DIVIDENDCAFE | PODCAST TRANSCRIPTION

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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 this week's Dividend Cafe. I'm glad to be back here in the studio in our New York office and prepared to go through a few different things with you today. It is actually, as I'm sitting here, it appears we're on track for our eighth day in a row of positive movement in the Dow. Now, you know, we still have a few hours to go Friday, so I'm quite confident that I have jinxed it by even saying that. But there has at the very least been already seven days in a row. And so many are asking what is caused this kind of reversal of sentiment as if, you know, two weeks of market action versus what had been maybe three weeks of market action before that qualifies as a reversal.

I just loathe this interest in the short term ism of the moment. But nevertheless, I think it's fine for the idle curiosity of the fact that there was, you know, a roughly 4 to 5 percent downward pressure on markets in the weeks of April. And there's been a roughly 3 to 4 percent upward pressure on markets here since we came into May.

And I will tell you that I think there's three things at play. One, I mean, the timing is just almost too coincident. At the feds meeting whereby they did not raise rates or cut rates as expected, but nevertheless kind of maintained the posture that we, that rate hikes are off the table that they see the present

level that, you know, we're getting pretty close to having been at this fed funds rate this July, which is only a couple months away now, it will have been a whole year that this represents the peak of the cycle for monetary tightening. But I would add that there's also been and someone had asked about this a week ago, and I'm answering it a little more fully now.

Marginally improved liquidity in financial markets as a result of the Fed's expressed vision to taper their quantitative tightening. And I think that enhancement of liquidity in the marketplace, either as a present tense condition or something that gets priced in at a forward guidance Has been a factor in a stronger market sentiment, stronger market optimism, but then to we should couple these two monetary conditions to the fact that there's been a reasonably healthy fundamental backdrop for corporate profits that the earning season, which is now more or less come to a close, did it.

And with pretty high margins being maintained revenue growth in line with expectation and a pretty strong maintenance of expectations for full year corporate profits. You take that fundamental backdrop, attach it to a reasonable optimism that even though the Fed is going to be later to cutting rates than some had started the year expecting or wanting, that they're not putting rate hikes back on the table.

And in fact have begun easing financial conditions, if not yet with the rate, but with the balance sheet the so called quantitative tightening. And so I think all of those elements

explain kind of where we are trying to time our way around those things. I mean, even someone who is. Explicitly critical, consistently explicitly critical of market valuation and the hope for market multiple expansion as a means of driving an investment result like myself.

I've never believed that valuation is a timing tool. I think valuation is a very poor timing tool and nevertheless a relevant factor in long term expected investment outcome. So you do suffer right now from a valuation issue for a good portion of risk assets, but the fundamental backdrop in the meantime, that can often serve as a catalyst to correcting those valuation issues has been benign and then, you know, Couple that to not worsening financial conditions.

And in some cases, marginally improved financial liquidity. You've gotten this kind of move back. It's not been a good period for market timers. But I don't think there's ever a good period for market timers. I think that timing what's a good period for market timing is the same thing as market timing.

And it's not something that, that people do very well. So let me just cover a few other things that I want to get to before I go a little deeper into quantitative tightening in this fed aspect this week. I just want to repeat a mantra because I've been heavy on this theme of valuation and because I am committed from the core of my being as a matter of ontological commitments.

To dividend growth investing that I really believe this summary that I'm about to offer is a very helpful way to think about the framework between those that are viewing a higher P. E. ratio or price momentum or the popularity of buzz around, you know, a high valuation growth sector of the market becoming an even higher valuation area of the market very much. That being one school of thought and our own, sometimes we're at varying degrees of self awareness and then our own school of thought, which of course is very committed to cashflow growth, more or less, I believe that our investment philosophy, it comes down to trying to get paid by the company that we're invested in and that the alternative.

Of price momentum and indexing linked to multiple valuation expansion. It comes down to trying to get paid by other investors. And investment return can come by another investor. It can come from the company, but ours is very self consciously tethered to attempting to get paid by the company. And I think there, there is a good and useful framework and summarizing the two schools of thought around that distinction.

Quantitative tightening. I've been, before I get there, let me talk about Chairman Powell for a second. I've been critical of Chairman Powell, where he has throughout this tightening cycle alluded to some elements of the Phillips curve to some elements of, you know, watching employment to make sure it doesn't you know, get, it doesn't stay good, doesn't, you know, get better, that, that type of language and alluding to the trade offs between unemployment and inflation that are embedded in the

Phillips curve, but I've been critical because I disagree so fervently with that idea that people having jobs is inflationary and Chairman Powell at the Economic Club in New York lunch, and I attended with him last October stated. That the Phillips curve appears to be a model that has worked at certain points of time and is not working now.

And I didn't really understand what kind of model that is that works sometimes and doesn't work others. And of course, it's my view that it's not any kind of model at all. And that even when there are times where you look at you can have periods of time where unemployment is high.

