FRIDAY, FEBRUARY 24, 2023

Well, hello and welcome to a very unique Dividend Cafe based on me being out of the country, actually being back by the time you're watching this. But I kind of want to do something different this week and I've taken a bunch of questions and topics that have come in and I'm just going to go through all these one by one. And so at the written Dividend Cafe, you'll see all of these things sort of drawn out and we're going to have the questions from people listed out, but let me just walk through it right now. And some of these topics may grab your interests, maybe all of them do. And if you have no interest at all and any of the things that I cover that I guess this really was a disappointment, but I think you might find something here to grab your attention.

The first issue I want to address is the expectations for the Fed Funds Rate based on the Consumer Price Index results of last week and the Producer Price Index. And all of a sudden they're being more discussion of, okay, well maybe the Fed is going to be kind of stuck going a little more aggressive. And you get these two loudmouth governors, Bullard in particular out of St. Louis, who is not a voting member of FOMC, but chimes in, “Oh, we think maybe now a half a point makes more sense.” But I just want to point out that the futures market is implying a 79% chance of another quarter point rate hike in March and a 73% chance of another quarter point rate hike in May. And so May is pretty far out and who knows where data is and the kind of posture and expectation of the central bank by then. But right now, most things still look, and this is all well past data and even how the bond market kind of tightened in response to the

PPI and CPI results last week a very close to 80% chance of a quarter point of both meetings. I do not think there'll be a half a point at either meeting, and I do think there's a possibility of no second rate hike in May, but right now the futures market are saying differently. So we'll let that kind of play out.

I made a reference to Bitcoin and it being so highly levered to speculation, which of course is a no-brainer right now, that the ebb and flow of Bitcoin for a long time has been that when the Fed is cutting rates and the NASDAQ's going higher, bitcoin's doing well. And when you're in an anti shiny object environment or anti speculation environment, Bitcoin's not doing well. And Steve Iceman, who is famously played by Steve Carell in the movie The Big Short someone I've met on a number of occasions and had a chance to speak with, I was formerly invested in one of his hedge hedge funds. They were shorting financial markets and housing and credit back in 2006, 2007 and 2008. And so anyways, I had printed a line from him, a kind of excerpt from a recent talk he gave in last week's Dividend Cafe referencing the idea that Bitcoin just simply isn't a reliable medium of exchange. It doesn't have the stability necessary for a store owner to feel comfortable taking Bitcoin is a way a been compensated for what they sell the goods and services they sell in the marketplace. It strikes me as an entirely self-evident proposition and so forth in the current environment. Somebody pointed out, I think it was a very fair question. Isn't that though, assuming that the Doller maintains its confidence that people maintain their confidence in the dollar and isn't that confidence in the dollar really a confidence in the government that underlies the dollar and shouldn't we have some sort of openness to the idea of a private currency? And my answer to that is that theoretically all those things are true there. There's a number of problems though. What we're talking about when we refer to confidence in the dollar is a confidence that one will buy something from you and that a minute later what they paid you with, you could go buy the same thing. That medium of exchange doesn't have a lot of volatility to it, a lot of instability, and obviously nobody can expect that transacting with Bitcoin right now that the volatility is so severe that one literally could accept a hundred units of payment for furniture they're selling on a Friday and only be able to buy 80 units of furniture by Saturday. I mean, it's almost literally that violent of volatility and that nobody believes that the dollar represents that even those concerned about the steady macro inflation that all currencies have simultaneously, even in eroding purchasing power, you're talking about, let's call it two or three or 4% a year, generally speaking, over 20, 30 years, right? The question is, do we believe that confidence in the government deteriorates to a point where confidence in the dollars, immediate stability and immediate preservation of what one can turn around and exchange it for alters right away? And my point is the government that does so many things to disagree with that is so fiscally reckless and that has a monetary policy. I think that can be so questionable that it has the guns, it has a legal monopoly on violence, it has taxing authority in the largest economy and most productive economy in the world. And so do I believe that there's coming a point in which that confidence with all the bad things one wants to say about government, that the stability of the dollar gets undermined for store owners relative to these other opportunities which, because the question included a anecdote, do you make room for any allowance of private currency? Do I think a private currency competes with the dollar when the private currency doesn't have the taxing authority and mono and military strength and monopolistic characteristics? Do I think that people find more stability as a medium of exchange in a private currency than that governmentally backed dollar? I do not. And if I did, that same government could quash those private currency ideas in a moment. They could do a Bitcoin in a moment. So no, they can, it's on the ledger. They can't touch it, but they make it illegal and takes away enough participation to undermine its medium of exchange benefit. They won't do that. I don't think they should do that, but they could also have a million other regulatory options of what they could do to just diminish enthusiasm for it. So there's all sorts of things that could happen, but fundamentally what we're talking about is a private currency where it can only kind of exist if the constitutional authority allows it to. The ability to mint money is delegated in the Constitution to the federal government. And I understand people can agree, disagree with it, and I myself have so many concerns about our own monetary and fiscal administration, but I've never allowed myself to go to the place where I believe that some of these sort of underground and the one that became very popular in the last 10 years, digital currency alternatives make sense. And that's why is the medium of exchange is generally not going to be there. There's not going to be confidence in the medium of exchange unless it is attached to a monopolistic militaristic power that has taxing authority over the largest economy in the world.

