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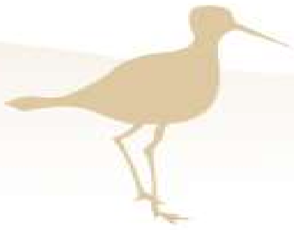
# Sandpiper Capital



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# Gleanings

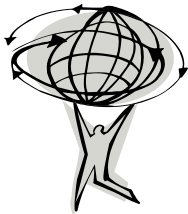
## Market Returns Annually

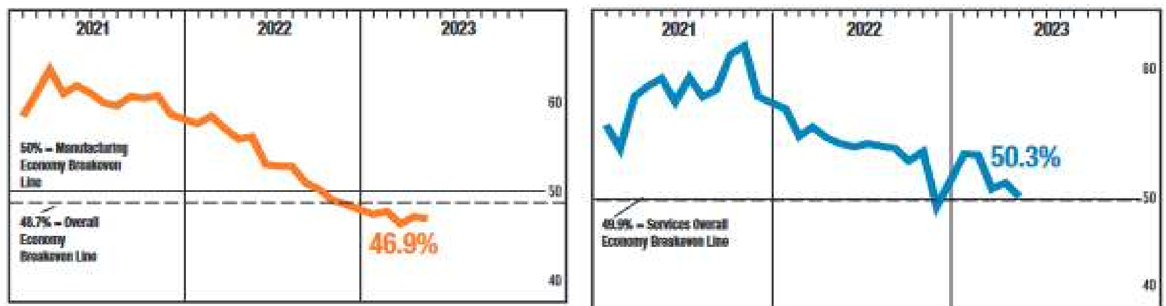
| Index | 2020 | 2021 | 2022 | YTD |
|---|---|---|---|---|
| S&P 500 | 18.4 | 28.7 | -18.3 | 16.9% |
| ML 1-5 yr Gov't/Corp | 4.7 | -.9 | -5.5 | 1.2% |
| EAFE (Dev Fgn Mkts) | 7.8 | 11.3 | -14.4 | 9.7% |
| Emerging Markets | 18.5 | -2.5 | -20.9 | 3.5% |

