FRIDAY, JANUARY 17, 2025

Well, hello and welcome to the Friday Dividend Cafe. I'm your host, David Bahnsen. We're going to talk today about Scott Bessent, the soon to be Treasury Secretary of the United States. We're going to talk today about a very different week in markets than we've had last week. And we're going to talk a little bit about some of the policy things that matter as the new administration comes in next week.

So, yes, I'm recording in the middle of the market day on Friday, January 17th. On Monday, January 20th is, first of all, MLK Day, therefore a market holiday. Markets will be closed, but it also, coincidentally, is, inauguration day. So we no longer have to say the word, the hyphen, and elect when we're talking about President-elect Trump.

It will be President Trump, again we will very soon not be talking about various cabinet nominees, but actual confirmed cabinet appointees serving in their role as secretaries or advisors or whatever the case may be. And one Bessent, is who I want to talk about. Today, because I think there's a lot of market reality and market sensitivity and relevance economically and otherwise around some of the things that the soon to be Secretary said in his testimony to the Senate Finance Committee this week.

He's written a number of things since he became a public figure. He has written and said a few things. When, in the process of when he was being considered for treasury secretary, he won what became a little bit dramatic of a internal soap opera that lasted a bit over a week to become the nominee.

There were very few other cabinet positions. And you know, it's so funny, the middle of November now feels like it was 50 years ago to me. But when I think back two months ago, were there any other situations that be even behind the scenes to my knowledge? I guess really the, certainly the most high profile, and there are a couple others that may have only played out in private, but this one played out in public, and it's one of the most significant.

Positions in a president's cabinet. And, and you had Howard Lutnick, who was one of the people chairing the transition work for the president. Howard is the CEO of Cantor Fitzgerald, a firm here on wall street. He's about to not be, cause he ended up being selected by president Trump to be the commerce secretary.

But he made a rather public play. For himself at Treasury Secretary, Elon Musk tweeted support of Lutnick and, and actually went so far as to say, Oh, this Scott Bessent who's being considered would be status quo. We need something real different. So it was clear that there was kind of an internal thing that was playing out in social media and, and in the meat and in the press and in other places.

And for reasons and other things I won't get into now, I, I just sort of had a little bit more of an inside view on some of the things that, that were going on. And so it was kind of interesting and, and dramatic and, and what I, what I'll say is this Scott Bessent ended up being selected. He was a global macro hedge fund trader for many years had worked with some very high profile people, including George Soros, but in his own right carved out a significant net worth and reputation in, in, in global macro and foreign exchange, foreign currency and things of that nature. He's a very smart guy. And I, I will tell you that there's a lot for investors that are not political enthusiasts, that are not interested in this stuff, that don't know some of the people or, or, or care all that much as I kind of do about some of the personnel in the, in the economic policy team of the incoming administration, that it still matters because some of the issues that the Treasury Secretary will end up addressing, and I think more so in this administration than others.

They're very relevant to those of us that are just interested in all this as it pertains to our portfolios. I'm interested in it at a deeper and wider level. I don't expect all of you to be but I just wanted to explain a few things today and talk about some of the issues behind it. Before we get into soon to be secretary Scott Bessent, the 10 year bond yield as I was sitting in this very seat a week ago recording, or wait, did I record?

Where did I record a week ago? I think I might have been in Georgia. Now I'm losing, I don't even remember where I was. Oh, you know what? Last week was the White Paper, so it had already been recorded. That's right, yeah. So we last week released our year behind, year ahead, both the video podcast and White Paper, and I had recorded a little bit earlier in the week than the Friday.

But as the distribution was getting ready to go out to you on Friday, The 10 year bond yield was at 4.8%, highest it had been in quite some time. The Dow closed last Friday down over 700 points. And you have this view that with a hot unemployment number, the Fed talking down rate moves, the 10 year moving higher, that one of the big themes I talked about extensively in my paper was The relevance of the 10 year in a market that is dealing with such high valuations that even if the 10 year is moving higher for good reasons, i.e., strong economic growth, that the valuations of the market are vulnerable when there are competitive bond yields. PEs tend to work inversely with, with bond yields at a certain level of magnitude. Now, a whopping five five market days later, as I sit here. The tenure is at 4.59%, so down 20 plus basis points in a few days.

The Dow is up 1,700 points. Now again, because I'm not waiting till the market closes to record today, it's entirely possible that that could move by the end of the day, but that's where we are now. From Friday close to near the close the following Friday, a 1,700 point move higher in markets. I don't think this says anything about how good the market is or how bad the market is.

