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VICTORIA Capital Management, Inc.

Market Musings

A newsletter brought to you by Victoria Capital Management, Inc.

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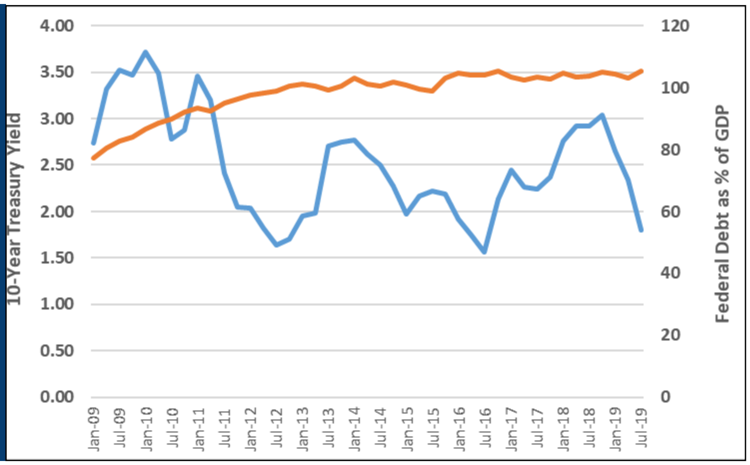
The chart to the right contrasts the total federal debt as a percent of GDP (orange line) with the current yield on the ten-year treasury bond (blue line). Since 2009, despite the rise in federal debt, the level of interest rates has remained near record lows.

(source: St. Louis Fed)



THE TRILLION-DOLLAR DEFICIT

From economist Paul Krugman (January 9, 2017) – Deficits Matter Again – asserted that:

"What changes once we're close to full employment? Basically, government borrowing once again competes with the private sector for a limited amount of money. This means that deficit spending no longer provides much if any economic boost, because it drives up interest rates and "crowds out" private investment."

Who would deny that we are at full employment when the national unemployment rate is 3.5% (2.6% here in South Carolina) and many companies are begging for qualified workers? Over 1 million jobs are going unfilled in the private sector due to the inability to find qualified employees.

Then there is government borrowing—exceeding a record $1 trillion! However, record low unemployment and record high government borrowing has not produced the forecasted higher interest rates. Actually, interest rates are near record lows. If this forecasting failure does not wake up the economics community, nothing will.

Given recent economic history, one might conclude that deficits are unrelated to either interest rates or inflation. While there are explanations for this divergence, the mainstream economic community continues to endorse the idea that deficits are bad and that our children and grandchildren will have to pay back the debt. Such theories can undermine a stronger economy.

The proclamation "federal debt must be repaid" is a failed economic theory because it focuses on only one side of the balance sheet. There are two sides to this debt "equation." Just as you and I must reckon with our liabilities, we also compare that debt with our assets. Do not forget a balance sheet consists of both assets and liabilities. Yet, in analyzing the federal government's balance sheet, no one ever brings up the value of assets that are available to offset liabilities. Individual mortgage debt can be offset by the market value of a home. In previous articles, we have pointed out that federal government assets are well in excess of debt levels. There is no reason to begin liquidating government assets to pay off debt. Deficits will continue to grow to provide support for economic growth.

"Take care of your employees and they'll take care of your customers."

John W. Marriott

Market Commentary

After a solid finish to 2019, equity markets continued to rise in January with major indices hitting new highs. The President's impeachment trial didn't faze investors and earnings came in ahead of expectations. Then came the coronavirus. Equity markets tumbled and returned all of the gains for the first two weeks of the year. The S&P 500 was flat while small- and mid-cap stocks turned negative for the month of January. Foreign equities also finished in the red. Conversely, bonds rallied as did risk-off assets. Prior outbreaks of similar viruses have caused weakness in equity markets until the virus is contained. Even though the underlying fundamentals of Corporate America and the economy remain strong, short-term uncertainty about the impact on global growth could contribute to additional market volatility.

29.3% of American workers belonged to a union in 1964. Just 10.3% of American workers belonged to a union in 2019.

(source: Department of Labor).