DOUBLE, DOUBLE, TOIL AND TROUBLE

Shakespeare switched from his normal writing meter, iambic pentameter, to the four-beat tetrameter that marks the way his witches speak in *Macbeth.* Emphasis and rhyme shifts to four (tetra) beats per line of dialogue:

<u>dou</u>ble, <u>dou</u>ble, <u>toil</u> and <u>trou</u>ble

<u>fi</u>re <u>burn</u> and <u>caul</u>dron <u>bu</u>bble

When you read the lines aloud, you hear four beats clearly.

What Shakespeare intended, as I understand it, was to greatly emphasize the importance of what the witches were saying by giving them a distinctive, rhyming meter. He was having them tell Macbeth that trouble – in fact, double trouble – was coming his way.

My equivalent might be this:

<u>bub</u>ble, <u>bub</u>ble, <u>de</u>flation <u>dou</u>bles

<u>few</u>er <u>souls</u> to <u>solve</u> the <u>trou</u>bles

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As we enter the closing months of 2016, my thoughts are very much on next year. Having written more than a few times that 2017 would be the year we turned up, the year the 2007-2016 fiasco was seen to end, was seen to bottom out, I think a quick reminder of why is appropriate.

There were two reasons I selected 2017. The first was that most economic slumps lasted about 3 years but the roots of this one were so rotted out that the slump could easily double in length . . . and it did.

The second reason was the Presidential election. I thought then that the years of stagnant growth, flat wages and discontent with all politicians would trigger major change in the 2016 elections and support a better 2017 and beyond.

I didn't have in mind the likes of Donald Trump, but had written more than a few times about the coming social changes. Who knew a spoiled, narcissistic rich kid would trigger a populist uprising. I wrote and believed then, and now, that decades of "leadership" are on the bubble of change and would be called out.

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What is now clear are the two “troubles” alluded to in my bad rhyme. We have an interwoven set of unique financial and demographic troubles.

The financial troubles are the level of debt, of course, and now negative interest rates. This negative rate phenomenon is a first in 5,000 years of monetary history. It is allowing corporations, for example, to make a profit center out of issuing bonds. Lacking meaningful growth, corporate cash is now directed to share buy-backs and higher dividends.

The Fed, in fact one person, has become the manager of world finance. Talk of pushing negative rates even further negative is alive and well.

Monetary policy has hit the wall – it hasn’t worked at all and fiscal policy is struggling to start. It requires governments to issue yet more debt to fund whatever government-project theorists guess will jump start growth. Defense? Perhaps. Roads? Bridges? Teacher salaries? Schools? Housing?

The velocity of money – how quickly it is circulating and, thus, reflecting economic activity, is at historic lows. This low velocity simply negates the great quantity of money sloshing around in our economy.

As this is written, the risk of rising interest rates is the topic of the day. The bubble – the massive rise in bond prices and concurrent plunge in bond yields – is being more broadly viewed as over. Yes, as Dave Rosenberg put it, we have heard “it’s over” many times before. He equates it to the boy who cried wolf and notes, correctly, that in the end the wolf did, in fact, show up.

The great flood of cheap money, globally, over the last decade did create one very real thing: Massive production overcapacity. We see that reflected in the price of goods. The word is deflation. Take a look at the chart on the next page.

The financial anchor takes this broad form, then,

- failed monetary policy
- negative interest rates
- no savings incentive
- one person controlling global finance
- taxes said to be going higher
- deflation, stalling capital investment
- a reluctant, maybe yes, maybe no, fiscal policy

