Ivory's Economic Outlook

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" People who sneer at a half a loaf of bread have never been hungry."

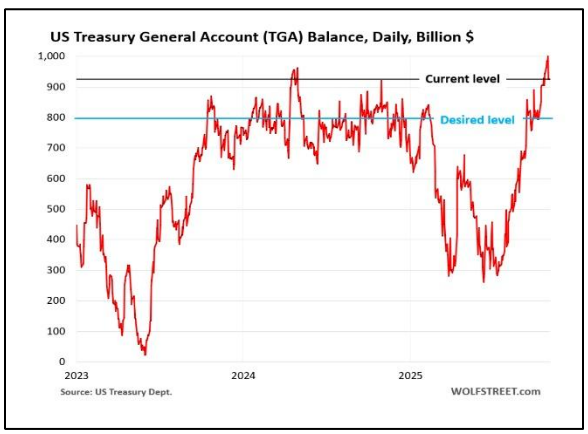
George Reedy, White House Press Secretary from 1964-1965

My father's claim to fame was his rust colored 1975 Ford Galaxy 500 with black vinyl seats that would send my sister and me flying from one side to the other with every sharp turn, and in the process, give playgrounds a bad name. He loved this car, and because this was the New York City where they stole cars with the speed of a switchblade, he protected his cherished possession with every fiber of his being.

If he parked in the street, it was always under a streetlight. If he bought new tires, he made sure to wash the blue paint off the white walls so the novelty didn't attract rubber bandits who traveled with cinder blocks to support the weight of the car once their act of thievery had reached its treacherous conclusion.

Fortunately, we had a parking spot a block away in a garage, and while it offered security, it meant that every time we went grocery shopping, the family might find itself carrying shopping bags through the parking lot, across the street and then up the elevator to the 19th floor. This was an unacceptable burden, even for a man who believed lazy children were the root of all evil. Instead, pops would double-park in front of our building, unload the car and then park the car back in the lot in what was billed at the time as a logistical masterplan.

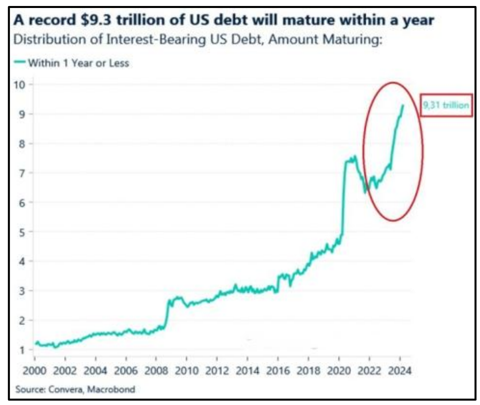
My dad's nickname was "Rip", short for Rip Van Winkel, a moniker he earned for his ability to fall asleep anywhere at any time if he was tired. And it was on one such occasion, this time with the car still double-parked downstairs, that he nodded off in his light blue lazy boy chair. The next morning my grandmother could see from her window that our car was not in the parking lot. My father went to investigate and discovered that somebody had indeed stolen his vehicle. He called the police department who had no information, then he wondered with great surprise who could have opened the gate without the remote.



Finally, my 4-year-old niece saw the car double parked in front of our building from the window with its hazard lights still flashing. It was a breakthrough, we were all optimistic, but this case was still not closed. He examined the scene of the crime, first looking in the ash tray to see if they were "smoking that stuff", a telltale sign of any misconduct. Then he looked at the battery cables to see if they had been tampered with, then under the dashboard for evidence of it being hotwired, until finally he declared: "it must have been a professional job!".

Everything is something but nothing is everything. As I write this newsletter, the markets are hopscotching their way to the end of a roller coaster ride of a year. First it was a tariff scare and now it's a government shut down. It's not everything, but it's definitely something, and if Congress solved a particular problem during this standoff nobody bothered to tell me.

The shutdown did, however, have a slight impact on the market. When you get paid, your bank account goes up, and it correspondingly goes down when you pay bills. When the government gets paid with tax revenue, their checking account held at the Fed, known as the Treasury General Account (TGA), goes up, and when they pay their bills, it goes down. Government spending currently represents 23% of the economy[i] and when they don't pay their bills through salaries and contract fulfillment, their checking account stays elevated. When that happens the money never makes its way back into the economy and that's a lot of liquidity tied up in a bipartisan temper tantrum. A few days or a week is no big deal; 40 days is a different story.