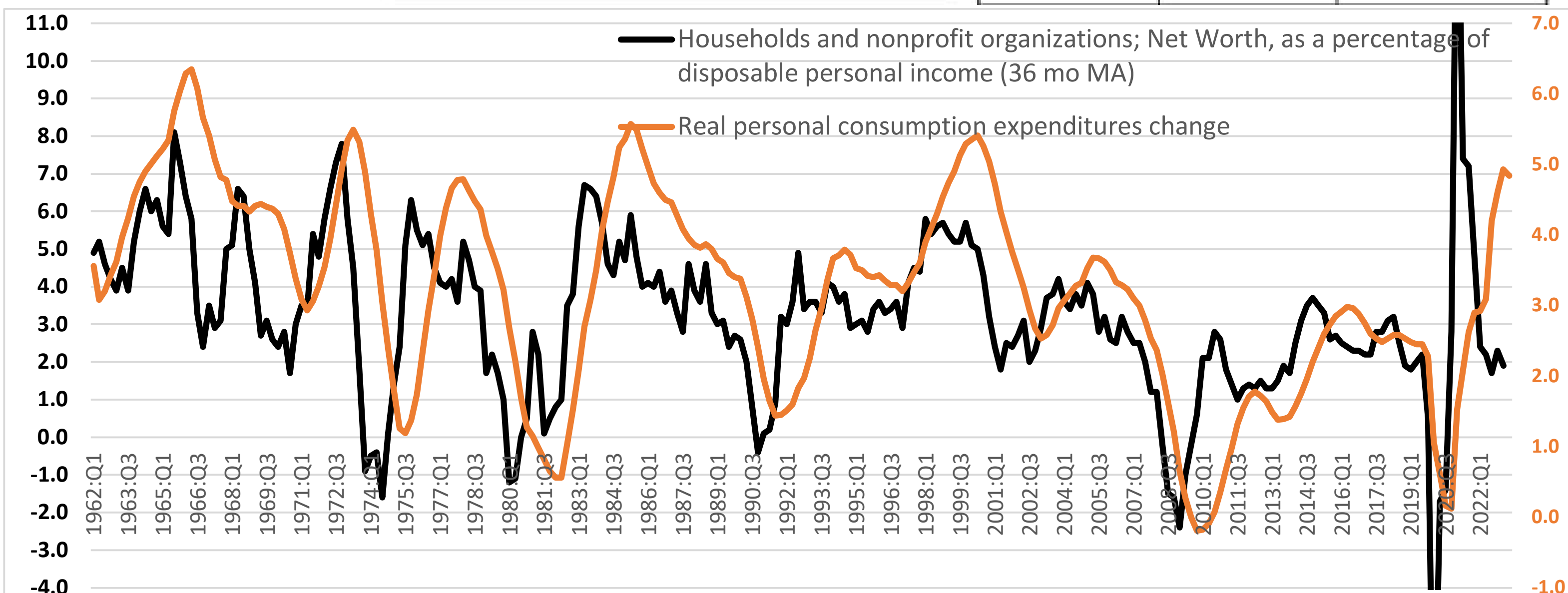
## Too much stimulation

The U.S. has been facing some pretty severe headwinds to economic growth over the last forty years with annual real growth halving to 2% per year from 4%. There are about 3 million fewer children being born per year than expected; just a third of national income gains in the last expansion went to the bottom 99% of the population; the returns on an investment in education have shrunk dramatically and the cost of servicing the government's debt is growing disproportionately *. There are some fairly adverse consequences for those whose elected positions depend upon some degree of optimism about the future and this has resulted in extreme measures being taken to cushion the economic pain. The Federal Reserve has kept the average real cost of bank borrowing below zero for the past fifteen years. Federal spending for the last ten years as a proportion of the economy matches almost exactly the amount we had to spend to pay for World War II. Desperate times have required desperate measures. The repercussions are that having injected trillions to avoid deflation, we've overshot and created a stubbornly persistent inflation. Lifting the government's foot off the accelerator has slowed the economy as shown in the two charts immediately below, but the effect on inflation has been minimized as households still continue to spend in spite of having consumed most of the stimulus money that had lifted household net worth literally off the chart in 2021.

*"The repercussions are that having injected trillions to avoid deflation, we've overshot and created a stubbornly persistent inflation."*

