Hoping to be Wrong

April 2023

"Capitalism without failure is like religion without sin; it just doesn't work."
- Allan Meltzer

More than a year ago we used a Warren Buffett phrase, that only when the tide goes out do you discover who's been swimming naked, to remind everyone that financial missteps (purposeful or not) tend not to be discovered until after the damage has been done. We also reminded everyone that the tide moves slowly, such that it may take some time for us to see or feel the consequences of 2022. Well, we certainly hope we are wrong, but we believe we are on the cusp of that reckoning, for lack of a better word. Please understand, I am not here to say the sun will not rise in the morning, far from it - we are actually pretty optimistic for the long-term - but I would be remiss if I did not tell you what concerns us.

Let's start with interest rates. As everyone knows, the Federal Reserve got behind the ball by refusing to admit, at least publicly, that inflation was much stickier than their "transitory" narrative was meant to have us believe. Unfortunately, the damage from rising interest rates was not completely visible to all, even regulators apparently. Silicon Valley Bank (SVB) became a case in point when their portfolio of bonds soured because, due to greed and/or stupidity (sorry, that's my humble opinion), they did not hedge against rising rates; SVB's collapse began a crisis of confidence that still plays out today.

Speaking of crisis, seems like politicians of every color are not only sticking their heads in the sand when it comes to social security, Medicare, and Medicaid, but worse still they are sacrificing the financial well-being of generations to come by failing to get serious about reform. And I know this sounds harsh, but if anyone (including me) claims that their own benefits should not be affected by reform, then maybe you should tell your kids, grandkids, and great-grandkids why they need to live a lesser life just so you can enjoy the rest of yours (I know, brutal but true). Because the reality is that the social security trust fund is expected to be depleted by 2034; our guess is that it will be sooner than that since higher rates make our massive debt even more costly.

Speaking of debt and politicians, we also believe politics has sadly devolved into a silly game of performative art. So don't be surprised if the Democrats and Republicans play a game of chicken with the debt ceiling in the next six months when we need more stability and not less. As for the blame game, I prefer not to get into the chicken and egg debate about who is more responsible, those choosing to spend more than what makes sense or those who want to fight about it after the fact, since debate and blame only distract us from painful yet possible solutions.

Next on deck is our concern for commercial real estate. In 2020, I clearly remember looking out from our downtown apartment during the first eight months of covid, watching construction workers build new empty office space, thinking, "does this make sense now that the world has so obviously changed?" Well, two years later we have tons of office space still sitting empty, the work-from-home phenomenon intact partially forever(?), and whispers of some borrowers beginning to think bankruptcy may help them lower their debt obligations. And this is just commercial real estate; consumers are getting squeezed by higher rates and debt loads as well, not to mention student loan payments are (finally!) going to re-start in the next four or five months (well, maybe…). Add this to the fact that automobile loan and credit card delinquencies are beginning to rise, and it could spell for a weaker consumer/taxpayer who will be responsible for a massive and growing public and private debt load.

In my opinion, the worst consequence of all this spending (to save consumers and businesses alike) is the moral hazard that might be created and perpetuated. Is it no wonder that colleges/universities keep raising their fees while the government seems to be in the student debt bailout business rather than the college-fee reform business? Are you surprised that people of all ages who may have tens of thousands of dollars of debt seem to be spending like there's no tomorrow since we tell them not to worry about paying their bills? Should we really be surprised if another bank or financial firm causes "systemic" problems after the government basically guarantees all SVB deposits when it previously said $250k per depositor was the limit? Seriously, why do we act so surprised when these things continue to happen? How can we not see that we might be distorting capitalism (with the best of intentions, of course) by preventing each and every failure?

Ok, enough of my rant(s) – but please know this is part frustration and part call to action, or at least attention: we need to allow capitalism to function efficiently, which means letting some failures occur so as to allow for re-birth and future growth. Remember, some of the most successful people in life are the greatest failures (in the best sense of the word) because they learned from their failure, never gave up, and tried again and again until they succeeded – that's capitalism! And I am sorry for my harsh and blunt words, but I believe too many people are avoiding uncomfortable truths in the name of current satisfaction – and if you know me at all, I do not bite my tongue, especially when it comes to finance.

As always, our advice remains the same: manage a financial plan and asset allocation that allows for future failure and success, because the only guarantee is that the future is unknown and unknowable. Preparing for good times and bad during good times and bad allows you to be optimistic for the long-term (which we are, surprisingly enough) while hoping to be wrong during a pessimistic short-term.

As always, thanks so much for your friendship, your trust, and your referrals!

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