asset management associates

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How do you Spell …Relief?

This past year we experienced one of the most rapid stock market meltdowns and recoveries in history. Now, a year later, the markets appear to have fully recovered, and as the vaccines take hold, people have started to migrate out of their caves and look forward to the world they once knew.

Most will find that behind the scenes the world has changed. The structure of our economy is very different.

The transformation really started during the financial crisis of 2008. At that time, the Federal Reserve learned that not only did it have the power to lower interest rates to almost zero, but it also had the ability to print money. It was out of desperation that the Fed purchased bad mortgage debt that traded among institutions like cash for many years. The Fed did not like the idea of creating so much money but it had no choice. It was either let the economy collapse or buy this stuff that no one else wanted and replace it with clean cash.

The Fed moved slowly and deliberately, and it took almost a decade to pull out of that mess. Many economists were concerned that all that new money would create inflation. It didn't. With the economy moving forward so slowly, the Trump administration took over and put through a hefty tax cut. That was the catalyst that fueled a surge in stocks.

The Pandemic

As things were moving forward at a reasonable pace, the virus emerged out of nowhere and shut down our economy. The most solid, dividend paying investments and bonds instantly lost their income streams. For this reason, both stock and bond values plummeted. With interest rates at near zero and the Fed already in money printing mode, it appeared that there

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Buying The Hype

I just got an email on the "Jesus Battery". It is going to power a car for a million miles and it can even run an electric toothbrush and blow-dryer at the same time. It is the investment opportunity of the century and, if you don't take advantage of it, you are destined to die poor.

I get these ads all the time and invariably I will have a client call and ask me about them. I suggest they get the details from a minister or priest. Better yet, find an exorcist to get the evil spirits out of your mind!

Tesla proved that an electric car can be superior to anything that is now on the road. Its stock has been stellar, so now the hype is on. Everyone wants to buy the next Tesla stock. Maybe the next thing is a hydrogen fuel cell car or a car that has the motor in the wheels, a flying car or maybe from the pandemic—a bat car! People are buying stocks of car companies that have not yet built a car! No revenue, no earnings, no sales, no car—just stock!

Here is another vehicle to make you rich. It's called a SPAC: **S**pecial **P**urpose **A**cquisition **C**ompany. Basically it is a "blank check company". It is like a big venture capital fund where cash is put into an account and held for a maximum of two years. If they don't buy anything by then they liquidate and mail your money back. The purpose is to buy the next Initial Public Offering of a

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This NFT sold for over $500,000. The most expensive went for 69 million.

was no way out. Most investors and economists believed that we could not print more money, but the Fed acted quickly and announced that it could "print an infinite amount of money." That was the game changer! Our entire philosophy of money changed as we opened the door to a new way of thinking. We realized that we don't need an economy to have an economy—we just need to print money and send it to people so they can spend, invest or hoard it!

Federal Spending

With this new tool handed down from the Federal Reserve Bank, the Federal government realized that it could borrow money to do whatever it wanted and pay for it with printed dollars. Rescuing the economy from the pandemic made sense, but as the virus became somewhat under control, the concept of spending became more controversial. To many it did not make sense to send checks to those that did not need it. But then again, the Federal Government was advised by the Federal Reserve Chairman that borrowing and spending money was the way to go.

Infrastructure

As we moved into the new presidential administration, the spending spree continued. The Federal Government felt it was necessary to continue supporting those financially strapped by the pandemic. So more checks were sent out this past quarter. Again, the more affluent also received checks since the checks were based on income and not assets. There are a lot of people that do not have great income but have significant assets in IRAs, retirement plans, or property.

Most recently, a bill is up for grabs to spend money on massive infrastructure. Under the past two presidential administrations, bills on spending for infrastructure have

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new company coming to market. Typically when a company goes "public", the new stock is priced at some arbitrary number when the market opens. It is not unusual for the IPO price to rocket at the open. Everyone wants in within the first second which is almost impossible.

