FRIDAY, JUNE 14, 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 Dividend Cafe, recording here in our New York City studio. Another exciting week in markets. We're still a few hours away here today on Friday from the market close, but a lot of up and down action this week. And this has been the trend for a little while. It's somewhat directionless. And yet day to day feels more volatile. What I want to talk about today is what I think is happening inside of markets and the possibility of what we call a Minsky moment. And a few of you may be familiar with that terminology. Some of you may be thinking what in the world are you talking about?

But as I was writing this morning, I got really inspired around this theme because it occurred to me. That if I'm talking right now about markets on television or in the dividend cafe or with clients, it's really almost entirely about the valuation story, the concern about the top heaviness, the popularity, momentum driver in certain large cap or mega cap growth names that have created, in my opinion, some pretty significant distortion in markets.

It's either about that. Or on a bigger picture, longer term thing. It's about government debt. And ironically, they're two totally different problems that I think have a totally different ramification in short term and long term impact. And what I

mean by that is that I would view the long term government debt that occupies a lot of space between my ears.

As somewhat irrelevant to short term market activity and very relevant to long term economic activity. And yet, The other subject that occupies a lot of my attention right now, market valuation, NVIDIA the kind of general lay of the land in markets, particularly the U. S. S&P 500 index I think has very large ramifications, short term in markets and very little. Ramification in long term economic context. And so you have a crisscross in these two different things in the way that we would think about them. But I bring up this idea of a Minsky moment because it does beg the question as to whether or not the things we're going through right now represent a potential for one of these moments that I'm going to explain in a moment, refers to a long period of stability, giving way to a period of instability to where the kind of good times rolling set the stage for a significant period of fragility. And the Minsky moment terminology comes from the 20th century economist Hyman Minsky, who I became somewhat familiar with as a much younger person when I was beginning to study economics more seriously.

And I didn't spend a lot of time on him. He's in a Keynesian framework. The, a lot of his contributions were redundant to other people I had studied more and and candidly people I had disagreed with in terms of a lot of first principles, primarily John Maynard Keynes himself. And my view was if I want to learn more about Keynesianism, I'll study Keynes, but Minsky's idea.

government intervention to offset excesses or imbalances in the economy. To me, it wasn't profound relative to others who had already said it. And I just remember doing kind of a cursory look at Minsky and not spending a lot of time with it. And that all changed after the financial crisis, 2008, when a gentleman by the name of Paul McCauley began writing about Minsky a lot And Paul was someone I read religiously, and I don't think I agreed with a single thing.

That he ever said, but I loved reading them and Paul was in the building. I was in at the time I was a managing director of Morgan Stanley and Paul was the chief economist at PIMCO. And we happened to be in the same building. Since then PIMCO went a few buildings down. And of course I left Morgan Stanley, that kind of little area, Newport Beach is where a lot of these. financial hubs were. And McCauley was a big cat at PIMCO a long time. And Bill Gross used to joke that Paul McCauley was more Keynesian than Keynes. And yet there was something about his communication style, his rhetoric, his writing, and his intelligence. He was a vigorously smart person. But he operated from a set of first principles that, that are largely at odds with the way I view the world.

And yet over the years I learned a great deal from him, but was always very cognizant of where the source of some of the disagreements were. But McCoy did a lot of work about the Minsky moment in the afternath of the financial crisis that was profoundly valuable. And the, to keep it as simple as I can for our

purposes here in the dividend cafe Minsky suggested that the nature.

Of calmness in financial markets and the way in which debt worked it gave way to the very forces of anti calmness that would come. That, in other words, the famous Minsky line, stability breeds instability. And in the periods of stability benign levels of debt generating a productive return then with no bad consequence and a lot of good consequence, then result in people moving up the food chain and he described the debt paradigm as moving from hedge borrowing to speculative borrowing to eventually Ponzi borrowing.

And McCauley applied Minsky's framework. Minsky died well before the financial crisis, but McCauley applied the Minsky framework to what happened in the GFC. And it was just brilliant. And I think this is a reasonably indisputable part of how we think about financial markets now.

Ironically, Minsky's prescriptions for a lot of this. I disagree with he was opposed to deregulation. He was opposed. He, he favored a very Keynesian intervention to offset what he considered to be the inevitabilities of these instabilities in financial markets. And I would argue Classical economic prescription to some of these things.

Although I think Minsky and I would agree about the role of the Fed as a lender of last resort. Although I'm not sure we'd agree in how that would have to be administered, but I don't want to

go down that rabbit trail. I think that The point I'm making is that there's a kind of underlying concept here that I now want to apply to not NVIDIA, not mag seven, but just overall right now, where we are in the market, which has this massive concentration of a few mega cap tech names.

