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The 'Growth Trap'

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Over the last 30 years I've read innumerable books, articles and papers by economists. And while I've learned a lot from these, I've also come to accept the conclusion of other skeptics: that economics is not a 'science', and that mainstream economists are wildly overconfident in the efficacy of their theories.

When I observe the current tenuous state of the World's Economy, I believe economists should shoulder the largest amount of blame. It is they, after all, who run our Federal Reserve and other Central Banks. It is they who counsel the Executive and Legislative branches on economic issues. And, unfortunately, after the bus runs into the ditch, it is they who are charged with getting it back on the road.

One precept I believe is at the heart of their errors: that all things economic should and will 'grow'. Here are some timely examples.

Budgets and Taxes. In the past 83 years the U.S. government ran a deficit 75 times ! When asked why this wasn't going to be a calamity the answer was always 'when the economy grows fast enough we'll increase taxes, which will create surpluses, which we will use to pay off the debt'.

This 'sounds' good, but look what's happened. Instead of surpluses we've run deficits 90% of the time, including record deficits in the last few years. And rather than even consider that their growth mantra might be ill-conceived, mainstream economists assert that we now need to create even larger deficits, and that these will finally create the growth that can be used to pay down the debt, and happy days will be here again. It was Albert Einstein who famously quipped that insanity was 'doing the same thing over and over and expecting different results'.

Pension Accounting. Actuaries assume their portfolios will grow at x % and, therefore, they'll have enough money to pay future benefits. The result ? A large majority don't earn what they projected and are severely under-funded.

Politicians' Projections. When our leaders assert that this or that economic plan will save $ billions over 10 or 20 years, those are 'always' based on an assumed rate of GDP growth that 'almost always' is higher than the resulting reality. I could go on and on.

It's a two-edged sword. Done via productivity increases and sound economic policies, growth raises the standard of living for millions. Used injudiciously, however, it is a trap that borrows from the future resulting in disruptions for many and, eventually, lowers standards of living. Most things in nature have a natural limit to their growth. One exception, cancer, if left unabated will grow until it consumes its host. Similarly, un-restrained debt will bankrupt the borrowers.

It is time we aggressively question our long-held, college-taught economic dogmas. It is just too easy to validate some voter-enticing, feel-good theory by projecting growth. We should break the monopoly that these mostly Ivy League group-thinking economists have on Central Banks, politicians, and our future.

Bond Bizarro World II – The NIRP Era

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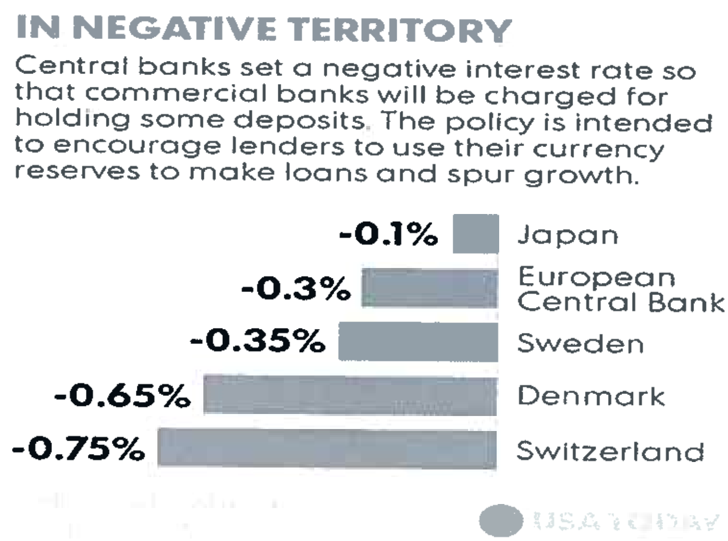
Here's what I wrote a year ago in this space, under the title Bond Bizarro World:
Until now, no government 10-year bond had ever been issued to yield less than zero. But on Wed., April 8th, the Swiss Natl. Bank (SNB) sold $378 million Swiss francs (about $391 million) of bonds maturing in 2025 & 2049, with the 10-year portion yielding minus 0.055%. That's right – buyers are guaranteed to lose money when lending to Switzerland over the next decade! This, from the Gnomes of Zurich, has me marveling how the world has changed to some sort of financial Twilight Zone.

What's happened since then is shown in this graphic:



With Japan's recent entry into the NIRP (negative int. rate policy) club, we now live in a world where over $7 Trillion in govt. bonds tied to this policy trade at prices that guarantee a loss if held to maturity. While commercial banks have not yet passed these negative rates on to their customers, there is enough fear of this eventually happening in Japan that there was panic buying of home safes in order to store yen. Bank profits worldwide are under extreme pressure due to squeezed margins, so creative ways to pass costs on to depositors will be found. Safe, mattress or back yard hole – what to do with our cash in the NIRP era? Questions we never thought we'd have to ponder.

Central banks & treasuries will do what they can to prevent this unintended consequence of their actions, which have been almost entirely unsuccessful in their stated objective of stimulating growth and employment. Discontinuing high-denomination bills ($100, 500 euro, 1000 Swiss franc) is increasingly being considered as a way to make cash hoarding more difficult and expensive. Efforts to promote digital currencies such as Bitcoin and make virtual money ubiquitous are gaining traction in many jurisdictions.

On the flip side, it's never been cheaper to borrow, and in Denmark certain mortgages will actually pay you to borrow! This is truly Bizarro World finance that simply can't continue on a large scale for an extended period.