I don't care about the politics - I spent enough time living in DC to know that it's an industry town where our elected officials spend three days a week in an office building off New Jersey Avenue down the block from the Capital Building, in cubicles no less, making fundraising phone calls. It was once the worst kept secret in the city until Wendell Potter spilled the beans when he wrote "Nation on the Take". What I do care about is what happens when $200 billion sits on the sidelines and my spider senses tell me the Wall Street lobbyists made phone calls to Congress that ended with "or else". In other words, this appears to be your garden variety event driven drawdown and not the next Armageddon.

The good news is the TGA will be spent, back wages paid, contracts adhered to and that in turn means the recipients of these obligations will spend the money buying stuff that flushes liquidity through the system. Also, retirement plan contributions paused during the impasse will be renewed and that could be favorable for financial assets. This goes to show how wedded the financial markets are to the mechanical flow of money as opposed to macroeconomic data. The more money in circulation chasing financial assets the better for the price of these instruments.

Robert Moses was an unparalleled city planner who reshaped the landscape of New York City for 30 years. According to "Power Broker" by Robert Caro, between 1946 and 1953, not a single library, airport, hospital, pier, or public construction of any kind got built without his approval or design. In Gotham, there are 416 miles of parkways. He built every mile. He also built every bridge in the tri state area not named Manhattan, Brooklyn or the Williamsburg, 13 in number, that includes the Triborough, Verrazano and Throgs Neck Bridge. He was so impactful that the country's interstate highway system was built on his principles. When he began building state parks in the 1920's, 29 states didn't have a single one and six had one each. By the time he was done, New York had 45% of all state parks in the country.

Moses was never elected to office, instead rising to power as a genius in the drafting of bills that made him an invaluable asset to elected officials such as Gov. Al Smith, Gov. Franklin Roosevelt and Mayor Fiorello LaGuardia. Need to outmaneuver a political opponent by referring to legislation written 30 years ago that impacts two important sentences of a bill coming to the floor the next day? Call Bob. He also built things that politicians could turn into votes, like Jones Beach, and his ability to have readymade engineering plans available during the Great Depression meant that New York City was receiving 14% of the entire WPA program in the country.

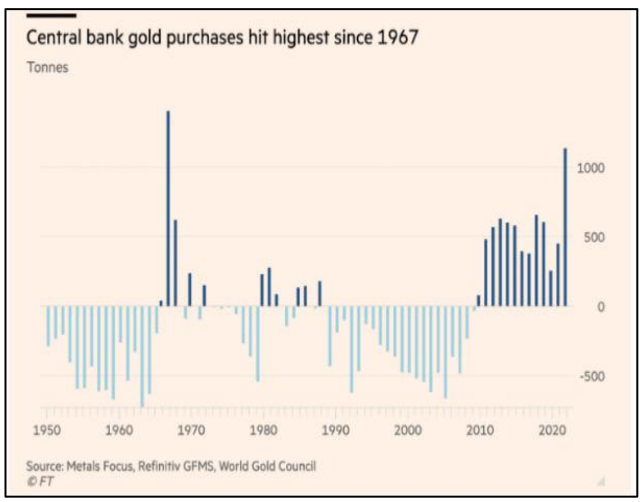
Nothing solidifies power quicker than money, and more specifically, other people's money. When Robert Moses built the Henry Hudson bridge, he created a Public Authority that possessed the powers of a private corporation and some powers of a sovereign state, both protected by the constitution, and would exist for the length of time it took to pay back the $5.1 million in bonds he sold to raise the money for construction. It was to be paid back with tolls estimated to generate $370,000 each year, or 10 cents on 3.7 million cars, but by 1939 there were 12.7 million cars and the net income after paying the interest and expense was a whopping $600,000.

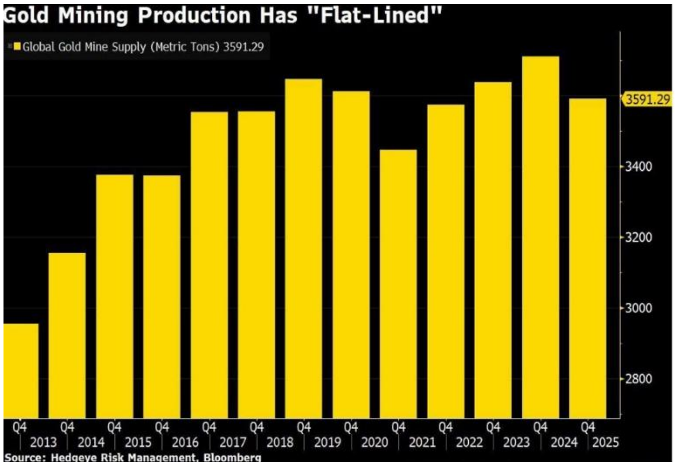
The law required this money to be used to pay down the debt and retire the Public Authority that Robert Moses controlled, and in so doing, created a termination date for his power base. In response, he drafted the amendment to the Triborough Bridge Authority Act in 1937 that hid the details in a legal tongue twister that gave the commissioner, Robert Moses himself, the unilateral ability to refinance the debt and extend the lifetime of the Authority. He snuck in language that gave him the right to exercise eminent domain, the power to enforce rules, maintain a police force and exist beyond the grasp of the mayor or governor of the state. In doing so, he borrowed not just $5.1 million, but $81 million, built other revenue producing projects and controlled the money to use as he wished. It goes without saying that the tolls never went away, even if the municipal bonds were eventually paid off, and it made Moses the most powerful man in New York for 30 years, more so than any mayor or governor of the state.

