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'You can check out, but you can never leave!'

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The rules which applied before 2008 don't necessary apply in a post financial crisis era amidst such brutish external interferences. Instead, it foments a broad misallocation of capital on a global scale. It flatters short term speculation over long term investing. It rewards unsound risk taking and punishes savers and risk assessed prudence. It has literally flipped the market's logic upside down. The so-called "new rules" entail central banks being deemed the authority on price setting. Especially in credit markets from where almost all other assets ultimately derive their relative values. These rules will be deemed inapplicable if and when price discovery is either allowed to return or it simply forces its will upon a market that perhaps finally reaches some state of waterlogged stimulus satiation.

Here we are, 13-years since Ben Bernanke turned on his "temporary" fix for the crashing credit bubble. However, the prelude to this was when epic credit and real estate bubbles which were spawned as a result of Alan Greenspan's prolonged stranglehold on short-term interest rates (no QE quite yet) which had been his "fix" for the early 2000's crash of the tech and dot-com bubbles. Alas, we seem to have become embroiled in an inescapable multi-decade central banking regime of serial bubble blowing. It doesn't take much of an imagination or even an adroit student of financial markets to recognize the obvious signs of yet a third central banking induced financial imbalance that we find ourselves entangled within today. Each central banking response to the crash of each of these preceding bubbles has needed to be even more forceful than the last so as to ameliorate the fallout from its successively larger and larger bubbles. But then the bubble that follows is only larger and more treacherous than the last. The tech and dot-com bubble was a rather narrow variety of bubble inflicting a narrow sector of the market and economy. Nevertheless, its size was massive and ultimately ensnared a very wide swath of the investing public. Therefore, its ultimate demise was devastating even as most all other traditional asset markets never reached levels which could be described as frothy.

Index	Aug. 23 2021	YTD%
S&P 500	4479	+19.25%
Dow Industrials	35,336	+15.50%
Nasdaq Composite	14,943	+15.90%
Value Line Arithmetic	9519	+20.30%
Russell 2000	2208	+11.80%
U.S. Dollar Index	92.93	+3.30%
Gold (ounce)	$1807.90	-4.50%
Silver (ounce)	$23.80	-9.50%
Amex Gold Bug Index	250.24	-16.50%
Oil (NYM Lt Sweet/barrel)	$65.64	+35.30%
30 Year Treasury Yield	1.89%	+0.24%
10 Year Treasury Yield	1.27%	+0.34%
2 Year Treasury Yield	0.23%	+0.10%

The S&P 500 is an un-managed index of 500 widely held stocks. The Dow Jones Industrial is an unmanaged index of 30 widely held securities. The Russell 2000 index is an un-managed index of small cap securities which generally involve greater risks. There is no assurance these trends will continue. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the Nasdaq over-the-counter market. The Value Line Composite Index is composed of all of the companies that are included in the Value Line Investment Survey. The Dow Utility Average is an unmanaged index comprised of 15 utility stocks. The Amex Gold BUGS (Basket of Unhedged Gold Stocks) Index is a modified equal dollar weighted index of companies involved in gold mining. Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results. Commodities and currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising. U.S. government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed value. U.S. government bonds are issued and guaranteed as to the timely payment and interest by the federal government. Treasury bills are certificates reflecting short-term (less than one year) obligations of the U.S. government.

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The 2003-2007 housing and credit bubbles, the byproduct of Alan Greenspan's response to the fallout from the tech and dot-com bubbles was a more serious and dangerous bubble because it once again ensnared a wide swath of the American public. But this time by making credit even more cheap and irresistible, nearly everyone came to believe that house prices only go up. Americans began using the equity in their homes as a veritable ATM machine with which to buy a second home or a home just to flip. Most of this speculation was backed by nothing more than deleterious and copious amounts of borrowed money. If the crash in home prices wasn't bad enough, the credit making machinery behind it all was what nearly caused a catastrophic collapse of the entire financial system when counterparties to seemingly good credit instruments were found to have been leveraged to the gills with all forms of mortgage related derivatives of their own.

The response to the crash of the kissing cousin housing/credit bubbles was as massive as it was aggressive. Alan Greenspan's successor, Ben Bernanke crashed the Fed's traditional policy tool, the Fed funds rate, to zero. As unprecedented as that was, he also

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ramped-up something so extraordinary, quantitative easing, that its unlikely that a single Wall Street economist prior to 2008 could have ever guessed such a policy deemed to be a desperate artifact of despots and Banana Republics would ever find the light of day in the United States as a viable policy tack of the Federal Reserve. Fortunately, Ben Bernanke assured markets that this was only a temporary but necessary use of the extraordinary measure when he penned his July 2009 Wall Street Journal op-ed, *The Fed's Exit Strategy*. That was over 11-years ago.

