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Hello and welcome to this week's Dividend Cafe, the week that this big, beautiful bill has gotten through the House. We're gonna devote our time in the Dividend Cafe today to talking about the big, beautiful deficit, the big, beautiful bond market, and a lot of the unpacking of these things that needs to happen 'cause there's a lot of, I think, confusion on some of the topics. There's some good stuff to say, there's some bad stuff to say, and I want to do it in a way that I think gives you information as to what it means for the economy. What it means for investment markets and ultimately challenge us to think holistically.

There's topics that are integrated, but they are filled with misinformation. We're here to do something better than that, better than misinformation. While I was writing the Dividend Cafe this morning the president did tweet this stuff about going after Apple on tariffs. He tweeted about the European Union wanting to bring their big tariffs back. The market dropped in the pre-market six or 700 points quite quickly. As I'm recording now in the middle of the market day, Friday market is down, but not that much. Where it all goes we'll see, but we're not I'll address it after the holiday weekend because there could be four tweets between now and then and there isn't really anything substantive to report on anyways, other than just the reminder that we're hardly out of the woods in terms of the finality of where a lot of this tariff stuff goes.

But what we do wanna talk about today is this question about the national debt and I wanna set the table up this way here. Here is one theory of what took place this week and I'll just put it out there before I read it. This is a preposterous theory, but it's the theory of the day the prevalent narrative, if you will.

The House ended up succeeding in passing its budget reconciliation bill. That's true enough. The financial markets were either surprised that they had the political savvy to get it across the finish line or the financial markets were disappointed in the bill itself. And this all served to stir up bond in vigilantes as the world's financial markets.

The primarily the bond market threw down a gauntlet in just being furious about runaway government spending and excessive sovereign debt. Alright, I've heard that story many times. I generally have a pretty low view of what I hear in financial media or from, let's say, more pedestrian mainstream sources.

But I heard some version of this even from more institutional sources that I would think intellectually might know better, but there is a little bit of a problem. With all three of these tenants. A, there is absolutely no way financial markets were surprised that this ended up passing the specifics of when and how were always a question, but that a thing was going to pass was never a mystery.

That this basically the, let me phrase it this way. The bill itself. And its actual deficit impact is not a surprise to markets that they were going to pass something that was going to be resulting in an addition to the national debt. It just simply isn't a surprise to financial markets.

But then, so not only are the premises wrong, but then the conclusion was that the bond market is revolting against it. And the bond market did absolutely no such thing. So as I'm sitting here talking, the 10 year is literally at 4.5%. My friends, if you believe that is bond vigilantism than you have a very different definition than I do.

Now, what is it gonna go to? 6%? Is it gonna go to 7%? That's a completely different story. Saying that they will come out is different than saying they have come out, but what we've done is put a chart at dividendcafe.com of the 10 year bond yield over the last 65 years to give you historical perspective of how utterly benign the current level of a 10 year long bond rate is.

Now 65 years is longer than I've been alive by quite a bit by the way. And you may just say, okay, so much has happened over the last 65 years. I can't even process it. The point of the graphic I image is to illustrate that we're talking about a relatively low place in history for 65 years. Relative to where the 10 year bond yield is, but let's just look to the last two years, okay?

In a very brief period of time, what we're to believe is that now this new bill and its impacted debt is causing the bond market to revolt, which the bond market has barely even moved. And what in a chart of the 10 year bond yield over the last two years is it's right smack dab in the middle of where it's been the whole darn time.

It's basically been between four and 5%. And sometimes it got up in the high fours and sometimes it was down in the low fours, but there's been 1, 2, 3, 4, 5, 6 times the last two years that it was at a, it had peaked up a higher place. Then now this is just untrue. I think the confusion is people not understanding what the bond yield is to begin with.

What is the 10 year bond yield supposed to be? My belief is fundamentally it measures. Nominal GDP growth, all other things removed. Now, the argument is that maybe sometimes not all other things are removed because if you become worried about the repayment ability, if you become worried about future purchasing power of the dollar, that is different.

Now, the purchasing power of the dollar should be priced into nominal GDP expectations. It's part of inflation. If you're worried about the credit worthiness of the United States. Then that becomes a different issue. But of course then you're talking about something that would be a real credit risk.

