MAULDIN ECONOMICS
SIC 2017
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Well, good morning, everybody. And it is great to be back. I was talking to John Mauldin last night and I said, wow, I can't believe it, I think it's been nine years in a row. And he said, yeah, Dave, and we're going to keep inviting you back until you get it right. So, I think I'm the only one in the room that has greater job longevity than Alec Baldwin does.

In any event, the last time I was in Florida, it was just about two months ago and I was speaking at a CEO conference in Naples which is, that's really Donald Trump country. And, in the Q&A at this CEO conference I was actually asked a question nobody has ever asked me before in thirty years of public speaking which was who my favorite economist of all times was? So, considering the location and I was in a very pro Canada mood I said John Kenneth Galbraith. And everybody looks at me and says why John Kenneth Galbraith? And I said, well, you know, this giant of a man who advised FDR during The New Deal, spoke at my convocation when I graduated with my Masters in Economics at the University of Toronto back in 1984. And, I remember his last few words to the graduating class and they still resonate with me when he said, there are only two types of forecasters and don't forget it. There are those who don't know and those who don't know they don't know. And, maybe I line up somewhere in between, but I'm not going to humiliate myself as an economist and talk about point forecasts.

But, what I want to do is talk more about what the principle risks are around the outlook under the proviso that I am talking to investment managers or wealth managers that in the end were all risk managers and the roll of the economist ultimately is not to give you some pointless point forecast but to really help identify when the sun is coming out and when the clouds are coming out.

So, I love alliterations so I call this the trials and tribulations of Trumponomics. My hope is that in six months, that it's just not down to the word trial but I could have actually called this the outlook in 3D, debt, deflation, demographics. Or I could have called it lessons in investing late in the cycle. And, I'm going to cover all of those topics but the first thing I want to discuss is this. Politics and investment is like oil and water and since November the 8th and thereafter, I was asked repeatedly by our clients and by prospects, how are you investing around Trumponomics? And, I don't know if you've ever gone on Google and done a search on Trumponomics, there's actually more search results than there is for Reaganonomics and the last I saw Reagan was there for a full two terms. This is a real phenom and what I would say, at Gluskin Sheff, we're not actually investing around Trumponomics at all, we're really investing around secular fundamental trends that would be in place no matter who took the oval office.

And, that was actually met with a lot of ridicule to be perfectly blunt because, of course, people are looking at markets and making the assumptions that this is all about Donald Trump and, of course, the stocks with the highest tax rates are rallying the most. The financials' that were the poster child for Trumponomics were rallying the most. And all the infrastructure stocks and people make up their narrative that this has all got to do with Donald Trump, although, we have no idea what would have happened if Hillary got elected. And, we all know that despite the fact that President Obama might have done everything he could to thwart advancement in the economy, the reality is that the stock market tripled under his watch. Now, it was probably the Bernanke Rally than it was the Obama Rally.

But, what happened was a certain epiphany. I'm marketing in New York and I'm getting ready for the first meeting and Becky Quick comes on Squawk Box and she's interviewing Warren Buffet. And she asked the question, how are you investing on Trumponomics. Well, I quickly, shaving cream in hand, run out to the television set to see what he's going to say. And, I got the transcript and he said, people who mix their politics up with their investment activities, I don't think that makes sense. And, then he reiterated, if you mix your politics with your investment decisions, you're making a big mistake. And, that's exactly what my philosophy has been. And, yet when you're taking a look at the surveys, you know, what people call the soft data, you know the ISMs, the Philly Fed Index, the expectations whether you look at the business surveys or the household surveys in the past several months, have shot up dramatically.

Now, it's not that first time this has happened. We also had a similar run up when George W was elected back in the early 2000s. And, who knew at the time he was going to preside -- and I don't think through any fault of his own, two recessions and point to point, a 35% decline of the stock market. I don't blame him for that. Because what I know about politicians is this, what I know election campaigns and I could take this all the way back to Ulysses Grant, that what I know as a historian, is that Presidents during the campaign, what they ultimately get through Congress where the bills get legislated, they typically barely get half of what they campaigned on.

And, as I sit here today as a new budget is being unveiled, we don't know which part of the Trump agenda is going to get through Congress and which parts won't. And, frankly I don't think it makes much sense to invest around speculation, around conjecture. I guess you could trade around it but you don't really want to own securities based on conjecture or speculation.

