FRIDAY, MAY 17, 2024

Well, hello and welcome to another episode of Dividend Cafe. I am recording this week live from our Newport Beach office studio and going to go through a few things today, just covering a couple of different subjects of market interest, and then conclude with kind of a longer and broader point that I think is a very helpful takeaway.

Just in terms of the lay of the land the market momentum and positivity that has been the case here in the month of May continued for the most part this week. And the beat goes on. I wanted to talk about the yield curve for a second. I think it is a fascinating development. That the yield curve has now been inverted for over 675 days and no recession has followed and no recession is really forecasted or predicted right now in any kind of reasonable definition of the immediate future.

And the reason I bring that up is I think we're going to have a conversation. About whether or not inverted yield curve has lost its predictive prowess or not. I think it's a tiny bit disingenuous when people will say, well, you know, it inverted in 2018 and we got that recession in 2020. It did slightly invert at certain points of the curve. And what we mean by this, of course, is that the yield for some shorter duration instrument, whether it's a 90 day or two year, goes higher than the yield for a longer maturity, such as a 10 year. And so technically if the three year is higher than the five year, there's an inversion.

And if the two year is higher than the 10 year, that's an inversion. But the more classic inversions, what we refer to have to do with, a two 10 or a 90 day 10. And The notion that the yield curve inverted in 2018 because it was predicting the few month recession from a COVID lockdown in 2020 is obviously asinine.

I would argue that we've now had Two yield curve inversion periods that did not result in an economic recession. The COVID recession obviously being outside the normalcy of economic activity. And in fact, the 2019 economic activity was quite positive despite 2018. So there's a couple of things that can happen.

You're going to have a recession at some point, and let's say it's in six months. Let's say it's in two years. The bottom line is we're already well past the point of someone being able to say the yield curve inverting had some predictive benefit to recession. You go, Oh, the yield curve just inverted and it could, it might mean that there's a recession is going to come in four years. Or in three years, the opportunity cost of that prediction is ridiculous. And therefore to a point of it being futile. And then of course you could have just no recession out at this moment at all. And so in my mind a market that is up 40 percent since the yield curve inversion began in July of 2022 does indicate to me a futility in using a yield curve predictably. Now what will happen is someone will say in the future, well, that time was different. And they will be right to some degree it was different. But my point is this is not the first false positive. We've also had other false negatives.

It doesn't mean it's not going to be of interest. By definition, when you have a short term yield paying more than a long term, there's something wrong. But the idea that it is predictive of a recession, I think is out of this period, a two year inaccuracy in terms of what the yield curve was supposedly saying to me is gonna prove to be lasting in its impact.

Speaking of data points that I think have a lasting impact I can't say enough about tip spreads as a valuable predictor or a valuable signal. Inflation expectations, inflation reality. There is so much noise and backward looking numbers, there can be hair on it. And what I mean by that is things that are somewhat idiosyncratic.

Why are rents showing a higher number and other things are not? Why did car prices spike but other things didn't? Why didn't things go up? I've always talked about for a long time, it's a very important point of my kind of lifetime doctrine of inflation. That there is a monetary inflation where the entire price level goes up and then there is government subsidized inflation, which is what we've mostly been living through in my lifetime, where inflation has been largely limited to housing and healthcare and higher education.

The only three elements that the federal government plays a very large subsidy, subsidy role in really, when you look at the overall price level, Tip spreads have become a financial innovation that not only has some degree of merit as an investment tool, but has just proven to be a really valuable component of price discovery.

And what a tip is a treasury inflation protected security. They're issued by the federal government, full faith and credit, just like the treasury bond. But their way in which they're structured and the way they pay out has a kicker in the yield around CPI. And so when you look at spreads in inflation, the yields that they're going to be offering in real time price mechanism, and we're, and this isn't a thinly traded market, like some municipal bonds are, this is a market that has substantial liquidity, volume, and robust participation from insurance companies, sovereign countries.