Today, nearly 13-years since Ben Bernanke first launched quantitative easing, the Fed continues to implement what was formerly described only as a temporary, unprecedented, emergency stop-gap tool. But instead of this being used as a means to arrest the fallout from one of history's greatest financial collapses, this policy is now being implemented at a point in time where stock, bond and real estate markets, by most measures today, are not only at record all-time highs but are also priced relative to many of their respective historical valuation metrics at all-time bubble highs.

So, as we've seen intermittently since Ben Bernanke foisted this *Hotel California* style of emergency monetary policy upon us 13-years ago (you can check out, but you can never leave), we have been forced to entertain this periodic dance where the Fed, out of trying to retain some modicum of credibility, begins preparing markets for its *pretend extrication* of this once unprecedented policy. And that's again where we find ourselves yet again.

Meanwhile, as the Fed and even the Bank of Japan and the European Central Bank (ECB) continue to hold the pedal to the metal on the "all-in" aggregate level of ongoing global bubble propping measures, it is beginning to appear that we may have already crossed the apex of the late-pandemic/post-pandemic (hopefully) recovery. *Citibank's U.S. Economic Surprise Index* has submerged to its lowest reading in over a year. In other words, incoming new economic data is beginning to undershoot even the usually overly-optimistic Wall Street forecasts. Second quarter GDP printed significantly below estimates, with a print of 6.5% versus expectations of 8.4% growth. This is despite personal consumption, aided by over $3-trillion of "one-off" direct fiscal infusions into businesses and consumer's pockets over the past 15-months, pushed the *Personal consumption* component within that data to an 11.8% annualized growth rate--- the largest such spike in that GDP component since the 1950s!! And more recently a surprisingly weak *Michigan Consumer Sentiment* print along with a weak July Retail Sales number seemed to finally register as a verifiable market concern.

It would be an incredibly uncomfortable proposition to see the economy wilt back to its anemic pre-pandemic growth rate, which had already been wind-aided by those 2017 mostly corporate boondoggle tax cuts, even before Powell and the Fed are able to implement any rollback of its ongoing $120-billion per month of modern day money printing, bubble propping endeavors.

While the heat on Fed Chair Jerome Powell and the Fed has increased as the number of anecdotal signs of growing asset bubble risks are now ubiquitous, the Fed, ECB and other global central banks find themselves in a quandary given that there are also obvious lingering signs of stresses that remain throughout the global economy. So, its noteworthy, in my opinion, that the *People's Bank of China* recently eased their policy in early August and Christine Lagarde, President of the ECB, recently suggested that it would now allow Eurozone inflation to run at or above its previously stated bogey. What, I wonder, are they worried about? The central banks have simply blown too many bubbles in a myriad of assets that are all at once rivalling or exceeding the extreme nature to that of the more narrow single asset tech bubble in 2000. This time, it's not isolated to just tech. It's virtually everything and a crash of *everything* has the potential of essentially delivering the final blow to the middle class. I'm worried that the 2008 financial crisis will ultimately serve as the warm-up act to what eventually might come from this. I've also said before that the crash itself might not be the worst of it. I am deeply concerned that the rampant and virulent level of political extremism we've witnessed over the past decade, which I believe is at least in large part due to the evolving wealth gap as folks increasingly allow their biases to guide their thoughts and opinions on who and what to blame, has the potential to spiral into very unsettling chaos if and when the now mostly finance-centric economy suffers a crash of the magnitude that I believe is now possible from such propped-up altitudes.

Capitol Hill Showdown looms

The next month and-a-half will almost certainly entail some legislative fireworks. Nancy Pelosi is now being squeezed on both sides of her own party with two diverging factions within her party in the House insisting upon uniquely different paths for getting the Senate's recently passed $550-billion stimulus bill ratified.

A caucus of moderate Dems insist on voting on this bill upfront without waiting for the budget reconciliation bill which progressive Dems plan on using as a vehicle to stuff it with even more bold "human capital" infrastructure initiatives. But getting the reconciliation bill passed in the Senate, by itself, is already a tricky endeavor with two moderate Dems in the Senate already publicly wincing at the costs. In the meantime, while this chess game plays out, the Federal Government is again bumping up against its upper threshold of its legislatively allowable debt limit. In mid-August, 46 Republican Senators signed a pledge not to vote for an increase in the debt ceiling so long as Democrats continue to pursue it's expensive budget reconciliation process as a means to pass their much more ambitious human infrastructure legislation. Treasury Secretary Janet Yellen announced earlier this month that the Treasury had already begun its "*emergency cash-conservation"* measures as a means to delay a full government shutdown after the Government's temporary suspension of the debt ceiling had expired at the end of July. The vote to temporarily suspend the debt ceiling requirement for 2-years came in July of 2019 as a means to get us through the 2020 general election. But here we are and it's the Republicans turn to use it as a political weapon.