And, my big concern here from a risk standpoint is the expectations which are just now rolling off the highs, there's some reality going on, I know that the markets have held in well for three days.

But, the reality is that the S&P hasn't made a new high since March 1st and actually the average in median stock are actually both down a percent. So, the cup is half empty, cup is half full, but it's been two and half months of really just a sideways pattern of the stock market. For all we know the highs have been put in for the cycle. We'll only know that in time. Now, my big concern when I see this chart, as somebody who likes to look and see what is actually priced in financial assets, what does this mean to you folks when you see expectations as high as they are? You'd rather actually being investing when expectations are low and you can under promise and over deliver.

But, right now rather it's across the business community or the household community my big concern is that expectations over what's going to be done through the legislative process is far too high. I mean even the great Ronald Reagan, it took him five years to get tax reform through and it almost didn't happen. And, ultimately, he needed more House Democrat votes than Republican votes to get it through.

Now, I get the question, of course, what about this ripping soft data we're getting? Which, of course, a lot of these soft data the survey data has rolled off. But, everybody was asking me, well this is animal spirits and surely the survey data lead the hard data. But, that's not always true. The survey data are only relevant insofar as they predict the hard data and despite the fact we had stuff like the Philly Fed Index at a 40 year high, we do know, and look, there will be revisions, the first quarter GDP was 0.7%. Then of course people say, well, you know there was weather effects and seasonal maladjustment. We'll get some pickup in the second quarter, make no mistake about it, a lot of that is unintended inventory buildup in the auto sector and I actually think we'll have another growth relapse in the third quarter, where people will wake up to the fact that, no actually the economy is actually fundamentally slowing down from an already slow growth rate.

What did Janet Yellen say? I'm not going to say Janet Yellen is perfect, but the Fed despite its feebles and foibles and its mistakes, it does run the most powerful econometric model on the US economy in the world. And, she comes out and says basically, that it's uncertain just how much sentiment actually impacts spending decisions and that the Fed hasn't seen these animal spirits notwithstanding what the stock market has done filter through into the real data.

I will say, inevitably, the markets will follow the real data and what's fascinating is you could argue, well, the stock market is saying Janet Yellen is wrong. But what does a 2.25% ten-year no yield telling Janet Yellen and it's telling her that she's right and my experience has been that the bond market tends to get the narrative correct earlier than the stock market does.

Now, what's interesting was that Donald Trump ran with a very similar campaign slogan as the Gipper did back in 1980, Make America Great Again. And, what I want to say is that when we look back fondly at the Reagan era, a lot of the good stuff, Iran-Contra aside, really happened in his last six years. So, be careful what you wish for.

People say, well this guy is very similar to Trump to Reagan, he had a similar slogan, he's an outsider, deregulation, tax cuts, and there are a lot of similarities. Maybe one is just a little more communicative and maybe less bellicose than the other, but there are some similarities.

But I kept on saying to people, well, we live in the here and now. Our clients aren't going to grade us over five or six years, they really take a look every 12 months. So I'm saying, be careful what you wish for because the first two years of Reagan for people with a memory that long were not exactly that good. He didn't get his tax cuts through just yet and what ended up happening in his first two years was Volcker raised interest rates, flattened, inverted the yield curve and through no fault of his own and Reagan certainly did not campaign on, I'm going to generate a recession in my first two years, we had a recession starting eight months after he got elected. Because Volcker raised rates, flattened the curve, inverted the yield curve and we had a six-quarter recession that nobody anticipated at the time, I guess except Gary Shilling, probably Lacy Hunt, and the market went down 30 very surprisingly.

And, then ultimately, because the Fed cut interest rates, and you know we called it the Reagan Rally, the stock market tripled under Reagan's last six years, but when you look at earnings and you look at the P multiple and you look at what the Fed did, it was really more two thirds Volcker Rally, one third Reagan Rally even in the 1980s.

Which is what I'm trying to say is that what is important, most important, is not even necessarily what the Trump team gets through. If they manage to get through any fiscal stimulus at this stage of the expansion, it's what is the Feds reaction function? I don't think anybody in the room voted for Ronald Reagan thinking we're going to have nearly a two-year recession and a 30% of decline in the stock market in 1980 to 82. And, I'm not going to say that we're going to do a full repeat of that, but the Fed is the elephant in the room and it is always the elephant in the room.

The chairman or the chairperson of the Fed, in terms of the contours of the market, which is what we're concerned about, the Fed is far more powerful, monetary policy is infinitely more powerful than fiscal policy is.

