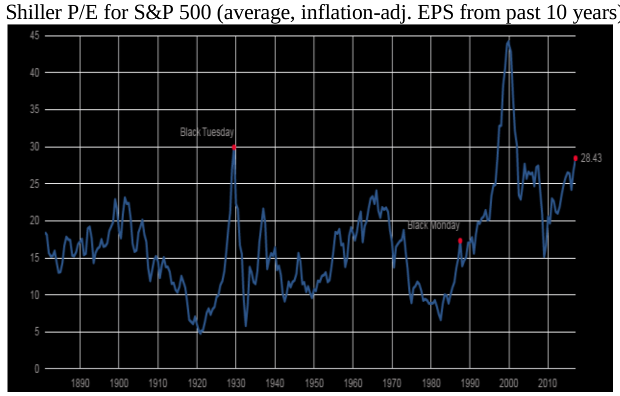
DK Analytics, Post #17: Fruitful disruption or more cronyism, debt, and inflation? And valuations? 2/9/17
Trade weighted US$: 93.12; US 10-yr: 2.35%; S&P 500: 2,293; Oil: $52.94; Gold: $1,243; Silver: $17.82

The leaders of Europe's main anti-establishment parties "Trumpified"

Source: Marine Le Pen/Twitter, 1/21/17

Shiller P/E for S&P 500 (average, inflation-adj. EPS from past 10 years)



Source: http://www.multpl.com/shiller-pe/

Introduction:

"This disruption is fruitful. The taboos of the last few years are now fully on the agenda: illegal immigration, Islam, the nonsense of open borders, the dysfunctional EU, the free movement of people, jobs, law and order. Trump's predecessors did not want to talk about it, but the majority of voters did. This is democracy." -- Roger Köppel, editor-in-chief of "Die Weltwoche," headquartered in Zurich, Switzerland.

On the heels of Brexit -- apparently with Prime Minister May-backed teeth -- and with Donald Trump's ascendancy to the US presidency under the appropriate mandates of "America first," regained US sovereignty," and the re-establishment of the rule of law policies, there is a growing pan-European underswell to resurrect national sovereignty, national borders, and representative government on "the Continent." Clearly, these are good, ethical developments as regards the true sovereigns in democracies and representative republics, the people. So far, so good, i.e., *assuming* those same nations still have the societal, cultural, and political cohesion to avoid splitting apart (Balkanization risk).

A closer look, and oil and water don't mix:

Yet well-founded concerns abound regarding the trajectory of corporate welfare in the US -- also known as crony capitalism -- as enabled by unrepresentative/unconstitutional government and accompanied by litigation excesses that stifle small businesses while driving big business overseas. Specifically, that a sustained, or even a more virulent form of Trump-style cronyism, is on the horizon. For flavor, consider that the US government announced on 1/23/17 that taxpayers will guarantee $1bn worth of private equity firm Blackstone's "buy-to-rent" mortgage backed securities. (We'll also revisit unsustainable deficit and debt issues, which neither the Congress, the new administration, nor the media pay attention to and which the Framers sagely sought to constitutionally squelch with "sound money.")

Crony capitalism can be defined as an economic/political system that allows for preferential regulation and other favorable government intervention based on personal relationships, wherein the false appearance of capitalism is maintained to preserve the exclusive influence and wealth of well-connected individuals. This is no academic matter. The reason: the US Constitution, *the supreme US-based rule of law*, which Trump took an oath to uphold, is steeped in the codification of perennially free market capitalism principles/rights, *which are tied at the hip to individual liberty*.

Those very same codified rights, *and the related constitutional limitations imposed on government*, can't be overrun by "executive order"-based legislating ("all legislative powers herein granted shall be vested in a Congress"), presidential lawlessness, and separation of powers/federalism eviscerating administrative (regulatory) law emanating from the executive branch, regardless of who is currently president. Nor can statutory laws (laws passed by the Congress) violate the Constitution's Supremacy Clause, i.e., fail to be in integrity with the Constitution and the oaths legislators took to uphold it. The same holds true of judicial decisions which either bastardize or **usurp** the Constitution, also known as "judicial tyranny" (e.g., the 5th Amendment-trashing Kelo vs. New London and the federalism/property rights thwarting Mass. vs. EPA decisions). In addition, the following constitutional bulwarks, also known as enumerated powers, serve to shield against tyranny while protecting personal liberty and property rights and also promoting trade:

- The Commerce Clause (Article 1, Section 8):
  "When the framers of the Constitution met in Philadelphia, they didn't sit there and think about how to create the most powerful central government they could to regulate trade. In fact, they included a Commerce Clause in our Constitution, the purpose of which is to promote commerce and trade between and among the states and between and among countries. Because we were getting killed with protectionism, from state to state and from our country to other countries. We couldn't compete. The purpose of the Commerce Clause is not to prohibit commerce. It is not to enable big government. It is also true that they used tariffs at the time, after the Constitution was adopted, because they didn't have an income tax, and in part, those tariffs were necessary to fund the federal government. But they weren't for the purpose of empowering far-off Washington bureaucrats and politicians to manipulate the economy" (and to coerce the purchase of health insurance!).
- The fact that states could make only gold and silver coins a tender in payment of debts (Article 1, Section 10). The goal: protect citizens' property from "money printing"-based inflation and from out of control gov't spending.
- The Takings Clause: no private property shall be taken for public use without just compensation (Amendment 5)
- Certain rights not enumerated in the Constitution are retained by the people (Amendment 9). In other words, unlisted natural or inalienable rights are reserved for the people, much like in the Declaration of Independence.
- Powers not delegated to the US by the Constitution are reserved to the states or to the people (Amendment 10): "allowing nationalist micromanagement of local and individual decisions would turn all Americans into minions of an omnipotent government." (Alexis de Tocqueville)

Our larger point: the US Constitution underpins robust and free commerce, sound money, federalism, individual liberty, and individual and corporate property rights, not protectionism, fiat money, nationalism, statism, cronyism, and pandering to organized labor. As a timely example in light of Trump's ballyhooed $1trn national infrastructure initiative (under President Obama, the US government geared up to massively boost infrastructure spending by borrowing/misappropriating $800bn, while actual government infrastructure spending fell through the floor), the Constitution de facto protects "open bidding" rights to federal public works (infrastructure) projects.

Yet access to large federal projects is restricted to more expensive, closed, union bidding typically featuring "bridges to nowhere" style pork, stout work materials inflation, uncompetitively high compensation packages, job productivity stifling work rules, and corporate welfare subsidies, all financed by the taxpayer. As only 10.7% of American workers, or 14.6m, belong to a union, the vast majority of Americans are shut out from any new government infrastructure spending initiative. This is a triple-whammy: a) potential revenue sources are fenced off for over 89% of American workers, b) project costs financed by the many for the benefit of the few (cronyism) are artificially bloated, and c) either debt and/or taxes rise beyond what a free market capitalist system would necessitate, thus de facto transferring the majority's wealth to the minority while saddling young generations with "baby boomer" debt. Will Trump's infrastructure initiative epitomize his economic policy? And what about his stance on trade?

