WASATCH CAPITAL MANAGEMENT OF RAYMOND JAMES®

April 2022

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Potemkin Village -Article by Mark Lazar

There's no such thing as a free lunch. **Milton Friedman**

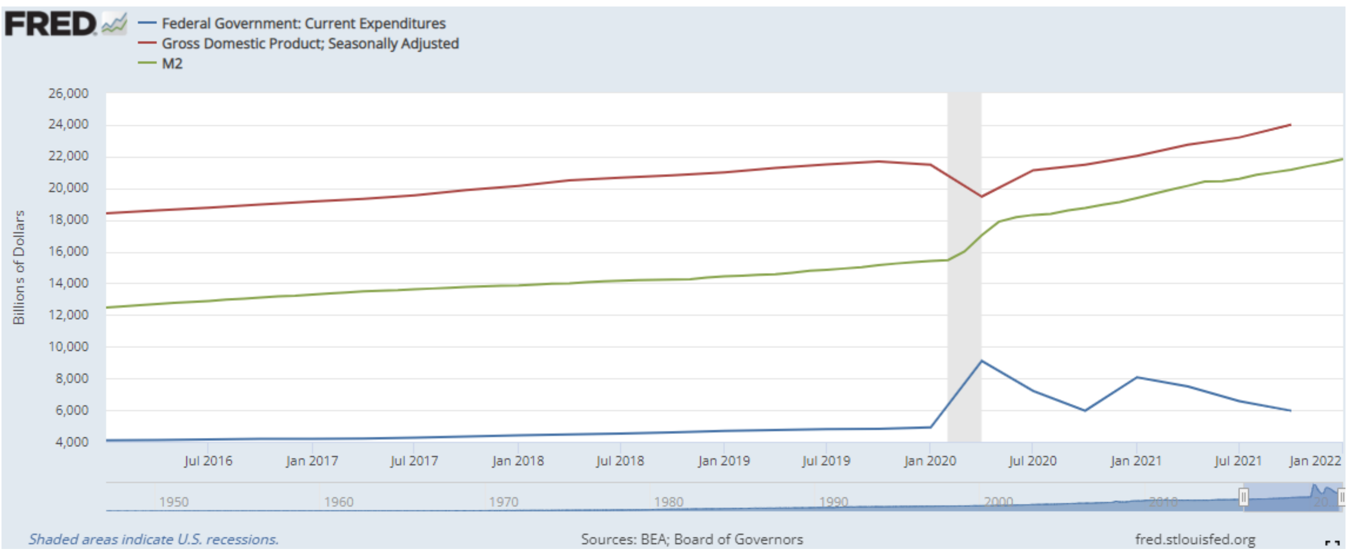
Item	YTD Change
Dow Jones Ind Avg	-4.57%
S&P 500 Index	-4.95%
EAFE Foreign Index	-6.61%
Emerging Market Index	-7.32%
Barclays Agg Bond Index	-5.93%
10-Year Inflation Forecast	2.84%
Unemployment Rate	3.8%

**Market index data as of 3/31/2022*

The term business cycle is synonymous with economic cycle, and refers to the normal fluctuations in economic growth found in every market economy. Nothing in life is linear and economies are no exception. Since the Civil War the US has experienced 31 economic contractions (recessions and depressions), or roughly one every five years.

There are a number of factors that can cause an economic downturn, such as natural disasters, asset bubbles (bursting), price controls, and war. But the primary culprit is policy failure; monetary, fiscal, and at times, social. Imprudent policy can produce periods of rapid growth which oftentimes leads to inefficient pricing of assets and risk, and a general misallocation of capital and resources. Which is why periods of excessive growth are often followed by a period of relative stagnation or a decline in economic activity (recession). It's during these periods in which excesses in inventories, labor, wages, and asset prices are "wrung out" and return to normal, or perhaps even below normal. In mathematical vernacular, an economic reversion to the mean.

Keynesian theory gave policymakers permission to meddle with the business cycle. Unlike supply-side policies, which lead to an increase in output, wages, and wealth, Keynesian demand-side policies instead boost government borrowing, spending, and transfer payments that temporarily increase consumer demand, but fail to increase production. In fact, government programs crowd out the private sector, doing the very opposite; reducing long-term productivity and growth. Post-COVID policies are a perfect example of this.