So, what does Janet Yellen tell us back at her Congregational testimony February 14th? Well, at least she's honest. She's talking about, why are we raising interest rates with nominal GDP growth slowing down with inflation and inflation expectations rolling over with the bond market telling us what's going on, she says, waiting too long to remove accommodation would be unwise potentially requiring the FOMC to eventually raise rates rapidly, which could risk disrupting financial markets and pushing economy into recession.

So, she's admitting right here, right now, that they feel they are behind the curve. What curve they are behind, I'm not so sure. But, there's clearly remorse in that comment. That Janet Yellen, quite surprisingly, who is ____________ 12:29 as the big dove, is now in the process of being preemptive.

Now, I know that the starting point of the funds rate was ultra-low, it's always ultra-low and lower this cycle to be sure, but let me just say this thing, that there's never been a Fed tightening cycle that did not expose and expunge the bubble of the day, whether that's in subprime autos, commercial real estate, leverage ETFs, take your pick. I might be missing some.

But, when the Fed is raising interest rates and these tightening cycles always start off benign but they never finish benign. And, once again a sense of history, because this time be a historian not an econometrician. That there have been 13 Fed tightening cycles in the post-World War II era, ten landed us in an outright recession that the economists don't see 'til we're knee deep in it. And, there's been three soft landings, the mid-60s, the mid-80s and mid-90s. The mid-90s is what made Alan Greenspan into The Maestro.

Take your pick though, growth is not accelerating. Maybe growth in some sectors like technology might accelerate. I wouldn't be expecting much acceleration in consumer discretionary, but let's just say there's never been a Fed tightening cycle that left the economy stronger than what it was when they started.

What I don't quite understand is we peaked on nominal GDP growth cycle this cycle a couple of years ago at 4.9%. That's never happened before. We've never peaked on nominal GDP growth year over year less than 5% until this cycle and now it's 4%. You've got to start asking, where does nominal GDP, does it go negative again in the next cycle, and the next down cycle and what does that mean for profits?

The yield curve to me is still the best leading indicator. Every single cycle there's reasons to ignore it. I say, ignore it at your peril. The 2s-10, you can pick whatever point of the curve you want to look at. The yield curve still is in my opinion the best leading indicator and it is flattening, the 2s-10 curve is already around 95 basis points which means, that we're only four rate hikes away from the Fed actually inverting the curve yet again, like they've done so many times. And, every recession was touched off by an inversion of the yield curve which is the bond market's way of saying, Uncle. We're only four rate hikes away from that happening under the proviso that the ten-year remains close to where it is today. I've got no reason to think that it won't. And, yet when you look at the dot plots you're going to see that over half of the FOMC officials, and who knows where Janet Yellen is on this or who knows if she'll even be around, over half of the FOMC officials on those dot plots actually want to raise rates at least four times between now and next year.

So, keep your eye on the yield curve if you're managing a risk, which I'm sure most of you are.

Now, something else to consider is this, is where we are in the cycle. And, we are by definition of full year ahead from where we were the last time that we met. And, once again, it's not Donald Trump's fault that he comes in heading into the ninth year of a bull market in economic expansion. In fact, this is the curse of the Republicans, is they always seem to come in late in the cycle. Do you know that every single Republican president back to Grant, so I'm going back almost to the Civil War, had a recession in the first half of their first term? I can't, you know, I can't fathom that except that it's just bad luck. Like George Bush, 41, George Bush, 43, both coming in late in a cycle with the Fed tightening. You actually want to come in, if you're President and you want a real tailwind, you want to come in when Clinton came in. You want to come in when Obama came in, at the low point of the cycle with Central bank giving you a liquidity tail wind. Do you not see that we are nowhere near there? This already is going down as the third longest expansion, not just since the post-World War II era, but since the Civil War. Now, it might be true that cycles don't die of old age but everything I'm seeing is smacking of late cycle.