I just think it says something about how stupid a bunch of things are. The trigger happiness by which people can become very panicky, and the trigger happiness by which people can become very euphoric right now, is not healthy, it's not smart, it's not good. It's not really defensible. It's not intellectually rational, but it is human.

It is not all that abnormal. And at these valuations, I expect more of it. So, some of the themes that I talked about in the very paper that came out, you know, literally a week ago, are playing out. Higher volatility versus what we had last year. More trigger happiness around these things, but the 10 year really becoming a bellwether that in itself in a singular data point captures tension in the market that deals with two different points, which is the tension between valuations and economic growth.

And so we've seen it play out in just a week. It's sort of a microcosm, what I expect over the course of the year. And, and hopefully if you have a temptation to trade around this thing, To get out because you're worried about the market having had a bad Friday, or to get in because you are missing a market having a good Friday, just understand that it's not super smart, not a great way to be invested.

Have a plan have that plan be defensible itself, factoring in all sorts of various circumstances, addressing the unknowns. And having the discipline, fortitude to stick to that plan. Now, as we enter 2025, and we go to the inauguration on Monday you know, I know that there were other confirmation hearings this week, and some of them were newsworthy, a lot of people had a lot of faith.

Fun with the, the Pete Hegseth hearing on, on the secretary of defense. It's not as much of a market or economic events. I'm kind of steering clear of it. Marco Rubio is going to be secretary of state. I suspect it's very possible of every Trump 2.0 appointment that Rubio may end up getting the most Democrat Senator votes that would, could end up being the most bipartisan.

I don't know that to be the case, but that's my suspicion. But from a market standpoint, Treasury is, is the big deal. A little factoid that I actually typed into Dividend Cafe and then went back to make sure I was right. I was pretty sure I was, but I wanted to confirm. But, you know, do with this what you please.

I just think it's interesting. The week in November 20th when President Trump kind of resolved the aforementioned drama about who his Treasury Secretary would be, that week ended up being one of the biggest weeks in the bond market. Over the last year, meaning yields dropped, bond prices rally, at that point they had gone from like 448 to 418 or something, and, and, then this week, in the week of him testifying to Senate Finance, and, and him being another prevalent figure in the news and addressing a lot of the issues that are on peoples minds.

About the incoming economic administration policy priorities and and whatnot. The bond market had its second biggest rally week in, in a year. And, and so best sense name in the news. So far, at a high profile, it's happened twice, and so far, both times, it's been, you know loosely affiliated, or perhaps directly correlated I'll let you decide, or maybe the truth's somewhere in between.

A lot of these things tend to be in between. A bond rally. So what did he focus on in his testimony this week? First of all, I will just say I thought politically he was, he, there was a deft in that there were certain issues that they asked him to comment on that he avoided. There was a way in which he expressed things that I'm not sure Deep down in places he doesn't talk about at parties.

He's in total alignment, stylistically rhetorically, and even philosophically with the incoming president. But there was, he, he handled the way in which he presented some of these policy priorities diplomatically. And that's not me saying that he's lying, because that's not what I believe. But I think that there's a way in which some of the stuff around tariffs is presented.

that I thought he handled with, with deftness, that's the word I would use. Now, the China talk was very revealing in the reaffirmation of my belief that there is going to be a Trump 2.0 tariff talk about China, and a Trump 2.0 tariff talk about everybody else, and that those two things are going to prove to be separate talks that in Bahnsen's comments himself, Other policy goals were held out as the primary focus for potential tariff talk around other countries. And with China, it was spoken of more in the context of trade imbalances. And so also, unlike the other countries, whether you're including Mexico, Canada, Japan, South Korea, European trading partners.

There was certainly not the same focus that there was about China regarding currency. And one of the things he did that caught me a little off guard, but was quite interesting is he took a theme that I've had, that they are going to use currency as a back doorway to still achieve a lot of policy objectives and not have to allow tariffs to be the vehicle.

In other words, they can get to what they think is still a similar place. through currency just as much as they can through nominal trade. And I believe that him quantifying what some of this looks like was quite interesting and I was not expecting it, but he provided data that he believes suggests that for every 10 percent increase in tariffs, you have the currency adjust by four percent.

So in other words, it kind of softens or absorbs, Some of that impact, and this has been a theme of ours, that we believe if they can get some of that currency impact without some of the tariffs, they effectively will move the needle. And that is. In line with other priorities that the administration has.

And he himself wrote an op ed referring to a Mar a Lago accord. Playing off the theme of the very famous Plaza Accord, which took place just a couple blocks from where I'm sitting now. With Secretary James Baker in the mid 1980s with Japan, Germany, France, UK, etc. etc. And I dealing with what at the time was a utterly Ascendant US Dollar.

