Talbot Asset Management Random Report

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That 70's Show

One of the few shows I have "binge watched" on Netflix was "That 70's Show." It could be because I lived through it and could relate to a lot of things in the show. The working titles for the show were "Teenage Wasteland" and "The Kids are Alright" which are both songs by the Who. However, the Who, (including an adamant refusal by the Who's Peter Townshend), refused to give song rights to the show. Economically, that probably wasn't a great idea as they probably made zillions when the Who song "Who are You" was used as the title song to the TV hit C.S.I. When the show was tested in front of a live audience, one audience member was overheard saying, "I loved that show about the 70's." Thus, the name of the show was created.

The show starred Ashton Kutcher as the dumb guy who hopes to coast through life on his good looks. He is now a very successful investor in Silicon Valley. Mila Kunis (known as Jackie) was pretty, very spoiled and usually quite annoying. She was born in Ukraine and at the age of 7 her family fled from Soviet Ukraine to the United States. Ashton Kutcher and her were married in 2015. Wilmer Valderrama was the foreign student known as FEZ. Not one time during the show did they reveal which country he was from. FEZ stood for Foreign Exchange Student.

There are a lot of similarities between the 70's and today. The 70's had a President that was being tested domestically and internationally. Iran was holding hostages at our Embassy. Ironically the Iranians just recently lobbed missiles into our consulate in Iraq. We had inflation out of control. We had an oil shock and an oil embargo. Gasoline shortages caused long lines. In fact, in some areas, you were designated what day of the week you could fill up your car based on the last number on your license plate. And we had a Federal Reserve who embarked on interest rate increases to break the back of inflation (this is actually starting now as the Federal Reserve just started interest rates increases).

Does any of this sound familiar? The biggest issue on everyone's mind right now is inflation. With every passing month, politicians and economists try to blame inflation on anything but excess money growth. As inflation gets worse, just like the 1970s, the list of excuses for inflation grows longer. At the start of the year, politicians on the left were blaming higher inflation on greedy companies; now they're blaming Putin. Meanwhile, politicians on the right started out blaming higher government spending and bigger budget deficits; now others are blaming unfavorable demographics and de-globalization.

Among all these excuses I think the silliest is that inflation is caused by greedy companies. Businesses are no greedier today than they were before COVID. And inflation was already underway WAY before Putin invaded Ukraine. As I pointed out in a previous newsletter and preached by famous economist Milton Friedman, an increase in the money supply is what is responsible for inflation. It doesn't matter whether government spending or the budget deficit is high or low, whether the labor supply is growing or shrinking, inflation is based on decisions made by central banks. If the money supply grows too fast, you get more inflation; if the money supply grows too slowly or shrinks, you get deflation. If the central bank does its job right, you get stable prices. The old saying of "too much money chasing too few goods" is the primary cause of inflation. Even with the Federal Reserve raising rates, we are a long way from getting "tight" money. Thus, inflation will probably be here for the next few years, or longer.

The types of investments that historically do well in an environment such as this is 180 degrees different than a low inflation, low interest rate environment. Commodities, such as oil, gold, fertilizers, copper, farm land, wheat, soybeans, etc. should perform better than growth stocks in this environment. The last big bull market in gold occurred in the 1970's! Value stocks should outperform growth stocks. I haven't quite bought the entire argument for that just yet since Treasury Bill rates are still very low and the ten-year Treasury is still under 3%. In comparison, the Federal Funds rate in 1975 was 6% and the Federal Reserve was tightening the money supply. It is hard to be totally bearish when interest rates are still this low. However, as I have pointed out many times in the past, I believe the risk in owning long term bonds in this environment is very high.

I do have a high conviction that oil prices will stay elevated for quite some time as well. The current administration is doing everything they can to destroy the oil industry. However, over 84 percent of the world still operates on fossil fuels so the comments about everyone going out to buy electric vehicles is pure fantasyland stuff. Even with oil prices up, it should be much less painful for the economy than it was in the 70's.

According to Steve Blitz, chief economist for TS Lombard, food and energy take up 10% of consumer's budgets today compared to 20% of budgets back then. Since cars get over twice the gas mileage they did during the first OPEC embargo, the shock to the economy should not be as bad. Energy companies have been the demon of the current administration and most don't have the incentive to drill new wells as they can't FIND WORKERS TO DRILL THEM! Plus, according to Baker Hughes, there was 3900 oil wells operating in 2012. Today, there are 1661 wells in operation in the U.S. Thus, several oil companies will be debt free in a few years and will likely be allocating money back to shareholders.

