DIVIDEND CAFE | PODCAST TRANSCRIPTION

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Hello and welcome to this week's Dividend Cafe where today I'm gonna follow up a little bit on something I talked about a few weeks back regarding the national debt. I wrote a Dividend Cafe, I think it was about three weeks ago now, where it was really very purposely meant to be somewhat hypothetical. What would the things be that I would do if I were a king for a day? And I referred to this mythical place called ‘Dave Land’, where I wasn't limited by political reality and I wasn't constrained by what is actually possible in our current democratic system, but was just talking through various things that I'd love to wave a wand and do to make more fiscally manageable, our budget situation, our debt, and our annual deficits or addition to such debt and to promote greater economic growth that would help drive the other side of that equation in a positive way. And I loved writing it and all of the ideas in there are ideas I stand behind. I really would do them in Dave Land, but I really don't live in Dave Land and neither do any of you. And so there's a lot of feedback from that particular Dividend Cafe. And one question, and I got it actually about four different ways from four or so different people that I was really interested in was some version of, okay, we understand that the hypotheticals you wrote about here are not gonna happen. But what if nothing happens? What if we don't do anything? What is the end run? Where is this going? And I thought that gets us out of Dave land a little and out of hypotheticals and out of political aspiration and into something a bit more tangible that is of economic interest.

Where is this exactly going? If we were to do nothing, we have close to $37 trillion in national debt, 29 trillion of which is owed to outsiders. We are adding in a good year, 1 trillion, and in a normal year, closer to 2 trillion to that debt every year. And we don't exactly have that, or the social security and Medicare obligations that are largely unfunded and not included in that number addressed, dealt with. So the overall scenario seems dire. And of course there are a million ways in which it could be addressed, none of which can or will happen without pain, but there's a big amount of uncertainty regarding that pain. Hard, high pain that is quick, less magnitude pain that is longer, pain that is very much directed at one group versus another, or this group versus the other. The distribution of pain, the magnitude, the term are all unknown, but what is not unknown is that there will have to be pain to deal with some of it, and yet it is worth wondering what does this exactly look like into the future.

You could even argue by the way that this has a certain degree of hypothetical to it as well in so much as I would love to believe that some part of it will be eventually addressed.

But I'm trying to take this from the vantage point of what if we just literally continue whistling through a proverbial graveyard?

Now for me to go about answering this question today, I get to start with the thing that probably starts to lose some clicks and plays right away, which is saying the answer to the question is that no one knows.

I say it all the time. You will not find a time on television where I'm asked a question that I know to be unknowable where I then go on to try to know it and answer it. You will not find in my Dividend Cafe writing. I could be wrong on things, but I will answer questions that I believe to be intrinsically unknowable as if they are unknowable.

What we're talking about here is not knowing specifics and timeline. General possibilities or a general framework for things. Why I am so adamant about this no one knows thing, is that the national debt is a wonderful tee up for a group of people that I loathe more than almost anyone. The perma bear, doom and Gloomers who manage no money for anyone that have the incorrigibility factor through the roof of time and time again, being wrong and being un remorseful, willing to continue scaring the heck outta people all without any shame whatsoever. That they are consistently wrong in such predictions, doesn't phase them, and there is embedded in human nature, unfortunately, a rather bulletproof amount of people that are always willing to hear the next pathologically pessimistic nonsense.

But see when I say that and critique the doom and gloomers who have been wrong over and over again. I speak from a vantage point of history. I do, I speak from a vantage point of human psychology. I by no means speak from a vantage point of rose colored glasses that suggest everything is fine with the national debt.

Everything is not fine with the national debt. That's why I write about all the time. That's why I care about it. What I am not saying though, is it will lead to this. The, those forecast not only are inevitably wrong, they lack specificity. They lack the ability to apply now to apply them into a real life scenario for economic outlook, let alone investment outlook.

Let's say that I wanna do, make my forecast being that dogs and cats were gonna fall out of the sky because of the national debt. I don't think that's gonna happen. If I wouldn't say it can't happen, but if I had to place money on these various options that's not one I'd be placing a whole lot of money on.

But even if I did, apart from it being maybe a right answer or very likely a wrong answer, it not, no matter what is an unhelpful answer because you have to be able to look to when it will begin and what you would do ahead of time and what you would do, what the aftermath to such a thing would be.

Various versions of societal unrest or chaotic unraveling feed various dystopian I don't know, aspirations of some psychopaths or opportunist or grifters. Or just the coping mechanisms of pathologically pessimistic people. All of that's on the table, but even then, it doesn't speak to then what you would do in the aftermath of the response to such things.