Right now I believe that to the extent they could get some sort of currency concessions with China, I think that they would be very happy. And the yuan, the Chinese currency, has indeed depreciated to the dollar four percent since the election. Which is interesting. It happens to be the exact same amount as what he talked about in the context of a 10 percent tariff.

So there are various things that China could agree to do. in terms of protecting their currency that could perhaps pacify the new treasury secretary and, and the president for whom he will be working. Okay, I know this is very thrilling stuff for you, but it's important to understand that there's a few variables, there's a few knobs to be turned, and trade levels are one of them, trade terms are one of them.

He did say, state, don't get me wrong, he is not stating it the way I would like to state it. In a perfect world in the sense of the priorities not being when I state that they are going to try to get better deals in national security that they do not want the China to be able to use its currency to alter terms of trade and that they would like China to buy more from us.

Okay, so just at a high level, let me be clear why I'm bringing this up. My view is that trade is a good thing and, and tariffs impede trade by definition. But their point is, but trade is not good if it's unfair. Of course, I always suggest, why would somebody want to participate in unfair trade if it's voluntary?

But this is the issue that they're bringing up is a lot of American businesses to get access to China's market. And have decided that they will take on worse terms and that their third parties are getting affected. And my argument is that they're right about that, but that there are fourth parties who get in, who get affected by the things we do to protect the third parties and so forth and so on.

And so this is a more complicated subject, but it is one that I believe. Treasury Secretary Bessent understands very well too, and we are going to enter a period of time that there is going to be tremendous volatility. about the way the tariffs are played out. And I just stand tooth and nail by my thesis that there will be volatility, surprises, fears, and concerns, even as, in the end, there will not be detrimental outcomes.

And those two things are at odds with one another, but this is part of the process. And ultimately, I think currency is one of the knobs that Bessent has his hand on, but I also believe that when he brings up China not living up to their end of the bargain in the 2020 trade deal, which of course had just begun to be effective right before COVID and the world shut down, that they are setting the stage to get concessions that I think

China will happily make which is commitments of buying US agriculture and and US LNG, liquefied natural gas.

So there's an energy story here and and so forth. Okay, a couple other things of note that when they asked him if he would favor getting rid of the debt ceiling, he did defend the debt ceiling to some degree while admitting he believes it is primarily been used as for showboating and grandstanding and, and creating certain dysfunctional stalemates that are problematic.

That's certainly president Trump's view. It's been my view for many, many years before any of us had ever thought about there being a president Trump. I have found the idea of infinite levels of debt unacceptable and the idea of a fake debt ceiling that is only used To create moments of political grandstanding to be a very bad idea.

But he did not just come out and say, yes, we got to get rid of it, which is what president Trump's been saying now for a few weeks. So I thought that was interesting. I'm not going to say he pushed back against president Trump, but he took a more nuanced view. And that could be interesting if it sets a precedent for, for, which is, by the way, his predecessor on the Trump side of it, Steve Mnuchin, did that quite well, too, where he was not contradicting President Trump, but he took a different perspective at times in the way he explained things that allowed for more nuance and you know, what he said about debt ceilings is he was very important to understand how market participants would respond if we got rid of the debt ceilings.

And I think that that revealed to me a theme I expect to see over and over is that he's very knowledgeable and sensitive due and understanding how market impacts are relevant to some of these policy decisions, what they can learn from it and what it means. And he referred to the bond market being in, and this is his exact words, a fragile, Equilibrium.

And I think that's a perfect way to state it, but it also was a great way for you to understand who this individual is. Someone who sees financial markets as providing information, providing signals, and, and I don't know that every Treasury Secretary we've had has always necessarily understood the power of financial markets in signifying things about the economy.

He did not back down at all from the fiscal havoc that excessive deficits represent. He did not back down at all from the belief that our need of the hour is not more revenue, but less spending. He defended empirically the idea that we are right now at very, very, very high deficits, despite the highest tax revenue we've ever had, and that it is spending that is running 3 to 4 percent above its own trendline, not a deficit of revenue And I think that his ability to constantly frame this issue in the, in the context of a fraction, a ratio, a numerator to denominator, meaning debt to GDP, budget deficits to GDP.