Russia exported 7.8 million barrels a day in December before the war started. A complete loss of Russian oil could send oil prices to $200 a barrel. A bigger concern I have is that oil is priced in US dollars. Putin is trying to now have the Europeans pay for their energy in Russian rubles. China is trying to get oil priced in Chinese Yuan. The US can not allow the dollar to lose its reserve currency status. If that happens, the dollar will decline and we will have even higher inflation from here.

The buzzword being tossed out right now is "stagflation" which is what wound up killing the economy in the 1970's and forced a long recession. According to Wikipedia, stagflation is a situation in which the inflation rate is high, the economic growth rate slows, and unemployment remains steadily high. Right now, only one of those conditions exist. Economic rates are slowing slightly but more due to the supply chain issues. The unemployment rate now is 3.9%. Historically, FULL EMPLOYMENT has been 4%. In 1974, unemployment averaged 7.9 percent. Throughout the seventies, unemployment rarely dipped below 6%. It will probably become a stock picking market instead of all boats rising as companies that can raise prices and make them stick will outperform those that can't. Using restaurants as an example, assuming they can find workers, the cost of those workers are increasing, the cost of the food is increasing and their rents are increasing and most restaurants would have a tough time raising prices significantly to offset those increases.

Some economists believe the time frame we're going through now is more like the 1940s as opposed to the 1970s. When World War 2 ended, there was tremendous imbalances in consumer goods because very few consumer durables were produced during the war. You could say a similar thing happened during Covid. Nine months after World War 2 ended, inflation was running at 20% and the Federal Reserve expanded their balance sheets just like they did under Covid. Around 1948 or 1949, pent-up demand subsided, and supply rebounded. The difference back then is most of the manufacturing was done in the US. We now have a hostile enemy in China disrupting our supply chains probably on purpose.

Since I wasn't born in the 1940s, I'm going to go with the similarities between now and the 70's. One of the sayings going around on the internet right now is "It was a lot more fun to be in your 20's in the 70's than to be in your 70's in the 20s." But then again, isn't is always more fun being in your 20s?

Password Protected

Unfortunately, I have had a few close friends pass away unexpectedly this year. In both cases, the wife had no idea how to access the husband's digital accounts. One wife had to turn to an IT forensic expert to help her access the accounts. One wife can still not access her husband's bitcoin account.

Years ago, I would help widows/widowers collect paper documents to put everything together. I remember one widow in Indianapolis who didn't even know how to pay the paperboy. With today's world almost all digital, it's very important for people to provide password and other account information to your heirs, advisors or estate lawyers before access is an urgent necessity. Since most accounts now are paperless, gaining access to these accounts can be extremely difficult for heirs since digital accounts are protected by a combination of strong passwords, encryption, multi layers of authentication (such as a text to your phone), facial or finger print technology.

Creating a list of digital accounts and instructions on how to gain access to them is as important as having a will or a trust. What good is a will if you can't get access to the assets?

Here are examples of digital accounts that loved ones or advisors may need to access upon death or becoming in-capitated:

- Traditional finance accounts (banks, investment accounts, PayPal, Venmo, etc.)
- Cryptocurrency wallets and non-fungible tokens.
- Home payment and utility accounts (mortgage, electricity, gas, cable, internet, home insurance)
- Email accounts
- Social media accounts (Facebook, Instagram)
- Smart Phone accounts
- Storage or file sharing accounts (dropbox)
- Photo, music and video accounts (YouTube, Shutterstock, etc.)
- E commerce seller accounts (Amazon, Etsy, eBay)
- Subscriptions (Netflix, Hulu, newspapers, Spotify, and other streaming services
- Loyalty rewards programs (airline miles, hotel rewards, etc. that may be transferrable)

Elder law attorneys suggest keeping an up-to-date list of accounts, passwords and access information and letting your trusted contacts know where it is. A process for your heirs should be outlined in your estate plan that tells them how to access all accounts, especially ones with multi-layered or biometric access.

Even if the plan is as simple as "here's a list of all my user names and passwords." Make sure you keep the list somewhere safe and DO NOT include them in a will itself as the will is part of a public record.

SOLD!

I get asked almost daily when the housing market is going to crash. Although I would love to predict that, the conditions today are a lot different then they were in 2008. Today's real estate builders are maintaining their inventories closer to home now than they did in 2008. They are not overbuilding and most of the independent spec home builders were driven out of business. In 2008, anybody could get a mortgage on a property even if they didn't have a job. The underwriting standards for a mortgage today are much tougher. In today's market there seem to be tons of buyers in the market but hardly any properties for sale. In Florida, the market is very tight all over the state and multiple buyers show up for almost every property that comes online.

