

By the Way

Monthly commentary from Jack Way

"What me `worry?"

I wrote last month that the debate would be must-watch tv and could turn into a "fiasco". Even at that I wasn't prepared for what went on. They say people can't stop looking at a car accident, and I felt that sensation watching Mr. Biden (He's the President of the United States!) stumble and fumble his way through the debate. His claim of being tired and his plan to restrict appointments to before 8pm and get more rest does little to alleviate my concerns. In fact, my immediate reaction is to worry that the enemies of the U.S. may sense an opportunity to be more aggressive toward a country with a leader in what some pundits are calling a "fragile condition". It's being pointed out that the sitting President very often loses the first debate, but then rallies strongly from there. Given the major issue this time is old age, that's tough to reverse. The logic for the much earlier than usual debate was to make the election more about a choice between the two men and not just about President Biden's record and abilities going forward. Obviously, that did not come to pass, given the ineffectiveness of Mr. Biden, despite ample opportunity to attack the many inaccurate or even fictitious assertions made by Mr. Trump. The Friday interview that followed on ABC was an attempt to convince voters of the President's competence but did little to impress me, or many others either since only 0.6% of the 18-49 cohort watched (tied with WWE Wrestling).

Trump now definitely sits in the driver seat heading to November. What are the implications both politically and economically should a Republican sweep take place? If Trump wins handily, he might also pull many down-ticket candidates into office with him. The U.S. system of Government is based on a series of checks and balances that precludes the Executive, Legislative and Judicial branches from getting together and having total control of the country. The Supreme Court is already loaded with Trump allies, so if Congress swings Republican, he will have the ability to push through the majority of his agenda. Economically we could expect to see such things

as rate cuts, tax cuts, tariff increases, lower regulations and increased fiscal spending. One prospect I wonder about is who will lead the FED given Chairman Powell's term is over in 2025? It's not out of the realm of possibility that Trump would appoint himself. The election is still far enough away that a lot can change, but "forewarned is forearmed".

The U.S. economy continues to grow but at a more moderate rate much to the relief of the members of the FED. The current buzz word seems to be "cooling" not weakening. Job growth was responsible for much of the above trend economic increase, but has now settled back such that June Non-Farm Payrolls reported an increase of 206,000 but revised previous releases down by a surprising 111,000. The pace of job creation is easing but so far not to the point of layoffs and firings being a big issue. Personal spending decreased by ½% in the first quarter to an annualized rate of 1½%. Housing isn't helping mostly due to a lack of activity. 96% of U.S. mortgages are at a fixed rate (a rate much lower than today) and 38½% of houses are mortgage free, leaving little incentive to sell or trade. ISM surveys are below the expansion level (manufacturing 48.5; services 48.8); all-in-all leaving room for the FED to cut rates at its September meeting.

The biggest concern, certainly for me, is the continuing profligate spending of the U.S. government and the resulting large increase in budget deficits. Just last month the Congressional Budget Office upped the expected 2024 deficit by \$400 billion to a new high of \$1.9 trillion. Part of the problem was a large decrease in tax revenues which caused the Treasury Department to increase debt issuance in June, and resulted in a reduction in liquidity in financial markets. The current average cost of U.S. debt is at 3.2%, which is more than likely going higher given today's rates and cheaper debt rolling off the balance sheet. As a consequence, U.S. Government interest expense is growing faster than GDP, an impossible

situation long-term. This is not lost on foreign buyers of U.S. debt. In 2008 over 50% of the Government borrowing was owned by foreigners; today it is less than 30%. Also of note, in 2003 about 5% of that debt was held by investment funds, today it is 60%. Indebted countries can go on like this for an indeterminate time. It won't be numbers but a collapse in confidence that will be the cause of a crisis. I remember Bear Stearns, that in 2007 despite its many problems, continued to trade near \$100 per share until confidence failed and in a matter of a few days it suddenly was rescued by J.P. Morgan at \$2 per share.

The S&P 500 has rallied 16.7% this year and there are no signs of serious trouble brewing. The economy and benign credit conditions continue to be supportive of equity markets. Excess liquidity is always helpful for stock demand, and I expect it will increase at least into the election. Of most concern to me is a lack of worry about a market decline. The technical department at Strategas points to a strange and rare dichotomy currently, where the S&P Index appears "overbought" but internals such as advance decline lines appear "oversold". The VIX which is supposed to measure the risk of downside volatility is at its lowest levels since pre- pandemic. Investment firm KKR has a model based on high yield bonds that indicates the market expectation is for a default rate of 2%; the long-term average is 5.7%. In short there is very little anxiety in markets or the economy, which is great until it isn't. As usual, there are other interesting or maybe even important things happening:

- Trump wins in the Supreme Court on Presidential immunity. Chief Justice John Roberts wrote "The President is not above the law", "but he is entitled to at least presumptive immunity." I am baffled as to what that means.
- Biden's bad debate performance inspired the usual wacko conspiracy theories. My favorite: the Secret Service supports Trump, so they put something in Biden's food.
- Almost all recent elections have been "anti" something not "pro". Bad for Biden as the incumbent.

- French election reversal. After the first run-off LePen and her National Rally Party were leading. After the second vote the leftist party wins and Le Pen falls to third. Fooled me.
- Despite China threatening to invade Taiwan, the Taiwan stock index is up over 20% this year. Mad Magazine had the correct motto, "What me worry?"



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