Corporate buyers, obviously mom and pop investors and, banks and so forth. So you have a lot of market actors with the, to the tune of trillions of dollars that are then pricing in what to expect in the two year tip spread. Has basically been something in between two to two and a half percent for a very long time. It's been at some periods a little bit lower one and a half to 2%, but the remarkable. Stability, where if there's been a point in which it did gyrate, it gyrated much lower at the point of the financial crisis, understandably, and at the point of the COVID shutdowns. But other than that, the kind of smoothness, there's a chart at DividendCafe.com I don't think they're able to put it up on the video right now, but I think you could go to DividendCafe.com to look at it. But when you see it, you just see a very stable expectation. The inflation rate out of tip spreads and I think it will remain as a market signal, one of the most valuable indicators out there.

Another chart, by the way that I put in dividend cafe today has to do with consumer prices the inflation growth in two different countries. And one of them has definitely seen prices go higher, but it's gone higher at about a two to two and a half percent rate per year for 30, 35 years now.

And that is the United States of America. And then there's another country that has spent way more money seeing its federal its national debt blow out even further. It's debt to GDP is more than double ours. The monetary tools that have been used with interest, zero interest rates, negative interest rates bond buying the via quantitative easing are remarkably more aggressive than what the United States has done.

And that inflation rate has been total flat line. So it defies all the conventional wisdom, but it's just a beautiful graphic illustration. of consumer price movement in Japan and the United States and why the conventional explanation of, oh, well, inflation goes up when governments spend too much money.

It's not true. Worse things happen when governments spend too much money. And the Japanification thesis is one that I've shared for a long time. There's another problem that comes out of many of the factors in Japan's economy, and that is when you get a declining population. birth rates are so low that at some point you don't have enough new people coming to replace the older people that are passing away.

And because you're going to lose people on the older end because of mortality, you have to have in the years that preceded these deaths, had enough people being born who then they themselves are having more kids. to maintain population growth. And Japan going into negative population. And at the same time in the early nineties, all of a sudden the percentage of vacant homes they have is grown.

And I say it's somewhat tongue in cheek in Diven Cafe. Again, this chart is available there if you want to check it out, but I point out I guess that's one way to get. to solve for a supply problem is to just have your population shrink. So then all of a sudden there's more homes than there were before relative to people and you end up with greater inventory.

Now, obviously that's about the worst possible way to solve for a supply problem. One really great way to solve for a supply problem is to You ready? Build more homes. But Japan doesn't have a supply shortage of homes because they have not had enough people born. And what that does, you go, okay maybe that's okay economically.

But This is an untrue, not merely because of my own philosophical and even theological beliefs about being pro family and pro people and not feeling that there being less people is a very good solution to much of anything in life, but as a basic economic tautology Economic growth equals the sum total of population growth plus productivity growth.

And so therefore, when you have less people, you have less consumers and producers, and therefore you get less economic growth. This is math. And Japan and their housing short supply Are a great case in point. The anecdotal point about some due to the election before I move on to my final kind of closing thoughts about behavioral investment reality.

President Biden did something interesting this week by announcing blowout, just massive, a hundred percent level tariffs in Chinese electric vehicles that are exported into the United States. So imports from the U S for the U S exports for China. Dealing with electric vehicle. He also through some such aggressive tariffs on Chinese solar panels and batteries as well. So on one hand, and I'm borrowing from my friend, Louie Gave at Gavekal Research to some degree, but you know, I suppose you could argue that this is a good sign for the environment, that they must not be that worried about what it means for the environment, that they're so strictly financially penalizing cars that are not going to be combustion engine, fossil fuel required. I also think that there's an interesting political dynamic at play because the tariffs that President Trump imposed had been something that President Biden was very critical of and that whether people agree with the argument or don't, whether it's a good argument or not putting aside what various people may feel about the use of tariffs as economic policy, and by the way, putting aside what I may feel about it, because this is obviously incredibly nonpartisan for me.

Because I am a critic of tariffs and I try to call balls and strikes when pointing out that whether you like them or not, they are paid by the consumers, the domestic consumers of the country that you are allegedly trying to help. But regardless, it was. both President Trump and President Biden now that have participated in such.