A new report from real-estate brokerage firm Redfin may shed light on another issue factoring into the national housing-supply crunch. The bottom line: Homeowners across the US are not moving as much as they used to. Redfin reported that as of 2021, the typical homeowner has spent 13.2 years in their house. That is up significantly from a decade ago when the average was 10.1 years.

The one trend rapidly occurring is a migration shift from the city to less densely populated areas. The new found ability to work at home has allowed Americans to move to larger and cheaper homes in these areas.

Other trends according to Redfin, is that rising interest rates may prompt some families to stay put in their current home instead of buying a new one. Plus, homeowners are getting older. Redfin found that 33% of households nationwide were headed by someone 65 and older as opposed to 28% in 2012. Their research is showing that they are opting to age in place, rather than sell the family home and relocate to a smaller property or retirement community (the Villages seem to be exempt from that theory).

Redfin also analyzed the impact of local economic policies and how that affected how long someone remained in their home. California has the longest tenure rate in the country and Los Angeles had the longest longevity living in a property at 18.1 years on average. This makes sense as California rewards families with property-tax rewards for families who stay put. Their Proposition 13 limits property tax increases and those benefits can be passed down generation to generation. Recent changes in California's property tax policies allow seniors to transfer their property tax rate to a new property but few are taking them up on it.

At this point, and it's only a guess, it would take mortgage rates going over 5 percent for a 30-year mortgage to slow down the projectory (which they recently did).

The New Cold War

Are we in a new cold war? No, we are in a hot war in cold places. People laughed at Donald Trump when he announced the Space Force. The Space Forces of China, Russia and the US are now in outright combat and no one even knows it. Each country is deploying killer satellites or creating space debris to knock out satellite capabilities. Russia, China, and the US have either launched or are close to developing hypersonic weapons as part of their space programs. General David Thompson, the former Vice Commander of the US Space Force said recently that "Russia and China are attacking US satellites with lasers and jammers almost every day."

Recently, the Norwegians found that 2 miles of undersea cable had been cut at the LoVe Ocean Observatory. This observatory diminished NATOs ability to track Russian submarine movements. These submarine fleets are stalking each other. Our military has deemed some of the things occurring as the "Grey Zone". Unfortunately, the public doesn't know what the Grey Zones are and they have almost no idea on the hot war in cold places. Beside the Grey Zone, the Chinese and Russians have also embarked on "Unrestricted Warfare."

After the 1991 Gulf War, the Chinese developed a plan to attack their enemies without firing a single shot. They called it "Unrestricted Warfare" These strategies included: Funding non-governmental organizations to create havoc (think Antifa), flooding the opponent's border with illegal drugs (think fentanyl), creating misinformation campaigns in the press or on the internet, economic warfare, cyber attacks and attacking networks, terrorism by infiltrating the opponent's borders, biological warfare (Covid?), strategic real estate purchases (think farm land) and controlling the means of technology (think semiconductors). These are all things we are seeing right now. The Head of the Russian Army, Valery Gerasimov calls it "non-linear warfare". He sums it up as anything goes. Russian Major -General Vladimir Slipchenko calls it "no contact warfare".

So how does that equate to an investment scenario? The era of globalization is probably close to coming to an end. Bringing plants and factories back to the United States will be a big trend over the next few years. We are finding out that having most of the semiconductors used to power our technology should not be produced in China. Our pharmaceuticals should not be produced in China. This will be a 3-5 year trend as companies relocate their facilities closer to home depending on the industry.

Investing in defense stocks will be a little different as the warfare has changed. Space technology will probably have unlimited funding but the need for tanks or even aircraft carriers will be altered. Missile technology or advanced submarines will be highly needed. Cyber warfare analysts and cyber security will be in huge demand (college bound students take note).

Russia's invasion has changed the world in profound ways. The most immediate impact will be in food prices as Russia and Ukraine produce about 20% of the world wheat market. Russia supplies about 25% percent of the fertilizer market. They also control most of the processed uranium used in nuclear power plants. This is a different investment climate than we had a year ago. Moving factories back to the US should have a big investment impact if done correctly.

Back to the Future

In the classic movie "Back to the Future 2" Biff steals a sports betting book from Marty McFly so that he knows the results of sporting events before they occur. With this book in hand, he is able to place bets on these sporting events and makes millions in the process. It is something we all have probably dreamed about.