Let's take a look at consumer confidence. So I saw a blog somebody sent to me saying consumer confidence at a cycle high, this is great news. I say, I don't know who it's great news for. If you are an investor, it's not great news when consumer confidence is at a peak. Take a look at where those recession bands are. You actually want to be bullish when consumer confidence is at a low. That's when you have the greatest run room for the cycle, at a peak. Do you know what it means as an economist looking at consumer confidence? What does it mean when you're at a peak? And, why is it that the peaks tend to coincide within a year of a recession? Why is that? Because there is no more pent up demand at the peak. Don't you see? It's like you just finished a five-course meal. You don't want to buy the market or you don't certainly want to be adding on risk at this time when everybody's belly is filled with consumer products. You want to buy the market when the runway is long at the trough of consumer confidence, when there is insatiable appetite for consumption. We're polar opposite of that right now, peak autos, peak housing, what else? Peak wages, everything I'm looking at is smacking of late cycle. I'm just not good enough to tell you exactly what inning that we're in. We're certainly not at the national anthem, and we're not in the third inning but we're past the seventh inning stretch and you want to start investing around late cycle themes, which I'm happy to talk about later on.

What about inflation, the case for peak inflation? And, inflation is peaking, core inflation actually peaked this cycle. Core inflation peaked this cycle, a double peak at 2.3%. We've never seen that before. This is the first cycle ever where core inflation peaked at such low a level and the peak's getting lower and lower. Where's it going to go from here? And, what's really striking me is how the broad-based nature of either disinflation or deflation is taking hold. Now, this hasn't really changed, which is the relentless deflation we're seeing in the good sector, in the stuff in the CPI. Not services, which is 60% of the index, but your suits, and your furniture, and your appliances, and we know what's happening in automotive, that anything you can see, touch or feel is deflating. In fact, the core goods, the X energy, the X food, goods, CPI has been deflating now for 14 consecutive months, year on year, and 43 of the past 44, despite the fact that we're in the ninth year heading in the ninth-year of an expansion. This is the sort of thing you'd be expecting in a depression. Ninth year of an expansion, you got to be thinking in the next recession, which I would will tell you is inevitable, it's just about timing, where are these inflation numbers going to go? We have never seen such a long stretch of negatives on the goods and now it's bumping against a peaking out and rolling over of service sector inflation.

Now, we know what health care is doing. That much is true. Education is really slowing down. Enrollment is way down. Tuition rates are slowing down dramatically. I should have brought the chart in. But, the big story here is rents, because they're such a dominate force in this CPI. They're like 30% of the CPI. And, now finally with the lags, and I might have talked about this last year, finally with the lags of the multi-family housing boom, translating into rising vacancy rates and the latest Fed Beige Book was full of softening rental markets, by the way, especially in New York City. So, we've seen a break in service sector inflation just at a time when we're seeing continuously negative goods deflation and I think that at the inflation rate right now, which peaked at 2.7, the headline inflation rate is 2.2, I think within a year we're going to be at zero. And, people won't be talking about how expensive bonds are anymore at that point.

Janet Yellen amazingly three years ago talked about how you can't get sustainable inflation until you get wage growth between 3% and 4%. Back then, the year over year trend in average yearly earnings, which was her favorite measure, was running just above 2%. And here we are, over three years later and wage growth has not accelerated at all. I get it all the time, well, wages are going up. Well wages are always going up. Wages are very sticky. But, normally, normally, when you have unemployment this low, normally when you have the Fed raising interest rates and concern about inflation, the year over year trend and average yearly earnings is flirting with 4%, not 2.3%.

So, what is going on here? An appropriate question in the Wall Street Journal a few weeks ago, why have wages, well it's not wages, why has wage growth flatlined? Why is it not accelerating? Especially with the unemployment rate. Talk about something that is a late cycle barometer, the unemployment rate is down to 4.4%. Every economic model you would use from the past would tell you that wage growth right now should be 4 to 4½% but we know it's not true. We know if you take the highest wage growth, you could take the Atlanta Fed wage tracker, you could take, or get a labor employment cost index, nothing is close to what would tell an economist based on a 4.4% unemployment rate we should be at.

So, what is going on here? Something called the Phillips Curve we learned in economics which maps out the relationship between wage growth, real wage growth and the unemployment rate, you look historically before the crisis and you can draw a normal looking line through that, the inverse trade-off between unemployment and wage growth. Unemployment rate goes down, wage growth goes up, pretty simple. Look what happened since the crisis. That is a horizontal line. We've had a move in the unemployment rate from 10 to 4.4 and no acceleration of wage growth whatsoever. Wages are rising about the same trend now that they were in the depths of despair and what is going on here?

Well, maybe we're measuring unemployment the wrong way. You know, you're taking a look globally at the number of industrial robots, add in the number of service robots, the ones that can do our task, not do our jobs, we're up to over 20 million robots globally. And this, I think, is what's happening right now. This spread of robotic technology is absolutely breath-taking and I would submit to you that actually maybe if we took robots and put them in the labor force, I guess we'll have to call it the non-farm robot report on Friday, you know the unemployment rate could be over 8% as opposed to 4.4%, if we start including robots in the calculation.