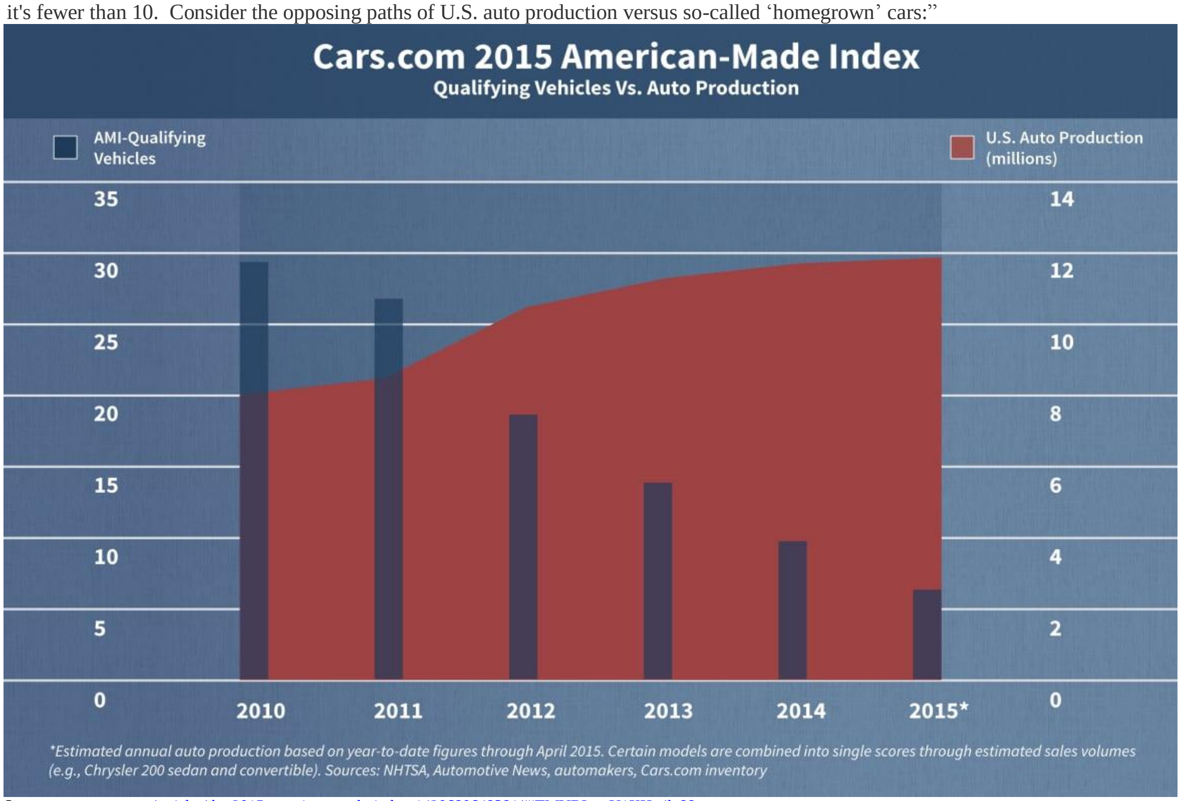
Unfortunately, we don't need to speculate on President Trump's penchants -- and yes, his demagoguery -- in this regard. Below, a recent and worrisome taxpayer property rights-trampling, anti-free market capitalism case in point:

> "… Trump is a showman, and he knows that he can make a big show of reversing these trends and "bringing back our jobs." Hence his big announcement about how he personally negotiated a deal to get Carrier to keep a thousand jobs at a plant in Indiana instead of shifting them to a new factory in Mexico. (Another 1,300 jobs are still going south of the border, but that's buried down in the seventh paragraph, so nobody is going to notice.)
>
> So how did Trump make this deal? With your money, of course. The company agreed after a personal call to the CEO from the president-elect—and oh, yeah, after Mike Pence, Indiana's current governor and our vice-president-elect, offered them a big fat chunk of what the New York Times report calls "economic incentives." That's buried in the eighth paragraph, demonstrating that our media is doing its usual bang-up job. So, in place of crony insider deals made in Washington DC, we get crony insider deals made in Indianapolis.
>
> The fact that the deal was a bad one – for both Carrier employees and for Indiana – was quickly pointed out by Chuck Jones, president of the local United Steelworkers union chapter. Union leaders in the US are hardly a sympathetic bunch, and their stubborn obstruction of any form of progress that might lessen their power is one of the reasons so many American industries are gridlocked. Nonetheless, Jones' analysis of the Carrier deal was accurate. Trump retaliated by going after Jones on Twitter, and the union leader has since faced a slew of death threats."
>
> But wait, it gets worse. The Indiana incentives are probably not the real reason for the decision. They don't offset the $65 million a year the move to Mexico was going to save Carrier. So, part of the story here is that Trump "helped" a manufacturing company by costing it millions of dollars a year in extra expenses. But the $65 million was actually small change, … to avoid the public relations damage from moving the jobs as well as a possible threat to United Technologies' far-larger military contracting business. Roughly 10 percent of United Technologies' $56 billion in revenue comes from the federal government; the Pentagon is its single largest customer. With $4 billion in profit last year, the company has the flexibility to find the savings elsewhere… So, let's see: the president cuts a deal with corporate executives to give him favors—in this case, a press conference and some good PR—in exchange for straightforward handouts and the implicit promise of greater rewards in the future, to be gained from personal access to public officials. What would you call that?"

Trade barriers, the ultimately destructive form of cronyism -- and what about fat corporate profits?
As regards protectionism, and assuming adequate domestic vertical integration, introducing higher trade tariffs may be the most dangerous form of corporate welfare/cronyism. Big government (via higher tariff revenues) and especially big business owners (via increased domestic pricing power) typically benefit handsomely, while already financially stretched consumers face more expensive products and reduced selection. Protectionism also has potentially very dangerous global implications for stock markets. Note that the US Senate passed the Smoot Hawley Act on March 24th, 1930 and that the stock market, with a similar valuation or P/E to today (please see Shiller chart on p. 1), collapsed roughly six months before, on "Black Tuesday," namely on October 29th, 1929. The initiation of higher trade tariffs also has very negative implications for trade and production, especially as tit-for-tat responses by impacted exporting nations must be expected, should the Trump administration successfully implement draconian tariff increases.

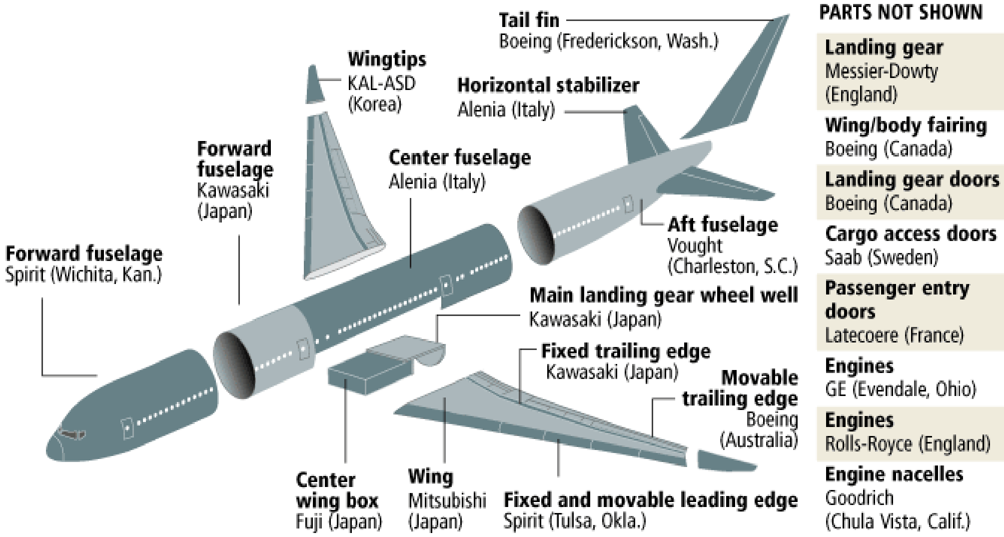
Yet Trump's threats of massively raising import tariffs -- the Trump White House recently embraced a House proposal to levy a 20% tax on all imported goods (the average weighted 2015 import tariff into the US in 2015 was 1.7%) -- in a *heavily-interlinked global economy featuring increasingly international supply chain dependency*, shrunken domestic supplier bases, and emaciated US vocational skills thanks to decades of deindustrialization/greater import dependency, is fraught with even bigger risks. The risks include potentially losing US manufacturing and export competitiveness superimposed upon a global economy buffeted by rising protectionism. This is thanks to rising outsourcing/reduced vertical integration. In today's global economy, foreign sourced parts play an ever bigger role. A case in point:

"What is shrinking is the percent of overall domestic-parts content. Five years ago, 29 cars qualified for the American-Made Index. Today it's fewer than 10. Consider the opposing paths of U.S. auto production versus so-called 'homegrown' cars:"



Source: www.cars.com/articles/the-2015-american-made-index-1420680649381/#iTMVBIoceU1XHu4b.99