It's funny, the global financial crisis of 2008 is the worst economic event anybody listening to this has gone through. In terms of it being the worst macro event of our lifetime, not necessarily a micro event in one's own life, but certainly macro in society. And and I guess I would say if any of you are listening and you were alive during the depression you would have an exception to what I just said.

My point being that for one to say, oh, I think the financial crisis is coming, I think banks are over levered, I think there's gonna be a lot of failures at firms like Bear Stearns and Lehman Brothers, you would've had to then also be able to forecast what Congress was gonna do, what The Fed was gonna do, what Washington D.C. was gonna do. Someone could have said they think economy will recover in four months. They would've been wrong. Someone could have said the economy will never recover. They would've been wrong. Some people said there's gonna be a new normal. That was a pretty big thing here, my friends at PIMCO around the corner in Newport.

But I don't think they meant by new normal that the stock market was gonna go up every single year for 12 years in a row or what, so the fact of the matter is even responding to the horrible things is not so easy. But I would say the dogs and cats falling outta the sky scenario. Being low probability is not super helpful in establishing a framework.

And that's what I want to do, a kind of incomplete list of potential responses and outcomes. And so I'm putting one on the list to start us off that doesn't belong in the list for the subject of today's Dividend Cafe. 'cause I said, what if they do nothing? And my first option is that they would do something, some form of fiscal responsibility combined with economic growth.

I don't believe that's going to happen. I don't believe there's political will for it. I don't believe there's political courage for it at either party, but it is still what I refer to as the Calvin Coolidge option, whereby modest austerity at the government level is combined with a pro-growth agenda and the private sector that is still not pain free at this level of credit card balance is significantly better in terms of where it goes and what the eventual outcome is than some of the other options. But because that's not really the hypothetical we're answering, we'll move on to things that I think are far more likely a reasonably, I don't wanna say benign 'cause there's versions of this, gradations of this that are really severe.

But I also think that this one just seems rather inevitable for one reason. 'cause we've already done it. Aggressively in our last two major trauma events in the national economy, and that's financial repression. Again, manipulated interest rates, central bank interventions to punish savers, but essentially soften the blow of excessive debt.

Okay. On a more draconian version, it could mean erasing governmental debt held by the central bank, which is a literal monetization of the debt that is textbook inflationary various other forms of financial repression. Our textbook deflationary I expect financial repression to be a part.

The national debt fiasco one way or the other, could they go to the more dramatic version for giving the debt owed to our central bank or even getting cute about it, issuing a trillion dollar bill and putting it on deposit as counting it as a credited payment that was made out of thin air.

Quasi debt monetization, if you will. I think those things will be, could be in the playbook. But I'm certainly willing to say that things that have already been in the playbook are in the playbook. Zero interest rate, quantitative easing so various forms of selective reduction. Monetization represent possibilities and ongoing aggressive use of financial oppression, including more aggressive and creative tools than we've ever even thought about.

I think I would go ahead and put that on your list. I. Now some would say, moving on to the next, that full-blown debt default is a possibility, not merely central bank monetization of the debt owed to the central bank, but not paying back sovereign wealth funds, not paying back insurance companies, pension funds, savers, retirees, banks, investors that are owed money and certain third world countries have done it.

In fact, some have done it more than once. But no, this is not low hanging fruit for our country, dealing with our problem. For the same reason that almost every chronic borrower ends up having to one way or the other, pay debt, even if they are taking on more debt to pay old debt. And that is because they want to continue borrowing.

And chronic borrowers have to pay their minimums because chronic borrowers need to be paying, borrowing more money. There's some who will say things like let's just not pay back China. We're just gonna take our adversaries and just choose not to pay them back to which I say they go, we could do that.

And to which I say no, you can't. There is no scenario by which a selective debt default would be on the table. Debt default and various versions of it I would like to think are extremely low probability. Moving on to something that I would tell you is getting much more realistic in that same category of financial repression is a recalibration of social security and Medicare benefits.

It's going to happen. It's just a question of whether or not it's gonna happen with our gun to our head or before a gun is to our head. And I would think that it will go better if it happens before a gun is to the head. What does this entail? Adjusting age eligibility. Reducing benefits means testing some things that are more popular than others.

Some things that are less painful than others, but some recalibration of the liability of social security and Medicare, whether we do it voluntarily with some political courage or we do it later and we're in a more draconian way because we were forced to, I think you are wise to believe that's on the table.

