WASATCH

CAPITAL MANAGEMENT OF

RAYMOND JAMES®

"The stock market is like a roller coaster, except I never throw up my hands and go wheeeeeeeeeeeeeee!"

JANUARY 2022

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INSIDE THIS NEWSLETTER

- **JANUARY COMMENTARY: UNINTENDED CONSEQUENCES**
- **WASATCH TEAM UPDATE**

Unintended Consequences - Article by Mark Lazar

***Lenin was right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency.* John Maynard Keynes**

Item	YTD Change
Dow Jones Ind Avg	18.73
S&P 500 Index	26.89%
EAFE Foreign Index	2.34%
Emerging Market Index	-2.42%
Barclays Agg Bond Index	-1.54%
10-Year Inflation Forecast	2.58%
Unemployment Rate	4.2%

**Market index data as of 12/31/2021*

In 1791 Alexander Hamilton's vision of creating a central bank became reality, and the First Bank of the United States was established and granted a 20-year charter by Congress. In 1811 the Bank's charter expired and wasn't renewed again until 1816. The second iteration was, not surprisingly, called The Second Bank of the United States. Suffering the same fate as its predecessor, in 1836 the Second Bank's 20-year charter expired and due its unpopularity, was not renewed.

After the Second Bank was shuttered, relaxed banking laws fostered an environment where state-chartered and unchartered "free banks, flourished. Absent oversight the financial system was literally the Wild West; banks routinely failed, bank notes (bank-issued paper money) commonly traded at discounts relative to the perceived risk of the issuer, and folks were as likely to keep their savings in the mattress as their local bank.

The Federal Reserve Act of 1913 created America's third central bank; the Federal Reserve System, oftentimes referred to as *the Fed*. The primary purpose of the Fed was to stabilize a mercurial financial landscape. Policymakers recognized that a stronger banking system would increase confidence in banks, improve the flow of capital and credit, increase savings, promote economic growth, and reduce the risk of future financial crises.

Historically the Fed has relied on traditional policy measures, such as guiding interest rates (via fed funds and the Discount Window rate), bank reserve requirements, and open market operations. Over time, however, the Fed's arsenal expanded to include unconventional monetary tools such as quantitative easing, negative interest rates (NIRP), purchasing/supporting private debt (including junk bonds), access to the Discount Window for non-member institutions, and the Term Auction Facility (TAF), to name a few.

Prior to the Great Depression, policymakers understood that the economy would ebb and flow with the business cycle and thus took a laissez-faire approach to economic policy. That changed in 1936 after John Maynard Keynes, a Cambridge academic, published *The General Theory of Employment, Interest, and Money*. Keynes' postulated that free markets, while generally efficient, at times require government intervention (via monetary and/or fiscal stimulus) to smooth out economic cycles. Keynes' words were a welcome dog whistle to policymakers' ears; central bankers, who had abandoned the gold standard three years earlier, could flex their muscle could proceed to manipulate interest rates, credit, foreign exchange rates, and the like. Similarly, politicians, no longer constrained by tax revenue receipts, now had permission to run large deficits *for the good of the economy*.

Years later, Keynes lamented some of his previous beliefs and admitted, "I find myself more and more relying for a solution—on the Invisible Hand which I tried to eject from economic thinking twenty years ago." But the genie was out of the bottle, and policymakers were unwilling to give back the power Keynes had unwittingly bestowed upon them.

For all of the Fed's pomp and circumstance, monetary policy is one part science, one part alchemy. Policymakers would have us believe they *know* what the future holds. They don't. Virtually every recession and depression were the byproduct of misguided monetary policy; too much gas, almost invariably followed by too much brake. Paradoxically, policymakers attempt to formulate future monetary policy based on past (lagging) economic data. However, unlike math or chemistry, economics is a soft science and models are constantly adjusted to account for human behavior.

Year	2006	2007	2008	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP in Trillions	14.04	14.72	14.61	17.13	17.85	18.33	18.97	19.88	20.81	21.69	21.48	23.2
Money Supply	6.88	7.3	7.79	10.72	11.39	12.04	12.86	13.59	14.12	14.84	17.68	21.44
Money Supply %	49.00 %	49.59 %	53.32 %	62.58 %	63.81 %	65.68 %	67.79 %	68.36 %	67.85 %	68.42 %	82.31 %	92.41 %
Fed Assets	0.87	0.89	2.24	4.03	4.50	4.49	4.45	4.45	4.08	4.17	7.36	8.76
Fed Assets %	6.20%	6.05%	15.33 %	23.53 %	25.21 %	24.50 %	23.46 %	22.38 %	19.61 %	19.23 %	34.26 %	37.76 %

Source: FRED. *Federal Reserve assets and M2 money supply values are in trillions.*

The table above illustrates the growth of both the money supply (M2) and Federal Reserve assets relative to GDP. Since 2006 M2 has increased from 49% of GDP to over 92%. For the same period the Fed's balance sheet jumped from 6.2% of GDP to nearly 38%—a 609% increase. The Fed has turned the volume up to eleven in an effort to manage or control every aspect of the US monetary system, including long-term interest rates, security prices, and the mortgage market.

In an effort to goose the economy via demand-side policies, the central bank increased M2 by 40% since 2020. This is the very definition of inflation—inflating the money supply. For the wealthy, Fed money printing made them even richer, pushing stock and real estate prices to record highs. But monetary stimulus doesn't create wealth. Rather, inflation makes us feel richer as opposed to being richer, and is a Faustian bargain at best. To illustrate, industrial production is *lower* today than it was two years ago. Furthermore, real wages—wages adjusted for inflation—*declined* by 2.4% in 2021; in other words, standard of living for the middle and lower class actually fell last year. Washington policymakers would be wise to remember Milton Friedman's famous quip, *there's no such thing as a free lunch*. Rather, there are always unintended consequences.

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Wasatch Team Updates

Mark
Mark in the snow

Stan
Stan and Ronda taming the wild beast while hiking in La Quinta, CA!

Rees
Rees & Lisa beginning the new
Year in Cabo San Lucas

John

John riding in the West Desert this month!

Nicola

Nicola with her grandbabies for Christmas!

Matt

Matt and Sam in Maui at Mama's Fish House over Christmas!

Jon

Jon playing arcade games with his daughter at Classic Fun Center!

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