FRIDAY, MAY 3, 2024

Due to the publishing time constraints for us to produce our daily missive, podcast, and video, the best we can offer at this time is a machine-generated transcription which contains errors. We will continue to work to improve this service and appreciate your patience with us.

Well, hello and welcome to the Dividend Cafe back here in the New York office. It's been a couple of weeks since I've been back here and actually sitting in my office right now because we had a few little tech issues with the studio. But nevertheless, the message is here for delivery.

I start off this week, I want to talk about this expression that some of you may have heard sell in "May and Go Away", and I could probably do a couple little pieces of Google search to find out different theories as to where exactly the thing came from, all I know is over the last, 15 years, you know, there's been a few years where May was down, a bunch of years where May was up, a bunch of years where May was flat. And that's where all of these stupid, trivial, juvenile, idiotic little sayings and euphemisms come from is not a particular statistical or archival foundation, but rather just kind of because they rhyme, they become some form of investment policy for certain people. And you'll hear it every now and then and often it will be used to say, you know, the tougher times of the market will be from May through September. So sell away a bit and come back into the fall. And then some say, come back in October. Some say to come back in November, you know, all, when I say some, I'm referring to what we call in the, you want a real intellectual term what we refer to as idiots. That's the types of people I'm talking about here. You be, you know, the notion that portfolio

construction properly constructed investment plan is to be disrupted around verbs that rhyme with months in the calendar. I don't think it's super cogent, but what I will say is this, the the idea that if you're going to build a euphemism, around some silly kind of rhyme that it would not even be connected to factual or statistical reality, I think is doubly dangerous.

That even the basic statistics it's meant to try to respond to are not accurate. So no, we don't have a sell and may go away type idea. We do believe in Constantly being a student of markets and a student of the economy and being rather rigorous and consistent in applying a very disciplined investment philosophy to the portfolios that we create on behalf of our clients.

And those things don't always rhyme. But let me give you a few little tidbits this week of things going on in the world. I've been enjoying a kind of multi partnership. Topic Dividend Cafe for a few weeks in a row and I'll keep it going till I kind of have exhausted all those topics that are on my screen.

I have a vision right now for a kind of longer single topic, Dividend Cafe in the near future with a more exhaustive discussion about Bitcoin and crypto. And that will come up here sooner or later. There's definitely going to be a single topic, Dividend Cafe coming soon about the election. We do that every four years and.

And I'm hopeful that there will be some new information and observations and applications this year and cycle that will be

especially meaningful. But in terms of going around the horn in this week's Dividend Cafe, one of the things I want to start off with, because the yen had gotten kind of pummeled in the last several weeks, and then this week had a dramatic late day rally on Wednesday, very likely byproduct of the Bank of Japan intervening.

It's hard to get a currency to move up 2 percent in 20 minutes without a central bank putting their thumb heavily on the scale but nevertheless, the yen had been weakening against the dollar for some time but my issue is not really about yen right now. I just want to make the broader point when we talk about inflation, that the idea That you have a period of price inflation and that people say, well, it's because of all these structural things.

You know, there's been too much money supply and there was too much government spending and there was all the federal reserve excesses. And this is this inflation moment. And now inflation is here to stay. And Oh, by the way the currency has done nothing but strengthen through this whole period.

You do not hear people address that issue. Okay. Because they don't want to, because it's an inconvenient, contradictory fact to their thesis. Why in the world would there be excessive inflation in one country vis a vis others, because of that country's policies that then at the same time caused the foreign exchange rate of that currency to appreciate.

A weakening currency is supposed to go with a structural inflation. And My view, of course, has been that we haven't created a structural inflation as much as dealt with a very significant Supply oriented disruption, one that was largely quite global. And then in fact, there were a significant amount of foreign countries that went through that period wanting to buy more dollars.

Sell more of their currency to buy our supposedly new inflationary dollar. And so I do think that there is something to be said there. You know, when you get into a place where a very high inflation becomes systemic and embedded. You can look at what happens to the foreign exchange rate, to the currency value in when this has happened in Venezuela, in Argentina, in Zimbabwe, in Nigeria.

These are third world countries that provide a big example but then nevertheless you get an idea of the economic math that is supposed to correlate here. I remain incredibly critical of so much of what the Fed has done and is asked to do. All the time. But the notion that the dollar could appreciate how it has and stayed so strong and been such an envy of the world financial system as far as a currency to own and that all speaks to these structural issues has got to be understood in the context of what it is, which is the global level.

Relative nature of these macroeconomic things. Switching gears. When I talk about the things I'm critical of the Fed, I thought this might be a helpful framework because I do think

sometimes my views, which I have taken most of my adult life to form and study and challenge and rethink. And in some cases reformulate I went through a period where I was an abolished the Fed guy.

