



Tales from Lake Wobegon

John M. Gustafson – 29 December 2023

“Welcome to Lake Wobegon – where the women are strong, the men are all handsome and all the children are above average.” - Garrison Keillor

Just as in the fictional Minnesota town where everything is unnaturally safe, fun and happy, 2023 has been a great recovery from the very disappointing year prior. As we’ve written for the past several quarters, the general economic narrative in most media was simply wrong.

There was no, and remains no, reason to predict a pending recession, unemployment remains historically low (with an actual shortage of labor we’ve discussed), the U.S. has never produced more oil and gas in our history and companies continue to make buckets of money. Even inflation is slowly withering away – to the point the Fed is now debating not “if” they will cut rates a bit next year, but “how many times.”

So of course, now is the time where I’m thinking more cautiously. Still along the lines of more going well than going poorly, but after this run, there is likely to be a pause.

God writes a lot of comedy... the trouble is, he's stuck with so many bad actors who don't know how to play funny. - Garrison Keillor

As everyone knows, and we hear over-and-over, the stock market is not the economy, and the economy is not the market. However, the stock market is a future discounting mechanism that shows what industry and financial resources believe is going to happen in the real economy in the not-so-distant future.

To use a sports analogy, “the eye in the sky don’t lie.” Meaning, what you put on video when the game is on the line is who you truly are and how you react to harsh reality. Big money doesn’t chase equities if they truly believe there are significant storms on the horizon. You only need to think back to early 2020 for a good example. The economy was finally doing well enough that the Fed had begun to raise rates in late 2019, but as soon as the gravity of COVID shuttering the economy became clear, things changed on a dime.

That is a significant, Black Swan type event that isn’t likely to occur again, but it is a good illustration as to how investment money-flow reflects reality better than whatever the latest pundits are bleating about. Especially since everything these days is tainted by Presidential politics and how those nefarious actors want everyone to perceive reality.

I believe in looking reality straight in the eye and denying it. - Garrison Keillor

If you recall the WSJ article I shared a few weeks ago that had a similar message to the one I've been delivering over the past few quarters... *"The economy is great. Why are Americans in such a rotten mood?"* (email sent on 11/1/23) The most recent evidence along these lines was just reported earlier in the week – despite everyone complaining constantly, consumer spending for the holidays rose once again.

That was further outlined in another WSJ article just this week entitled, *"How can spending be up, when people feel down?"* The article began with this sentence, "According to the Misery Index, Americans shouldn't be all that miserable. But they might only recently have started to catch on." Ya think?

This is the basic message that was outlined in my July comments ("The Power of Perception") and followed in October with ("Climbing the Wall of Worry"). Not trying to hurt my shoulder with vigorous patting of my own back, I point this out merely to show that we all need to heavily filter the daily media-noise and look at what is truly happening, not what someone would like you to believe.

That is the exercise I have always employed in these quarterly notes and actually why I began to write them over a decade ago. It forces me to put my head down and focus on what is real and what is noise and how the two may meet.

Democracy is the art and science of running the circus from the monkey cage. - H.L. Mencken

Let's discuss a bit as to how Goldilocks's porridge might become too hot or too cold and what we could see occur in the new year.

You may have heard that there is another Presidential election coming at the end of 2024 and it is hotly contested. Although it is also the third time in a row that will most likely cause voters to go against the candidate they dislike more, rather than the historic norm of voting *for* who they like better.

It's a weird cycle in American politics that had never really happened, historically speaking, (as discussed here in the last decade) but because of the hyper-partisan atmosphere currently, it is the reality almost every time we go to the polls. Gerrymandered districts at both the state and Federal levels have made very few races competitive, which causes the candidates to dig in on the margins rather than looking for compromise. It will be interesting to see if that strange brew dies with the two current contenders somewhere not too far down the road. But I digress...

"Most economic fallacies derive from the tendency to assume that there is a fixed pie, that one party can gain only at the expense of another." - Milton Friedman

The Federal Reserve has done a masterful job of ratcheting up interest rates methodically to truly choke off inflation. Yes, things cost more, but we literally spent over a decade (since the 2008

great Recession) with almost zero inflation. If you graphed a more historically normal progression over that decade-plus, things would likely be close to where we are now. It simply wouldn't be as painfully noticeable.