Costs of key foreign parts and materials, should stout and broad tariffs be imposed by the Trump administration, could hugely and negatively impact domestic inflation, domestic production, US exports, and, yes, potentially even American jobs, and especially American corporate profits (caveat emptor, exuberant shareholders!), which have been levitated by decades of foreign outsourcing as evidenced by both Walmart merchandise and by America's intractably huge net export deficits. In extreme cases, such as with the Boeing 787 Dreamliner, the majority of the airframe's manufactured value is based on global parts production, including very high value-added center fuselage sections (Japan and Italy) and substantial sections of the ultra-high value-added wings (Japan):



Source: www.modernairliners.com/wp-content/uploads/2015/07/Boeing-787-part-suppliers.gif

For some unsavory historical flavor of what happens when protectionism "takes flight," let's revisit 1929 America:

> "In 1929, exports accounted for nearly seven percent of our national production, and a much larger share of the production of goods (as opposed to services). Trade also accounted for 15 to 17 percent of farm income in 1926-29, and farm exports were slashed to a third of their 1929 level by 1933.
>
> Even these numbers, however, understate the significance of trade. Critical portions of the U.S. production process can be crippled by a high tax on imported materials. Other key industries are heavily dependent on exports. Disruptions in trade patterns then ripple throughout the economy. A tariff on linseed oil hurt the U.S. paint industry, a tariff on tungsten hurt steel, a tariff on casein hurt paper, a tariff on mica hurt electrical equipment, and so on. Over eight hundred things used in making automobiles were taxed by Smoot-Hawley. There were five hundred U.S. plants employing sixty thousand people to make cheap clothing out of imported wool rags; the tariff on wool rags rose by 140 per cent.
>
> Foreign countries were flattened by higher U.S. tariffs on things like olive oil (Italy), sugar and cigars (Cuba), silk (Japan), wheat and butter (Canada). The impoverishment of foreign producers reduced their purchases of, say, U.S. cotton, thus bankrupting both farmers and the farmers' banks."

What Trump really should be focusing on as concerns the trade front, is pushing for global tariff reductions instead of stoking potential "trade wars" by threatening to dramatically raise US import tariffs, which will elicit in-kind responses by other nations. In other words, as a for instance, look to "ape" Mexico's zero-tariff access to 44 countries for its exports, including those nations comprising the EU; America has tariff-free agreements with only 20 nations. Note that BMW went to Mexico for additional North American capacity not primarily because of a net $300 labor cost advantage ($600 gross less $300 in higher transportation costs per Mexican vehicle export) per assembled vehicle or because of $1,500 per vehicle savings thanks to cheaper Mexican parts, but primarily because BMW can import parts into Mexico tariff free (very significant given the high value-added nature of BMW's imports) and then export from Mexico tariff free to more than twice the nations the US can, which saves BMW an average of $2,500 per car!

Unfortunately, President Trump has thus far shied away from seeking the same zero-tariff access to more nations for American vehicles. Apparently, such a free market capitalism/global trade constructive stance doesn't lend itself well to macho, shock-and-awe, "tweet" soundbites or to demagoguery. But such a stance would arguably go a lot further towards promoting the wealth of all nations, most especially America, as it has the most to gain from re-establishing manufacturing vitality. (The US has 26% of world's recoverable coal reserves, i.e., cheap energy which, at current production rates, would last over 200 years; this is complimented with more miles of navigable internal waterways than the rest of the world combined, an incomparable 1-2 manufacturing competitiveness punch, if again unleashed!)

A return to higher manufacturing output *over time* would reduce America's chronic trade deficits. This would bode well for slowing the growth of its $7.5trn net debtor status, which is increasing by about $500bn annually and ultimately threatens to collapse the dollar, America's purchasing power, and thus America's wealth, along with it. But this will only happen IF the US is open for business once again thanks to *huge, sustainable*, *and credible regulatory, litigation, and tax reforms* that give corporate decision makers *the confidence* to bring capital home, *and* *not just for "stock buybacks*," but for rebuilding US production prowess. Will Trump's bullying or executive orders do the trick? And what if we get a leftist president in four years; will America be closed for business again?

Fiat government, fiat money, deficits, and economic carnage, cont'd? (Mr. Hyde and the "deep state")
Staying with Trump's vows to return America to a nation of laws, one can't help but notice that the constitutionality of executive branch-based tariff increases is suspect, threatening a further move away from the rule of law/separation of powers on top of the economic uncertainty/damage heavy-fisted state intervention is known to bring:

> "All bills for raising revenue shall originate in the House of Representatives; but the Senate may propose or concur with amendments as on other Bills." (Article I, Section 7 of US Constitution)
>
> "The Congress shall have power to lay and collect taxes, duties, imposts and excises, …" (Article 1, Section 8 of US Constitution)

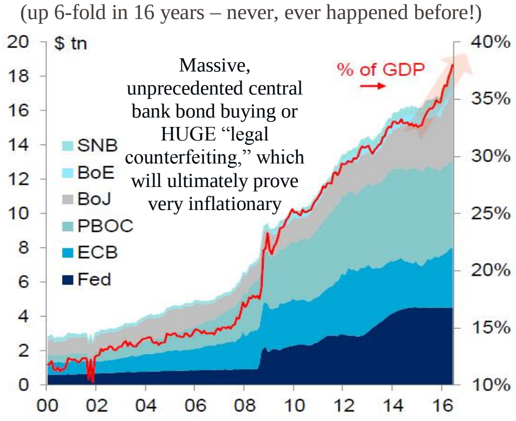
The same hold true for President Trump's rapid-fire executive orders. While these are arguably in large part "break glass in case of fire" necessary to reverse the unconstitutionality of his predecessor's numerous "diktats," they do amount to more executive branch legislation, de facto stripping the Congress of its primary legislative constitutional role (together with the power of the purse). Have we transitioned from a leftist, Saul Alinsky-inspired, monarchical president to yet another monarchical president, namely to the impulsive, populist/nationalist Donald Trump?

Is the trajectory, thus, ever further away from constitutional fidelity as defined above as the aggregation of separation of powers, strictly enumerated governmental powers, sound money, federalism, and inalienable individual rights? For these constitute the very "recipe" which, when married to personal responsibility and a Protestant work ethic, enabled America to reach untold individual freedom and societal wealth (and, in an over-arching but not in a one-on-one sense given parliamentary systems elsewhere, in the West at large). Much of this was presciently pointed out by the Convention of States project just days prior to Trump's inauguration:

> "While no one knows what he will say, there are a few things we know he definitely will not say. He won't promise to limit his own power. He won't commit to eliminating the tyrannical practice of executive orders. And he definitely won't talk about his plan to reduce the power and jurisdiction of the federal government and return it to state legislatures.
>
> This is all to be expected. Trump is President, and he believes he can accomplish much good through federal means.
>
> But this country doesn't need more federal solutions. It needs the federal government to step aside and allow the states and the people to assume control of domestic policy. The federal government will never allow this to happen, …"

Staying in this rule of law arena, will the Trump administration also turn a blind eye to sustained and well-documented manipulation of asset valuations/markets by leading money center banks, by investment banks, and by central banks themselves, which in the Fed's case is owned by "household name" Fed member banks (never mind that if you or I got caught manipulating markets, we'd be behind bars)? Will Trump also refuse to have a go at the central bank cheats and their statist bail-out pals that have long enabled a massive, often criminal, inflation-stoking, debt-based redistribution of wealth from Main Street to Wall Street and to K Street via a fiat currency-based monetary system? Will Trump rally Congress to jettison the property rights eviscerating, moral hazard-enabling, bail-in and bail-out legislation facing bank depositors and taxpayers? Finally, how about reinstating Glass Steagall while deregulating?

Aggregate balance sheet of large central banks* in trn of $
(up 6-fold in 16 years – never, ever happened before!)