Is there a Minsky moment where it has gone so well, so long that complacency is forming and it's an insta, it's a stability leading to an instability and in a weird way, right? Even as much as I want to talk down the sustainability of this big tech moment, I'm not sure I would describe it in a Minsky context for the simple reason.

That for whatever one wants to say about the tech excesses over the years, the boos and busts that take place with the kind of froth and euphoria that comes into the sector from time to time. It's almost always been equity oriented, not debt oriented. And one of the cornerstones of Minsky moments whereby financial markets destabilize the economy is largely debt driven, and I think that there can be and will be collateral damage to equity valuation implosions, and I think there can be and will be. Collateral damage beyond just simply, Hey, I owned a stock. It went down, too bad for me. I don't believe we're going to get off the hook so easily when there ends up being a repricing and the, and some of the excesses of the current AI moment, but I wouldn't describe it categorically as a Minsky moment whereby the the stability is leading to a future instability that is.

systemic. I think it's contained within the risk taking parameter as it should be. And yet, I think the instability that exists economically, is debt driven, that has that kind of cycle of how borrowing works, is largely governmental. And yet when I look at the significant excesses John Maulden and I had dinner last night with Brian Szytel and the three of us talk about these things a lot.

I don't know if the number's 36 trillion, 40 trillion, 50 trillion, in two years, five years, 10 years, there's a point in time in which, a hangover comes from the binge. of excessive government borrowing. And I talk about that as manifested through what I call Japanification a lot. But I don't believe that is on in the short term now impacting markets.

Meaning I don't think that the 34 trillion a debt is what I'm worried about happening to the S&P 500 next week or in the next month or what have you. That's a longer term economic, Story that is, largely at the center of our focus study and work here at the Bonson group and where the remedies of things like dividend growth and alternatives come in.

And yet then on the other side that, so that's your Minsky moment of where there's this instability. Everyone believes governments could borrow infinity at, to infinity until they can't. That is Minskyish where. If I'm right, Nvidia ends up one day looking a lot like the Cisco of 1999.

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I, I candidly don't believe it's Minsky ish, I think, and it ends up being much more contained. So there's a shorter term market risk in my mind, in, in the current tech large cap growth cap weighted index environment. And then there's more of a Minsky ish moment that is less market sensitive, but more long term macroeconomic sensitive with government indebtedness.
And there. Two different stories. They're both relevant. They both matter to what we do for a living. And yet with different characteristics and ultimately conclusions and how they play out for investors and how they play out for the economy. So that's the story we wanted to give you today.

I will say that if you look at dividendcafe. com and look at the chart of the week, you will see something very interesting. There's no reason for me to argue. that even weighted or equal weighted indexes are superior to cap weighted indexes. I don't think that a 4 billion company which I don't think there is a 4 billion company, but regardless, the smallest of company in the S&P 500, I don't think should be weighted the same as Nvidia, Apple, and Microsoft, but that three companies can become over 20 percent of a 500 company index.

Or that 10 companies can become 35 percent of it. It does speak to the fact that it how do I say this? Which calculated indexes are what most people own that you get self fulfilling prophecies up and self fulfilling prophecies down. And I think it can be it can hold and hide and ultimately, Unleash a great deal of risk.

When you look at the chart of the week, you will see that effectively periods in which cap weighted indexes let's we say it backwards, where equal weighted indexes are significantly underperforming cap weighted index. Like right now, it is been a secular period of the dot com boom, the FAANG boom, or right now the AI boom. And then the result in which tap weighted underperforms even weighted for an extended period of time. They are not merely a rotation like growth to value. They're periods in which the market significantly suffers. And out of that, some great value comes with a lot of defensive opportunities. There's all kinds of things that we have done over the last 20 something years that I believe in a great deal. But my point being I think that you can look and see that we're not really talking about cap weighted versus even weighted. We're really talking about when big tech can drive and when it can't. And what that means overall for an index investor. And so this is a theme that I don't want to let go of. I also do not want to give the impression that I'm talking about it as an imminent story. I have a very clear idea of what I believe is going to happen and I have absolutely no idea of when I think it's going to happen and nor do I care.

So those that are interested in kind of the timing of it, from a trading standpoint, I very much understand. It's just that it's not what I do or we do or will do. And so unfortunately we can't help you there. What I will say is. That there is always merit in being conscientious of Minsky moments in the economy, instability, fragility, and there's always merit in defending against those

things with a quality portfolio that is counter cultural and different than the popularity trade of the day.

That to me is the essence of how we want to think about economic positioning and market positioning that we are not exposed to the Japanification of current policy and we are not exposed to the euphoria of a certain moment like the one I think we're living in. I'm going to leave it there for the week. I want to say happy father's day to all you dads. And I also want to say. That any questions you have about this week's Dividend Cafe, you can send the questions@thebahnsengroup.com. Happy Father's Day. Thanks for watching. Thank you for listening. And thank you for reading The Dividend Cafe.