The SPAC bypasses this process. Because the SPAC is already trading on the market holding nothing but cash, it could outright purchase the new IPO company. So it is just an acquisition - one company buying another. After the acquisition is completed, the company starts to trade under the symbol that represents the company it acquired. Although there can be opportunity, you don't know what the SPAC is going to acquire when you initially buy into it. You may have an idea—like space companies or tech firms or tomatoes—and in anticipation, the SPAC price can appreciate dramatically, even though it still owns nothing. Also in the process, the directors pocket significant fees and many experienced investors are skeptical about these things. It has become very popular in these crazy times.

The hype also works for a person out of work and ends up earning more money not working because of Covid. They take the free government money and, after downloading a free trading app, buy a few hundred dollars of stock...maybe some fractional shares with no trading fees. This phenomena has contributed to at least a part of the mania in some shaky stocks. It also proved that small investors can disrupt the real market, such as what happened with GameStop that surged and crashed a few times back in February.

When we see this type of speculation on the part of the small investor, we start to think that we are getting to the end of the line. Rampant speculation is usually a sign of a market top. There are certainly going to be a lot of hot stocks coming down the pike over the next year. The mistake that new investors make is that they think they can get rich because they saw some stocks surge last year. But usually they get burned.

We are also seeing hedge funds buy stocks with mountains of debt. A major hedge fund borrowed mega amounts of money from various banks in various countries to buy stock. The market went against them and the liquidations jolted the entire market and put pressure on major international banks. This happened in the past few weeks.

The best money making bet, however, is the NFT: Non-Fungible Art. It is art that is created electronically and then logged into "blockchain", much like bitcoin. Once locked into the blockchain, it can not be altered so it is an original. I don't know what to say about it except that one piece went for 69 million. I didn't realize the relief checks were that big!

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been brought up. None made it to first base primarily due to the cost involve. But now, since cost is not an issue, there is little resistance from both parties to have an infrastructure bill. It is true that most of the current infrastructure in this country is from the 1950s. Train tunnels in NYC were built in the early 1900s. It is easy to see that we are way behind the high speed train systems found in China, Japan, and most of Europe. Our airports, roads, bridges, dams, and levies need to be upgraded and it would certainly help if there was some assistance to build out the high speed internet and communication systems that are inferior to much that is found overseas. China is rapidly building infrastructure and military capabilities such as carriers, submarines, sophisticated electronics and missile systems. An infrastructure plan is important to make the U.S. competitive, primarily with China, who is taking market share around the world. China is even trying to start up their own crypto currency that would compete with the U.S. dollar and bitcoin. As we learned through the pandemic, China is the backbone of our supply chain for medical and electronic supplies.

The problem is always the same. The fundamentals of building infrastructure are sound, but then there is all the "pork" that keeps getting attached. To some extent it becomes an argument as to how to help the people that are most in need of financial assistance. One is to have a spending package that rebuilds this infrastructure and puts people to work. As people work they start to learn, gain more responsibility and continue to increase their income because they are worth more to their employer. The second way is to develop government programs that directly pay or supplement basic needs. The hard part is that it is difficult to figure out who is having a rough time and needs some help and who is just taking advantage of the system. In other words, do people accept welfare only when they need it or does welfare become a lifestyle? Today, there are unemployed individuals that are making more income now from pandemic benefits than they were when they were working. This is partly to blame for the labor shortage that some businesses are now facing. These individuals feel they might as well take advantage of free money as long as they can rather than go back to work and actually earn less. They cannot be blamed, but this is an example of a well intentioned government program that ends up hurting small business rather than helping it.

It appears that the proposed spending program is doing a combination of both. This is obviously to appease both sides of the aisle. Let's be optimistic and hope that we rebuild our infrastructure and become more competitive, while we enjoy modern air traffic control systems, high speed 5G internet, safe bridges and fast trains.

Taxes and Inflation

Of course there is no free lunch and all of this spending comes at a price. Somehow we have to pay it back. Taxes will go up, starting with income tax for those with income over $400,000. The second is raising the corporate tax, which would include an alternative 15% tax that would hit larger corporations. Personal capital gains tax is on the list and may be increased. Also, right now, if you inherit stocks, the cost of those stocks is "stepped up" to the price as if they were purchased on the date of death. That benefit could be removed, and at the same time, the estate tax exemption of 11.2 million will be cut by half. There is a lot of detail in this bill in both taxes and credits that include student debt relief, climate change and a host of other items. On the surface the plan claims it is attacking the rich and the large corporations. What is always missed is that large corporations have a lot of resources and the ability to bob and weave through any tax code. They also have the ability to pass on costs to customers and the people the bill is trying to help.