* Global central bank balance sheet CAGR: 12.2%, more than 2x global nominal GDP growth p.a. over 16-yr period

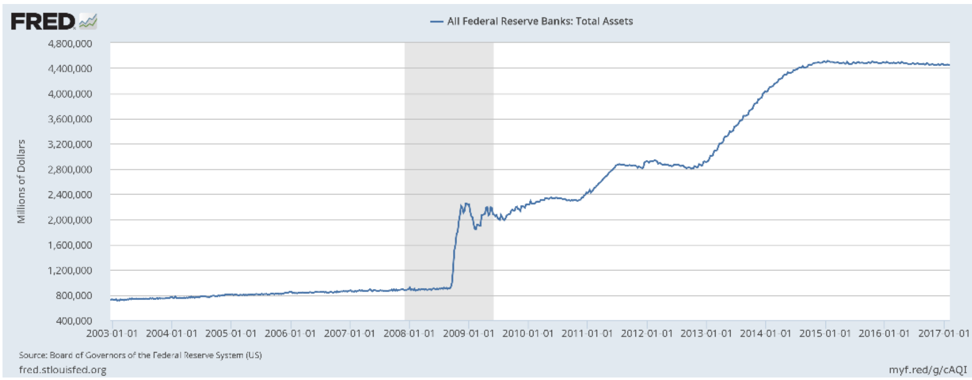
It is central bank bond buying (QE) and fractional reserve banking that has facilitated the enormous global debt expansion in absolute and in as a % of GDP terms

- Total global debt in Q3:2016 exceeded \$217trn, nearly 3x global GDP as government debt continued to surge
- Total global debt in Q4:2000 was \$87trn, or 246% of global GDP
- Global debt grew at an annual rate of 8.3% over the same period, well in excess of nominal global GDP growth
- Global central bank counterfeiting keeps sustaining debt growth, misallocations, and yield deprivation as it increases claims to economic output in the hands of the very few

Sources: Citi Research, Haver Analytics, www.iif.com, http://www.reuters.com/article/us-global-debt-iif-idUSKBN14O1PQ?il=0, www.mckinsey.com/global-themes/employment-and-growth/debt-and-not-much-deleveraging

Inquisitive minds with allocation thoughts want to know if we're adding "swamp monsters" to the "DC swamp" instead of "draining the DC swamp" after all, Trump "über alles" soundbites notwithstanding. Mister President?

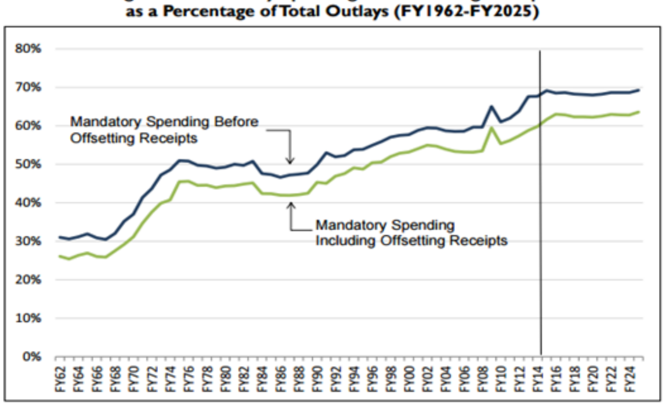
The aforesaid is all the more apt given Trump's Goldman Sachs'-laced cabinet picks. Frankly, they are broadcasting "status quo" statist/elitist, deficit-ridden policies. These very policies, enabled at the outset by terminating the dollar gold standard in 1971, and anchored by the zero interest rate policy (ZIRP) and by massive bond buying-based monetary base expansion (QE) since 2008, have *quintupled* the Fed's balance sheet, …



… and have *sustained and turbo-charged:*

- *Productivity-drubbing misallocations* (massively expanding "mandatory" social spending while providing low-cost financing for trillion USD deficits since 2009 versus making capital available for small business expansion):

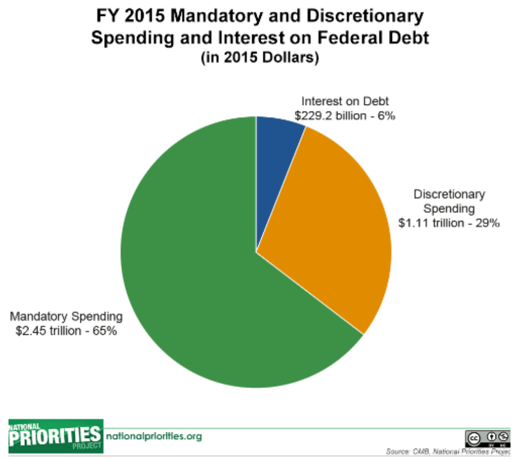
Figure 1. Mandatory Spending and Offsetting Receipts as a Percentage of Total Outlays (FY1962-FY2025)

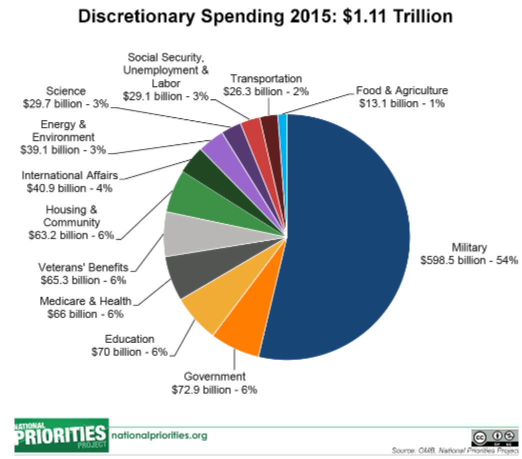


Source: Data for FY1962-FY1973 from OMB, Budget for Fiscal Year 2015, Historical Tables, Tables 1.3 and 8.5; Data for FY1974-FY2025 from CBO Historical Tables and CBO Budget Projections data.

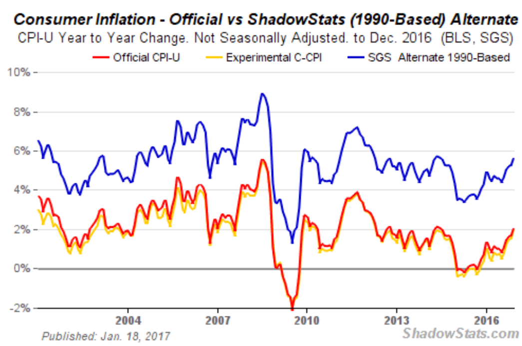
Source: www.senate.gov/CRSpubs/15d57e58-f7d7-4d4c-8ab8-2fb8bfe52cef.pdf

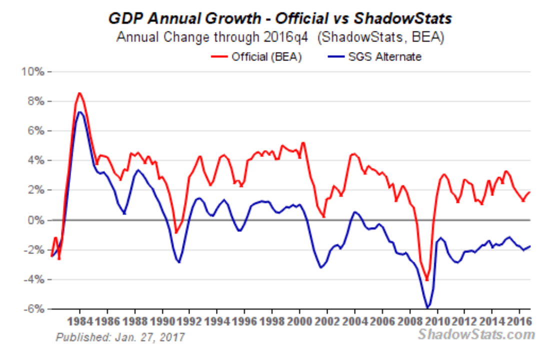
- *Continued huge annual federal government (US) deficits.* Federal tax receipts from Q1:2009 to Q3:2016 (we were unable to source Q4:2016 numbers) were up 88.3%, from $1.17trn to $2.19trn, or by 8.4% p.a., yet federal spending growth continued to outstrip US federal receipts growth over the same period, increasing government debt by $8.94trn over the same 7.75 years of the Obama administration, or by $1.16trn p.a., on average. Going forward, President Trump stated that he wants to cut federal government spending by 10% and federal government jobs by 20%. But in so doing, he won't touch the "mandatory government spending portion (includes Social Security, Medicare, food, and, de facto, interest on debt), which made up 71% of FY2015 outlays! On the discretionary side, the biggest line item is military spending by far (54% of discretionary outlays), which Trump wants to increase markedly; and we won't even go into the fact that Trump wants to raise veterans' benefits and to increase infrastructure spending dramatically, which are also in the discretionary section. Translation: over 60% of the discretionary budget is set to grow, leaving less than 40% of discretionary government spending, or about $420bn, to "absorb" the majority of a sought 10% reduction in aggregate government spending of $380bn as per FY2015. Politically impossible, cutting $420bn to $40bn! Talk about absolute fiscal spending reduction dishonesty/demagoguery with which to rationalize tax cuts. The pie charts below tell the story:





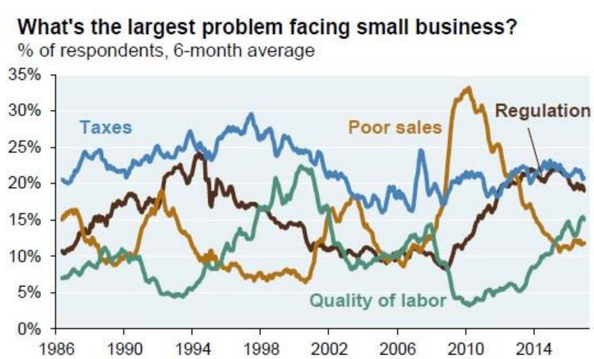
- *Stubbornly high "real world" inflation in the US and thus negative "real" US GDP growth or stagflation*, assuming "real world inflation" (if the US government imposes stout trade tariffs, inflationary pressure will grow):



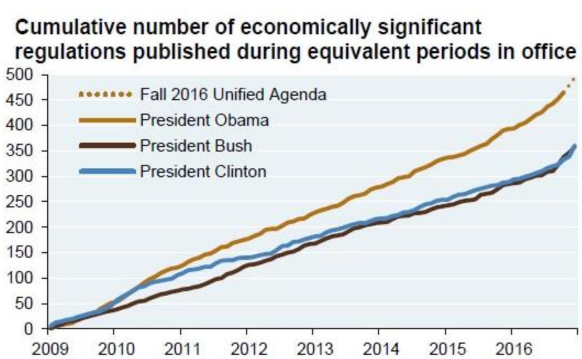


Sources: www.shadowstats.com/alternate_data/inflation-charts, www.shadowstats.com/alternate_data/gross-domestic-product-charts

- *Regulatory insanity* ($34.7K p.a. per small manufacturing company employee and over $2trn p.a. economy-wide!), which the statists and their crony elite pals benefit from.



Source: National Federation of Independent Business, Haver. December 2016.



Source: George Washington University Regulatory Studies Center. 2016.

With some 6,000 newly posted federal regulations (courtesy of the administrative state) in the pipeline, and some 3,500 regulations added to the federal register annually -- which last year reached a record 81,640 pages in length -- Trump's regulatory relief demand that federal agencies "cut two regulations for every new one" is as pathetic as it is useless in terms of freeing up the maligned free market sector and the associated "under duress" enterprises it contains.

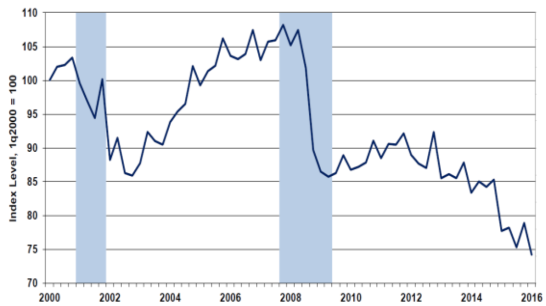
The good news: the regulatory/administrative agencies are domiciled in the executive branch. They thus report to the president. Trump thus has enormous power, *if* he so chooses, to restructure/liquidate the very agencies which have usurped most of Congress's sole, constitutionally-based legislative function -- the 114th Congress passed 149 bills -- despite huge bureaucratic intransigency sadly underpinned by court decisions. Such redress wouldn't lend itself to "shock & awe" tweets or macho soundbites, however. It would also be a "trench warfare" marathon against entrenched leftist bureaucrats and leftist appeals court judges, *hugely powerful factions of the "deep state" that are increasingly "immune" to electoral mandates*. But if Trump truly wants to return to representative government, reduce regulatory despotism, reduce government spending, and liberate the free market economy/Main Street to grow more vigorously, there is no other path forward but to confront the statists and the oligarchs.

- *Unfathomable yield deprivation*, a huge challenge to enormously underfunded pension plans and retirees alike.

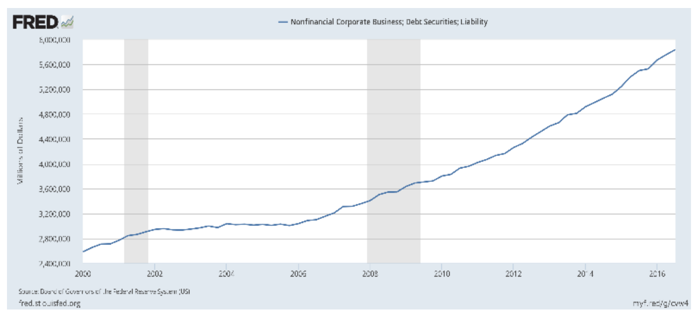
In short, financial repression, or fiat government and fiat money, is short-circuiting both the vibrancy of free market capitalism and the attainment of real yields. It favors and protects statists, cronies, and debtors while it impoverishes savers and starves small businesses of capital. The prime reason: the most important aspect to free markets, price discovery, or private sector determination of asset values, has been hijacked by central planners/central bankers.

To add insult to misallocation/economic injury, financial repression has also encouraged "Big Cap" America to focus on stock repurchase-based, "Potemkin Village EPS" growth in place of organic (sales) growth. Specifically, shareholders, how long can Corporate America's EPS decouple themselves from lacking top line and weak investment, especially in light of an overdue recession and the weakest "recovery" in modern times? Please have a look below:

Real S&P 500 qtrly revs per share adj. for share buybacks, deflated by CPI-U, and indexed to January 2000 = 100

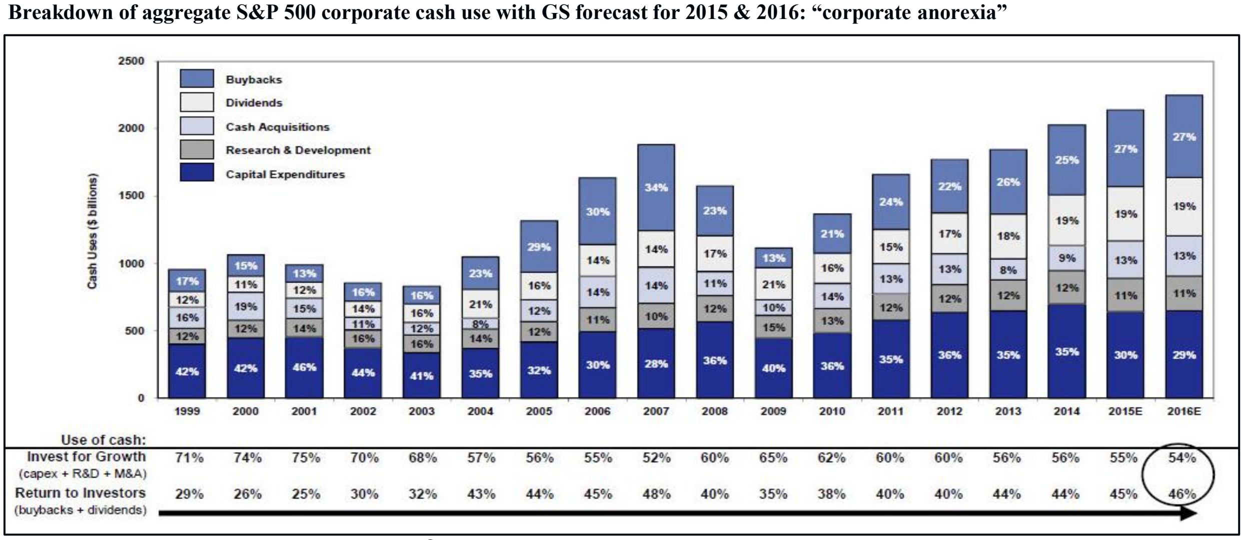


Nonfinancial corporate business debt: $3.4trn Q1:08, $5.8trn Q3:16, up 71%



Sources: ShadowStats, https://fred.stlouisfed.org/series/NCBDSL

Breakdown of aggregate S&P 500 corporate cash use with GS forecast for 2015 & 2016: "corporate anorexia"



Source: Goldman Sachs (of all outfits, we readily admit ☺!)