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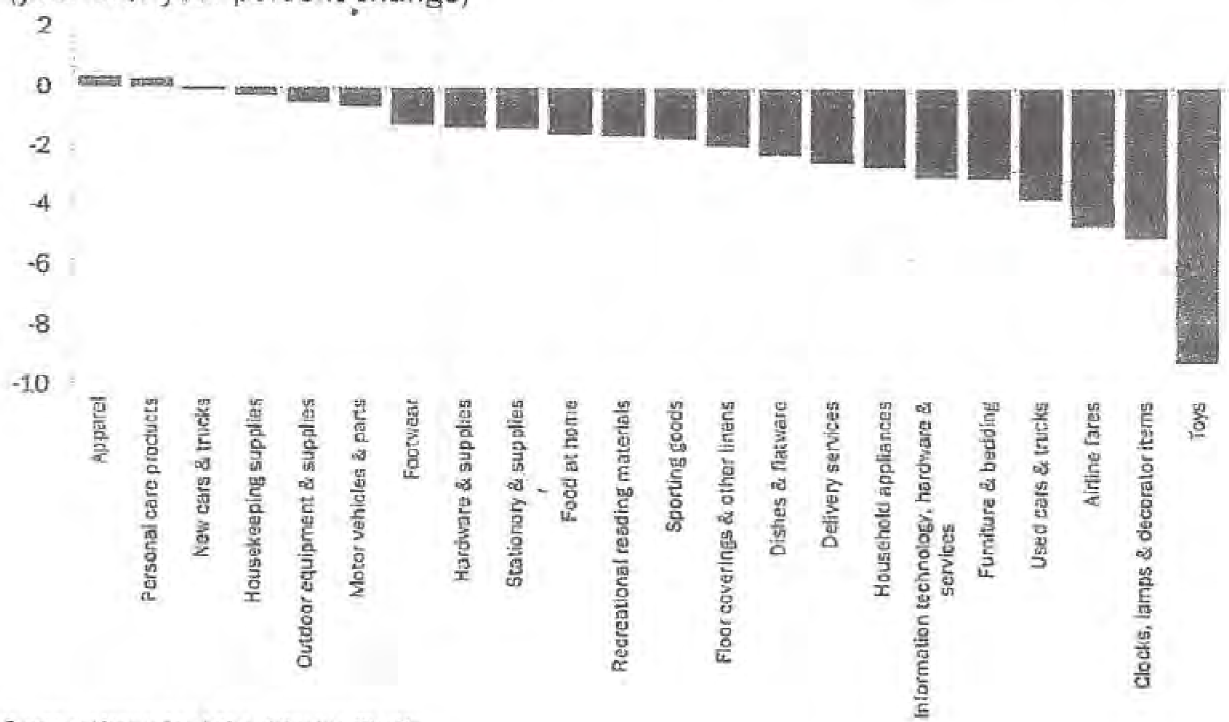
- o excessive debt limiting new spending
- o stagnant money in banks and corporations
- o a bond price bubble growing more obvious
- o the real risk, and need, for higher rates
- o low rates for years to come growing likely

When one stops and looks hard at a list like this, and others have created even longer ones – the thought is that this should be solvable. Kennedy did, Reagan did, Clinton did – what's the barrier? Offered up are the usual reasons: A weak Congress, an out-of-control Fed, uncertain businessmen and equally unsure consumers and, of course, fear and anxiety.

CHART 2: ANYTHING YOU CAN SEE, TOUCH OR FEEL IS DEFLATING

United States: Consumer Price Index Expenditure Categories
(year-over-year percent change)



Source: Haver Analytics, Gluskin Sheff

All well and good. What I think is being totally missed is one very big, very false demographic assumption that must be recognized and dealt with.

Yes, in this country the demographic shift to an older aging population is very real. What and how they consume is tilted to services rather than goods and conservative spending is solidly in

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place. That is seen in service inflation and goods deflation. Further, a growing demographic segment is more than willing to take a handout from the government, be it disability income, welfare or unemployment benefits.

A very large populist segment has arisen. Always there, their arrival in the public spotlight has drawn attention not only to what better times used to look like, but also has drawn attention to the current state of politics, political correctness and the power of college freshmen to shape their parents' world.

These twists in the demographic profile are well known. The real "trouble" in the global demographic profile is the simple fact that world population growth, particularly in the wealthier developed nations, is falling. Live birth rates, save for Africa, are falling behind death rates. Fewer and fewer workers are carrying more and more aged and thus funding the care the aged have been promised.

All economic schools – Keynes, Hayek, Friedman, the lot, had this as their unspoken first premise: Populations would <u>always</u> grow. This is the great fallacy of our time.

We are seeing what happens when birth rates fall, a population ages and, to accelerate it, immigration is restricted. The poster child for this is Japan with its now near 3 decades of zero growth and massive (2½ times the whole economy) debt.

