A CHANGING OF THE GUARD
DON'S BLOG 2018.03.26

How interesting it was over the last several weeks what with a new Fed head and the action of the financial markets. For the first time in many years we have a Fed that is not led by a mainstream academic, who believes in economic models that do not exist in real life. Also of course, we have a new economic advisor to the president that does not advocate the usual economic models that we have followed since the maestro himself, Alan Greenspan took over. We truly have a changing of the guard. The question then becomes, can we expect the same type of monetary and fiscal policy as we go forward? The put for the financial markets may have gone the way of the dodo bird. Isn't it interesting that we have these two very distinct top-level changes at such a critical point? If I were any one of the two, I'd be scared to death. Why? Cleaning up 30 years of poor public policy won't be easy.

Please note the following picture that makes me almost puke—puke, that's a funny word as one of Jerry's fellow comedians once said. In this case however, it's not at all funny. The recently passed spending bill is an abortion. President Trump should have vetoed it in a millisecond. Note the two senators who are poster boys for what's wrong with Washington. How they can have smiles on their faces is beyond my comprehension. I'm afraid the swamp is getting larger just when I thought an outsider might be draining it. I am not a happy camper.

The major problem? Debt. Please note the following summary from Danielle DiMartino Booth's recent podcast. It well tells the story I have been preaching for many a year. The point is with all the debt we have, both public and private, 3% today is like 6% in the past. Much more in the way of Fed interest rate hikes is likely to bring forth a major economic downturn. Be careful.

> *Via Financial Sense,*
> The following is a summary of our recent FS Insider podcast, "Danielle DiMartino Booth: Problems at the Fed, More Volatility for the Markets."
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> *Danielle DiMartino Booth, founder of Money Strong and author of Fed Up: An Insider's Take on Why the Federal Reserve Is Bad for America, warns that the US is more highly levered today than it was in 2008 and it won't be long before rate hikes start to impact the economy.*
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> Though our own Fed funds risk neutral index (see below) shows Fed monetary policy as still relatively loose and not yet a threat, a combination of slowing economic growth and further rate hikes will eventually usher us into the next downturn.

It has always been difficult for market participants to understand why all this money that has been provided by the world's central banks has not caused inflation. Didn't Milton Friedman teach us all that to much money chasing too few goods was inflationary? Yes, he did, but two things have proven this idea wrong during these times. One, there is no shortage of goods; in fact, there is an oversupply. Two, he didn't think about the velocity of money. There is little money going into the economy, it's going into financial assets. Wall Street says inflation ahead. Those that know say deflation. At least I think that's right. That's where my chips are.

President Roosevelt's famous saying was "we have nothing to fear except fear itself." What we need to fear now—in my opinion—is a rerun of Irving Fisher's great piece on debt deflation written in the middle 1930s, after he lost his family's fortune on the stock market. Isn't that interesting? We always know what the problem is and was after the fact. You know that's even not true. Greenspan and others have always claimed the 1930s depression was caused by the Fed not increasing the money supply. The real cause was the ultra-loose monetary policy of the 1920s, followed by the Smoot Hawley Tariff Act. That begs the question—are we seeing a rerun?

What I Think Now

Economic growth is slowing and will quite possibility be negative before this year is out.

The stock market top is in, note chart #3, which I have shown you before.

The government bond market, especially the long end, will move upward in price. Note charts 4-6. Also, please pay attention to chart 7 showing the unbelievable short interest in Treasury futures. Since the middle of 2013, almost five years, traders have been bearish. This bodes extremely well for a sharp rally in the future.

