WASATCH
CAPITAL MANAGEMENT OF
RAYMOND JAMES®

Let's Talk Turkey - by Mark Lazar

"Debt isn't a problem… until it is"

AUGUST 2018

- - - - - -

INSIDE THIS NEWSLETTER

- **LET'S TALK TURKEY**
- **WASATCH TEAM UPDATE**

It is incumbent on every generation to pay its own debts as it goes. A principle which if acted on would save one-half the wars of the world. **Thomas Jefferson**

It's not even Thanksgiving yet everyone is talking Turkey … the country, not the bird. Turkey's 2018 2nd quarter GDP grew by 7%, yet last week the Turkish lira shed roughly 1/5th of its value (relative to the US dollar) within a matter of three days. Where did Turkey go wrong? In my opinion, Erdogan, Turkey's president, has no understanding of economics and neither does his newly-appointed treasury and finance minister … who also happens to be his son-in-law. The new regime has been quite vocal in its disdain for free market principles and policies, so the market did what it always does when faced with this type of uncertainty; runs for the exit.

The pummeling of the lira is especially painful since most of Turkey's growth was fueled by foreign borrowing, so the relative amount of debt and debt service just increased by 20%. Ouch! Which leads to this month's commentary focus; government debt. There seems to be a general misunderstanding when it comes to public debt and just what it means to a nation. U.S. public debt currently stands at $21 trillion. U.S. GDP is expected to finish the year at just under $20.4 trillion, so debt to GDP is over 100%. Personally, we feel this is a misleading ratio, and a more useful one would be debt to federal tax revenue. The Congressional Budget Office projects 2018 tax receipts at just over $3.3 trillion, which would put debt to tax revenues at just over 600%[5].

To drill down a bit further, U.S. government non-discretionary spending (i.e. Social Security, Medicare, Medicaid, welfare & unemployment benefits) is currently forecast at $2.54 trillion, discretionary spending (i.e. national defense, foreign aid, education, transportation, etc.) at $1.28 trillion, and net interest at $316 billion, for a total of $4.14 trillion. But $4.14T is greater than $3.3T, which leaves a shortfall of $853B, which is also known as a budget deficit; something our government is quite familiar with.

But the U.S. isn't the only profligate government. Let's see how the U.S. compares to other developed countries (debt data is from 2017, government bond yields are as of 8/21/18) both in terms of debt to GDP and what their 10-year government bonds are currently yielding:

Country	Debt to GDP	10-Yr Yield
Japan	253.00%	0.10%
Greece	178.60%	4.24%
Italy	131.80%	2.99%
Portugal	125.70%	1.77%
Singapore	110.60%	2.40%
US	105.40%	2.82%
Spain	98.30%	1.37%
France	97.00%	0.67%
Canada	89.60%	2.26%
UK	85.30%	1.27%
Germany	64.10%	0.33%
Switzerland	29.70%	-0.12%

**Trading Economics*

The U.S. is middle of the pack in terms of debt to GDP, but second highest in terms of government debt yield. Notice Japan's bonds are 1/10th of 1% and Swiss bonds are *negative* .12%. So, what factors determine government bond yields? Monetary policy (central bank policy), inflation expectations, economic outlook, debt to GDP, and political stability are the primary drivers of sovereign bond rates.

A question we hear frequently is *when* will U.S. debt become a concern? IN our opinion, the answer is; *debt isn't a problem … until it is*. The credit markets will tell us when debt is a problem, and will do so very loudly, clearly, and oftentimes, quickly, in the form of rising treasury yields. With that said, we feel U.S. Treasuries represent quite a bargain compared to other sovereign debt. Yes, we have our problems, but our economy is growing faster, we're more productive (than Denmark, France, Germany, Netherlands, Switzerland, Sweden, etc.), capital investment is robust, taxes are competitive, and the U.S. enjoys some of the lowest energy costs in the world.

Debt isn't a problem today and the U.S. isn't following in the footsteps of Turkey. We at Wasatch Capital Management are very constructive on the U.S. economy and believe the U.S. economy "has legs" and will continue to grow for the foreseeable future, likely through 2019 and possibly longer. Bull markets don't die of old age but, rather, from policy failure; monetary and/or fiscal. Presently, interest rates are still low, taxes have been reduced, and the regulatory environment is becoming more business-friendly by the day. In other words, we see no policy risk threatening this recovery. Additionally, unemployment continues to fall, wages continue to rise, business and consumer confidence are strong, corporate earnings are at record levels, U.S. profits formerly held abroad are being repatriated ($1.2T for 2018) at a breakneck pace, home prices continue to rise, and trade negotiations appear to be moving in the right direction. It may not be a perfect economic picture; it never is and never will be, but we believe investors would be wise to dismiss the pouting pundits and, instead, look around at what's happening on Main Street, where capitalism is alive and well.

Index	YTD Return
Year-to-date S&P 500 Return[1]	8.41%
EAFE (developed foreign) Index[2]	-2.20%
Emerging Market Index[3]	-7.54%
Barclay's Aggregate Bond Index[4]	-0.75%

Source: *[1]Bloomberg, 8/22/18, [2]Bloomberg, 8/22/18, [3]Bloomberg, 8/22/18, [4]Bloomberg, 8/22/18, [5]https://www.cbo.gov/publication/53770,[6]https://www.cbo.gov/about/products/budget-economic-data#3*

Wasatch Team Updates

Mark

Mark and Savina cooling off from the summer heat with an Alaskan Cruise! They’re pictured here on a shore excursion to a Glacier. Sure beats a snow cone!

Morgan

The first thing I always want to do when I go home to upstate New York is hike in the Adirondack Mountains. This year I took my mom, husband, and my Raymond James shirt up Gothic’s Mountain in the High Peaks of Keene Valley, New York! If you look in the far back of this photo, my hand is extended to point out can see the Olympic Ski Jumps from the 1932 and 1980 Olympics in the far distance.

John

You can always count on John to represent the team! Here he is at Raymond James Cares, Community Service Day. He spent an entire day helping to fill backpacks with School Supplies for Children in Need. Thanks John!

WASATCH
CAPITAL MANAGEMENT OF
RAYMOND JAMES®

About Us

2750 E COTTONWOOD PARKWAY
SUITE 520
COTTONWOOD HEIGHTS, UT 84121

Mark.Lazar@raymondjames.com | Senior Vice President, Investment | 385-275-3609
Morgan.Irvin@raymondjames.com | Financial Advisor | 385-275-3606
John.Bergerson@raymondjames.com | Investment Portfolio Associate | 385-275-3608

www.raymondjames.com/wasatchcapitalmanagement

Like us on Twitter & Facebook! @WasatchCapital | www.facebook.com/wasatchcapitalmanagement

"If you truly believe you're the best at what you do, why wouldn't you want to help your friends" – Tom James