Okay, another question. Do we believe that even though demographics point to a lot of cultural problems and a lot of threat to future productivity, that there could be a technological innovation that overcompensates for declining productivity and so that even if the demography goes against us, the productivity could go for us and create a better result? And I want to remind people of a basic algebraic formula. I use a lot that more or less is a topology inherently true, that G = P1 + P2. Growth = Population Growth + Productivity Growth. These are two different Ps, P1 and P2, and that those two combined represent our growth in economic output. And do I think in theory that P1 could decline, but P2 could grow more than P1s declined and and it still offset? Well, not only do I think that could happen, I think at various occasions it does, but the question is will we? But we anticipate the productivity growth and technological innovation being greater than the impact. And I would simply point out we've been living through an unbelievable technological innovation and expansion of digital growth for 50 years and it went in light speed 20 years ago, and yet the various demographic challenges in certain countries, Japan's example I use all the time but even here in the United States, we've had this very subpar productivity and very subpar gross economic output at a period of incredible technological advancement. So empirically, it doesn't appear that is the case yet. I also think that there is just a broader reality that we're not only dealing with the aggregates, but that productivity potential versus population growth, but that when productivity growth goes higher, the population that is working tends to offset that. And I put a link in Dividend Cafe to a paper that MBER published about this, but this is sort of the study of the 1990s is that we saw a much greater capacity because of technology and not a big growth in utilization. And just to kind of really dumb it down and say something that isn't totally accurate, but just make the point. In other words, because we could get more done with a tool, we used the tool less because we were getting more done, and therefore we could offset that a bit. That's more or less what I think technology's done is not lead to greater net net productivity but lead to less exertion to get the same productivity. And that people could say is great, you get these four day work weeks and all the things, whatever, I don't think it's great, but even if I did economically, I don't think it is creating the productivity growth necessary to create greater economic growth long term.

I got a wonderful question about what I would do, and I clarified with the person, the reader asked the question what I think they will do or what I would do about this Japanification. And the question seemed to indicate more of an interest in what I would do in Japan, and of course being an American managing capital for American investors, my family and our long-term legacy being Americanized. I have more thoughts around what I wish were the case in fiscal and monetary administration and economic growth potential and some of the cultural ramifications thereof in the context of being an American. But there's a lot of principles at play that would factor into Japan as well. And I'd certainly use the Japanification analogy in a negative context to describe what I think's going on in America. I don't generally like answering the question because I have to be so abundantly clear that what I'm about to say is never going to happen. I don't believe any of the things I'm suggesting are going to be the way things play out, and therefore that difference between the descriptive and the prescriptive is a very important distinction when you actually manage real money for real people. But because the question was specifically about prescriptive and not descriptive, I will say that as a general formula for what I think Japanified countries that are dealing with stultified economic growth have to do, I do think I believe in a general framework as to what ought to happen. The problem is is that none of these things will be popular and in a democracy and in a political context, if it isn't popular, it very likely won't happen or won't be able to continue happening because those who are unpopular are no longer there to see it through. That's the definition of the political realm, or at least in a democratic environment. And yet there is no play way this will play out that can be entirely popular. There's no way that the patient is escaping the bender without a hangover. There's no way that the patient is getting off the morphine without pain. There's no way the dieter is going to go off the diet and not gain weight. I could go on and on with all these cliches and analogies, all of which I think are pretty good. I certainly believe as a prescriptive framework that one of the most obvious things that has to be said is when you're in a ditch, quit digging. And I don't know that there's any solution to beginning to pause

Japanification, let alone reverse Japanification. That doesn't start with a balanced budget, and there's no way you're getting a balanced budget without across the board spending cuts. And there's no way you're getting a balanced budget without entitlement. And we're nowhere near entitlement reform and we're nowhere near spending cuts. And so the balanced budget aspect is just simply not on the table. You also, in my mind, have to have a rules-based monetary policy that significantly humbles and diminishes the responsibility of a central bank in Japan or Europe or the US to be more focused on a lender of last resort than accommodating the spender of last resort. And that's just have decades now of a total redefinition of what we expect from the central bank. And so that framework of reverting to a lender of last resort central bank, a balanced budget. And then on the other end of this, do I think that there needs to be a pro-growth dimension? Absolutely. And there's a lot of elements that go in into that instant dispensing of capital expenditures, full deductibility of capital expenditures is a huge issue. Flatter tax rates on both business and individual income some type of reform around investment income that stimulates capital formation the general pursuit of creative destruction as opposed to trying to constantly baby and massage creative destruction, leaning into it to get better capital allocation and resource allocation in the society, the that's a general framework. There's more details and bullet points at Dividend Cafe, but I'll leave it there.