The Fed now claims that because inflation is once again trending toward their 2% annual target, they will likely remove some of the increases in 2024. If they drop the ball or other outside influences cause problems, this could go poorly. However, Powell has done just as planned so far, so at this point I'm simply watching and waiting and not expecting a misstep. Stay tuned...

"There is no instance of a nation benefiting from prolonged warfare." - Sun Tzu

The hot wars in Ukraine and Gaza could certainly cause some economic derailment, but it's not as clearcut as to how that may present. Two main options come to mind, although I think both are unlikely, but definitely something to monitor.

The first would be Arab opinion continuing to swing further-and-further against Israel, to the point they attempt to use oil to punish Jewish state's largest ally. Again, American energy output continues to hit records monthly and annually, but OPEC still retains the ability to make things sting in the short term, if they are willing to lose money as well.

The second would also have to do with either conflict that may cause some sort of terrorism outbreak of significance here in the U.S. Since 9/11 we have certainly been lucky and law enforcement detection has improved dramatically, but the ability to radicalize multiple groups online with no actual travel or contact with our enemies continues to make that a danger to safety and security as well as economically.

"Only two things are infinite, the universe and human stupidity, and I'm not sure about the former." - Albert Einstein

On a completely boring front, it is absolutely possible that Americans simply become financially complacent, chase the "hot dot" and cause severe overvaluations as we saw in the late 1990's. We are not close to that level of insanity, even in the tech world, but it does make me worry if significant numbers of investors stop worrying about the downside and only chasing the rockets.

There is a fine line between propagandists telling you the economy is garbage despite what you experience daily, and others who say that nothing is wrong, and you blindly follow that path instead. These are the waters we navigate and as is a favorite saying here in the past, "We need to deal with reality on reality's terms."

"Success depends upon previous preparation, and without such preparation there is sure to be failure." - Confucius

The most likely scenario in my mind and how I am proceeding into the new year is believing that the economy will continue to grow and the Fed will execute the "soft landing." The least-productive Congress in history will attempt to break their own record ("...full of sound and fury, signifying nothing" as the Bard exclaimed), by spending a lot of time on TV complaining, yet passing absolutely no legislation of significance to muck things up or attempt any repairs.

Immigration will remain a hot-button-issue on two fronts – Congress will be recreational complainers and not propose actual solutions that can be implemented, (mere sound-bite / bumper-sticker slogans) and companies that struggle for labor will have some of their growth curbed if they cannot hire any of the people who are already here. As stated multiple times over the past couple of years, our rate of economic growth cannot be sustained if we cannot find workers to fill all the jobs. Ask the Japanese... (and Iowa farmers)

I will become increasingly cautious throughout the summer as the political winds blow more fiercely – especially if one of the current players should fail to awaken some random morning. That would be as shocking (to the markets) in the near term as almost anything, as it would swing everything in the arena to the opposite side of the aisle and remove all fantasy of balance we have from our current horse race. However, worse yet maybe that they are the only two options available in the end and we see a replay of the dangerously ridiculous 2020 aftermath.

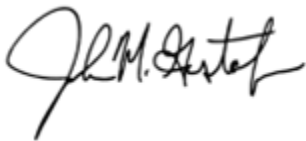
“Do not dwell in the past, do not dream of the future, concentrate the mind on the present moment.” - Buddha

It's too early to hit the political panic button right now with economic items are viewed in such a positive light. There will be a usual rebalance performed later in January since portfolios have performed so strongly this year and can be a little out of whack for our desired allocation. Keep an eye out for that email.

In the meantime, please have a safe, happy, healthy new year and enjoy the time on our lovely planet.

Thank you, as always, for your business and friendship and never hesitate to reach out if you have questions, comments or just want to catch up on the world.

Cheers!

A handwritten signature in black ink, appearing to read "J.M. Gustaf". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.