Now look, those of you that read my daily, I pour through about ten newspapers a day and I cannot remember a time, and I've been doing this for 30, over 30 years, I don't remember a time when every single day I am reading about robots, every single day. I didn't have one from in here yesterday.

Did you see the front page of the New York Times yesterday about the unemployment situation in Utah? Did anybody read that? So, the unemployment rate in Utah is at 3%. They're quoting this guy, Ron Gibson who's a fifth-generation dairy farmer in Utah and it's funny because he says, his kids, nobody wants to work in that sort of dirty business anymore. He says, we're really going to have to import labor or import milk. He can't raise prices, so what he's doing is, he's actually looking to buy robots, they actually have robots that will milk cows. That's just something different all together. But, between artificial intelligence, the shared economy, robotics, we are in what is termed from those liberal latte´s in Davos, The Fourth Industrial Revolution. This is big. This is why actually I don't quibble about the GDP numbers, but I do quibble about the productivity data. I don't think they can possibly be as weak. I think labor input is being over measured and productivity is being understated.

And, what's really quite telling is on his way out the Obama team, the White House economists put out a report in December, this is unbelievable, AI driven changes in the job market in the United States will cause some workers to lose their jobs, even while creating more jobs elsewhere. The economic pain this causes will fall more heavily upon some than others. This was Obama on his way out.

And, this is a real tragedy because I would say actually the most egregious statistic over those, that eight year period under his presidency which is unbelievable, when you think about what we were expecting when he got elected was that, what's called the Genie Coefficient or income inequality in the United States is actually worse today than it was eight years ago.

So, then when I see Donald Trump and one of the issues I have with Donald Trump is this, that when you have the wrong diagnosis, you're going to have the wrong policy solution. And, the angst in America, in middle America is not about the foreign worker, it's not about restricting H-1B visas. It's about this exponential move in technology we're seeing, which is actually even bigger than we saw after Netscape went public in the mid-1990s. And that is displacing workers, creating anxiety, and one of the reasons why people feel nervous about asking their boss for a job. Because he's going to say, I thought I fired you last week because I got Watson in the garage.

Okay, the other part here, of course, is Amazon. And, again you saw the Wall Street Journal today, Amazon is handing out free bananas. I really can't believe it. But, Amazon is shaking up and creating deflation in the broad retail sector now and for the next several decades, much like Walmart has done for the past 20 years.

So, frankly I don't see where the inflation is coming from. I can only see wide spread deflation at the peak of the cycle wondering where it goes in the next economic downturn. Inflation expectations are only high among those people that like to short the bond market or reduce their duration. But, consumers who do the shopping in this country, their inflation expectations are at a record low.

Businesses in the NFIB survey that actually set the pricing in society, claiming inflation to be a problem, is at the lowest level on record. So, once again to quote my hero, Bob

Farrell, Rule number 11, in the early stages of a new secular paradigm most are conditioned to hear only the short-term noise they have been conditioned to respond to by the prior existing secular condition. In a shift of secular or long-term significance, the markets will be adapting to a new set of rules while most market participants will still be playing by the old rules. And, a lot of people are still playing by the old Phillips Curve which I showed you before is no longer relevant.

My big concern is that there is a lot of people in the Fed that are still wed to the Phillips Curve and that's why they're raising interest rates and that's where the policy mistake that we've seen time and again is going to occur. We just basically have never seen a situation going into a recession where measured rates of inflation and measured rates of nominal GDP growth were as low heading into the situation.

So, we talked about the deflation and part of the story is the debt. And it also helps to explain why interest rates are so fundamentally low and they can't go up. So, after the crisis, the McKinsey people put out this wonderful report, cross-section of countries over long periods of time looking at what happens after you have a credit contraction and you have an asset collapse that we had go viral, and they came to the conclusion that once you get past the worst part of the crisis, you spend six to seven years in purgatory before you get to the next sustainable phase of growth inflation and higher interest rates, and higher interest rates are what everybody wants.

I still think the biggest fear for a portfolio manager in equities is that the bond market continues to not ratify this pro-cyclical view. Everybody wants higher interest rates but they don't happen. I should say higher bond yields since the Fed does control the short end of the yield curve. Well, the McKinsey people said that debt to GDP, and they're talking about debt at every single level since we all own that debt as the people in Ireland surely found out. Whether it's corporate, household or government, that debt ratio on average, and the average is just the average, it's just the norm, comes down 25%.