Chart 3

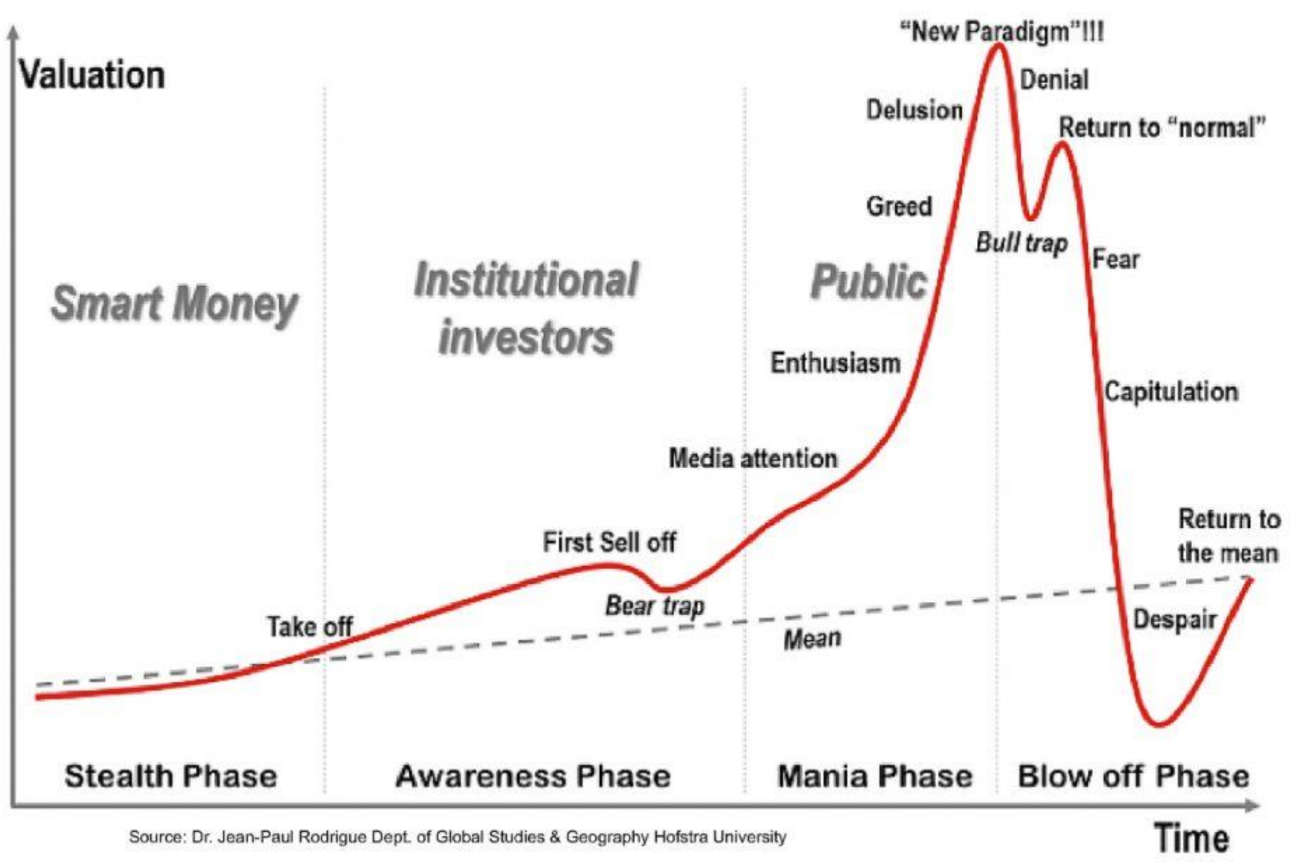
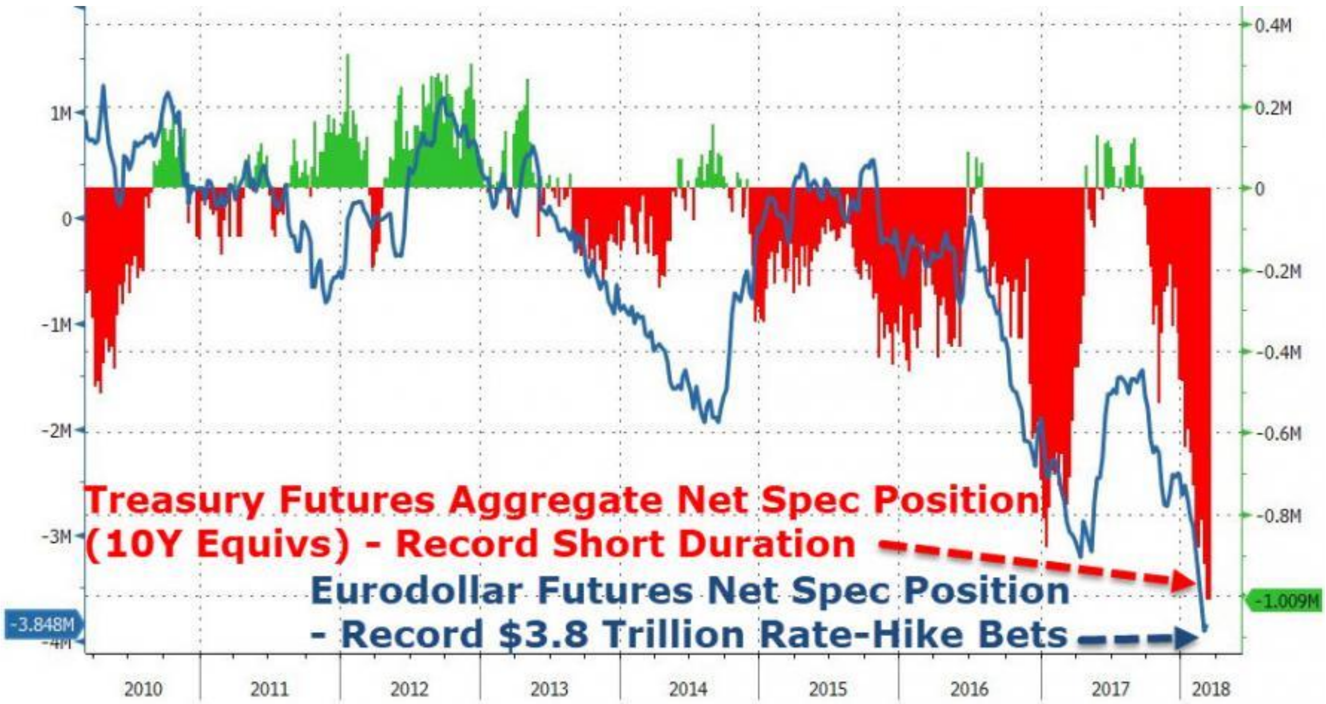


Chart 4

Chart 5

Chart 6

Chart 7



Adapted from zerohedge.com