Okay? Nobody can say with a straight face that they believe 4.5% on a 10 year is calling into question the credit worthiness. The issue is about inflation expectations and growth expectations. So over time, nominal GDP, not in three months, not in three years. Over 10 years, that's a long and period of time to say I am in a part with my money for 10 years by lending it to the United States government.

And the opportunity cost of doing so is basically equal to what would be available in the economy. So nominal GDP growth, I should be able to get that. Let's say you believe that inflation will be. 3% and real GDP growth would be 2%. So a nominal GDP growth at 5%. If the economy's growing, nominally at five, you should find things that are creating that economic result, creating that nominal GDP, if that is happening in the economy at 5%, there's a bunch of things creating 5% growth.

I could be getting those things, but instead I'm lending it to the government, therefore I want 5% on the money and the composition of that nominal GDP growth matters. Okay, 1% inflation and 4% real GDP growth. I'll take a 5% yield there all day because that would mean really healthy economy, really healthy corporate profits, really healthy job creation and wage growth and all of the things you want in a growing robust economy.

If you were gonna get 5% normal GP growth from 1% real GDP growth with 4% inflation. That's awful and that's gonna be bad for bonds, bad for stocks, bad for risk, et cetera. Now I just wanna ask you a question. If we're at a four and a half yield right now if we were gonna have 10 years of one and a half percent inflation and 3% real GDP growth, let's call it three, one, just to equal our post-war 70 year average until financial crisis.

Really good times for American economic growth. Who wouldn't take that all day long. Anyone who thinks they're gonna get that is utterly insane, that maybe inflation gets that low and, but real GDP growth is not going to be that high. And if it is, it's gonna be a really good thing, especially the combination of those two.

So the whole point is that there are bad things that could make nominal GDP expeditions higher and good things. But right now, why do we think. Something in the fours would be a problem. If it was something in the range of one and a half to two and a half inflation with two and a half to three growth.

That's the best case scenario of what you're gonna get. That would probably mean a four to five yield on the 10 year. What are people rooting for A three and a half year on the tenure? 'cause we had it. We had one and a half, 1.6% real GDP growth for 12 years post-financial crisis. We had low inflation, but we had low growth, and that put downward pressure on the bond yield that kept it between two and 3% for a decade.

That's not what you want. So this whole entire thing, if you wanna talk about bond vigilantism, where it is, bonds. Pricing in repayment worries about excessive government debt or putting downward pressure on growth expectations. It's a very different conversation, but the bond vigilantes coming out to punish excessive runaway debt, it is just not true.

It could become true. Now, immediately the question becomes, David, are you suggesting that everything is fine? I don't know how I could be any more clear that I'm not suggesting that. Okay. What I am suggesting is that. We have almost not quite, almost $37 trillion of national debt that's money we owe.

Now, if you discount the public debt, meaning that is not intergovernmental, 29 trillion of public debt. Our last year's fiscal last, the fiscal year, the budget deficit was 1.8 trillion. That's how much we're adding on a year by year basis to the national debt. The budget deficit, the yearly delta between government revenue and government expense.

Quite frankly, it's the opposite. Government expense minus government revenue divided by the economic growth. Total goods and services in the economy was over 6%, 6.1. It had basically been somewhere between zero and 3% all the way from 2001 to 2020. It's now more than doubled. So you had a debt to GDP, not the annual deficit to GDP, which is currently 6.1% more than double what it's been in the last 20 years.

Then the total amount on the credit card divided by the size of our economy is now at about 120%. That's three times what it was. Three times from 1960 to 1990, and it's two times what it was from 1990 to 2010. This is the issue, okay? But again, we skyrocketed debt to GDP for a 30 year period, 20 year period.

It's moved to this range, and I'm not suggesting in that process that the world has fallen into the ocean, that our country's fallen into the ocean. What I'm suggesting is. That we have now gotten ourselves into a position where it's very difficult to create the real economic growth we're used to because we have crowded out the more productive resources in the economy.

There is a greater amount of total capital stock in the country that has to be allocated to unproductive use, and that has created a major problem for growth. And created a major question for how we're gonna address it in the future. Which now brings me to the new tax and spending bill. How could somebody so concerned about debt to GDP and annual budget deficit, GDP wanna see lower taxes?

