



April 2, 2019

Dear Clients and Friends:

It is theorized that at the center of our galaxy resides a black hole, furiously churning through stars, planets and all forms of matter. What happens to all of this stardust is a topic well outside the scope of this discussion. However, there is a parallel in our small corner of the universe, where the concerns are slightly less cosmic in nature. Like a black hole in outer space, with a gravitational pull so strong it doesn't allow even light to escape, the European Central Bank and the Bank of Japan sit at the center of the fixed income universe, sucking in over \$10 trillion in government bonds through the proverbial rabbit hole and into the realm of negative yields, thus extinguishing any hope of a positive return. We can spend far too much time debating the relative merit, or more likely the lack thereof, in such policies, and we can make fun of the pseudo-intellectual framework upon which such policies reside. In fact, this never gets old for me, as it is a gift that just keeps on giving. However, it has become apparent to us that this is akin to complaining that winter in Minneapolis is cold.

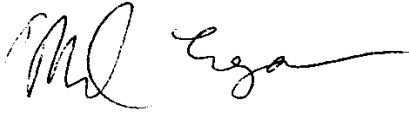
In 2018, as the Federal Reserve pursued a strategy at odds with the rest of the developed world and our interest rates began to resemble, in a relative sense, those of a developing economy, it became increasingly apparent to us that it was an untenable strategy. The gravitational pull from the rest of the world was simply too strong, and the break toward lower yields seemed to become inevitable. This shift has been tectonic in nature and will not be easily reversed. Slowed, perhaps, but reversed, no. It looks to be a matter of time before policy reverses course and we follow the rest of the world into the abyss of negative yields. We may be the last to succumb, but succumb we likely will. Japan has been in such a state for decades and Europe for almost a decade. When we join them, and for how long, remains to be seen, but the die seems to have been cast. The ultimate escape may be from a "theory" recently gaining traction, Modern Monetary Theory (MMT).

This theory posits that deficits don't matter as long as debt is denominated in the currency of the home country. You know, like Venezuela. Anyway, governments needn't worry about deficits, spend away and the Fed can just finance it. If inflation gets too high, we can control that; trust us. Most economists deride MMT as snake oil, and I understand why. However, I say it may be worth a try. We were told Quantitative Easing would ignite massive inflation (or at least some inflation), yet it has failed to do so over an extended period of time. Clearly the formulas and fancy equations need some work. Even more concerning, it appears they have no idea what they are doing or what effect their policies have. Fifteen years ago, the idea of QE was anathema to central banks, now it is just another policy lever. MMT, or some version of it, is hardly implausible.

In terms of portfolio management, it seems that the risk of higher yields is misplaced, and while possible, the greater risk in the U.S. is lower (and perhaps significantly lower) yields. Given the

current fairly low level of yields, this is an unpleasant position to be in. Yet given how it has played out in Japan and more recently in Europe, prudence dictates defense against lower rather than higher yields.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Egan', with a long horizontal flourish extending to the right.

Mark M. Egan, CFA
Managing Director

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