SEMI-MONTHLY FISCAL/MONETARY REPORT - CAPITAL MARKETS GYRATE - THE RUBBER MEETS THE ROAD!!

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Most of the trends we describe in this semi-monthly (or bi-weekly) column are very long term in nature. Day to day capital market trends are driven by short term trading techniques, often driven these days by computers that are making decisions based on price patterns, with no regard for the underlying fundamentals. I believe that the fundamentals drive the price patterns over the long term, not the reverse, and make my financial bets accordingly, in restaurant industry investments as well as broader decisions with my total capital. Lots of market commentators, including the infamous Jim Cramer who is a brilliant short term trader, fit their daily commentary to the daily price action, because there must be a reason that the market was strong or weak today. Trying to "game" the markets day to day is not the way to make money and keep it over the long term, and keeping it can be even tougher than making it, because there are lots of ways to lose.

We believe that a lot of the long term problems that have been overhanging the capital markets for decades are becoming very intense, and are likely to explode in the fairly short term, like a simmering ember prepare to ignite. The deficits, the debit, the spending, the money creation by Central Banks, the suppression of interest rates, the challenging worldwide economy, the wealth gap, the political dysfunction, the social unrest, and I could go on.

The current day to day news flow demonstrates the increasing intensity of the problems.

(1) The US Treasury must raise over $100B every week, to finance the annual deficit and refinance the maturing debt, and the Federal Reserve is no longer a buyer but a seller of securities. Last month's "bid to cover" ratio for two year US Treasuries has been coming down in recent months, last month was the lowest since December 2008. You might remember that this was the peak of the financial crisis of '08-'09.

(2) Major foreign purchasers of our debt, including China, Japan & Russia have backed off or eliminated entirely their purchases of US Treasury securities, to some extent replacing that portion of their foreign reserves with gold. As a corollary, the US trade balance that President Trump is so desperate to improve, would reduce the US dollars in foreign hands, in turn reducing the demand for our securities, contributing to higher interest rates here which slows our economy.

(3) Readers of this column know that we have been skeptical of the apparent strength in our economy, though only six to nine months ago, reporters were talking about "worldwide

synchronized growth" with no sign of inflation, truly a "goldilocks" situation. Headlines in today's Wall Street Journal say "GLOBAL ECONOMIC SLOWDOWN DEEPENS", "INFLATION TICKS HIGHER...", "INTERNATIONAL FIRMS IN US SEE AUTO TARIFFS AS A THREAT". Japan and Germany reported GDP contraction in Q3, Chinese growth continues to slow. So much for Goldilocks.

(4) Jay Powell, our Fed Chairman, has a serious problem. He is committed to raise rates further, and continue to sell off assets (which are only down about 7% from the peak 14 months ago), but higher rates will further stall our economy. His other choice is to back off, even do QE4 in some form, ignite inflation (and a run on gold), but that has its own risk of economic disruption. We may already be in an unrecognized "stagflation".

(4) The US current deficit will clearly be over $1 trillion in FY ending 9/30/19, with the total debt going up by more like $1.5T including borrowing from the Social Security Fund. There is no chance of less government spending, especially the next two years with the two houses of Congress split. According to the Wall Street Journal last week, the US will spend more on interest in 2020 than it spends on Medicaid, more in 2023 than it spends on national defense, and more in 2025 than it spends on all nondefense discretionary programs combined. *THIS IS SERIOUS, AND IT IS IMMINENT. The relevance of the deficits and debt is that the higher the debt load, the chance of the economy breaking out with productive expansion is reduced.*

(5) The long term suppression of interest rates has serious unintended consequences. Among them is the "misallocation of resources" as investors large and small "reach for yield". The current news flow is starting to reflect it. Today's Wall Street Journal has the headline DEMAND FOR RISKIER DEBT LETS COMPANIES SHIFT ASSETS. The text starts...."Investors are literally giving away the store to squeeze out meager returns from picked over market for corporate debt. Demand for riskier bonds and loans has been so intense that companies...are able to move valuable assets beyond the reach of creditors. Investors continue to make it easier for them to do so by agreeing to terms ...that offer fewer and fewer protections." The financial community has a very short memory. Ten years ago, the phrase was "covenant light", and mortgage companies were making NINJA loans to homeowners with No Income No Job, and No Assets. Who said, "history doesn't repeat, but it rhymes"?

(5) Don't take it from me. I'm just a veteran restaurant analyst. What could I know? However, within the last few months: Richard Fisher, former Dallas Fed Chair said: "...interest expense and healthcare expenditures will soon be more than 50% of revenues. At some point you have to pay the piper...We (the Fed) have been suppressing the yield curve..if rates rise, it's a ticking time bomb".

Ludwig von Mises, the legendary Austrian economist long ago provided a succinct summary: "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come soon as the result of voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

Unfortunately, though Jay Powell, and other Central Bankers, might wish to persist in (just the beginning) of their collective attempt to contract credit, the politicians around the world can be expected to continue to kick the can down the road. Their unstated reality is "whatever happens will happen, but "not on my watch." Politicians, economists, and capital market strategists, will soon be screaming "DO SOMETHING" and the Central Bankers will accomodate. The best we can do is to stay physically fit and financially flexible.

Roger Lipton