Speaking of fiat government, the Obamacare economic and constitutional train wreck comes to mind. Unease is palpable regarding both the administration's and the GOP leadership's Obamacare vacillation. This is despite Republicans' umpteen promises to "kill" the unconstitutional legislation on the "campaign trail" to get elected/re-elected. Yet once in power, the GOP legislators typically break election promises. They also fail to always uphold their constitutional oaths (Congress has improperly exempted itself from Obamacare under the fraudulent claim of being a under 50-employee business!). So, do tell, can representative government be expected from such scoundrels? Obamacare has made both medical care and healthcare insurance unaffordable for a large segment of American workers and their families. It has also kept small businesses from hiring the 50th full-time employee and it has begun to erode the ranks of full-time jobs as corporations seek to jettison Obamacare-related costs associated with full-timers.

Yet instead of focusing on getting the government out of healthcare (uninsured, private market elective procedures have been going up more slowly than reported inflation, or even declining in price, while medical care costs have trumped overall inflation by a wide margin) and opening up competition, statist Republican senators are trying to get the Patient Freedom Act through the Senate. They are touting this as a valid replacement for Obamacare, but it would really enshrine Obamacare permanently. Worse, it would raise spending, increase administrative complexity, allow states to impose intrusive requirements on individuals and businesses, and repeal Health Savings Accounts. Not exactly a deregulatory, less government, more competition, "America's open for business again" proposition. Worst of all, what kind of relief will this bring Americans suffocating under healthcare-related costs that have, in too many cases, eclipsed average monthly mortgage costs? (Meanwhile, Trump has promised better healthcare at a lower cost while allowing every American access to coverage -- haven't we heard this before? Wasn't it called Obamacare?)

The good (Dr. Jekyll!) and the mixed bag:

For an administration that will allegedly be focused on returning America to the rule of law, the president's appointments, speeches, policies, and edicts are anything but an academic point. While we don't harbor much hope on the corporate welfare or financial repression front, and while it doesn't look like Obamacare will be replaced by the free market (the only correct economic and constitutional solution), there is significant initial hope in the national sovereignty realm, as happily evidenced by President Trump's recent victory in Miami against codified lawlessness paradoxically called "sanctuary cities" and by Trump's promised execution of the "Secure Fence Act of 2006" ten plus years after it was signed. As for trying to regain a constitutionalist Supreme Court of the United States (SCOTUS), Trump's "originalist" Neil Gorsuch nomination bodes very well, indeed.

If Neil Gorsuch is confirmed, the increasingly "activist" leanings and decisions of the SCOTUS stand to face "Scalia-like" resistance, revisited. This augurs well, over time, for a return to greater rule of law-protecting inalienable rights versus our current status quo, i.e., consistently expanding fiat law or a declining circle of liberty:

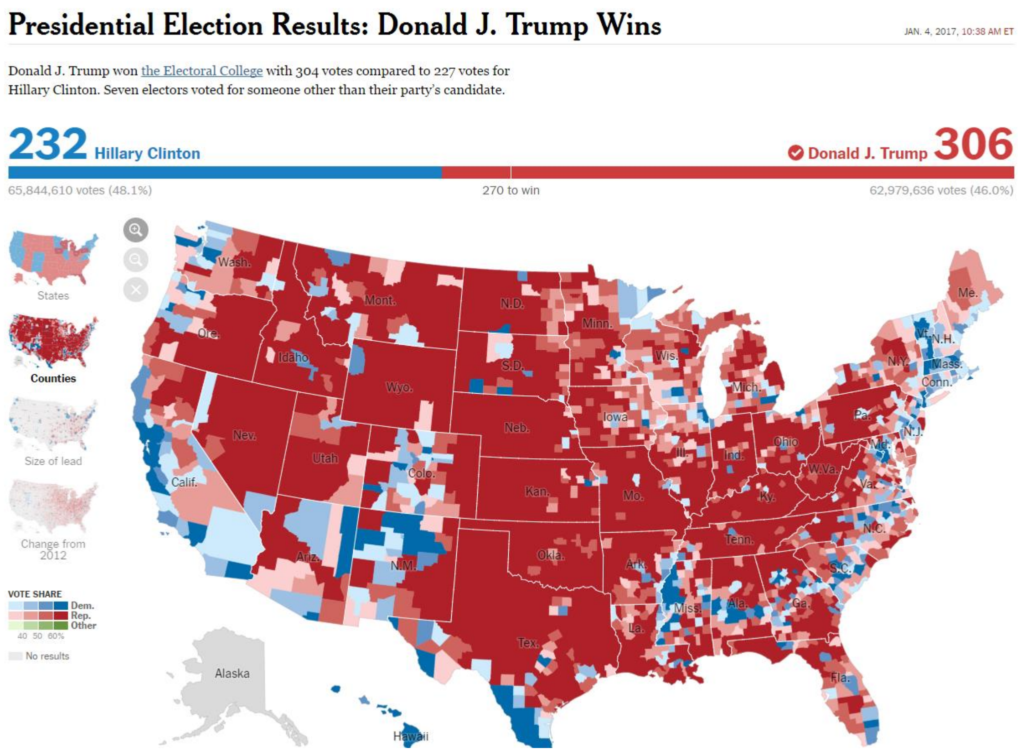
> "At the core of our political disagreement today is whether Americans are to be governed by the Constitution written by the Founding Fathers (Framers) or by a Supreme Court acting as a permanent constitutional convention, making up the law as it goes along."

Moreover, Trump's stupendous attorney general pick, namely the capable, honorable (Sessions was involved in the prosecution of and the death penalty for the head of the KKK in Alabama), and fair Jeff Sessions, who will strive to bring "justice" back into the Department of Justice after eight, long, lawless years, is another very promising sign on the rule of law front.

Just confirmed US Attorney General Sessions will hopefully get a constitutional, federal-level mandate to investigate extensive voting fraud in the US, which may very well have affected the popular vote tally during the 2016 election, possibly by a substantial margin. Consider that in the 2012 presidential election, 59 precincts in Philadelphia showed zero votes cast for Mitt Romney! Or, consider that as of 2014, 20 states, the majority of which were "blue states," didn't require voters to show any ID when they go to the polling place, and only seven states required a photo ID! This is truly banana republic stuff and can make a mockery of a legitimate voter's franchise, which can be diluted or even overwhelmed by voter fraud. Very corrosive as concerns a representative republic and the rule of law.

Nevertheless, ultimately it's a bet on Donald Trump. Here, we must admit that we won't be holding our breath based on "who Trump is," i.e., a very mercurial character animated by making vitriolic claims of sometimes questionable integrity; claims that provide great tabloid headlines, but don't necessarily square with reality, and thus at times unfortunately smack of disingenuousness or potentially dangerous demagoguery. For example: as a candidate, Trump blasted the stock market as an ugly bubble that would be pricked by rising interest rates. Now, with the Dow above 20,000, Trump touted it as milestone despite raising rates; a confirmation of his "brilliant, nascent stewardship?"

We do think, however, that "the good, the bad, and the ugly" mixed Trump administration bag will inevitably result in higher government deficits (we can easily imagine $2trn annual deficits) and thus higher government debt; a higher trade deficit thanks to a weaker dollar (you read that right!); higher inflation thanks to a weaker dollar and to tariff increases; lower corporate profits thanks to the budding recession, higher tariffs, plummeting productivity, and eventual production relocalization; a potential dollar crash once the RoW grasps that a growing US economy is a mirage and the Fed lowers rates and revisits QE; and possibly even a global trade war, which would profoundly impact worldwide asset values and economic activity. *Economics eventually trump politics*, no pun intended! Upshot: we should prepare for a bumpy ride while simultaneously supporting a determined, well-intentioned, gutsy "Dr. Jekyll," and lashing out against an impetuous Mr. Hyde, when he surfaces or "tweets." Moreover, even if "return power to the people Dr. Jekyll" dominates, he will be faced with a statist Republican majority in Congress and a truly unhinged, increasingly despotic party of big money (Democrats) that refuses to accept election results. To add insult to injury, the "*deep state*," i.e., the *non-elected*, yet increasingly entrenched, de facto or actual power brokers/"policy-shapers" in legacy and Internet media, Hollywood, Silicon Valley, the educational system, the courts, the bureaucracy, Wall Street, the Keynesian Fed, and trial lawyers, *leans heavily Democratic/statist*, and wants to further distance itself from *representative, constitutional government*. The American heartland, tallied below based on county-level results, voted heavily for Donald Trump to dislodge the "deep state" and to reinstitute control over America's porous borders:



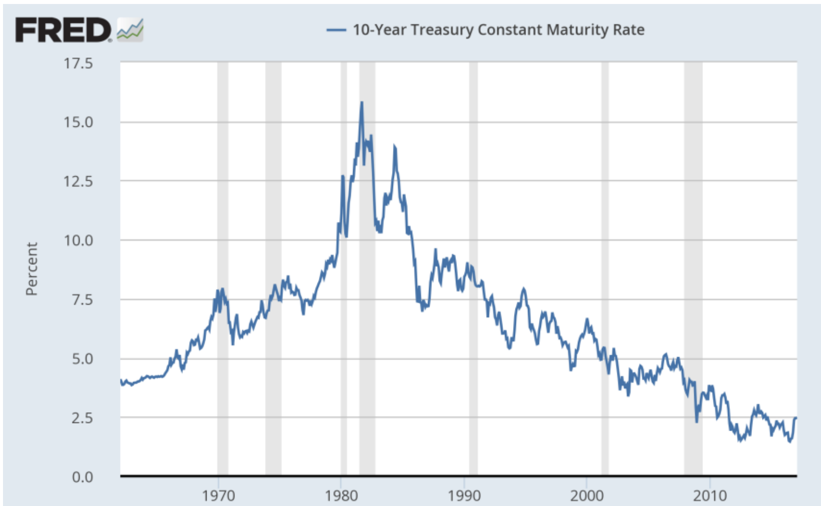
Source: www.nytimes.com/elections/results/president

Will President Donald Trump and the Republicans that control Congress be able to live up to the mandate they were given by the American heartland, a huge, "red" geographical expanse that is pro American cultural cohesion, pro American heritage, pro Protestant work ethic, pro free market capitalism, and pro American Constitution? That would make navigating the inevitable "asset valuations reset" ("reset"), or *plummeting bond and stock values*, a worthwhile, yet painful, endeavor.

Some inconvenient facts, figures, and inferences:

The US debt from operations is $20trn, currently 105% of GDP and true federal deficits, as stated elsewhere, have been in the one trillion dollar plus range p.a. since 2009, including last year. If one tabulates federal, state, corporate, and individual debt, the country is nearly $45trn in debt, or 2.7x current US GDP. Each one percentage point increase in the average cost of debt, i.e., in the interest rate -- which is typically keyed off the 10-year Treasury (yielding 2.35% currently) at the long end -- equates to $450bn in additional interest expense for the American economy. A return to a 3.9% would trigger $698bn in additional annual interest expense; 7.5% borrowing costs would raise the nation's annual interest expense by a whopping $2.3trn, which would sink an overindebted, misallocated economy, eliciting more QE or bond buying-based monetary expansion. Based on a 146-year period, the median 10-year Treasury yield is 3.9%; "stagflation" Treasury yields of the 1970s averaged roughly three times today's yield, or about 7.5% – 8.0%, yet America had an incomparably better balance sheet back then featuring less than a third of today's public debt to GDP, and it also had no material external financing needs – the US was a net creditor nation through 1988!)

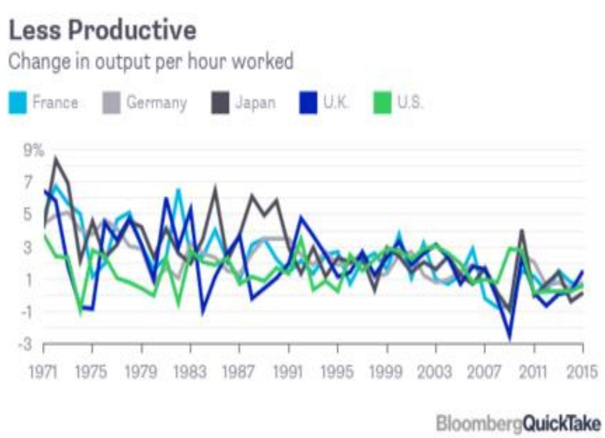
In the interim, USD bondholders are not achieving a real rate of return assuming real world inflation; in fact, much like their "OECD world" brethren, they continue to face negative real returns thanks to financial repression and to politically-based inflation undercounting. Moreover, for USD-based creditors, both solvency and monetary inflation risks continue to grow and the RoW appears to be reducing exposure to the dollar, which, for a nation that requires roughly $500bn in annual foreign financing, is not exactly bond price supportive. The 35-year bull market in 10-year Treasuries is thus very vulnerable, and may end up trapping investors in low-yielding bonds whose value can plummet for over a decade, especially as the 10-year Treasury yield is the benchmark yield off which other bonds are priced:

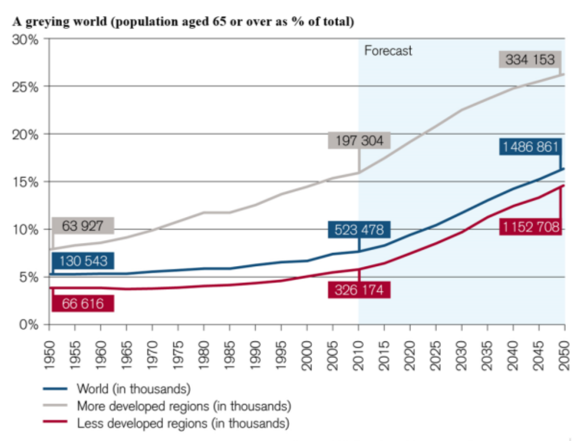


Source: https://fred.stlouisfed.org/series/DGS10

Meanwhile, to repeat, the planet is over $217trn in debt, or some 2.9x global GDP of $74.2trn. This leverage means that a one percentage point increase in the interest rate related to that debt would yield a whopping $2.17trn increase global debt expense, itself about 2.9% of global GDP. (Consider what an interest rate normalization would imply!)

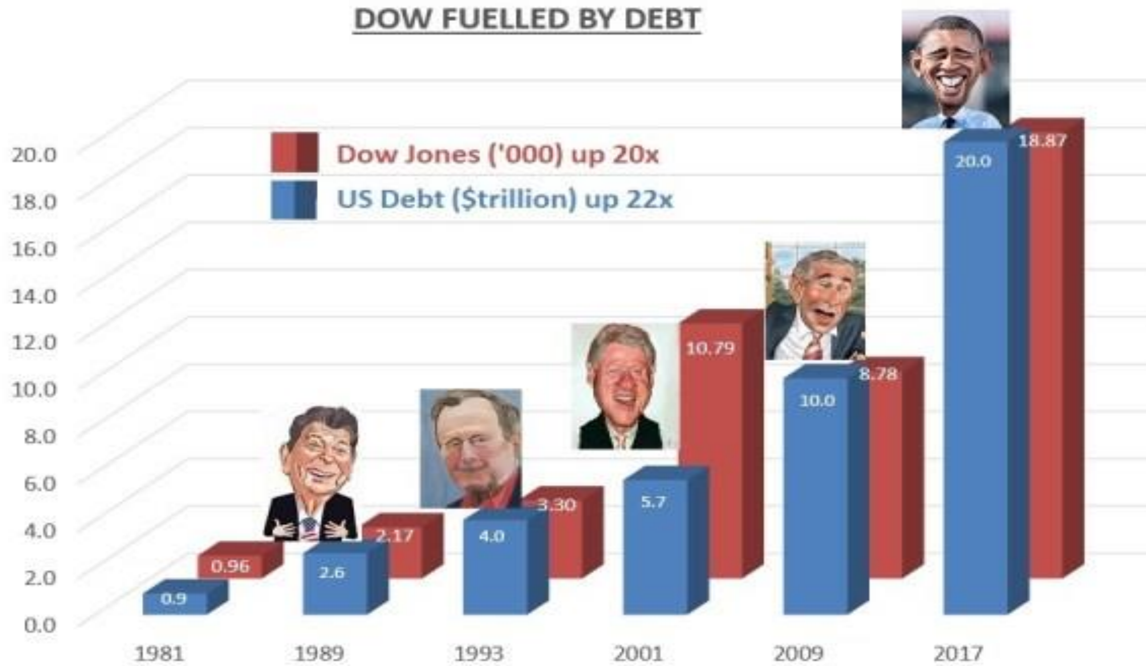
Global debt has gone up way faster than global GDP growth for a long time, a testament to declining productivity made worse by financial repression-induced misallocations and an aging global population:





Source: www.bloomberg.com/quicktake/productivity

The unsustainable, positive correlation between the ever more debt-encumbered US economy, as enabled by fiat money, and US stock valuations (which is mirrored all over the OECD) is depicted in the most graphic terms below:



Sources: David Stockman, https://goldswitzerland.com/dow-fuelled-by-debt-190117/, https://fred.stlouisfed.org/series/GFDEBTN, https://www.google.com/?gws_rd=ssl#q=dow+jones+index

Meanwhile, let's not forget that bond and the stock markets are tied at the "interest rate hip" (for details, please refer back to post #16, page 3). Upshot: with stated inflation and the 10-year Treasury yield near 35-year lows, there is virtually only one way that both interest rates and inflation will trend over time, and that is up. In such a world, the net present value of bonds and Blue Chip stocks, the latter being the ultimate long duration assets, will get "clocked," especially given current bubble valuations. Stout losses in both asset classes at some point are thus all but a given.