And that's the average. Of course, Japan is very grotesque example, a modern-day example of what the average can mean and what the tail could actually mean. But until we restructure the debt and get that debt ratio down 25%, until that happens, you don't get that rebooting of the debt ratio to kick off the next sustainable economic expansion that doesn't need the crutch of either fiscal or monetary stimulus.

Well, the McKinsey people then revisited this and they concluded that well, the decline in that debt ratio never took place and, in fact, in many cases it got worse. So, why would anybody think that we're going to have accelerating economic growth under any circumstance when the best we really did was level off that debt GDP ratio. We never took it down to the levels in the past that touched off a much more full-fledged and pronounced recovery, which was lacking. People are wondering, why has growth rate been so low? It's been low everywhere, it's been low everywhere, not just in the US and one of the reasons is there's too much debt, we're choking on it. And, it's a tax on future consumption at these levels.

So, when you look at the US, you look globally, look in Canada, where the debt ratio is 290%. In the US it's almost 250%, it's actually leveled off, it has not come down. Global economy it's 270%, over 300% in China. This is a constraint on global economic growth. That's one of the reasons. And my big concern is that by adding on more deficit finance, if that's the route we go is going to make matters worse. This is not Ronald Reagan, when he stimulated with a 30% federal debt to GDP ratio, that's the net number. Today that's 80% net debt to GDP ratio, just on the federal government side. That's not going to be very helpful. And based on certain assumptions that debt ratio under Trump's policies just goes up and up and up. We never actually get through what we needed to actually see which was that five to seven-year restructuring phase the McKinsey people illustrated from history as to what has to happen.

So, I'm not going to say it's a ticking time bomb, it's just a relentless constraint on growth. We should be working much harder to repair the national balance sheet and I mean that everywhere. And, I'm not going to say that I'm a student of Kelvin or Kant and that, no, debt's got to be zero. You can't run a modern industrial economy without credit.

But, there is a sweet spot, you see, there is a sweet spot. The best growth for the United States was when that debt ratio was 125% to 175%, not 250% and rising. For the world, the best growth was 200% to 225%, not where we are today. This is like, treated as a future tax on growth. That's how you have to look at it. And, that's what I was saying to the people that believe that, oh, it was great news to have this new Trump team, one party government in Washington. It finally means that we're going to be able to take the baton from monetary policy to fiscal policy. That was never going to happen and it's not going to happen. There's no baton to be passed. There is no torch to be passed.

Fiscal policy, writ large, is as tapped out as monetary policy is. We all know at the zero bound, Central banks are hamstrung. QE has very marginal impact, negative interest rates were a disaster. And, of course, it comes down to the first thing you learn in economics which is the law of diminishing returns, diminishing utility. It's like I tell university students; think about it, your first two beers at the pub, they're great, but it's number 12, 13 and 14 that don't feel so good, especially the next morning. It's the laws of diminishing utility. There's such a thing as too much of a good thing and we're seeing that in monetary policy. It's the same with fiscal policy. It's not linear, the impact you get on fiscal stimulus, and Japan's been a great example, is incrementally very small. And, that's for whatever reason something that I just don't think the White House economics team, as they concentrate on credit, on dynamic scoring, which to me is a real hoax.

Dynamic scoring, that's like the Laffer Curve. We know the Laffer Curve was laughable. I mean those deficits, I mean, all that stuff from Reagan was supposed to pay for itself. Meanwhile the debt ratio was 30% when he takes office, by the time George Bush 41 takes over, it's 40%. There's no such thing as tax cuts paying for themselves, unless your starting point is 100% top marginal rate. You can't believe everything you read. But you can believe in basic economics and it's called Recardian equivalence, which is that when you reach certain thresholds on the debt ratio, the impact of government action is actually very, very limited. And that's why I think that earlier chart on expectations is a big risk. Even if they get the stimulus through, the impact on aggregate demand, GDP and profits is going to be a lot less than you think.