Inflation

The biggest concern right now is that the amount of cash being generated is going to lead to inflation. We are seeing stock prices and residential real estate prices going up. Gas prices are rising, and due to minimum wage laws, some wages are rising. It is hard to believe that inflation is not far behind and with inflation, interest rates rise. In the first quarter of this year interest rates on the ten year Treasury have doubled and are now hovering around 1.7%. This is much higher than the pandemic lows, but still well below the almost 3% level back in 2018, which even at that time was historically low. The Fed has indicated that it intends to raise the

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rates it uses to lend money to its member banks, but the market determines the rate of the 10 year Treasury and that is the one that governs mortgages and mostly concerns investors. The concern is that the Fed will fall behind the rates set by the market and be forced to raise rates rapidly to catch up to the market rates.

The Treasury borrows money by selling Treasury bonds from 30 days to 30 years. As it pays off old bonds, it issues new ones. The problem is that we are accumulating so much debt, and we have to re-finance that debt by constantly issuing and selling new Treasury bonds as the old ones mature. Federal debt grew from 9 trillion prior to the 2008 disaster to 22 trillion just prior to the pandemic. Over the past year it has increased another 6 trillion to a current total debt of 28 trillion! Three times the 2008 level and we are not done! Ironically, as debt climbed after 2008, people were very worried about those increasing levels of debt. Today no one is worried and both the Federal Reserve chair and the Treasury secretary say it's OK!

So, at some point, investors will not be happy with paltry 1.7% rates and will not bid on 10 year treasuries until a higher rate is offered. But paying higher rates on treasuries means we have to raise tax revenues to pay the interest. In the meantime, while everyone waits for all this to happen, the market marches higher because there is still no place to put money. It should be noted that although we are concerned about rising rates, Germany has been dealing with negative interest rates for some time. For this reason German banks have finally decided that they can't handle it any more and have started to charge people for maintaining a balance in their bank account. This could be a source of demand for our ten year 1.7% Treasuries....keeping our rates low. It actually illustrates how messed up the world economy is.

The Re-Opening.

Last year the stock market had a narrow focus and tech stocks had a banner year. The first quarter of this year we saw a reversal. Tech stocks pulled back while the airlines, travel and some of the old economy stocks charged forward. It seems like 2021 will be a more normal year where the participation in the market advance will broaden out. Although technology companies took a hit in the first quarter, they are still strong for the future. We will continue to use technology more than ever. A little bit of a rise in interest rates means we are getting to a more normal economy. There also could be some opportunity for bond investors to collect interest on bonds, but we are not quite there yet - rates are still low. The Fed, in its infinite wisdom, is saying that we will see a short term spike in inflation due to the reopening, but then things will flatten out and inflation is ...no problem. They see low rates for at least another year.

Conclusion

We are in the process of reopening the economy after a cataclysmic event forced the U.S. Federal Reserve to print money and mail relief checks to most individuals. As we move forward, investors wonder how long this can go on. Basic finance taught us that borrowing money is a risky policy for any individual and printing money was the worst thing any country can do. Today, however, all of that has changed. The current view is that borrowing money, and even printing it, is not a problem as some countries have adopted a policy of negative interest rates. At the same time, our willingness to procrastinate rebuilding our infrastructure has finally caught up with us and it is a problem that needs to be addressed. Unfortunately, we are in a box with no where to go. We need to spend, and it appears that the only way to pay for that will be through some form of tax increase, unless for some reason, the economy grows so quickly that the tax base increases enough to cover the bill. How do you spell relief? Free college, student loan waivers, mortgage relief, rent relief and free checks in the mail. But before we know it, the bill will be in the mail and it will probably hit us sooner than we may think. We'll worry about it then.

For now, interest rates are extremely low and that's good for stocks. Feeling better already!

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