He taught us that debt doesn't matter as long as you can keep refinancing the obligation. In the same vein, over the next 12 months the United States has to refinance over $9 trillion[ii] and borrow another $1.8 trillion[iii] because of the budget deficit. That money has to come from somewhere, and since Uncle Sam doesn't have it, the money will be printed by the central bank and that increases liquidity. This is not my opinion on the pros and cons of various fiscal matters, but rather an observation of what the mechanical flow of money might look like in the coming months.

There is also something called the repo market which sounds more complicated than it is. Basically, a bank gives a money market fund a treasury bond as collateral in exchange for cash, and the next day they repossess their bond and return the cash plus the interest (thus the term repo). Without giving you a headache, this is considered the plumbing of the financial markets because banks use it to create liquidity and right now it's sitting on empty[iv] because there's too much collateral (treasury bonds), and not enough cash, which is what happens when we borrow too much money by issuing too many bonds.

Unfortunately for us, and unlike Robert Moses, Uncle Sam's revenue doesn't generate a profit. Yes, it's complicated, but the lack of available cash explains in part what has also caused volatility and suggests the Fed may eventually have to print money so the banks can buy all these bonds the Treasury is about to sell. On the other hand, the Fed has been noncommittal about cutting interest rates in December which is seen as a hindrance to the bull market. As they say on Wall Street, the more printing the more grinning.





And nobody's smiling about Japan. It turns out that when they had artificially low interest rates it invited something called a carry trade: you borrow money in one currency at low interest rates (the yen) and use it to make investments in another currency with higher interest rates (the dollar). It's all good in the hood until everybody wakes up to the fact that Japan has a more ominous debt to GDP ratio than America, it makes their rates go up, the carry trade works in reverse and that puts pressure on stocks. That's what I mean by it's a muddled procedure, mostly a function of which direction the money flows and hopefully temporary.

What does all this mean for investors? I sure wish I knew. There are lots of moving pieces, some smaller than others, and if I were a betting man I wouldn't panic. Sure, a lot of good hardworking people are on the cusp of massive health care premium hikes, can't afford food and have delinquent car loans, but Main Street isn't the concern of Wall Street (or the folks making phone calls on New Jersey Avenue) because financial assets trade on more than just macroeconomic data. Truth be told, this chop bucket could very well be the ebbs and flows of money, and if it's something more sinister, then I'll react accordingly.

Bitcoin is scarce, there will only be 21 million coins available, and unlike your currency that keeps losing its purchasing power, they won't print more bitcoin. As you've seen however, the minute liquidity slows down bitcoin has a temper tantrum of its own. Meanwhile, gold supply growth has been flat for close to a decade and central banks haven't purchased this much gold since 1967[v] because they're increasingly concerned about the amount of paper money floating around the system that's not backed by anything of value. By the same token, AI might be expensive, although nowhere near as pricey as the entire HR department fired by IBM and replaced by technology[vi]. Yes, the economy might be stuck in neutral for the moment, but sometimes it's best to do nothing.

Uncle Sam is a winded bull in a fiscal china shop, his hand searching for a rabbit in the hat he just borrowed with some Federal Reserve mechanism that keeps breaking our purchasing power. Could the labyrinth of central banking shenanigans stabilize the erosion. Who knows? We're really just trying to figure out how fast the plates, the bowls, and the cups come crashing down at Tiffany. That's the point of this exercise, to make it simple so we can make a better decision and solve for X: given the current state of things, do you believe liquidity will accelerate or will it subside, and after that, do with it what you will.

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[i] *United States Treasury*
[ii] *New York Federal Reserve*
[iii] *United State Treasury*
[iv] *New York Federal Reserve*
[v] *World Gold Council*
[vi] *IBM lays off 8,000 employees as AI replaces HR department: MSN*