



Rhyming & Stealing

John M. Gustafson – 30 June 2022

“History doesn’t repeat itself, but it often rhymes.” - Mark Twain

Recently I’ve spent the majority of my time analyzing the components of our portfolios to highlight where the primary risk lives and how we are positioned for the expected and potential road ahead. That’s generally an ongoing process but becomes far more focused in times like these where we are at inflection points and the markets have been going against everyone.

The recent environment strained my memory a bit, but I do recall a very similar scenario that played out in 1994. Several of you reading this were clients back then as well... After cutting rates early in the decade to pull the U.S. out of a shallow recession following the first Gulf War, the economy had begun to over-heat a bit (sound familiar?) and the Federal Reserve realized they needed to be aggressive and put out the fire. (Lots of chatter about Paul Volker in the early 1980’s.)

The situation is far more complex than I can explain in this missive, but the short version is that the Fed got it right, by being swiftly aggressive and raising rates an unheard of six times in a nine-month window. The markets initially reacted poorly in the spring, but once economists and market participants realized that this was a sign of a rapidly growing economy and not the dreaded stagflation of the late 1970’s, things recovered nicely and we began a bull run that didn’t end until the dot-com bubble burst in the early 2000’s.

This is how Fed Chairman Alan Greenspan earned his nickname (which became the title of a Bob Woodward book), “Maestro.” Can the current Fed orchestrate such a soft landing of our still growing but inflationary economy? That is the most important question we face in the near term.

“There is no sadder thing than a young pessimist, other than an old optimist.” - Mark Twain

As we're all aware, the only narrative in the media these days is one of negativity. Part of that is clearly political messaging as one party roots against our country for political gains in the fall. Part of it is potential reality. Where is the truth?

The fact is that inflation has taken hold more than previously expected and that is a cause for concern. It is also the reason that the Fed's recently aggressive posture has been met with something other than complete market disaster. We have already fallen into Bear Market territory in all of the major averages several weeks ago – mostly driven by tech stocks – and we are griding sideways at those levels. A sort of wait-and-see approach to observe how things will resolve going forward.

Despite all the negative news, opinions and whatnot, consumers are not entirely backing away. In other words, they may say they are negative about the economy when asked, but they are still out there buying cars, shopping online and going about their lives. And also, continuing to quit their jobs to take a better one. As we've said over and over again, especially for those of us old enough to remember the economy at its worst, **NOBODY** quits their job if there are concerns about finding another one.

“Get your facts first, then you can distort them as you please.” - Mark Twain

One of the greatest wastes of time recently is who to blame for inflation and what can be done about it. It a fairly simple answer in reality... Two years ago, the economy came to an almost complete halt because of COVID, billions of stimulus cash flooded the system to fend off a complete disaster. (The absolute right move IMO – in times of crisis, the Government is supposed to be the spender of last resort – we are NOT supposed to run significant deficits when things are going well.)

We are now in a place, as we have been since the middle of last year, where all this stimulus money coupled with historically low unemployment is continuing to be deployed. The increase in prices of most items is almost purely demand driven. Does Russia's action affect oil prices? Yes, but that was only an accelerant to a trend that was building from other factors.

Our economy went from a position of full-stop with no demand - where our Federal Government actually negotiated a deal with OPEC and Russia to *reduce* petroleum output and prop up oil priced to help domestic producers in 2020 – to now completely in the

opposite direction only months later. I'm not sure there has ever been an economic cycle this dramatic in both directions in such a short period of time in our history.

It does look like the moves on the front end, economically speaking, from the Fed and Congress were the right things to do. Now we're in a position to see if the Fed can slightly apply the brakes without crashing the car. Again, it worked in 1994 so there is a good chance they can do it again. No guarantees, but that is how we're adjusting the portfolios to seek our own balance.

"Whenever you find yourself on the side of the majority, it is time to pause and reflect." - Mark Twain

An old gambling saw is "fade the public" and that, as most of you know is generally my bent. I'm a "zagger" to use a more appropriate colloquialism and steer clear of the gambling imagery. However, I'm not looking for the positive simply because almost everyone is negative... The environment in 2008 was wholly negative and that was 100% the right decision / posture to take. We're not in that same situation currently - we don't have significant, systemic problems that can potentially burn everything to the ground by the time we all wake up tomorrow as we did back then. We have an economy that was stopped, restarted and has accelerated away in an incredibly short period of time and that is bound to cause dislocations. As we've said countless times when things have gotten crazy, "hope is not a strategy" - but neither is "panic."

Remember the looming supply chain and shipping disasters that were going to "ruin Christmas" last year? Shockingly the backlog was cleared and Ralphie was able to get his Red Ryder air rifle under the tree. Most of the other economic issues we continue to deal with today also flow directly from the pandemic disruptions.

"Patriotism is supporting your country all of the time and your government when it deserves it." - Mark Twain

On the inflation front, the one measure I'm completely shocked the current Administration hasn't taken, that would be an immediate relief to consumers is to remove the stupid, uneconomic tariffs that are simply a tax on Americans, NOT China. You've heard me railing about that nonsense in these notes ever since the tariffs were put in place. They didn't make sense then and they especially don't now.

Should we "buy American" and encourage more business here? Of course we should, but that takes time and the proper incentives, not a club-like 27% tax on American

consumers. Don't punish the buyers - entice the sellers to change their venue. It does work.

As I sit and type this report to you, I'm literally five or six miles from the site of Intel's latest and largest investment in a new microchip plant in their history – and the largest single corporate investment in the state of Ohio. \$20 billion initially that could turn into \$100 billion within 10 years to produce chips that up until recently only a Taiwanese firm could make. (at least until their plan burned down, causing the current global shortage)

That business wasn't won with a big stick to keep the company in the country and bring it here to Ohio. It was done with a big basket of carrots – the same way China has been siphoning off American manufacturing for several decades.

“The only way to keep your health is to eat what you don't want, drink what you don't like, and do what you'd rather not.” - Mark Twain

So, what does this mean for our portfolios and allocations going forward? We are making a few adjustments that should benefit us if the Fed gets it right, inflation is lowered and the economy continues on its growth path. But we are also de-risking some of the core to play a little defense in case Chairman Powell and his gang fumble the ball.

We've been through these storms before and despite the constant hyperbolic fear-casting in the media, this is something that can't entirely be wished into existence. Again, I will emphasize that at this point, people's actions do not reflect their negative outlook. That is the canary in the coal mine that is on our radar. Stay tuned...

Thank you as always for your business, trust and friendships. If you have any questions or need anything in the interim, please reach out via phone, text or email. Cheers!

A handwritten signature in black ink, appearing to read "J.M. Gustaf". The signature is fluid and cursive, with a large initial "J" and "M" and a stylized "Gustaf".