The Long & Short of It
Quarterly Newsletter
Second Quarter 2024

Robinson Value Management develops and implements investment strategies with the goal of taking advantage of the macroeconomic environment. While we continue to employ traditional fundamental security analysis for our stock and bond portfolios, we also analyze financial and capital market responses to government policy-making and execution. In other words, we pay particular attention to the government's influence on both company-specific and systemic risk when we build and manage client portfolios.

Who Spiked the Punch?
Despite over two years of restrictive monetary policy, economic growth remains strong and inflation sticky. Is this truly a "new era of growth," stronger than the "Great and Powell-full" Federal Reserve? More likely, this is a moment of unsustainable government spending, where growth is fueled by extraordinary fiscal stimulus served up courtesy of the US Congress.

In a profound display of dysfunction, the policy mandarins in Washington implement monetary and fiscal policies that are deeply at odds with each other. Monetary policy restricts, while fiscal policy stimulates. One destroys the work of the other while the economy overheats and debt accumulates for the next generation. In June, the Congressional Budget Office (CBO) increased its estimated deficit for the year ending September 30 by $408B (+27%), from $1.4T to $1.9T. This growth rate is unsustainable. Debt piles higher and the economy remains too hot. Why inject extra fiscal stimulus with inflation so high and the Federal Reserve tightening? Could Congress and the executive branch (aggressive party-goers) not borrow and spend a little less money? If this were the case, perhaps the Fed (the chaperones) would not have to push interest rates so high for so long.

We argued in our recent blog post that the United States is already in a recession absent the excess (larger than normal growth) deficit spending. With deficits this large while tax revenues from income and capital gains are solid, one wonders what level of deficit spending will arrive during the next recession when tax revenues and capital gains inevitably decline and recessionary spending mechanisms kick in.

Sentiment may be changing. Rumblings that deficits must be brought under control are beginning to surface in economic circles. In November 2023, Moody's downgraded the outlook for US debt from "stable" to "negative." The *Wall Street Journal* editorial board spoke up about the deficit on June 19, just after the CBO's revisions. Even the International Monetary Fund, an organization that is relatively comfortable with large amounts of sovereign debt, warned on June 27 in "United States of America Staff Concluding Statement of the 2024 Article IV Mission":

> *There is a pressing need to reverse the ongoing increase in public debt-GDP ratio… Such high deficits and debt create a growing risk to the US and global economy, potentially feeding into higher fiscal financing costs and a growing risk to the smooth rollover of maturing obligations. These chronic fiscal deficits represent a significant and persistent policy misalignment that needs to be urgently addressed.*

In Congress, there seems to be little agreement on raising taxes but even less on reducing spending. Any reduction in spending while monetary policy is restrictive could be devastating for economic growth, even if it is the correct medicine for the long-term fiscal health of the country.

Enjoy the Party, but Stick to the Plan
During most monetary policy tightening cycles, a too strong but slowing economy appears promising. One unintended side effect of measured slowing is that it suggests the Federal Reserve is successfully in charge and gradually bringing inflation under control. With excess liquidity, stable growth, and declining inflation,

uncertainty wanes. The stock market celebrates and the party typically lasts until after the Fed begins to lower the Fed Funds rate. By that time, the Fed has tightened too much, especially when one considers the 2-3 year lag between a change in monetary policy and its economic impact.** Today, the economy and markets appear to be in that "have my cake and eat it too" moment before indigestion sets in.

Last Minute After-Party for the Remaining Few

However, the champagne only flows for a few firms. Narrowing leadership suggests that the bull market may be nearing its end. The broader stock market fails to participate in these gains. The three largest companies in the S&P 500 (Microsoft, Apple, and Nvidia) now make up a record 21% of the index. The ten largest stocks in the SPDR S&P 500 ETF Trust (SPY) posted a median gain of 31.0% through mid-year, while the other 493 gained only 2.9%. In addition, stocks as a percentage of total financial assets often peak well before the broader market. This was the case in 1969 (29.5%), 2000 (30.9%), and 2007 (26.2%). In June 2024, this measure posted a record high of 34.7%.

Déjà Vu All Over Again?

The investment industry is correct in stating that stocks are best for the long run, and that timing the market is quite difficult. However, there are times when it seems that valuations are so extreme that one might be tempted to declare a top and cash out. But do you really trust the government to protect the value of the dollar?

While ebullient investors are chasing the last remaining winners and day-trading zero dated options (0DTEs), we offer a few words of caution. The future path of the stock market seems more dependent than ever on a policy-conflicted, overleveraged government that is deeply dependent on extraordinary borrowing. As a giant bureaucracy, there are behavioral aspects to the government's normal policy-making process that astute investors can pursue. The future remains uncertain but new opportunities unfold each day. Please join us as we explore ways that investors can meet the challenges of today's "managed economy" environment and more successfully cultivate their own wealth and that of our nation.

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** We have discussed *"The Slow Roll of Monetary Policy"* in past versions of *The Long & Short of It* since the fourth quarter of 2022. It shows the slow and steady progression of monetary policy as it works through the economy and drives inflation. We continue this visual depiction of monetary policy lags and their actual and projected impacts in blog posts on our website that are posted after the CPI announcement subsequent to each quarter-end. (See our prior publications of this chart in previous quarterly letters.)