Someone had asked if I was on the side of believing that population reduction is deflationary, inflationary and points out the very accurate statement that there's a plausible case for both because you're losing both consumers and producers and in theory you end up with less producers, therefore less goods and services, and yet a money supply that might be level or growing. And of course, my ultimate belief in that algebra is that the declining amount of producers and consumers in concert is putting down pressure on velocity, which is disinflationary, however, and of course has been empirically and historically established over the last 25, 30 years in Japan and 15 years in the United States and Europe. But even apart from that, we can't really just evaluate it in terms of population growth. There's something that we call the dependency ratio. But all that is a way of saying that it's not about your total top line of people. It is the composition of the people. Folks that are under the age of 16 are generally high consumers and low or no producers, people from 20 to 60 are generally very high producers and less focused in consumption. And those obviously over a age, whether it's 65, 70, what have you become much more consumption focused and less production focused. And so the people dependency ratio is really a way of saying those in your society under 18 and over 65 put together divided by your total population and a higher dependency ratio is, in my mind, very disinflationary as it does create less tax revenue, more government spending, therefore higher deficits, which I believe puts downward pressure on velocity and is more disinflationary and in fact at taken into extremes, deflationary. But then that issue of less production of goods and services invites other questions. And what I essentially believe is it creates more wealth disparity because I don't believe you get less production. I think you get more less people doing more production, getting wealthier from doing so. Thank God that they are there to wake up the slack for when there is a diminished democratized productivity. But there's a lot of variables about demographics besides age and besides top line population, there is divorce rates. There's age of when one marries, there's household formation, there's a number of kids in a household, there are mortality rates. So there's a lot that goes into a global population impact of all these metrics. But I do lean to the side that views most demographic challenges as being a narrowly deflationary.

Finally, there was another question that came through about in this kind of volatile period of stocks, does it make sense to just really capture these nice high yields? You can get 4% to 5% in a treasury yield for one year or two years, and does that make sense in the meantime, because of the instability of stocks, I wrote a whole Dividend Cafe in 2022, and the link is in Dividend Cafe this week about the opportunities and not opportunities that exist in the present state of the bond market, the health of having a higher yield at the risk-free rate. And I also wrote a whole Dividend Cafe about why this isn't apples to apples with dividend yields that the growth of dividends over time from risk assets is an entirely different risk and reward profile than just essentially being able to get a 4% return for a year where you don't get growth of the income, you don't get growth of the principle, and you also have a reasonably high chance of reinvesting even that 4% at a much lower yield in the future. I think that those two links, which I've provided Dividend Cafe go deeper in the question, but fundamentally, we just to remember that those who are promising the question on I'd like to wait till I can find a time where stocks don't go up and down anymore. They will wait forever. I usually say on this side of gory, I'm not even sure stocks won't go up or down in heaven, by the way, but I will leave that theological quandary for another time. I do believe that stocks go up and down all the time right now, last year, last decade, last century, next decade, next century. So no, I don't think it makes sense to be hiding out in treasuries while we go through a period of what is actually a permanent condition, that being up and down movement of stocks. I don't believe that this is sustainable, that the one or two year yields will last, and I don't believe it has anything to do with the investment objectives of a long-term investor who needs growth of that income growth of the underlying asset class. So that's my answer to that question, and there's better links and reinforcement.

For those who go to dividendcafe.com, I have a couple other bullet points, not questions from readers, but actually just a few takeaways from some research I had done before recording, and I want to share with you about China and whatnot. So I'll throw that out. There's kind of a bonus idea if you want to go Dividend Cafe.com, I'm going to leave it there. Next week, I will be back in the California office, Monday and Tuesday and in the New York office Wednesday, Thursday, Friday. And I'm really looking forward to a great full week, and I hope you've enjoyed this kind of unconventional Dividend Cafe. I hope you've enjoyed watching, listening, reading that you will rate us, subscribe, put us in your player of choice and help us grow our traffic because it does benefit from being in those subscriber based lists and all that kind of stuff. Thanks again for all your support at Dividend Cafe. We'll see you soon.