Higher tax rates on the middle class. This is fascinating 'cause people say, why are you talking about the middle class? I say look, I'm already assuming if we get to this point, they've tried to squeeze everything they can out of the upper class. Right now, 22% of all national income is generated by the top 1%, but 40% of all federal revenue is coming from the top 1%.

So sure, they can try to turn the knobs a little bit there, but you are in such a laffan curve moment with the top 1%. There's not a lot of shall we say, juice to come from that squeeze. The middle class and I'm gonna give you, there's a chart at Dividend Cafe that I would love for you to see is very telling here. Middle tier of wage earners, those from 25% of wages the 25% to 50% earning level pay only 10% of income taxes, but they earn 18% of total income. You go up higher from the 25% to 10% level. They pay 15% of all tax and earn 21% of all income. So those two middle class brackets of wage earners, basically from the fifth decile of wage earners up to the ninth decile, 50 to 90%. So we're not talking about the bottom 50, we're not talking about the top 10, all right. That middle range, that's the only space where they're paying less of a percentage of taxes than they are receiving or generating percentage of national income. It's politically disastrous. It's been deemed to be totally unacceptable since Walter Mondale lost 49 states talking about it, but that's the only place they can get real meaningful revenue is higher tax rates on the middle class.

Now finally, one thing I'll throw out there is this notion of federal government selling assets. They on their own balance sheet in the financial statements that the government puts out show 1.3 trillion, which is just a drop in the bucket of plants and factory or or inventories and equipment and various, buildings and so forth that, that's the depreciated value. There's certain things they could do to go rent and do a sale to someone who would lease back to them and generate that revenue. Yeah, maybe. But the bigger issue is federal land, and again, this is politically just toxic. The Bureau of Economic Analysis suggests that they own $23 trillion of land. You're talking about national parks, you're talking about various oil, gas and mineral deposit depositories that have leases. Do I think that we're gonna be selling Yellowstone to Blackstone so they can build four seasons? And I do not, do I think that there's some form of liquidity that would be created from some portion of the heretofore untouchable federal land assets. It's possible.

I would put it on the list of potential outcomes, not as a full solution, but essentially you look at financial repression, highly likely higher taxes if nothing is done, highly likely at a, at again, a gun to head moment. Recalibration of social security, medical obligations, highly, likely, and large, and likely at a gun to head moment. Acid sales and a couple other things I think are less likely. I would view all these things being on the table, all of them being painful, all of 'em, and being unpopular. And the vast majority of 'em only happening in that context that Winston Churchill once said, Americans can be counted on to do the right thing once they have exhausted every other option.

I would very much love to avoid that moment, but let me conclude with what I really believe is the base case here. Far more so than getting to things like tax increases here and reduce social security there, and asset sales and all of these different mechanisms. What I believe is not will be, but is, and then may very well be worse, is decline of growth, downward pressure on real growth because of this ongoing burden of excessive governmental debt.

That extracts from the productive side of our economy, which we call the private sector. The great algebra syllogism of one of my favorite living economists. Lacey Hunt. That national income is by definition reduced by national debt, and savings comes from national income and investment comes from savings and productivity comes from investment and growth comes from productivity, air go.

National debt reduces growth. That is not philosophical. It is mathematical. And this, to me is the least hypothetical thing I've said today. This ongoing Japan ification thesis that isn't, I've always said, is still somewhat unhelpful because it is not attached to a timeline an fi, an epilogue. It's not attached.

To any number of things that are relevant to this great uncertainty of our own national economic journey. But the process whereby capital is misallocated, resources are mis or suboptimally allocated, and it affects growth. That's a reality we've already been living in. It just hasn't felt that bad because of all the great assets we have.

Can something come change it? You bet. Do I wanna bet against American innovation and productivity? I do not. Do I believe the Industrial Revolution changed our country? Yes. Do I believe automobile changed our quality of life? Yes. The personal computer? Yes. Do I think TikTok changed our quality of life for the better?

I do not, I don't. I'm out here to say that there won't be some new thing that alters this paradigm, but I am saying that whatever paradigm we are in and need to be is hampered for the worst by excessive national debt. And I say that in the most basically obvious way any economist could talk. So I hope this has scratched the itch of what the scenarios could be and will be and yet avoided the seductive trappings of trying to predict a doom and gloom for the purpose of clickbait. What we ought to be doing is investing for what is and approaching the challenges of the moment with the focus on quality that I think serve as the cornerstone of our investment philosophy.

Thank you for listening. Thank you for watching and thank you for reading the Dividend Cafe.