A static or falling population

- cannot produce rising tax revenue from wages or profits to feed government commitments;
- cannot produce the new, incremental demand for goods to justify wage growth;
- does not induce capital spending when sales are poor; and
- will very likely see falling worker productivity for lack of improvement.

Why would what few young people there are want to work harder or smarter to support an aged population when wage gains are nominal at best?

What accrues to all workers when saving money brings no benefits? Does ever cheaper goods induce new demand in a satiated, cynical and anxious population? Maybe toys, but beyond that . . . ?

Deflation is what happens when you have productive capacity geared to continuing growth and that capacity was further made excessive with cheap money. Too many goods, not enough demand.

To my way of thinking, what we need to spike demand – spending – is about 10 years of patchwork policy. In about that time the millennials hopefully will have begun to outgrow their

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dream-world existence and realize that home, family and work can lead to a better place, mentally, than having a Ping-Pong table at "work."

In about that time, we can bridge the current reluctance to spend with

- o Significant middle-class tax cuts – up to and including my favorite – a flat tax. The Roman Emperors long ago discovered "1 in 6" was a rate of taxation the population could live with. Of course, a flat rate by definition means everybody; no carve outs, no exemptions, no special deals. Realistically, a sharp cut to the top personal rate would likely trigger spending. Want more taxpayers? Allow immigration, with tighter rules, to happen on a far broader scale.

- o Not enamored with the idea of a lower corporate rate (because <u>few</u> pay the 35% top rate), I nonetheless would prescribe some relief to the sole proprietor who files as an LLC or S-Corporation through his personal return.

- o Far less focus on compliance laws and regulations, Elizabeth Warren aside. Consumers have <u>some</u> responsibilities and millions of corporate man-hours spent "proving" something on a form is no more than a Washington power trip.

- o Aggressive pursuit of Medicare, Medicaid and disability cheaters would greatly improve attitudes about paying for those truly in need.

- o Perhaps a repeal of Dodd-Frank? Perhaps the return of Glass-Steagall? Perhaps some attitude shift in Washington about American business?

You may have some additions to this list. The point is a very simple one: This mess can be fixed and 4% or 5% growth instigated. Bridge the next 10 years with some meaningful relief and wait for the millennials to grow up.

As we enter 2017, I expect to see continuing positive but very weak, global growth – organic growth if you will – rather than growth from new wealth, new debt or new consumers. I certainly don't see immigration – the solution – being seen as anything less than the problem. Sad, how quickly we forget. Vet them, for Pete's sake, and get on with it. Force assimilation, learn as our grandparents did that to flourish here you have to integrate into the existing society, not create your version of it. Yeah, yeah, I know. You have a better plan?

Plan on low inflation mainly because Central Banks are staying with easy money policies (see *Weekly #342* for my logic). With that easy money and migration issues in the Middle East, I am bullish on defense spending. Syria, for example, is a pivot point: All the factions – Russian, American, Kuwait, Turks, Sunni, etc., etc. are in play there and boundaries of prior nation-states will continue to fall to religious or cultural pockets rather than sovereignties.

As Jacob Shapiro put it in *Geopolitical Futures*, the map of the Middle East of 2001 no longer exists. Libya is no longer a country, Yemen has fallen apart, Lebanon is divided and deadlocked, Egypt and Jordan are under severe strain from both Jihadists and militants, Syria

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has been cut into pieces and Iraq now has 4 different segments. The regional powers – Turkey, Iran, Saudi Arabia and Israel face this and issues among themselves. Years of chaos are yet to come. Lots of smart, hungry talent in that mess, looking for "a chance."

I think under both candidates we'll see fiscal stimulus, starting I think, with military buildup. Construction, housing, industrial goods – all should benefit.

Largest among changes next year will be the further emergence of populism – that movement that is slowly destroying "politically correct" and has far more durability than the "One Percenters" or "Occupy Wall Street." The middle-America voice is going to be much louder and, who knows, it may reach all the way to our elected officials. My last concern is that the Middle East, in fact, totally explodes and Washington can then duck behind that and push aside growing pressure from citizens who would like to see fewer taxes, fewer regulations (with many revoked) and fewer people telling them how to live, work, interrelate and vote.

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