April 5, 2021

Dear Clients and Friends:

A long held wish Bob Crider and I have had is to see how the current, misguided monetary policy regime of at least the last 12 years resolves. This policy has as its central tenet not a stable level of inflation and a maximum level of employment, which are by statute the Fed's dual goals, but a monomaniacal focus on asset prices, and more specifically equity prices. We have pegged the beginning of this de facto policy shift as the fall of 1998 and the bailout of Long-Term Capital Management, which occurred under former Federal Reserve Chairman Alan Greenspan, formerly known as "the maestro."

Since that time, we have witnessed serial bubbles form, as asset prices are first inflated then rapidly deflated due to an unforeseen systemic shock. Rather than allow excesses to be cleared, the system to be cleansed, and perhaps a sustained decline in asset prices, policy becomes ever more aggressive and inventive, and a bubble quickly inflates anew. All the while, debt remains, grows and metastasizes. Asset holders of virtually all types see their wealth rise rapidly, while the vast majority holding essentially no assets receive little benefit, and the wealth gap continues to rise. Yet the prophets of doom, those calling for a reckoning, those who believe there must be a consequence for such clearly irresponsible policies, have certainly been left chagrined, if not despondent. I count myself among such prophets, and while being early can be the same as being wrong, I believe we are on the threshold of judgment day.

For the many years and many variants of quantitative easing we have seen, the level of inflation remains remarkably stable. This has emboldened officials to continue pursuing ever more aggressive and outlandish policies, as the only consequence seems to be higher asset prices. While these actions may cause the wealth gap to continue to rise, it is hard to gin up opposition to higher levels of the S&P 500 index. One sounds like a crazy old man telling the young folks that the world is going to hell in a handbasket, a phrase my father used often that I never really understood. So why now? Why is it "different this time?" Well, we are now practicing MMT, modern monetary theory, the idea that the government can spend essentially unlimited amounts of money and run incomprehensibly large deficits and it does not matter. The pandemic was the catalyst; the prior administration started it, and the current administration has accelerated it to a level that would be laughable if the consequences were not so dire.

The fiscal side has always been the missing link, but that is no longer the case. The spending in the last 12 months, and the amounts planned for the remainder of this year, should do the trick. The explosion in nominal growth and inflation will be impossible for the market to ignore, and the resolve of the Federal Reserve will be called into question. They will now face the reckoning. How do you deal with an inflation problem that isn't transitory by raising rates in a massively leveraged economy? How does it resolve?

As I stated in the beginning, nobody knows, but a clue might be that all of that cleansing that needed to be done in prior cycles was really just deferred. I believe asset prices will decline, rates will rise, and debt will be either defaulted the traditional way or through inflation. There will be pain; there will be losses, but I believe there will be opportunity. The next ten years will be nothing like the last ten, or that is the hope of a few monetary mavens, traditionalists and believers that all actions have consequences and that there is no way to have your cake and eat it too.

Stay safe, stay liquid, be patient, and be ready. The ride is going to be rough, but that's the way we like it.

Sincerely,

Mark M. Egan, CFA
Managing Director