious pre-teen years it was time to expand our territory.

I'm obviously dating myself, but a subway token was 50 cents, and we could buy two slices of pizza and a coke for a dollar which required a \$2 subsidy from mom or dad who had already left for work. Asking pops for money when he was at work would be life threatening and so I rode my bike to my mother's job across the street from where the World Trade Center once stood to improve my odds.

The problem was my mother would make a buffalo jump off a nickel and she didn't appreciate unannounced lobbying efforts any more than pops did. The American dreamer from Cuba took no prisoners. This woman is tough, and at times stoic. Now she was irritated. In a Solomon like gesture, she whipped out a dollar for lunch, and when I asked for the other dollar, she said I was just gonna hop the subway and pocket the difference. Then she told me to have a good time as she turned around and got back to work. I recently reminded my mother of the story and without missing a beat she quipped "you got home, didn't you?"

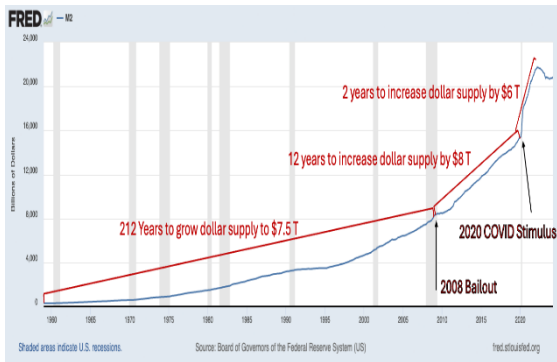
Don't we wish a dollar could still buy lunch? Sometimes nothing is as it seems, what it once was or how it's supposed to be. Change can be difficult. I fell in love with the financial markets and economic theory in State College Pennsylvania when Paul Volcker was the Fed chairman and Sony Walkman's were all the rage. There was a time when corporate earnings meant something, when inflation and GDP growth pulled the stock market wagon and if you could get the direction of those two things right you were in business.



Last year earnings and income growth were negative for both the S&P 500 and the Russell 2000 in all four quarters<sup>1</sup>. My Reagan era professors would have congratulated me for forecasting this slowdown, but that's because they had no way of knowing that the city upon a hill would become a landfill of corporate balance sheets strip mined into a generational bull market and that Congress would add a few more trillion to the mountain of debt just to keep the economic hall of fame narrative intact. Funny thing is nobody cut rates last year. It turns out that what moved prices higher was the Fed increasing liquidity by expanding the balance sheet.

Think about your own household for a minute. Imagine if you owed 100% of your income in debt, your \$100,000 salary complimented by \$100,000 in credit card and car note obligations because you live well beyond your means. Year after year, your friends and family marvel at your lavish lifestyle, and as they sit at the Thanksgiving table, you scratch your head wondering how the hell are you gonna pay for all this stuff.

Fortunately, you have a rich uncle with a golden goose in the basement, the only one of its kind, mass producing golden eggs that the uncle uses to pay off your debt. Several things are set into motion. First, your creditors get repaid and can use the proceeds to lend other people money. At the same time, they are willing to lend you even more money. Finally, this debt doesn't disappear, but rather gets stored in your uncle's basement. Year after year, boxes of your debt pile up in the basement next to the golden goose while you serve filet mignon for Thanksgiving to a family that likely would have preferred turkey.



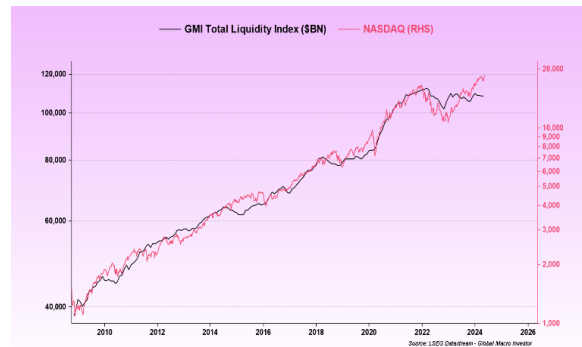
As the saying goes, the U.S. government sells bonds (your debt) to the public to pay its bills and those same government bonds are then purchased by the Federal Reserve (your rich uncle) and placed on its own balance sheet (his basement) which is independent of Uncle Sam's ledger. In doing so, by flooding the market with the manufactured money (golden goose eggs), the Fed increases the money supply and liquidity by legitimizing money not backed by anything of value with the elegance of a seasoned money launderer. It's a win-win for all parties involved: the government (you) gets funded, bondholders (your creditors) get interest payments and

their money back, other families are given credit (liquidity) and the value of financial assets (your lifestyle) keeps increasing along with the size of the debt. There's only one problem: Uncle Sam (you) still have to pay the interest on all that debt, and to do that, he (you) has to borrow more and more money.

On some level, the imminent demise of the financial markets is a bit overblown when the Fed can just grow its balance sheet. One could go a step further and admit that there is no alternative to the current central banking policies here or abroad because the world has more than \$307 trillion in debt<sup>ii</sup> as seemingly every country with a pulse, and good credit, is running up the tab and debasing their currency.