I am very much of the opinion that the Fed ought to have a very humble role, not a significant role in the economy. So I don't really play in to the most extremes of either side on the Fed, either those who basically are in the majority now, which is let's have a central bank, try to run the economy.

I find it abhorrent, but I'm also not in the other side of things that believes it's all a big conspiracy. And the Fed exists for the purpose of trying to help four or five people from Jekyll Island or something. Sometimes I say this stuff, but it makes me laugh while I say it. No, my view is that the Fed is setting the cost of capital.

When I think lenders and borrowers ought to be able to do that. And using the fed setting the cost of capital as a policy tool, I think is extremely unwise. I think the fed should be operating in whatever form of monetary policy they do administer. With more rules and less discretion, I think it'd be better for markets, and I think it would be better for the economy, and it would neutralize much of the boom bust cycles we've become used to, at least neutering on the edges, the severity of some of these booms and busts, if the Fed had more of a rules based approach and less discretion in the administration of their policy objectives.

I very much, number three, wish the Fed would not operate out of a Phillips curve model that presupposes employment and price stability are at odds with one another because they are not. And number four I just think as a general approach to a central bank, it should be viewed not as the responsible body in charge of the U.S. economy. In Dave land, we would have the Fed purely operating as a lender of last resort. But this notion of the Fed being there and again, I could now turn this whole Dividend Cafe into a larger treatise on the Fed. What we did post financial crisis, what we did post COVID. Across so many elements elements of our financial system involves an entirely new ambition for the Fed that I find to be very destructive for economic health.

So speaking of the Fed, we know they did not raise rates this week. They did not cut rates this week. There was 100 percent chance going into the meeting that they were not going to either raise or cut. And I guess what Chairman Powell did that did cause markets to rally a bit not much, but on the margin, markets moved higher since his presser was Reinforce that they don't view rates going higher and then still say all of the normal language he needs to say about why they don't want to cut until they feel like they're seeing the progress they want for their policy objective.

But then, so he kind of talked up the fact that we want to really make sure that we've feel good about the path on, for inflation, but then he said that the 60 billion a month of quantitative

tightening they're doing is going to be reduced to 25 billion. And so they had been at 80 billion a month.

They got about a trillion dollars off the balance sheet at that level. They lowered it to 60 billion and now have said they're down to 25 billion. This was a big theme of mine entering the year. I think that in particular with the reverse repo market. Clearing out as it did that the Fed now is in danger of removing too much liquidity from the financial system and that they are going to be forced to stop the quantitative tightening.

They have already decided to try to get in front of it by dramatically reducing. And then at some point, there's a question as to whether or not they will even have to resume some quantitative easing. I'll hold off on that right now, for one thing, because I don't know. I don't want to get overly ambitious in my prediction, but I also am expecting them to continue to run into problems with this experiment, speaking of discretion.

I also think that they could make the case that, look, this is not inconsistent with us saying we're still trying to worry about inflation. First of all, some quantitative tightening is still tightening. It's less tight than we were, but it can't be called easing when we're still reducing the balance sheet.

I think that's fair enough. If they wanted to be really honest, they could say that a reduction of quantitative tightening is not inflationary. Because quantitative easing itself is not inflationary. It's a mechanism for putting money into the banking system's

excess reserves, and it is manipulative, and it is distortive but it is not inherently inflationary either.

And then ultimately, the reason why I think the Fed right now can mess with the policy tool of quantitative easing quantitative tightening, but not the interest rate is the interest rate is watched by everyone and reasonably understood by everyone where I think that Quantitative tightening is understood by almost no one and really not watched by a whole lot either And so this just becomes a little easier way to start putting the hand on that lever Volatility.

Do I think the month of April was volatile? I guess so. You know, the Dow, Nasdaq and S&P were all down in between four and 5%. It's not a significant drawdown, but you had a lot of up and down movements throughout the month, but you didn't have a single day in the S&P that was down over 2%. You had a number of days that were down over one and one and a half.

But no S&P days in over a year down even 2%. And you know, the extreme volatility moments around COVID 2 percent was just like a, you know, like from 6:30am to 7am. I mean, Those were not normal either in the sense that those seven, eight, nine percent down days, five, six, seven percent down days, that was extreme volatility the other way.

But no I don't I think we've gotten enhanced day to day volatility this year around the CPI number was this and J. Powell said that, but as far as the gravity of it, there's a higher frequency of

moves, but the gravity has still not even gotten to a down two percent day in the S&P, that's worth it. Economic growth, U.S. real GDP growth, as we talked about last week, came in at two and a half percent for Q1. It had been at 3.4 last quarter, and it was expected to be, excuse me it came in at 3.4, 1.6, it was expected to come in at two and a half. I apologize. The reality is that global growth where, you know, emerging markets, China, other things have outpaced us growth for a long time.

