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Market Musings

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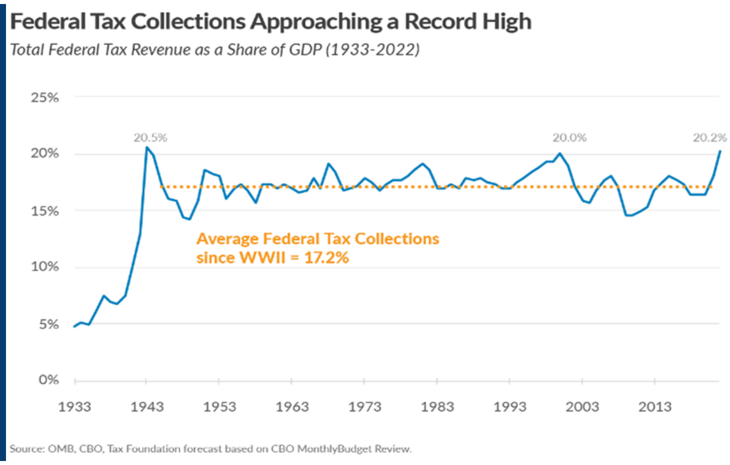
According to the Tax Foundation, federal tax collections are on track to hit a multi-decade high of 20.2% this fiscal year, up from 18.1% last fiscal year and exceeding the last peak of 20% set during the dot-com bubble in 2000. Federal tax collections are approaching the all-time high of 20.5% of GDP set in 1943 during World War II.



"The way I see it, if you want the rainbow, you gotta put up with the rain."

Dolly Parton

Market Commentary

The rapid increase in the fed funds rate in both August and September sent bond and stock markets into a tailspin during the month with domestic stocks falling across the board bringing year-to-date losses to as much as 32%! Most asset classes declined over the past three months except natural gas, Brazilian and Chilean stocks, and the U.S. Dollar that is serving as the safe haven for global investors. The bad news is that a strong dollar hurts domestic corporations with earnings from abroad. Fixed income markets fell during the month bringing losses year-to-date to nearly 17% for the 10-year U.S. Treasury bond. Foreign bond markets tumbled and are down almost 20% while the "safety" of gold play has not worked this year and is down 9% through the end of September.

The Fiscal Side of the Economic Equation

Financial market participants have focused on monetary policy ever since the Fed promised to increase interest rates (the fed funds rate) to get inflation reduced back to the 2% level. The basic belief is that, by raising interest rates, business activity will slow and thereby lower demand relative to supply resulting in a decline in inflation. The narrow focus is on the relationship between money and inflation. Money is not the only game in town when it comes to economic analysis and inflation.

There has been little attention given to the fiscal policies employed by the federal government during and after the pandemic. Fiscal policy is related to decisions that affect federal government spending and taxation. At the onset of the pandemic, fiscal policy provided an enormous lift to the economy through broad government spending i.e., the Payroll Protection Act that pumped trillions of additional dollars into the economy. In the aftermath of that spending surge, reality began to return to fiscal policy as the deficit declined by over $1 trillion through September of the 2022 fiscal year. Moreover, tax revenues increased dramatically for fiscal 2022 estimated at about $5 trillion, $1 trillion more than last fiscal year. Individual tax collections have risen the most (+32%) to $2.4 trillion. One reason for this surge in tax revenues is that all that government largesse is taken back over time in the form of income taxation on both personal and corporate tax levies. That money continually works through the transaction process and partially becomes taxed again and again until virtually all that money is recovered by the federal government. An even bigger boost came from capital gains payments because of the stock market boom in 2020 and 2021. These data provide evidence that fiscal policy is extremely tight relative to the stimulative impact from the pandemic spending since mid-2020. The impact of both tight fiscal and monetary policy combined with rising levels of inflation suggest that a recession is around the corner unless we can get a quick reversal of these programs this year.

Tax receipts collected by the U.S. in April 2022 were $863.6 billion, creating a monthly surplus of $308.2 billion, both numbers representing all-time monthly records for the U.S.

(source: U.S. Treasury Department)