A *Wall Street Journal* report cites estimates form the Bipartisan Policy Center who believe the Federal Government should be able to get into October amidst the Treasuries "*emergency cash-conservation*" measures, but not much beyond that. One curve ball that could arise from this, assuming Republicans carry-out its threat, and progressive Dems are also equally

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as steadfast in pursuit of passing its ambitious social infrastructure initiatives, could evolve into a totally new debate over the Senate filibuster.

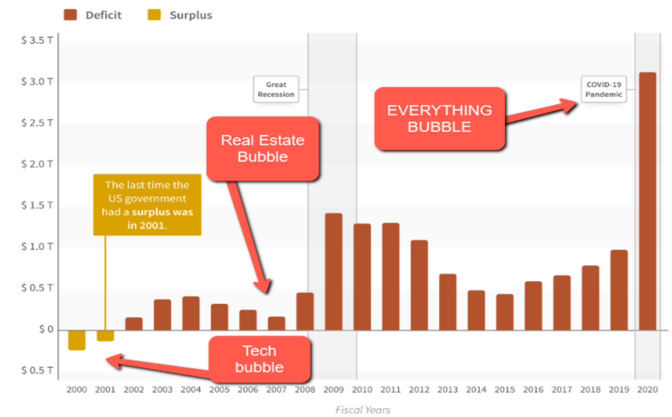
If this turns into a prolonged stand-off which could ultimately threaten an eventual default on Treasury debt and the obvious market disruptions that would cause, this uncomfortable stalemate would begin to shine the light brightly on those two lone moderate Senate Democrats, Joe Manchin and Krysten Sinema, as being the two single individuals capable of ending such a standoff. Both have made it clear that they oppose rescinding the filibuster. However, under the circumstances described above, could the heat be dialed-up enough for them to be persuaded? Could Dems persuade their moderate brethren to implement the "nuclear option," to rid the Senate of the filibuster to relieve the immediate pressure associated with a government shutdown? If so, this would then pave the way to lift the debt ceiling along a strict party-line vote? But then, this would also ultimately open-up a much easier path for all kinds of progressive initiatives that could come back to haunt Republicans. Either way, the next 60-days on Capitol Hill are shaping-up as a potential doozy.

Let's hope deficits also never matter

Bloomberg reported recently that the world's largest pension fund, Japan's Government Pension Investment Fund (GPIF), has lowered its allocation to U.S. Treasuries within its overall bond allocation from a weighting of 47% to 35% over the past 12-months ending March 31st. The skewing of incrementally more and more risks by the world's largest pension fund is testament to the degree in which pension funds appear to be "reaching" for returns by incrementally accepting more risk for the prospects of meeting their actuarially targeted returns. But as readers might guess, the tradeoff, of course, could end-up being more severe losses which could ultimately end-up exacerbating the ability for pensions and other actuarially managed portfolios to be able to meet those future obligations. This also has some negative ramifications on the manner in which the U.S. will have to continue funding massive deficits which are sure to be over a trillion dollars per year for pretty much as far as the eye can see. This removes yet more of the *natural buying influences* among U.S. treasuries leaving the influences of credit market price discovery more and more to the influence of the *non-price sensitive* Fed.

But finally, some good news! Kinda. The U.S. Treasury reported in early August that the U.S. budget deficit narrowed from $2.8-trillion to $2.5-trillion over the first 10-months of fiscal 2021. Now the bad news, we're on pace for a nearly full year annual budget deficit of $3-trillion, plus, again. To ponder such a thing occurring simultaneously with the Fed's ongoing $120-billion per month of price discovery obliterating QE, is testament to the degree of the double barrelled artificial price distorting stimulus being force-fed into the financial sphere. Both record external forms of stimulus have also aided U.S. stock markets to blow-way prior record valuation highs of both total stock market value to GDP and S&P 500 market-cap-to-Sales.