To recap: eventually, and perhaps sooner rather than later, …

- Money printing-enabled over indebtedness on a global basis
- Rising monetary, tariff, falling dollar, and relocalization-based inflation risks (latter two solely from a US perspective)
- Falling productivity
- Emaciated corporate top lines, lacking organic growth, a weakening US economy, and protectionist threats
- Unprecedented bail-in and bail-out risks
- Huge paper claims to assets such as stocks and precious metals that can be multiples of either existing certificates or the underlying assets that they are associated with, and
- *Growing attacks on cash* juxtaposed against bonds and stocks priced for perfection and beyond (thanks to financial repression), …

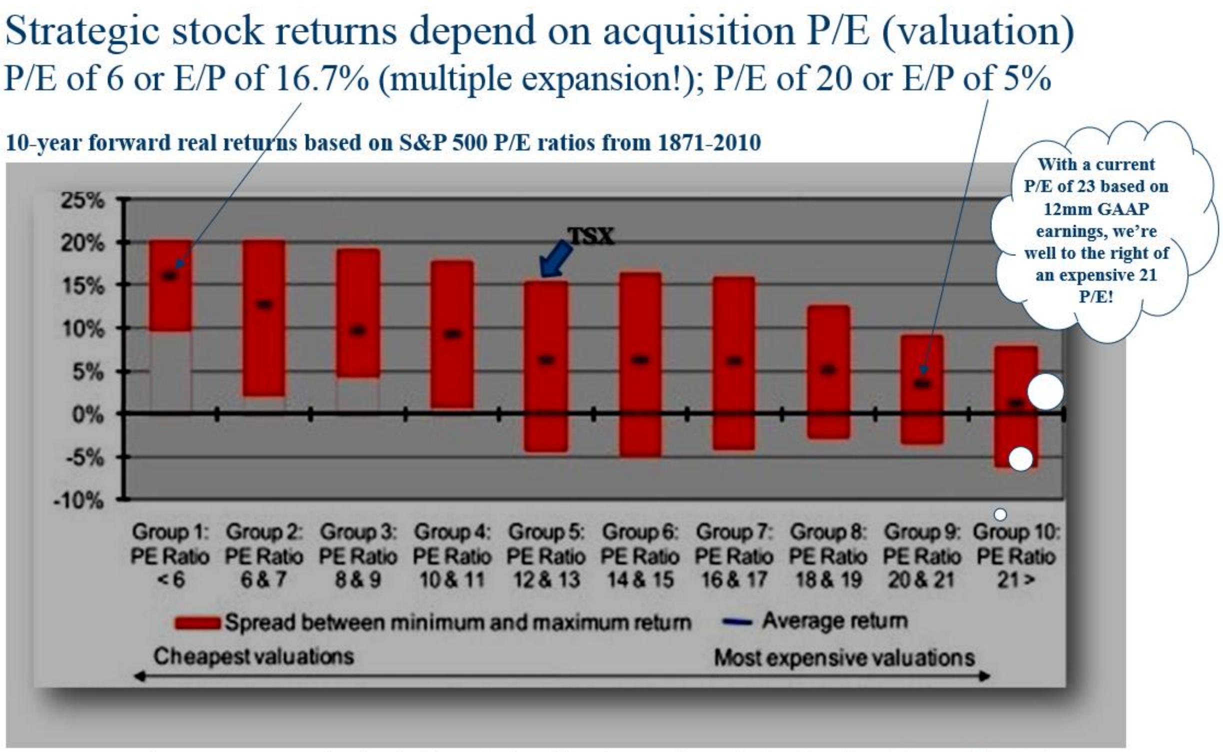
... will conspire to turn confidence in the status quo and "central bank puts" into "the emperor wears no clothes" fear.

So, what's next (it's not a question of "if," just "when"), and how to best prepare?

The resulting fear will manifest itself via sales of overvalued bonds and stocks (there are some $300trn worth of bonds and stocks out there). This will vastly overpower global central bank intervention of a few trillion USD annually, even if the ante is upped substantially. Computer-based trading/algorithms will amplify "60-day moving average" or pro-cyclical stock sales volume. Bonds and stocks will be "repriced" from boom to bust (we don't have reversion to the mean, but beyond the mean!). Huge opportunities to purchase bonds (think "a *slice* of Volcker 1981 tough love, revisited") and stocks that will again provide sound capital protection and return prospects will abound.

(CAVEAT: secular bull and bear markets in both bonds and stocks can last a very long time, and the "value curse" suggests that low P/E Blue Chip stocks will get even more attractive and higher yielding, which is a euphemism for "they will try your patience," but in the meantime you will be collecting 4 – 6% dividends to offset your boredom and to possibly fund "low P/E stock portfolio" expansion, setting up an income and capital gains "twofer.")

As such, *for those investors that bought assets at lofty valuations* that offer poor income attributes, unsatisfactory capital preservation odds, and poor capital gains perspectives -- *assets that are even loftier/frothier now* -- this is the perfect time to cash in your "overvalued chips." With the resulting funds, a portion can be parked in bail-in risk-free, bail-out risk-free, and rising interest rate or "duration" risk-free short-term government bonds, such as Treasury Bills. Investors should strongly favor higher-grade short term government bonds in currencies that can be printed. This way, investors can safely await "value play" opportunities in bonds and stocks. Let's revisit this seminal chart on long-term stock market returns over a 139-year period to drive home our point:



Sources: Plexus Asset Management (based on data from Prof Robert Shiller and I-Net Bridge per 9/30/2011), http://us.spindices.com/indices/equity/sp-500

Finally, we would be remiss if we didn't also call out portfolio reallocation into vital, scarce real assets (which can't be printed into existence), especially dense energy and ag assets, and into real money, physical gold and silver, or precious metals (PM). PM have been artificially suppressed by central banks and their member banks (Wall Street, London, Frankfurt) for a decade, if not longer, and in sync with unprecedented and sustained global financial repression. As such, and on the heels of the upcoming great "asset valuations reset," *PM liberated from paper manipulations may prove to be "cash on steroids," bestowing substantially increased purchasing power on correctly positioned investors.* History clearly suggests that fiat currency regimes, and the assets tied to them, are quite short lived -- their longevity is less than three decades, on average. We are nearly 46 years into a global fiat currency system anchored by a debasing dollar that officially buys only 17% as much as it did in 1971 (it's actually a lot less, but …).

As citizens of troubled Western constitutional republics and democracies, we can vote for politicians that promise a return to representative government at the ballot box -- and then hold our breath, and, too often and sadly, our nose.

Financially, the more robust our finances are post "reset" and the potentially highly destabilizing political/economic developments that will accompany plunging bond, stock, and currency values, the more we'll be able to help our families, our friends, our neighbors, our counties, our states, and our countries. In so doing, we will hopefully help build a bulwark against potential anarchy, which history shows always leads to one or another form of tyranny, i.e., goodbye representative, liberty-protecting government(s)!

Sincerely,
Dan Kurz, CFA
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