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Economic and Market Commentary

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If it slithers around on its belly, they'll know what it is. No, I'm not talking about a political animal who follows politicians. I'm talking about a herpetologist, someone who specializes in the study of reptiles and amphibians.

Back in the 1930s, the San Diego Zoo was led by a man named Frank Buck. Buck had been an actor, producer and adventurer who traveled the world capturing wild and exotic animals to be displayed at zoos, circuses, and side shows. During this time, he wrote about his exploits in a series of immensely popular books including *On Jungle Trails*, *Fang and Claw*, and his tour de force, *Bring 'Em Back Alive.* Of all the terrifying encounters Buck wrote about was "malayopython reticulatus," the reticulated python, Asia's largest snake that spooked him the most. A masterful swimmer and stealth-like predator, the reticulated python is sometimes casually referred to as a boa or anaconda. Known specimens have been reported to grow in excess of 30 feet and weigh close to 400 pounds. Right here in America, the Kansas City Zoo exhibits a reticulated python named "Medusa" who was still growing when it weighed in 10 years ago at 350 pounds.

You see, the terrifying nature of these creatures is not their size but the manner in which they hunt. They are "ambush predators" who lie quietly in wait until their victim passes within striking distance, then grab the head of their prey in their powerful jaws while their coiled bodies begin to slowly wrap themselves around their victim and the constriction process begins. The coils wrap tighter and tighter until death occurs by suffocation.

Small pythons live off rodents, bats and the occasional stray chicken, cat or dog. Bigger pythons can take down primates, pigs and deer. And yes, most regrettably, humans have fallen victim as well making us rethink our definition of "man eater."

As the Planet Has Just Learned, We Are Not Immune to Unexpected Danger

You'll remember that in the last commentary I promised we'd delve into the many challenges we face to make this an "American Century." The list was a long one, daunting for sure, but impossible? Absolutely not. Now I know my limitations and yours as well, which is why I would never presume to give you an analysis of the myriad of land mines we face all at once. That's why, as promised, I will be dedicating this year's upcoming columns as a continuing series on this subject. The goal here is not just to identify the many challenges our society faces but also to look at how we can combat them and be smart investors trying to avoid the pitfalls as well as be opportunistic investors when the right opportunity does present itself.

So Here's the Connection

So far, we've learned that the python is an ambush predator. With stealth, it lies in wait until it can slowly strangle the very life out of its prey. Well, poor and excessive tax policy will do the exact same thing to our economic health; it will strangle it to death. Here's why: The concept of taxes is almost as old as civilization itself. Its earliest recorded references date back to ancient Egypt, roughly 3000 B.C.E. The Book of Genesis tells how the pharaohs would send collectors throughout the land to take 1/5 of all the grain harvests as a tax. Go to the British Museum today, and amidst its jaw-dropping collection sits a modestly sized polished stone. It's the most visited artifact in the entire museum. Its name: The Rosetta Stone. The instrument was discovered buried by Napoleon's archaeologists in 1799 and it proved to be the key to translate ancient hieroglyphics. You see, it had chiseled into it a translation of Egyptian hieroglyphics into Greek. One of the central chapters described Greek tax collection around 200 B.C.E.

And so it went, from the days of the Roman Empire through the Middle Ages, taxes were imposed on property, inheritance, purchased goods, manufactured goods and everything in between. Not a continent existed that didn't engage in this civilization-building concept. Sometimes it contributed to the public good in the form of defense, food stores and irrigation. Just as often, it contributed to royal excesses, egotistical monuments, war (after all, what good is that army if you don't use it) and empire decline.

Here in the colonies, British tax imposition was the key factor in lighting the fuse to the American Revolution ("no taxation without representation"). Look no further than the very first article of the United States Constitution, Article One, that clearly states the U.S. House of Representatives is the central body that organizes the federal tax system based on executive branch recommendations. State and local taxes usually follow a similar suit.

So Here We Are

Over the past several years, U.S. sovereign debt has hit all-time highs. We broached that subject in last quarter's commentary saying when you're at war, you spend whatever it takes to win the war. After the war has been won, then you figure out how to pay for it. Well, long before we needed to spend trillions of dollars on our war with Mother Nature along with trillions to provide a life ring to those poor souls drowning from the financial fallout of the pandemic, America was spending money like a drunken sailor. Trillion dollar after trillion dollar. National budget deficits became the norm. Our total government debt (read that sovereign) exceeded more than an entire year's gross domestic product. Each man, woman and child in America is responsible for roughly $80,000 of debt, more than double what the figures were just 10 years ago.

Pay Up Or Shut Up

For 46 of the last 50 years, our government has spent more than what it has taken in by way of taxes. Sounds dire I know, but the counter argument is this: Instead of the government trying to balance its fiscal budget each year, it should calibrate toward full employment. In other words, deliberately overspend when you want to boost demand.

Ironically, it was just 50 years ago (1971) that America went off the gold standard (we no longer guaranteed we'd redeem an ounce of gold for $35). We became a pure fiat currency, and our dollars were good because we said they were. You see, unlike those balancing a family budget, there are those politicians and economists who say: at the end of the month, if we're short, we can always print more money and that's okay. In recent years, a new school of macroeconomic thought has grown around this principle. Its name is Modern Monetary Theory (MMT). The basic premise behind this theory is that our government can't be forced into insolvency. Why? Three primary reasons:

- We issue our own currency
- We allow its exchange rate to float
- We avoid borrowing funds that require repayment in a foreign currency

As odd as it sounds, it's not as novel as its namesake might imply. We've already talked about this for months. There are times when a country needs to spend what it takes to avoid catastrophe, lessen misery and figure out how to pay for it later. Remember, every purchase is a sale, so if the government spends $1,000 and only takes in $900, granted that means it is $100 in the hole. On the other hand, there's an extra $100 in the economy that wouldn't have been there. That's $100 of sales and purchases. With each dollar changing hands between various transactions somewhere between six and seven times, that represents substantial monetary activity. Increased monetary activity equates to more jobs.