Investors are beginning to lose faith in our Ivy League economists' ability to manipulate markets, currencies and the banking system. The NIRP era we've entered smacks of desperation. Gold, silver & mining stocks have just produced their best quarterly gain in decades. Coincidence? I think not.

How to avoid mistakes naming Beneficiaries

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Following up on our February Estate Planning Workshop with a topic that sounds simple, but isn't: The correct way to name Beneficiaries for your IRA, 401-k, life insurance policies, etc. Like other estate issues there are numerous ways to structure your accounts and, importantly, they need to be done correctly since once you pass away, the actions you took are irreversible.

Most married couples name each other as Primary Beneficiary. This makes sense and comports with most state laws that restrict the ability to dis-inherit a spouse. If, for example, you try to name someone other than a spouse on a retirement account, that spouse will have to sign agreeing to that arrangement. Things get more complex from there. Investors often name children as Contingent Beneficiary to receive assets if the Primary is not living, e.g., you and spouse are both killed in an auto accident. What if you name your three children equally but one of them is no longer living ? Do you wish their portion of your assets go to their wife, or their children ? What if there are step-children, do you wish them to get a portion ?

What about grand-children ? Some could be born after you name your beneficiaries, do you wish them to be included ? You and your spouse could have children from previous marriages, who could also have children, how do you wish them to be treated ? We could go on and on, our modern society has created a wide array of extended family situations.

Fortunately you don't have to invent the answers as the estate planning profession has done the necessary work. Their solutions include terms like 'per stirpes', 'per capita', 'or to their estate', etc. Used correctly these can ensure that just your blood-line receives your assets, or include step-children or grand-children, define what happens if people get divorced, or re-married. It is not too difficult to customize to achieve what you want.

One attractive feature is that naming beneficiaries correctly doesn't establish some complicated and expensive ongoing estate structure. As we explained in our Estate Planning Workshop referenced above, we are not fans of complicated structures. For most investors the cost and aggravation are, simply put, not worth it. Figuring out exactly what you want to happen and finding and implementing the correct language will take some time, and possibly a modest fee to an attorney, but then it's done and shouldn't be a big hassle to those to which you wish to gift. Maybe also reduce or eliminate legal fees spent to sort things out.

Life in America can be complicated. Having assets entails handling them properly, both while alive and after. We're here to help if you need it in a wide variety of personal financial issues. Please give me a call if you are unsure that your beneficiary designations will accomplish your goals. We can check it out relatively easily and, perhaps, implement some new language to improve in this important area.

"Monetary Mayhem World"
Peter Boockvar, Chief Market Analyst with the Lindsey Group

William Mason CFA

The P/E ratio of the S&P 500 is above 22 currently. This makes it the second highest valuation in stock market history. Now the earnings of the S&P 500 have been declining. Below are some comments by some individuals I respect. Included are many comments regarding the Federal Reserve because the only reason the stock market is able to levitate to extreme overvaluation is because of Federal Reserve policy.

David Stockman

David Stockman wrote the following on March 7 (CAGR is compound annual growth rate):

"When reported S&P 500 earnings peaked at $84.92 per share in June 2007 (Last Twelve Months basis), they had grown at a 6.8% annualized rate since the prior peak of about $54/share in Q3 2000. By contrast, at the reported $86.46 level for the LTM period ending in Q4 2015, the implied 8-year growth rate is.......well, nothing at all unless you prefer two digit precision. In that case, the CAGR is 0.22%.

"That's right. Based on the kind of real corporate earnings that CEOs and CFOs must certify on penalty of jail time, profits are now barely above the June 2007 level, and are once again heading down the slippery slope traced twice already during this era of central bank bubble finance.

Bob Rodriguez

It doesn't take any imagination to realize why Bob Rodriguez told me last November that:

"...this is an unsound, absurd, insane investment environment... We are in a great Ponzi scheme environment. Pretend economics is running rampant at the Fed and other central banks."

Fred Hickey

As Fred Hickey wrote in the March 3, The High-Tech Strategist:

"The Fed's money printing jacked up stock valuations to create the second most overvalued stock market in history... GAAP (Generally Accepted Accounting Principles) earnings in 2015 dropped 12.7%."

Ray Dalio

The following is from a March 3, Bloomberg interview:

"The next big move, I believe, will be toward quantitative easing rather than a big tightening. The circumstances that are now happening are surprising them (the Federal Reserve), have surprised them, because they're not paying enough attention to the long-term debt cycle.

"Gold, at 5 percent of your portfolio, 5 or 10 percent of your portfolio, under the circumstances, would also be a prudent thing to do. Prudence is the important thing to do."

Peter Boockvar

The following is from a March 20 interview on King World News:

"It gets to the point where the Fed continues to wing it in terms of the policy.

"People have to take a step back and understand that in a variety of metrics this is the second most expensive stock market we've ever had. Now that you have earnings declining and you have what I think is going to be a continuation of lower multiples (lower p/e ratios). That is a rough combination; lower multiples and lower earnings.

"It's clear that negative interest rates are gold's best friend. Janet Yellen is also gold's best friend... historically, new bull markets exceed the levels of the previous bull market's high which is 1900. And in this kind of monetary mayhem world we can be sure it's going to way overshoot that."

Lacy Hunt

Nominal GDP, the broadest and most reliable indicator of economic performance, rose $549 billion in 2015 while U.S. nonfinancial debt surged $1.912 trillion.