THE CHICKEN LITTLE REPORT
DON'S BLOG 2019.02.11

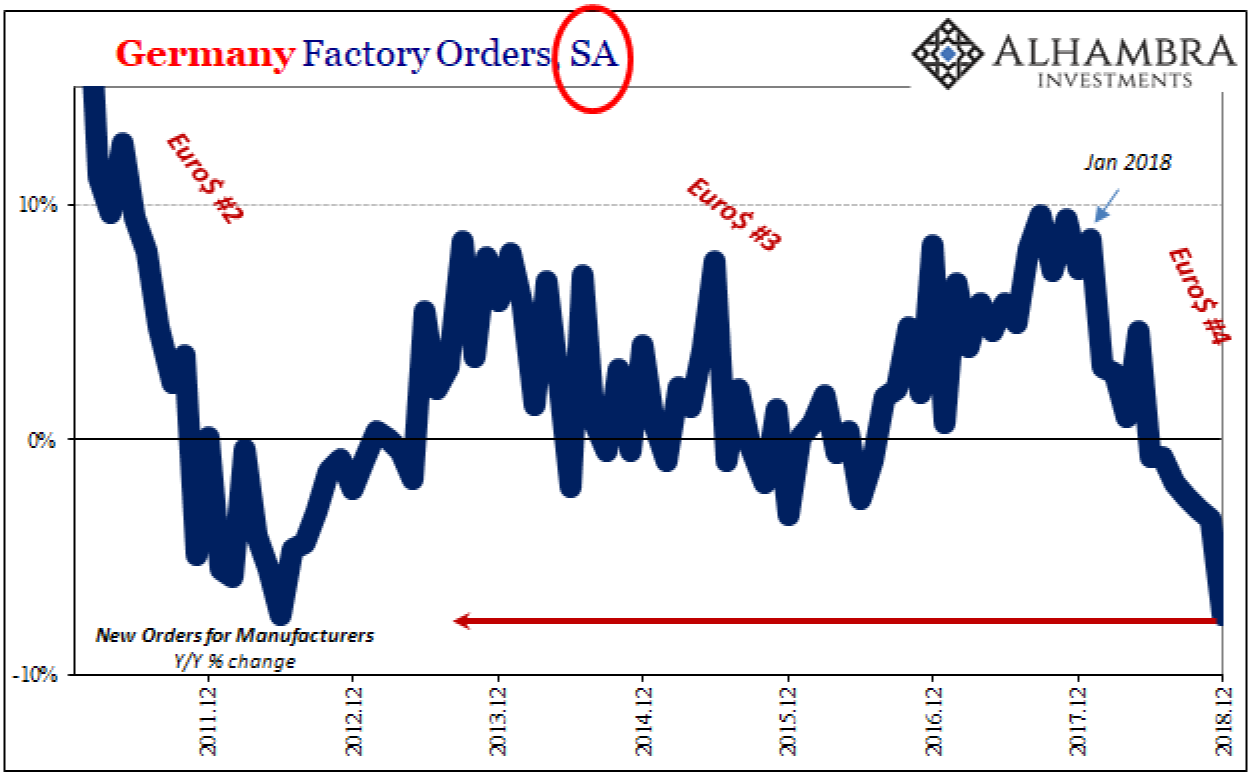
The Federal Reserve raised rates in December 2018 and had indicated that they would increase them at least twice more during this year. Why? To get back to "normal." The thing is, normal is not normal anymore. 3% today is what 6% was ten years ago. After the sharp decline (20%) in the stock market late last year, the Fed got religion. Ten years of monetary ease has led to a decade of rampant leverage never witnessed before. The simple truth is, the world economies cannot stand an increase in interest rates. We are in one hell of a mess. Too much debt means little to no economic growth. Too much debt leads to deflation. The Fourth Turning began with the election of Donald Trump and the question then becomes—what comes next?

My best guess is that the only thing the Fed can do is inject additional funds into the economy. Many might say this will cause inflation. Forget it! Fiscal policy won't work. We have already seen what two years of $1 trillion deficits has brought us. Would you believe that negative interest rates are in our future? I do. Nothing except death and taxes is for sure, however, negative interest rates come close.

Markets are beginning to factor in the coming probable recession and the above-mentioned financial problems. Stocks are weak and will probably get weaker and bonds have been strong. Bonds, however, will split in direction before long. Government bonds higher in price, and corporate bonds lower. As mentioned in previous blogs, corporate defaults are on the horizon, therefore present a major risk for these bonds.

The proper asset allocation, if one is able to change by investment charter, is cash and government bonds. How many will do that? Zero would be my guess. Another thing that scares me can be seen in chart #1 below. When the economy of Germany sees exports decline, things are not good.

Chart #1



Germany Factory Orders, SA
ALHAMBRA
INVESTMENTS
Euro$ #2
Euro$ #3
Euro$ #4
Jan 2018
10%
0%
-10%
New Orders for Manufacturers
Y/Y % change
2011.12
2012.12
2013.12
2014.12
2015.12
2016.12
2017.12
2018.12