And you can see firsthand how people's behavior are changing. I was struck by the latest Fed loan officer survey that showed that even as the banks were starting to become a little more accommodative on their lending guidelines, that the demand for credit in the business sector, the demand for credit in the last quarter contracted. This is the effect of the debt situation. Look at the debt/equity ratio in the corporate sector. Commercial real estate, finally at classic, classic late cycle indicators. We're now starting to see contraction in demand for credit across almost every line of bank lending, which is why I think after the second quarter hiccup, a reflexive rebound in automotive, we're going to hook right back down again on growth in the third quarter.

And if you ask me how we get out of this, and this is a whole different presentation, how we ultimately get out of this. How do we get out of this debt morass, is a critical question, because you can pay down debt, or you can write it down, which is the same as defaulting, as if we're not seeing that in the auto sector right now. At some point, especially I think in the next recession, we're going to dust off Bernanke's helicopter speech from November 2002. By the way, everything that the Fed has done, check it off, it's like a menu, is in this speech he gave, the famous speech in November of '02, and the last part is called The Debt Jubilee. Uh, something tells me you'll be hearing more about that. I know it's been a theme of David Zervos, and you'll hear from him later on.

So look, we talked about the deflation. We talked about the debt overhang. And then we got to talk about the demographics. I mean, we're wondering why we're stuck in the mud. Excess capacity, intense competitive pressures, that's the deflation story. So you've got to find ways to cut costs or maybe improve productivity to offset that. We have, we have not resolved the debt situation, my friends, and that's critical. And we have the demographic situation. Because something else, I said before the cycle's a year older from the last time we got together, and we're all a year older too. And that's one thing that Donald Trump can't do either is make us younger, I wish he could.

But I'm going to say that the most significant event of the past year was not Brexit, was not the US election. The most profound development of the past twelve months was that the first of the Baby Boomers turned 70. First of the Boomers turned 70. You know what I'm talking about. The 78 million pig in a python that's driven everything from the economy to capital markets to politics. And that is where the wealth and power reside, not with the Millennials. And in fact, look at Hillary and look at Donald, they are both early Baby Boomers. The first of the Boomers turned 70 this past year, but the story doesn't end there. Because one and a half million Baby Boomers in America turn 70 each year for the next fifteen years. So, this will transcend Donald Trump, whether he survives one term or he survives two terms. And this is going to have a profound impact on the economy, on inflation, on interest rates and how we're going to invest.

Meanwhile they're still digging themselves out from a hole from where they were ten years ago in terms of net worth, and in terms of savings. You know that half of these people that are retiring, half of them don't even have $100,000 of liquid assets. I don't know if you saw this once again, this was in yesterday's -- sorry, the weekend Wall Street Journal had this reference to this article commissioned by University of Michigan. It's called, *Living Too Frugally Economic Sentiment and Spending Among Older Americans*. What am my bid? Well, you can pull it off the internet. They found, and remember I'm talking about this because it is such, when say pig in a python, it's such a wide swath of the population. The study found that, once you turn 60, you start to cut your spending annually by more than 2% a year, maybe even without knowing it.

So, this, for sure is going to have a big impact on aggregate demand here at home. And, what I find fascinating is the employment picture. You know, the nonfarm numbers come out and everybody focuses on what does that mean for the Fed, what does it mean for the bond market? But the household survey contains a lot of interesting demographic information. I find it striking. Why is it that people over age of 65 have the fastest employment growth? What is going on here? Everybody else averages out to 1% in the past year and the aging but not aged boomers, over 4% employment growth. What is going on here? Why are they hanging onto their jobs at the same time creating a huge pool of unemployed for the younger folks? Historic chart here. We're getting up to basically one in five Americans, one in five, are staying in the labor market past the age of 65, one in five. In the old days, it was basically one in ten. I take this to our team and I say, hey look, if the Boomers are staying around in the job market longer for cash flow, maybe they'll start to treat their investments the same way, maybe recurring cash flow income is more important than capital gains at this stage. And for sure that's 100% true.

That's the other reality, you turn 70, you're not going to die next year necessarily. You don't smoke, you got normal blood pressure, go to your physician, then you go to your insurance guy and he gives you the mortality table, that's when you really have a conniption because you say, oh my God, how terrible is that, I got a 50/50 chance of making it to 85. And if you're a woman, 87. So you're going to live another 15 or 17 years. And this is a huge part of the population, they're savings strapped, and they're staying in the labor market longer.