Federal Reserve Economic Data

The chart above illustrates GDP, M2 (money supply), and federal spending since 2016. Q1 2020 witnessed a sharp decline in GDP and corresponding Keynesian boost in both M2 and federal spending (i.e., stimulus checks, PPP loans, state and pension bailouts, etc.). Not surprisingly, within two months of government-imposed shutdowns, civilian unemployment surged from 3.5% to 14.7%. Since 2020 US federal debt swooned, increasing 40%, or $8T in two years, exceeding the combined borrowing (plus interest) of our nation's first 230 years. However, despite the massive Keynesian increase in borrowing/spending and money supply, industrial output has fallen 5.5% and real wages are 3% below pre-COVID levels.

Paradoxically, despite businesses closures and soaring unemployment, unprecedented government stimulus caused stock and real estate prices to soar in 2020 and 2021, putting a big smile on investors' faces. While investors were the biggest beneficiaries of government largess, the average family received nearly $5,100 in stimulus checks. Additionally, unemployed workers received $600/week *over and above* regular unemployment benefits, meaning unemployment benefits commonly exceeded regular wages.

Similar to administering morphine to an accident victim, government stimulus makes us feel good, but masks the underlying economic damage. Government, in essence, pulled forward wealth and prosperity via borrowing and money-printing. But the inevitable effect is higher inflation, slower economic growth, and reduced prosperity.

Politicians on both sides of the aisle supported reckless policies that enhanced their political capital to the detriment of the nation. Wasteful government spending, money printing (Modern Monetary Theory), forced closure of private enterprise, and excessive unemployment benefits, ultimately leads to slower growth, higher inflation, and lower real wages

Reckless monetary and fiscal policies are nothing more than an economic Potemkin village, creating the appearance that everything is wonderful. But it’s a façade, and if one looks behind the props it’s just an illusion. A parlor trick. If government spending produced economic growth via the oft-touted multiplier effect, then no country needs ever suffer a recession as bureaucrats would simply spend more money. But there’s no such thing as a free lunch. At some point, you have to write the check. And that check will come in the form of lower future growth and prosperity, and a greater debt burden for generations to come.

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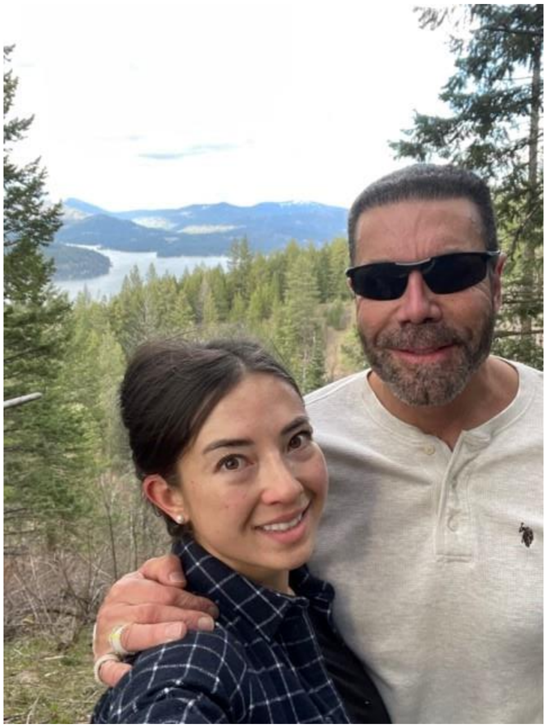
Wasatch Team Updates



Mark

Mark & Savina on a walk

Stan

Stan at birthday dinner for him and his daughter!

Rees

Rees & family at Park City Museum event, The Pendry

John

John on the beach at Turks & Caicos!

Reed Grant

Reed’s granddaughter hanging out with “Papa” eating ice cream and pickles!

Nicola

Nicola with her son and friends in Vancouver!

Matt

Matt on the course with a bunch of friends!

Jon

Jon and daughter pumping up rugby balls getting ready for the season!

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