First of all, I. The main part of this new tax bill is just extending the taxes for where they currently are. They're not talking about new tax cuts and so raising taxes, which are almost entirely felt if you were to su sunset the 2018 tax bill 17 going into 18 tax bill almost entirely be felt by.

Middle class wage earners. Look, the issue we have with runaway debt and deficits is spending, and on the revenue side, I can only tell you the testimony of history. It is absolutely indisputably true that lowering the corporate tax rate resulted in higher corporate tax revenues. It is indisputably true that when President Bill Clinton lowered capital gain tax rates, we increased capital gain tax revenue.

It is the story of my lifetime economically, that when President Reagan slashed marginal income tax rates, we substantially increased revenue. To treasury. It is indisputably true that when President Kennedy slashed tax rates business and individual, it was passed after he was assassinated, it raised revenue to treasury.

This is not a political point for me. This is historical and empirical. I'm not worried about the revenue side from cutting tax rates. I am worried about the spending side, and I believe that this bill massively. Failed to do it in the way many of us were hoping and expecting. And so at the end of the day, I recognize the political reality.

You could have done more for fiscal hawks like me. There could be more truth telling and more honesty and more sobriety about what we did with the Medicaid spending growth. But then that would've lo lost some votes. You could have refused to pander to some who wanted special things in their districts that would've lost some votes.

I, I can't speak to the political reality of it. I'm not running for office. I'm never running for office. I can't even imagine having to go do what those people have to do. But the lack of courage to go do hard things is a problem. Now, am I criticizing the bill? Look, they had to keep those tax rates from going higher, that was going to be bipartisan if it had to be there.

There was never a point where those tax cuts were going to be sunset. I. The, are there what I'm calling Easter eggs in the bill? Yes. I truly believe that it's unappreciated, the supply side. Pro growth benefits to bonus depreciation. Full business expensing for capital expenditures to enhanced r and d deductibility to enhanced deductibility of corporate debt.

The interest cost on debt additional opportunity zones, marginally effective. These things aren't getting barely any coverage at all. And that's probably fine politically, but they're probably the only supply side pro-growth things in the bill. But this issue about whether or not the Senate's gonna block it, the Senate, we're gonna make some tweaks here and there.

They're not gonna end up blocking it. So now I don't know that this is gonna add 3 trillion to the national debt over 10 years. I think that the CBO scores way too conservative on the dynamic growth at SA side. And I think that there are fiscal watchdog groups that are too arduous in the way they're scoring the expense side.

But let's say it isn't 3 trillion, it's two and a half or two. We need to be going the other way. And this is why I believe we face an issue that is gonna have to be dealt with sooner or later. And it's not that it has to be, it's going to be dealt with sooner or later. But I don't say it as a figure of speech.

It's either sooner or it's later and later is harder. And harder is worse. And sooner is hard, but hard is better. That's the issue we're dealing with. I can't go deal with that politically, but from a market standpoint. I do not believe we have bond vigilantes coming out. I do believe there's supply side benefits in this bill.

I do believe they obviously had the political and economic necessity of not seeing the taxes go higher, and I believe they're kicking the can on what has to be done on the fiscal restraint side. That's the bottom line. If that manages to upset. People who wanna refer to this as the biggest, most beautiful bill ever and the greatest thing ever passed.

I'm sorry, I'm not gonna say something like that. And 'cause it isn't true. And if you want me to come criticize it and say we should be raising taxes to deal the deficit, I'm not gonna say that either. 'cause it isn't true. What I will say is for those of us in investment markets, we continue to be in a position where extrinsic things on the fiscal side are putting downward pressure on real economic growth opportunity.

And that forces us to be even more selective and opinionated about how we navigate. And to the extent people worried about the bond market revolting, I believe that they failed to understand the reality of the moment. I would love to see the bond market at 4.5, 4.7% because I would love to see 1.5% inflation and three to three point a half real growth.

We're gonna need it someday. There's no political will to create it right now. In the meantime, I hope you have a wonderful Memorial Day weekend. I look forward to coming back to you. It'll be on Tuesday instead of Monday with the long form early week Dividend Cafe. I hope the Knicks win tonight after that utter debacle the other night.

And I look forward to being with you next week. Really do Have a wonderful Memorial Day weekend and God bless America.