Well, What's Wrong With That?

As the old adage reminds us, "There's no free lunch." When deficits get too big, there's inflation. We're seeing that right now, at the gas pump, at the supermarket, in housing costs. Now it's too early to tell if what we are witnessing is as a result of a pent-up demand from the pandemic or if other factors are at play. There is no doubt about it: Deficits do matter. When demand outpaces the resources of commodities, labor and industrial capacity, government needs to curb in deficit spending and entertain other remedies such as more stringent business and financial regulation as well as higher taxes— the two-headed snake certain to strangle any economy if not handled deftly.

The Stage Is Set

Hard to believe, but mid-term elections will soon be upon us. With the pandemic all too slowly receding in the rear-view mirror, tax policy will be a front and center issue which the market will follow, as will the electorate, most closely. The goal is to close the gap between what we spend and what we take in. Much of the debate will center around the questions: what do we really need to spend on, and if we spend it, will it help us grow the economy to the point where our expenditures pay for themselves by reducing the need for public assistance and collecting more taxes, not just by raising rates, but by having more people employed at better-paying jobs thereby increasing productivity. Increased productivity is simply producing more with less. It's this basic maxim that results in real wage growth without inflation. That's what truly increases people's standard of living, something the middle class has not seen for the better part of 20 years.

It seems everybody has a plan. Some want to do away with capital gains taxes in lieu of everything being subject to ordinary income. (That would certainly retard capital investments.) Some want to increase corporate tax rates, while others want to increase individual tax rates. Still others want to increase both. We're hearing proposals that would lower estate tax exemptions, particularly galling to many, since the deceased would have already paid taxes on the money before they died. Talk about double taxation. As if all the proposals weren't confusing enough, you still have to get them passed. Remember Article One of the U.S. Constitution and how Congress organizes the tax system? Well, they also vote on the budget. Now ordinarily bills can be blocked by filibuster in the Senate, but if you can't muster 60 votes to break a filibuster, the bill never gets voted on.

The budget is an exception. Here you need a simple majority. This is known as "reconciliation." Now with the Senate split 50/50 between Republicans and Democrats and the Vice President casting a tie-breaking vote, from a practical point of view, it would mean that any tax increases will most likely have to carry all Democrats which is no sure thing. The President's ability to win passage of a tax bill through reconciliation is certainly in doubt.

Gridlock Is A Disease, Not A Remedy

In a post-pandemic economy, national debt must be put on a downward trajectory by the government's own estimates by 2023, when federal debt will be higher than at any point in American history as measured against the GDP. Reduction in debt cannot be handled by reduced spending alone. New revenue sources must contribute. Hopefully, cooler heads will prevail, and we won't choke our economy by taxing income. If we tax income, people will have less savings and less investment. If we need to raise tax revenues, why not do it by taxing things we do all want less of, like pollution. Tax polluting industries hard until they clean up their act. We'll all benefit from it.

The Best Laid Plans

Now it was my original intention to bifurcate this column into a discussion of both taxes and regulations. Regulations can be either overly aggressive or stupendously ineffective. Just think of the banking crisis of 2008. Poor regulation retards our growth and competitive edge. You've heard me complain countless times of my needing to kill some trees by having to send out some notification or another. Alas, I fear there is no immediate end in sight, and I'm sure that over the next 6-24 months, I had better sharpen my axe because more trees will fall. They'll fall so that The Putney Financial Group can serve its clients for the next 25 years as it has for the past 25. As you can see, there's a lot to be said about regulations and their effects on economic productivity. So much so that I won't tax my readers patience (no pun intended) or give the topic short shrift. That's why my next commentary will start with an in-depth look at regulations: The Good, The Bad and The Ugly.

Conclusion

Keep your ears attuned to the rhetoric these next several months as the budget and tax debates start to heat up. Let's hope for some thoughtful discourse along with some open-minded give and take. In the meantime, we will continue to stay focused and shovel ready looking for thoughtful, innovative companies with solid balance sheets and smart management.

For the past 15 months, I've concluded each commentary with a series of "coping skills," many of which had been shared with me by my friends and clients for which I am most grateful. Now it's time to turn the page. So, my postscript, for at least the immediate future, will no longer be sharing coping skills, rather sharing some "reentry" skills. Let's hope someday soon they too will be able to appear in the rear-view mirror. But until then, here goes.

Reentry Skills

- Don't try to make up for "lost time" by making too many commitments, wearing yourself out and perhaps finding yourself in uncomfortable situations.
- Safety first. We all need to prioritize our health and safety. If you feel better in a social or public setting by wearing a mask, wear a mask. Move at your own pace.
- It's ok to say no. If you're not comfortable attending a friend's dinner or party, it's perfectly fine to say you're unable to attend.
- One day handshakes and hugs will again be the norm. Until then, if a fist or elbow bump feels better to you, a fist or elbow bump it is.
- Not ready to sit in a theater yet? I know I'm not. Check out some of the live drive-in theater venues. Think of a drive-in movie, but you're watching a live performance from the comfort of your own car. The Oakland Theater Project is putting on four or five productions this year.
- Say no to panic, yes to precaution.

Stay well and stay safe. With very...

Best Regards,

Ray Lent
Enclosures
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