And, there's something else that we have to consider for those of us that are managing wealth in this room, and this is on a very large scale, is what happens when you turn 65. This is 65 to 74, the bars on the right, so the median is 70. This is what's important about these people turning 70 for the first time. When you turn 70 for the first time, whether you know it, consciously or not, you undertake your most profound asset metrics change in your portfolio. Since you were in your 30s, when you went into the equity market in your first job. At the margin you turn 65, this is what you do. You start to raise your bond allocation and start to reduce your equity exposure. And, it's not just because you become more conservative, it's also because you want the income stream. Which is why you are working longer in the labor market to get the income.

But, here is the challenge, it's look at the interest rate environment that these Boomers are rolling into. Only two other times historically have bond yields, now this is from, show of hands, who's read the Homer and Scylla book? A few, this is actually, I used to read this to my kids to get them to sleep when they were babies. But, I actually, I could piece together data all the back to the Phoenician period. But, that chart really looks crazy. So, I take it back to the 1500s, say, only two other times historically have bond yields been this low. Only two other times have global bond yields have been as low as they are today. In the 1500s that was a supplied deflation because you had people like Magellan and Francis Drake and Vasco da Gama sailing around the world and spreading the supplies and the riches. In the 1930s we had the demand deficient deflation. And now we have something that's very similar. We have both the supply side and we have the demand side.

I don't want people to get the wrong impression from this chart, this is a 600-year-old chart. You think that bond yields ratchet up sharply from those lows? This is a 600-year chart, do you know when you look at the data, bond yields bounce around the lows for between 20 and 30 years, those other two periods. We're just in year nine. For those people that are betting on reflation, betting on higher bond yields are going to still get it wrong for long period of time.

So, to get to the crux of the matter and our Central bank governor, Stephen Poloz, gave this phenomenal speech, you know sometimes you just figure, wow I could have said that. In last September and this transcends the politics because, of course, Hillary and Donald were running neck to neck at this stage and Poloz comes out and I made sure by the way, everybody in our firm's got this pasted on their wall. I hand this out to our clients so that they can understand, nobody ever said investing was easy. Some of the forces leading to low interest rates will persist for a long time so we need to prepare for lower for longer. Individuals need to plan for retirement with different assumptions about longevity, interest rates and growth.

It comes right back to Bob Farrell, invest in the new paradigm or invest in the old paradigm. We are still in the mid part of that new paradigm, of deflation trumping in inflation, aging demographics, excessive debt burdens, which is why rates can't go up. We already had the template, the debt ratio, we could not carry that at 5% bond yields 10 years ago. Barely, barely we can carry it with 1% bond yields, which is what we have to do today, is ultimately, to repair the balance sheets will allow for those rates to back up long term. That's years and years away. This woman, Ann Richards of Pru-Bache, actually I think once again wrote something very interesting in the FT which I fully agree with, that the theme is a shift in the focus of policy driven by demographics. Fixed income and dividend paying equities will probably benefit in this environment.

And I would tend to agree that it is a brand new world, where if you are buying equities today, it's providing you with the much greater cash flow stream than bonds. I would readily admit and you can talk to my friend Lacy Hunt, the way you make bonds today really is trading bonds and garnering the capital gain, if you can catch those interim moves. But, the coupon, I mean at 1, 1½%, I mean, it will take you 70 years to double your money.

So, the last point I'll make is this. At Gluskin Sheff we've come more cautious on the market, we've been de-risking our portfolios. We're still invested in equities but we have reduced the cyclicality and we're focused on liquidity and late cycle investing means, that you also want to step up the quality of the portfolio, the ratings, the balance sheet.

But, I will say that for somebody who's viewed as this bear, I will say this much, there's no such thing as a sure thing. I'm giving you what my thought process is. I can't guarantee it's going to be right. And, I don't believe in being in zero or 100 in anything. One thing I learned in 30 years in this business, is there is no such thing as a sure thing. And, you don't put all your eggs in one basket.

But insofar as I'd be investing around equity market, it would be, yes, late cycle thought process in mind, stepping up quality. But, focusing on dividend yield and the good thing about today's market is that you go back 10 or 20 years, that would be saying, wow, utilities and telecom, but today there's just a cornucopia of companies run by CEOs that understand the demographics, understand their investor base and actually do pay out dividends.

And, it's not just dividend growth but we look at the all cash yield and it's also dividend growth on top of dividend yield. I still think in the lower for longer environment if you're going to be in the equity market outside of very special turnaround situations, that would be the key to investing. Investing around yield.

And, with that in mind, I think that I will now yield. And, I think that Michael Lewis is going to come up and ask me a few questions provided we have some time. Thanks.

[END]
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