This is very cogent and important, and the data is undeniable. And I thought he did a very good job in navigating the discussion on, on debt and avoiding some of the questions they wanted about what he would cut in spending or what he thought about the Medicaid provisions from ACA that were except they were, they were given bonus COVID that are set to expire at the end of 2025. and he didn't take it on. What ought to be spent and not spent is not constitutionally in the domain of the executive branch of government where the Treasury Department lies. It is the job of Congress. So for people in Congress to ask the Treasury Secretary where they should cut spending, it's a gotcha question he avoided, but it's also a constitutionally dubious question.

Because it's one person not doing their job asking someone else to do something that isn't their job. It's very backwards. So I thought that was a telling part of things as well. Then finally, tax cut priorities. He really did focus on what I believe will be the major, major priority, the no tax on tips, and then talking about their desire to get an even lower corporate rate for domestic manufacturers.

And I think part of that is an offset to the impact of any particular tariffs that may come about and trying to further incentivize re shoring and on shoring and whatnot. I, I, unless I missed it, I don't believe he did bring up a couple of the other tax cuts that were discussed on the campaign trail.

And so I take that to mean, it's a bit of an argument from silence, but I take that to mean what I've already believed, which is the real high political priority will be tax on tips and then the extension of the 2017 tax cuts, which he reiterated emphatically on that latter point. So interesting as the new treasury secretary prepares to come in, and I just wanted to circle some of the major bullet points for you this week.

There's also a little information, by the way, at dividendcafe.com about the buyers of our debt. When we talk about the bond market, the importance of financial markets, when I talk about the 10 year yield and its high relevance to markets this year, You know, I just constantly am forced to revisit this discussion.

I remember in my second decade of managing money, a lot of talk about, well, what will happen if China stops buying our bonds? And China does own about 800 billion dollars of U. S. Treasury bonds. We have 29 trillion of public debt. Japan owns like 1.3 trillion. They own a very small percentage. But the appetite right now from foreign buyers for our debt that are not currency driven, that are not central banks, that are not sovereign wealth, but I mean private, insurance, corporate, investor, in foreign domiciles, that want US debt, is massive.

And of course, the appetite right now with higher yields is pretty solid for American savers, investors, retirees, pension funds, insurance companies. There have been times where central banks are the big buyers. There are times when foreign countries are the buyers that are currency driven. So you have economic and non economic actors.

But the one theme that I don't think people have fully appreciated is that the notion of foreign appetite declining

is patently false, patently false. And, and right now you're in a period of robust appetite. for U.S. dollar denominated debt that is at reasonably good yields, and even as the short end begins to come down, the spread between the short and long end has widened, and appetite has stayed quite robust, and so, there just continues to be this idea out there that, well, one day no one will want U.S. Treasury debt. I don't like it when everyone wants U.S. Treasury debt because everything's terrible, you know? Because when they buy it because everything's terrible, that, that means everything's terrible, and who wants things to be terrible? But, right now when the economy's very good, there's high appetite for U.S. Treasury debt, and when things get very bad, there's high appetite for U.S. Treasury debt. And to the extent that people think there's stuff that's about to change in that, then they can make that argument. But you have to understand that is a crystal ball argument. It is not one that has any support in the present or past tense.

So just want to lay that out there. Wonderful chart of the week at dividendcafe.com on the household debt to asset ratio, or all of these things have to be expressed as fractions, as ratios, not just U.S. debt, but even household debt. When you compare it to assets, is it the lowest it's been in 50 years?

Now, that begs the question to some degree, because if the asset values themselves are overinflated, and there were a big correction in housing prices, or a big correction in the stock market, then obviously not only would the asset prices go down, but the debt to asset ratio. ratio would go up. But my point being that a cogent analysis of debt levels requires a relationship to assets.

And right now you can talk about credit card debt and student debt and, and all of these things, mortgage debt, but the combined household levels of debt relative to combined household levels of assets are the lowest they've been in 50 years. I find that not something you're going to necessarily hear, on your favorite doomsday newsletter.

I'm gonna leave it there for the week. Very excited to get back to California. All 75 members of the Bahnsen Group team will be in Southern California next week for our annual off site of meetings retreat. We, we, we'll have a lot of fun together. We have a lot of intense sessions walking through our business.

You know, we have a lot of new faces. It's just, it's a really wonderful time. Very healthy for our business and very healthy for the way that we refocus, reorganize in our commitment to serving clients. I will, of course, have the normal Dividend Cafe on Friday. There will not be one Monday because of Martin Luther King Day and the federal holiday on Monday.

But in the meantime, reach out questions@thebahnsengroup.com anytime. Share that white paper from last week anywhere you'd like. Share Dividend Cafe anytime if you think there's anyone who'd be interested in it. We appreciate you sharing it. But mostly have a wonderful weekend and we will be back with you next week.

Take care.
