October 2, 2019

Dear Clients and Friends:

We closed the third quarter with rates not far off of their all-time lows in the 10 and 30 year space, yet there seems to be little chatter about a bond bubble or the massive losses that bond investors could soon experience as rates return to a more "normal" level. This may be due to the fact that it has become virtually impossible to define what normal is. The much-discussed amount of negative yielding debt globally and the gnawing fear that we may join this depressed and depressing group of economies has expanded the range of what normal is, resulting in a form of paralysis among investors. To say that it is impossible for the U.S. to experience negative rates is simply irresponsible, yet to forecast such an event as was done recently by that old carnival barker Alan Greenspan smacks of attention seeking. We believe it is better to realize the environment is both unprecedented and perilous, and rather than focus on rates and their direction, it may be a better use of resources to focus on why we find ourselves in such a state.

As anyone familiar with our views will recall, we are deeply skeptical about the approach central banks have been taking over the last 20+ years and have become increasingly so in the past decade. We are troubled by the cult of personality that has developed around these individuals and instead liken the Federal Reserve to the DMV with advanced degrees, possessing a similar level of creativity and ability for critical thinking. Lest you think we are too harsh in our assessment, observe the recent action by the European Central Bank to combat a lingering fear of deflation and sluggish economic growth: simply more of the same policies that have not only proven themselves ineffective but are also likely sowing the seeds of the next financial crisis. Then look at our Fed chair. We are told the economy is "in a favorable place" while they cut rates 25 bps twice during the quarter. I was, of course, reminded of the June 2008 statement by then-chair Ben Bernanke when he indicated that the economy was on "stable footing." We all know what followed soon thereafter.

When we look at the financial landscape around the globe and across assets, we see a slow rolling crisis. A crisis of too much debt and not enough income to service it. The actions by central banks are predicated on fighting the last war, with antiquated weapons. Before this cycle passes - and we may have several mini cycles within the cycle – we believe it will become apparent that a new approach and new tools will be necessary, but this is not likely to occur until the crisis is upon us. This may include the much-discussed Modern Monetary Theory or something not yet on our radar. It will also require decisive and inspiring leadership, something that will be a far cry from the milquetoast, DMV-like individuals we have had. A Monetary Moses will be required to lead the global economy from the bondage of excess debt much like Paul Volcker was required to save the global economy from the scourge of inflation. Like then, we believe this will occur only after considerable pain in both the real economy and asset prices.

With this in mind, we remain cautious. We understand yields are unappealing based on history and may in fact rise from here. We also believe the economy is far from a "favorable place" and that we may experience significant repricing in risk assets as this becomes apparent and investors lose confidence in the ability of central banks to manage the economy. This loss of confidence will be well merited. It will be in this repricing of risk that significant market dislocation could occur and, to those with the necessary liquidity, present an attractive opportunity. We intend to be one of those few.

Sincerely,

M Egan

Mark M. Egan, CFA
Managing Director