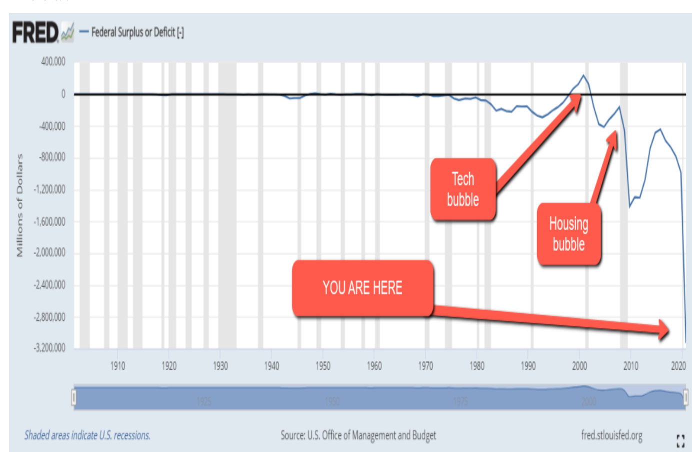
The last two times we had a raging bull market anything reminiscent of the current bubble environment in financial assets and real estate markets, was back in the year 2000 and again in 2007. Both times we saw subsequent spikes in Treasury revenues amidst such highly transactional capital gains. Below, you can see that at the height of the tech bubble, this marked the last time the U.S. enjoyed a brief budget surplus. Then, by late 2006, amidst the raging real estate bubble, the U.S. budget came within $160-billion of almost reaching a balanced budget.



Annual Nominal U.S. Budget Deficits, 2000-2020 (Source: Beta DataLab)

From the perspective of fiscal prudence, policy makers should desperately want to scootch closer and closer to running a balanced or even surplus budget the later we get into any respective credit and business cycle. Instead, we appear to have so drastically altered the rhythm of the traditional credit and business cycles to the point of now running massive deficits in the 13th year of the longest running credit expansion in history. Many economists proclaim that a new business cycle started last year after the roughly *3-week long bear market* in stocks in late March and early April of 2020. However, despite the amount of non-financial corporate debt nearly doubling from 2010 thru early 2020, this would mark the first recession in modern history which actually saw a surge of net new corporate debt. Alas, unnatural external market intrusions effectively masked over what should have been yet another natural cleansing of the previous decade's excesses. I fear this portends very bad things for the U.S. dollar and inflation in coming years.

Below is basically the same data, but instead depicted in terms of respective budget years being above or below balanced.



Federal surplus/deficit annually, 1901-Current (Source: St. Louis Federal Reserve/Office of Management and Budget)

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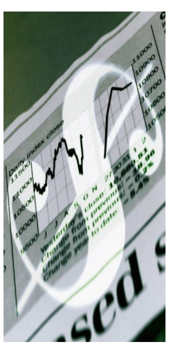
We can also think of these deficits and the degree to which they have exploded higher as essentially *inorganically generated funds* that ultimately get spent into the real U.S. economy. When that spending is being done, whether it be school supplies by a single mother for her children who is using one of her three pandemic relief checks (stimmy) or a business which used their forgivable PPP (Paycheck Protection Program) loan to pay its idled staff, the recipient of those funds as it recycles back throughout the economy multiple times couldn't care less whether those funds were generated organically by real productive economic endeavors or simply conjured-up by the Treasury through further debt issuance, and subsequently monetized by the Fed's massive ongoing QE operation.

Accordingly, I'm afraid the latest weak Retail Sales numbers smack of there being an emerging void of sustainable *inorganic spending sources* (stimmy) that had been behind the otherwise unnatural buoyancy of the economy and the stock market throughout, of all things, a historic and "real" economic crippling pandemic. The Commerce Department reported that U.S. Retail Sales fell a very sharp 1.1% month-over-month in July. Excluding Auto Sales, Retail Sales fell 0.4%. Both were quite a bit weaker than expected. It should be noted, however, that the drop is actually from an already very elevated and I would stress, unnatural level, given the incredible levels of pandemic fiscal stimulus coursing through the economy. Check out the chart below.

U.S. Retail Sales, 2017-Current (Source: Wall Street Journal/U.S. Census Bureau/St. Louis Fed)

While U.S. Retail Sales suffered an unprecedented collapse last spring (2020) amidst the economic shutdown, we have since over-shot to the upside so significantly above trend (trendline in red) that absent those same levels of ongoing stimmy, it's almost inevitable that Retail Sales will collapse at least back to trend. But absent the same level of unprecedented fiscal spending seen from April 2020 thru March of this year, it also seems quite likely that we collapse back under trend by sometime early next year.

The sad reality is, as I've beat this point to a pulp, the Fed is going to find it next to impossible to get much beyond a trivial-like tapering of their current $120 billion per month of QE. Unless, of course, Powell & Co. can convince the ECB and the Bank of Japan to seamlessly pick-up the slack, as Ben Bernanke was able to do when he successfully turned-off the Fed's QE spigots, temporarily, in October 2014. The predicament for *all of the major central banks* is that they are all coming off an 18-month period of their fastest nominal increases to their respective balance sheets ever. No single central bank remains to pick-up the slack. Meanwhile, their bubbles look angry my friends. Welcome to the Hotel California.



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