It came in at only 2.2 percent Q1, and it had been only 1.7 in Q4. And so you really have downward pressure on global growth as well. China is not picking up a lot of slack. Germany is struggling. United Kingdom is doing better. South Korea is doing better. Malaysia is doing better. Brazil is doing quite well.

There are some pockets doing better. Some doing worse. But there really is A bit of muted global growth in the U.S. Story is very likely part of that as well. Somebody had asked me last week and we answered it in ask TBG this week. Never forget to send questions@thebahnsengroup.com. Any questions you want?

If we believe in these 10 year cycles between growth and value, why not overweight one or the other? And I had to remind people that what we ultimately believe in this cashflow growth as a means of monetizing mechanizing and fulfilling investments, whether it's for withdrawers or accumulators, and that we would rather own growth and value, not alternate between the two around imperfect calendar cycles.

But I also want to point out that if you go back what's the time period? About 50 years. The growth of earnings per share in what they call growth, large cap growth in an index is 5. 9%. The growth in value is 5.4 percent of earnings per share. This is what your growth is actually supposed to be talking about.

So there's really very little daylight even between the earnings per share growth. And then of course you get where the valuation issue comes in and you can see why to the extent that dividend growth tends to lend itself more to value than growth as far as how these things get compartmentalized and defined, you can see why we have that bias that way.

Do I think small cap is about to get a moment in the sun? And all I can say is The 10 year period like this of large cap outperforming small cap is really quite a historically. It's usually been five year cycles, seven year, but to go for a 10 year period that we've seen with large cap outperforming a small cap where small cap stocks are only five years.

4 percent of the total stock market capitalization right now. They've historically averaged about 8%. I don't know when this story turns, but do I think the relationship between large and small cap is well off of its mean and likely to revert at some point? I certainly do. I'm going to leave it there for the week.

There are a few other things I do want you to look at in the Dividend Cafe. One being a little explanation about what's

happening with a lot of corporate pensions that are being moved to insurance companies to take on the asset management, but then also the liability responsibility and how some of those are now being bought and run by.

Managers. And there's a story in there. I want you to read about Dividend Cafe. And then I also have a tribute to Daniel Kahneman who passed away over a month ago now, but run a Nobel prize for behavioral investing and the Wall Street Journal and others all did extensive stories on it. He's a legend in our business.

He significantly influenced me. I did not know him personally, but I just want to remind people that the great takeaway from the book is that of the behavioral finance movement is really summarized by loss aversion is a larger emotional consideration than desire for gain. That, that people are more impacted by loss than gain.

And that when they suffer loss, they then tend to respond to it as opposed to we won't take a risk because we're so averse to loss. It's when it happens, the impact is behaviorally is magnified. And this work of Kahneman, I think provided a profound explanation for what I think is a Fundamental part of the value proposition of a business like mine at the Bahnsen Group where myself and our advisors are really here to allow behavioral mistakes to impact a portfolio success and a financial outcome as little as possible.

The the optimal level being not at all. Read a bit more about that and given cafe too. Do I see a catalyst to growth coming my friends? I really hope that the subpar economic growth we've been struggling with for 15 years can at least get an intermediate waiver driven most likely by some increase in capex manufacturing, productivity, factory factories needing to refill inventory levels that have gotten low that this cycle creating a sort of a virtuous super cycle that can last several years.

If there were to be a catalyst to growth, that's what I imagine it would be. We're not talking about stock market growth. I'm talking about basic real GDP growth. Some say could the wealth effect help? I don't know. The stock market's been up for years and years. The real estate prices are as high. I mean that the wealth effect to me is just one big myth that has never really properly been dealt with.

You know, fed dovishness. Could it come and boost asset prices if they do end up overly you know, surprising markets with more dovish monetary policy? Certainly it could, but does that have to do with anything to do with real economic growth? No, generally it doesn't. Could artificial intelligence be an issue?

Some sort of technology advancement? Perhaps it drives some efficiencies, but again I always want to see productivity boosted by technology advancements. It seems to me right now, the actual productivity is having a very hard time keeping up with

the hype. Maybe that changes. But we've had a lot of factors put downward pressure on growth.

And a lot of those factors I think are long term structurally embedded. And I've talked about those things many times. Excessive government indebtedness being at the top of the list, and then the various forms of financial repression and allocation, misallocation of resources that comes about thereafter.

Those are the headwinds that growth faces. But in a shorter, inter or intermediate period of time CapEx renaissance continues to be the thing that we'd be hoping for. I'll leave it there. Thank you very much for following us another week here, Dividend Cafe. Please do send questions anytime and we'll look forward to seeing you Monday in the Dividend Cafe as well for our normal Monday edition going through all the different topics that are near and dear to you.

Have a wonderful weekend. Thanks for watching, thanks for listening, and thank you for reading The Dividend Cafe.