And inflation is low, but the notion that these things are intertwined in a state of tension is categorically untrue. And that what puts upward pressure on inflation is downward pressure on unemployment. I vehemently disagree with, I think you can have low unemployment and low inflation all at once and the Phillips curve that posits these are intentional one another, I think is absurd. And in fact, I actually think that the greatest antidote to inflation is the production of goods and services that therefore requires more people to be working, but I digress. The reason I bring the subject up is to compliment Chairman Powell in this sense.

I think he has said some of the wrong things about the Phillips curve. And even without mentioning the name, I think that there have been moments in which he has posited the theory that

inflation and unemployment have to be, you know, thought of in that way. But in practice, I don't think he is doing it.

The fact that he's coming up on almost a year now, the fact he has begun to kind of thaw the conditions and financial liquidity. They've been so tight. And again, going from 60 billion a month to 25 billion a month in quantitative tightening, it's not exactly hyper loose, but it's looser than it was a year ago.

All the while unemployment has stayed in the threes, somewhere between three, six and three, nine for a long time, very low unemployment. And I think that what I'm referring to, this is a Phillips curve in theory, but not in practice. And, you know, he could reverse course he, he may not stick to it, but I will be surprised if the fed takes a tighter posture, and I believe that's being done all with a healthy employment backdrop. That's not Phillips Curve practice, and Chairman Powell should be recognized for it, even if I really kind of consider it table stakes to sensible monetary policy. So on the subject of quantitative tightening, and then I'm going to direct you to dividendcafe.com for some of the other components I cover this week, because there are a lot of other things that I'm not gonna have time to do here on the podcast or video. I really believe that quantitative easing was done after the financial crisis because the policy tool they were most aggressively using to facilitate easier monetary conditions was the interest rate and they had cut it to zero. And so they said, okay, well, we can't really go any further. So how can we add to the easing of monetary conditions when we're already at zero, if policy rate is our only

tool. And they said, well, quantitative easing helps us pile on. It's a way to be even more accommodative of in monetary policy when you're already the most accommodative, you can be with tool number one, the interest rate. So you move to tool number two, which was the balance sheet. Yet quantitative tightening, you say, okay, was it just inversely true? But see, not really, because you can always get tighter with a higher rate and higher rate still.

You can't get lower than zero when you're easing, but you can get higher than five and a quarter if you're tightening. In fact, we've been higher than five and a quarter a lot. Now it's true that this five and a quarter is tighter than many other times in history where five and a quarter in the sense that we had been used to 15 years of the zero bound.

And there is a you know, I think a kind of societal expectation right now also much higher levels of leverage both at the sovereign level, a much, much higher government indebtedness and at the corporate level as well. And so. You have to take all these things in a relative context. But I would say that the, if they were simply trying to use quantitative tightening to get tighter monetary policy, they could do so with a 6 percent fed funds rate.

I believe that quantitative easing was done to pile on a monetary easing, but quantitative tightening is not being done to pile on quantitative tightening. I think quantitative tightening was done To leave themselves in a position to do more

quantitative easing that effectively once that balance, you got to 9 trillion.

They felt we got to get this back down to 6 or 7 trillion if we're going to use it again. And even 6 or 7 trillion is a lot higher than the 4. 5 trillion. We were. Well, after QE 3, at the point of the COVID moment, we were still at four and a half trillion, not at six or seven. But nevertheless, I think that they view quantitative tightening as a way of resetting the optionality for quantitative easing.

And that something may come up some issue that I do not need to or have to, or want to predict what it may be, but just merely saying from the testimony of history, there will be some financial moment that comes up whereby they decide they need to ease with the balance sheet again. And they would rather have a few trillion of room relative to where they've been.

That's my view of the case, and it's why it speaks to them, even when they're holding the interest rate at five and a quarter, you see them starting to limit the level of quantitative tightening. Now, as long as they're doing any quantitative tightening, there's still technically a net reducer of their balance sheet albeit at a very slow pace right now, down to 25 billion would only be 300 billion a year.

And that wouldn't even by the end of this time next year, get us below 7 trillion on the balance sheet. But I think that they kind of got the first trillion and a half done pretty easily, and they

recognize at this point that there will be difficulties. This calls for probably more Dividend Cafe coverage of the overall issue of the feds balance sheet.

It is complicated. It is wonky. I've probably already lost some of you and that's never my desire, but this is important stuff I have opinions on, but that's the framework I wanted to leave for you today. You got to check out dividendcafe.com to see a chart of the industrials versus technology and what our view on that is.

The just general critique of conventional wisdom. About Japan versus China versus, you know, other markets, what the economy has done, what the markets have done, and just getting that kind of historical context, and then a really fascinating chart of the week that I think speaks to and against doomsday is a message, but something I want everyone to see.

That maybe just maybe is another element of some green shoots in the economy, in an economy filled with some concerns. There is an optimism in the chart of the week that I want you to check out regarding new business applications. So I'm going to leave it there for the week. I'll be back with you next week.

I will be in New York most of the week, but I'm back in California at the end of the week. So I will bring you Dividend Cafe next week. from the Newport Beach studio next week. And in the meantime, thank you for listening. Thank you for watching and thank you for reading the Dividend Cafe.