I just spent the last two days at an investment conference listening to multiple economists, market strategists, and various portfolio managers. This is what I learned about the future: Interest rates will be going up, interest rates will be going down, the stock market will be going up, the stock market will be going down. Oil prices are heading significantly higher. Oil prices are heading significantly lower. Inflation will stay high for 4-5 years, while inflation will be peaking in the 2nd quarter of this year.

I probably haven't seen such a wide dispersion of opinions in several years. A recent commentary by Bill Miller of Miller Value Partners summarizes the current environment pretty well. He states: “No one has privileged access to the future, a future which involves what Keynes called irreducible uncertainty. No one knows how long the war in Ukraine will last nor what its outcome will be. No one knows how high inflation will go nor when it will begin to subside. No one knows if oil prices stay over $100 or begin to decline or even double from here. No one knows how many times the Federal Reserve will raise rates nor what impact, if any, reducing its balance sheet will have on the economy.”

“What we do know is that the stock market operates as a real-time information processing entity that continuously incorporates the changing beliefs about the future into today’s prices. The value of all the companies in the market reflects investors collective expectations of the future of the key macro and micro economic variables. As investors assess the probabilities of different outcomes, they are confronting a regime change in the economy, in capital markets, and in geo-politics that most have not seen in their professional careers. Headline inflation is the highest in 40 years, real interest rates are also the most negative they have been in decades underpinning strong and rising commodities prices, and the Fed has indicated they will do “whatever it takes” to bring inflation down. There is a war raging in Europe that few believed would occur and whose path so far has confounded those who thought Russia would secure a quick victory.”

“Where does all that leave us? Even after last week’s move, stock prices remain down year-to-date, and I believe there are many good values in the market. I also believe that a strong US economy with low unemployment, plentiful jobs, rising wages, the strongest real growth in years, and a Fed that has begun to raise rates makes it likely that value stocks will perform better than growth stocks from here.”

I do believe the investing playbook has changed. For years, the US has outsourced inflation to emerging economies such as China, India, and Vietnam, etc. Companies figured out they could shift labor and other manufacturing costs to cheaper markets to boost profit margins. It kept costs down as consumers wanted a cheaper product even if they were buying it from political enemies like China.

The problem now is the cheap labor in foreign markets is no longer cheap. These foreign workers have seen the global supply chains and with the internet they have the information to desire more. We are realizing how fragile our supply chains are when we rely on others. I think there will be a huge race to secure resources as the global economy “deglobalizes” especially in the areas of energy, food, and defense. It’s unlikely one nation can do 100% on their own so you’ll see various “sides” developing with the US and Western allies on one side and China and Russia on the other. Food and energy should be a long-term investment theme if this race to secure resources continues. With this new trend of “insourcing,” this will keep our labor market tight and inflation a bit more “stickier” than we have seen in years.

If we only had that Back to the Future sports book.

re·view

[rəˈvyo͞o]
NOUN

a formal assessment or examination of something with the possibility or intention of instituting change if necessary:

VERB

examine or assess (something) formally with the possibility or intention of instituting change if necessary:

A review can actually be a noun or a verb….but in either case the Regulators would love for me to conduct one at least annually. If we haven’t done one lately, expect Nancy, Sam or myself to reach out over the next few months to schedule some time to catch up.

Late Night Revelations and Other Useless Information...

- Did you know that Bruce Springsteen never had a number 1 hit? “Dancing in the Dark” reached number 2 on the Billboard Charts.

- The term “inflation” is from the Latin term inflare, meaning to “blow up or inflate,” and it was first used in a monetary sense to describe “an increase in the amount of money” in 1838.

- In 1974, President Ford declared inflation public enemy number one and the government urged people to wear the pins they distributed. The pins said “WIN’ which stood for “Whip Inflation Now.” The public thought this was incredibly stupid and started wearing the pins upside down (NIM) which they said stood for “Need Immediate Money”.

- According to First Trust Advisors, more people died last year from taking “selfies” (14) than died from shark attacks worldwide (10).

- No number from 1 to 999 includes the letter "a" in its word form.

- According to Economist Dr. Pippa Malgren, most people don’t fill their tanks up when they go to the gas station. The average is $28 no matter what the price of a gallon of gas is. Higher prices = more trips to the gas pump.

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* Bond prices and yields are subject to change based upon market conditions and availability. If bonds are sold prior to maturity, you may receive more or less than your initial investment. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.