And so if I'm critical, I'm being critical on both, not one, but I think that President Biden's taken that off the table a little bit by going this route. It's going to be difficult for him to say, Oh, the terrorist President Trump's done were too aggressive, or they're crazy, or they could lead to economic instability, or they could hurt. Consumers, which I think would be a right argument, but no one can make it now on either presidential campaign side because they both are doing it and believing in it. But I think that the point I would like to make is, of course, in real life. We don't really import very much in electric vehicles from China.

It isn't actually going to hurt the environment and it isn't even really going to result in customers paying a lot more because we don't do it. And so the question really becomes why. Why impose a tariff on something that doesn't have that impact? And I think people can answer that question for themselves.
So the final thing I want to talk about this week is, first a reiteration and then an expansion upon something. That I

believe is the most important reality and investment success. And I have talked about it for the entirety of the 15 and a half years. I've now been writing a weekly market commentary, even before it was branded as dividendcafe.com I've always believed and tried to write and advocate around the notion that the behavioral decisions one makes as an investor and the ability to avoid big mistakes is really paramount in our investor success and that the fear factors that often can drive people to bad decision making. Are part of human nature.

So we, investors can get scared during times of severe market sell off and choose to make other investors very rich by selling them their shares of assets that are worth far more money at less money. They can do so as a result of their own fear at a given point in time, and that is not happening against human nature and therefore our burden or our task, or our mandate as professional investment advisors and counselors and even our mandate as investors is not to avoid the aberrant idea.

And if we store human nature, it's to recognize that is human nature, that human nature though, is allowed to have those emotions, but the investor mistake made is acting on them and that one needs to go against the strong gravitational pull of our own emotional instincts when it comes to investing and the sort of add on to this greater point that I want to make today.

I'm increasingly of the belief that what we often talk about as fear versus greed, sometimes make a mistake. People make a mistake by panicking in a moment of fear. And other times they make a mistake by being too greedy in a time of euphoria that I do not really. No, I that classification is accurate because I increasingly believe that a lot of what we call greed is itself a subset of fear.

It is a greed and a recklessness and a lack of prudence, lack of wisdom and investment decision making. That comes from a different kind of fear, not a fear of markets dropping, but a fear of someone else making dumb money that you didn't make, a fear of missing out, a fear that you're behind and you want to play catch up.

It has all the components of greed, but they're driven by a fear. And my basic suggestion to people is to recognize that truncated view of fear is too one sided. I believe that we really need to understand human nature and all components to be wise investors and certainly at my firm to be good investment advisors.

What your neighbor is doing, what he's, he or she says they're doing the idea that someone bought some dumb thing at a real low price and sold it at a big high price. And it could be true. It could not be true. It could be part of the story, not the whole story. And it could even really happen. And there really could be someone out there that won a lottery ticket that you didn't win. And In any world of rationality and common sense, that's just totally fine. There is no sense in which your neighbor winning the scratches somehow, some advice to you if there are things we believe in. But how to prudently generate investor returns the idea that someone else ran into something.

Now when usually people don't say my neighbor got lucky, I want to get lucky. What they say is my neighbor didn't get lucky. It looks like maybe they found this new thing where you can get 30 percent a month and there's no risk or blah, blah, blah. That's where it's very important for us to remember that thought enters your head because you're not an idiot.

Yeah. Yeah. So you don't think something so idiotic because there's something wrong with you intellectually. You think it because of the fear of missing out the fear of not participating in a particular moment. And there, and it manifests itself as greed, but it comes from a place of fear. And it's my view that that kind of significant fear has no place in a truly prudent and intelligent investor.

Philosophy and investor plan and process. It is the duty of behavioral modification to remind us all how incredibly stupid. So many of the things people do are generally rooted to some incredibly stupid things some people believe. They do not believe them because they are stupid people. They believe them because they are people and people sometimes need to believe things that cannot possibly be true.

And we work to the end of countering that underlying reality and dynamic of human nature. That is what our focus is here at the Bonson Group and what it needs to be for all investors that are outcome oriented. This is my final takeaway for you today in the Dividend Cafe. Thank you for listening. Thank you for watching and thank you for reading the Dividend Cafe. Look forward to being with you again next week. Have a wonderful weekend.