Once again, it's not as complicated as people like me make it sound. If U.S. debt (your credit card balance) to GDP ratio is 100% and the GDP (your salary) is growing at 2%, when interest rates are 2%, we're using 100% of economic growth (salary increases) just to pay the interest on U.S. debt. Everything else must be borrowed and that additional debt compounds. When short term interest rates are 5%, you monetize the debt by putting the 3% gap on the Fed's balance sheet and turning your uncle's basement into a storage unit.

Ayn Rand is one of my favorite authors, known for her classic novel "Atlas Shrugged", a fictional account of self-determination without the need for government interference and incompetent moochers picking the pockets of the free-market masters who create value. The fact that it was written by a Russian immigrant morally opposed to the welfare state who cashed every social security check she could get her hands because she claimed it was restitution is more American than baseball, hot dog's apple pie and Chevrolet.



To make her point she wrote “Money is made possible only by the men who produce. Whenever destroyers appear among men, they start by destroying money, for money is men’s protection and the base of a moral existence. Destroyers seize gold and leave to its owners a counterfeit pile of paper. Paper is a mortgage on wealth that does not exist, backed by a gun aimed at those who are expected to produce it. Paper is a check drawn by legal looters upon an account which is not theirs: upon the virtue of the victims. Watch for the day when it bounces, marked, ‘Account overdrawn.’”

That’s quite a mouthful, but to be clear, the chronically dovish Federal Reserve and profligate government spending resembles a processed food diet of financial engineering that values short term pleasure over the threat of long-term pain. Why waste time in the kitchen when you can snap your fingers like Jerome Powell (Houdini) and have a dish of great tasting diabetes delivered to your doorstep? I mean, it’s not like fast food will kill you over night – sometimes it takes decades, so guess what, super-size me.

Over the last 20 years the Fed’s balance sheet has grown seven-fold from \$1 trillion to \$7.7 trillion. If the market goes up 20% and your homeowners’ insurance increases by the same amount<sup>iii</sup>, your insurance hasn’t gotten better, your money has just gotten worse. The craziest things happen when nearly two-thirds of the total existing money supply was created in the past thirteen years<sup>iv</sup>. Having said that, some indices thrive more than others in this environment and bitcoin and Nasdaq have been the biggest beneficiaries of rising global liquidity.

Bitcoin is easy to understand because there will only be 21 million coins ever produced and you’re exchanging something in abundance, namely a dollar, for something that is scarce such as bitcoin. Nasdaq, for what it’s worth, is dominated by technology companies that improve productivity and have recently benefited from artificial intelligence. More important, and for these purposes, Nasdaq is highly correlated to the ebbs and flows of liquidity.

In this sense, we’re trying to figure out where liquidity is going from here. For a little perspective, the COVID stimulus led to the biggest increase in the money supply in the history of the United States<sup>v</sup> and caused the inflation we’re dealing with now. The Fed raised rates in response and decreased the money supply, but inflation didn’t come down as fast as we’d like.

Now the Fed is in a pickle. They can raise rates and hurt the economy, lower rates to boost economic growth at the expense of higher inflation or do nothing and live with higher inflation and middling economic growth. Should they cut rates, liquidity would go up and that’s positive for all financial assets, bitcoin and Nasdaq in particular. If they raised rates, financial assets would initially suffer, but maybe only for a short time until the Fed comes to the rescue. It’s one thing for Paul Volcker to raise rates when debt to GDP was 30% and quite another when your debt is larger than all economic output, to say nothing about the commercial real estate loans, corporate bonds and private debt maturing in the near future.



Uncle Sam simply can’t afford to pay higher rates on all the debt that’s coming due since we’re already spending more on interest payments than we do on the military<sup>vi</sup>. We are structurally guaranteed to operate at a deficit and borrow money at an increasing rate just to keep the lights on. Nobody has a crystal ball, but chances are the easiest way to do it will be to monetize the debt by increasing the Fed’s balance sheet. No legislation is required, voters have no say and investors think they’re making money until they’re forced to pay their homeowners’ insurance.

It's long been understood that lower rates were good for the markets, but the strong correlation between the Fed's balance sheet and these two asset classes in particular is noteworthy. The case can be made, therefore, that bitcoin and Nasdaq are defensive positions against events that we suspect will come to fruition because the terms have already been set, even if the subsequent effects are unclear.

We're essentially solving for a rising supply of fiat currency. Sure, there are lots of macroeconomic factors involved, but a dominant theme for the next 18 months will likely be a Fed balance sheet that grows like a tumor. Addressing the elephant in the room, that important market signals matter less than they once did, is a tough pill to swallow with all of this steak I've been eating. Hard times make strong men, strong men make easy times, easy times make weak men, weak men make hard times and I'm pretty sure your rich uncle's gonna need a much bigger basement.

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*The S&P 500 is an unmanaged index which cannot be invested into directly. This index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*

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<sup>i</sup> Bloomberg

<sup>ii</sup> 'A slow fiscal death' awaits some countries in this 'decade of debt,' says economist; CNBC; 2/6/2024

<sup>iii</sup> How High Could Home Insurance Rates Jump This Year? Here's What Experts Predict, Money; 3/1/2024

<sup>iv</sup> The Money Supply Is Growing Again and the Fed Wants It that Way; Mises Institutes; 5/18/2024

<sup>v</sup> Federal Reserve

<sup>vi</sup> Congressional Budget Office (CBO)