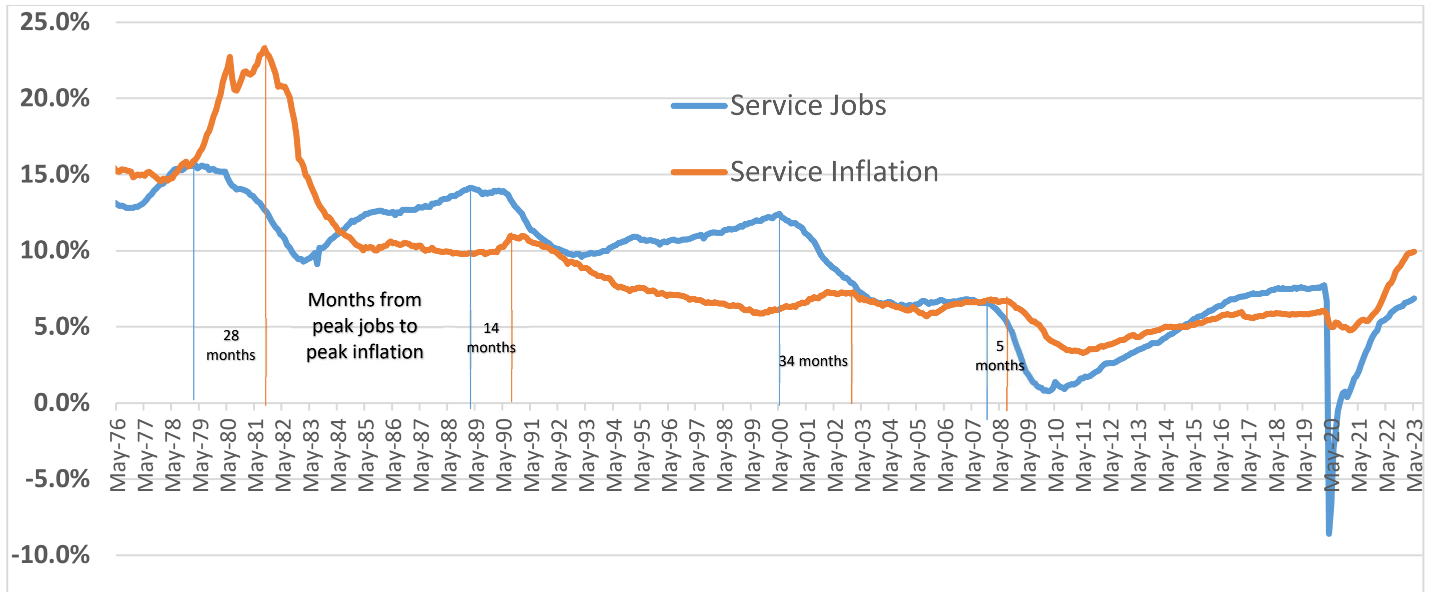




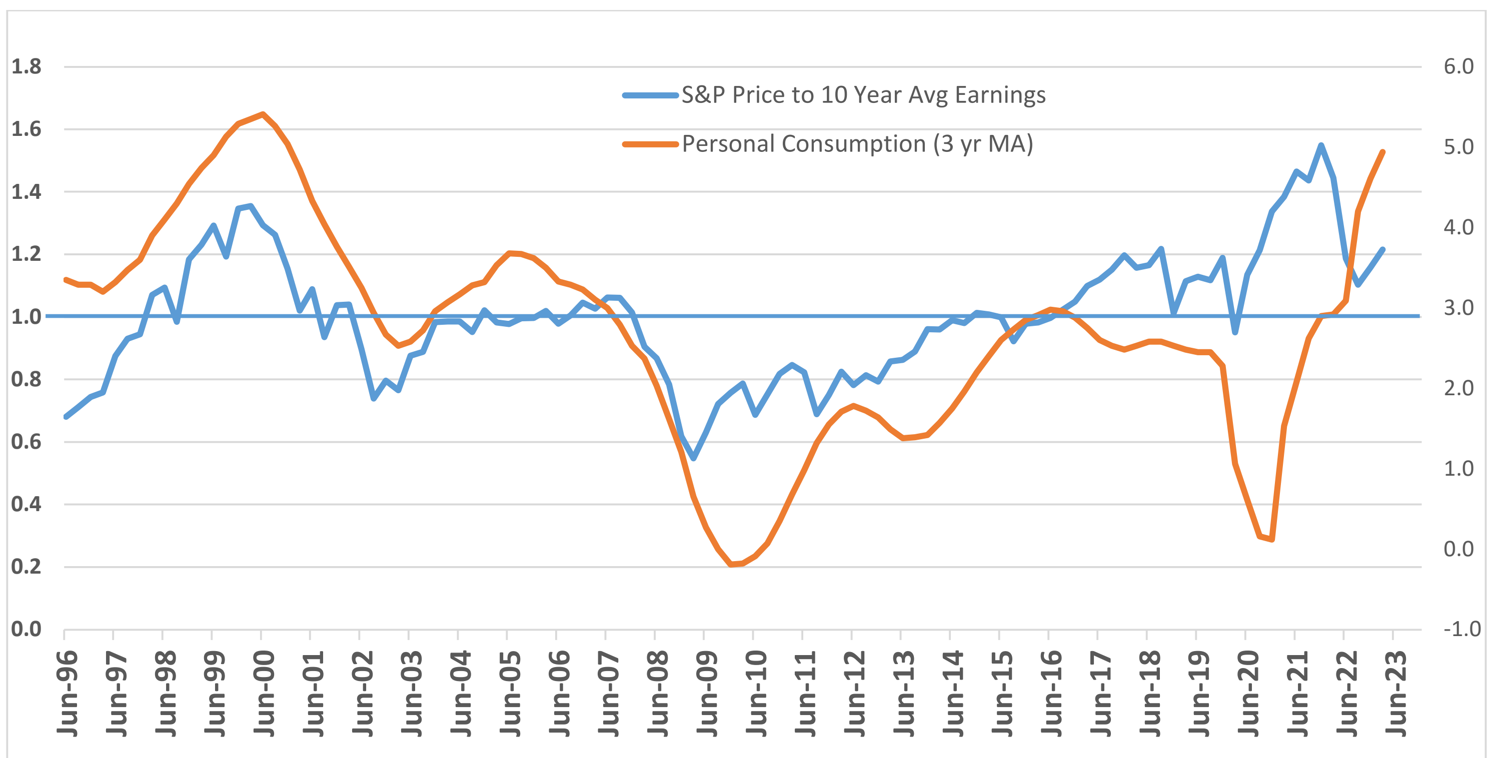




- See Robert Gordon's *The Rise and Fall of American Growth*

While there are any number of indicators that economists use to predict the direction of the economy, the number of people employed is a solid barometer that, while not providing a ton of advance notice, definitely does identify the start of an economic downturn. Similarly, when jobs (specifically service jobs in the chart below) are expanding rapidly, you will typically see service prices follow. It takes many months of contracting numbers of service jobs before you see inflation pressures abate. To see progress on inflation, the monthly number of people newly employed will need to be substantially less than the number of new potential employees hitting the workforce. There's no hint of that yet.




One often overlooked effect of government stimulation of consumer spending is an elevated stock market. Businesses and market participants look at recent rates of spending growth and extrapolate that into the foreseeable future. That is, if spending (and with it corporate profits) has been growing at a high rate, then if that is sustained into the future, businesses are more valuable. You can see below that there is a strong historical relationship between the rate of growth of personal consumption and the price that the market will pay for earnings. (I've used ten-year trailing earnings to smooth out the economic cycles). While valuations have come down in the last couple of years, we are still about 20% above normal levels. If consumer spending contracts, that will bring down both earnings as well as the price paid for each dollar of earnings.




*Tom Lukic*