

# Views From the Stream

July, 2021

The Monthly Letter covers two topics this month. First, we provide Part 1 of our Global Economic Quarterly. Many Global Central Banks have declared an end to the emergency policies adopted over the past 18 months to fight the Pandemic and a return to normal. However, actions by Central Banks may not just repeat policies followed before the Pandemic. With government policy goals focused on accelerating economic growth and geopolitical strife, the economic policies they need to achieve these goals differ markedly from the 2009 – 2019 era. Given this, a Return to Normal may not mean what most observers expect. Second, we address the recent political movements in the United States that arose to push certain viewpoints at the expense of basic liberties. These views appear inconsistent with the Bill of Rights but have arisen cyclically in US history. As has occurred as well, a countermovement appears underway to reestablish the basic freedoms under The Constitution. And Third, as always, we close with brief comments of interest to our readers.

## Global Economic Quarterly Part 1: A Turn in Policy & There You Go Again

*“There you go again.”*

Second US Presidential Debate, 1980  
Candidate Ronald Reagan to President Jimmy Carter

With the Pandemic headed into the rearview mirror, Central Banks around the world signaled their intent to normalize policy over the next year. This means, essentially, an end to non-traditional policy, such as Quantitative Easing (QE), coupled with a return to the type of monetary policy followed prior to the Pandemic, dependent on the country. Or, at least, that represents the picture as presented to the public by institutions such as the Federal Reserve and retold by the press. However, there exists a critical assumption behind this picture: the world of today requires the same policies or seeks to achieve the same policy results as prior to the Pandemic. Both of these represent questionable assumptions at best. And, if these assumptions turn out less than true, as governments desire a different economic result than before the Pandemic, then a different policy mix will ensue. Thus, A Turn In Policy may not mean what most observers assume.

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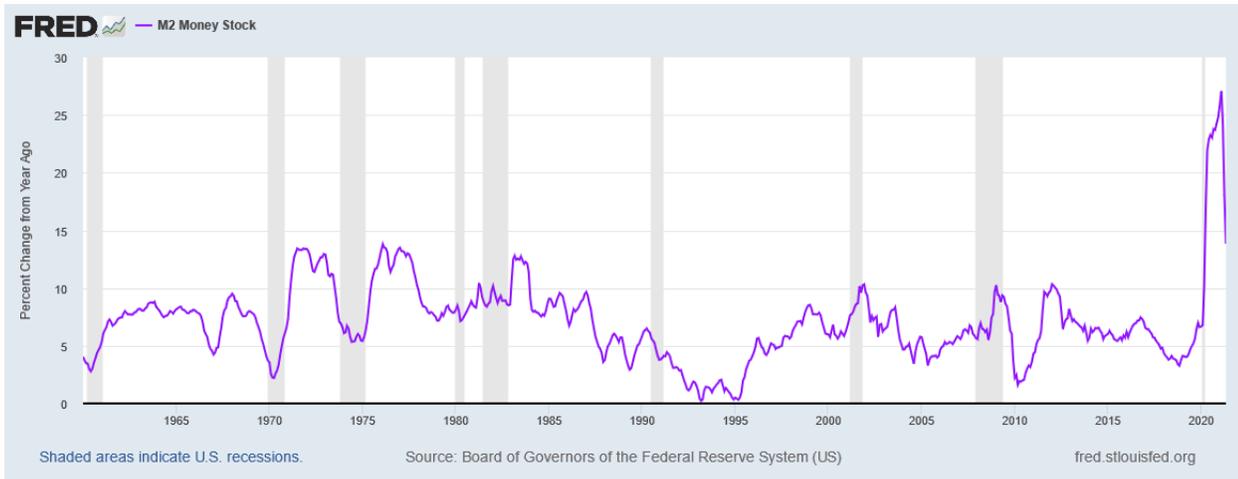
A simple example will demonstrate this issue. Prior to the Pandemic, the European Central Bank (ECB) utilized a policy mix that delivered little to no economic growth for a large portion of the EU. Specifically, the Southern European Countries, such as Italy and Greece, never shook off the aftereffects from the 2008 – 2009 Financial Crisis and Recession such that they produced real economic growth over the past decade. And, as pointed out in this month’s Views From The Stream, Italy’s economy stands at the same size as in 2000, when it joined the European Union. This poor growth stands in contrast to the growth obtained by the Northern European Countries. These economies all produced solid economic growth over the past decade. Should such an outcome continue, the odds of the European Union remaining intact stand somewhere between slim and none. The following chart illustrates the change in ECB policy over the past two years:



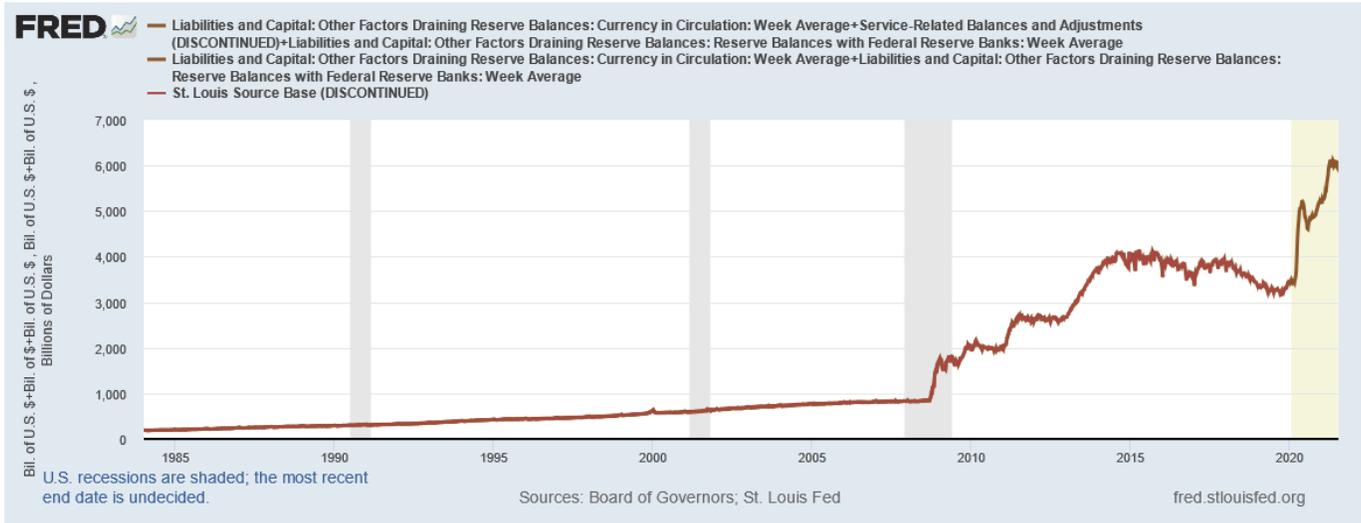
As the chart demonstrates, monetary growth returned to the level achieved from 2000 – 2007. During this time, money expanded at a pace that allowed for both inflation and economic growth. And given recent comments by Madame Lagarde, the head of the ECB, the ECB plans to continue its QE over the next one to two years to ensure that money growth accommodates economic growth. Thus, monetary policy will not look like the growth posted prior to the Pandemic.

This then brings us to the US Federal Reserve. The US faces a global geopolitical environment that will require its economy to grow more rapidly to meet its challenges and fund its policy goals. This will require three things to happen simultaneously. First, Nominal GDP Growth must accelerate. Second, Fiscal Policy must maintain a neutral to expansionary posture. And Third, the Federal Reserve must control Interest Rates as it did in the past. The chart below lays out US M2 Growth Year-Over-Year, one of the core monetary aggregates:

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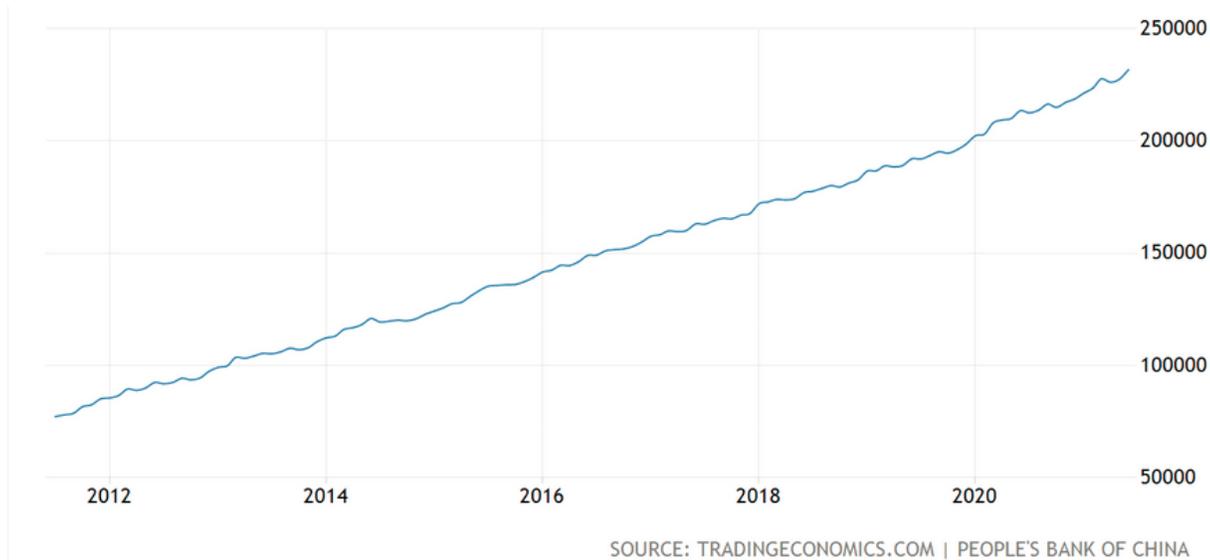


The chart clearly demonstrates the emergency liquification of the US economy conducted by the Federal Reserve to support the massive government spending put in place to counter the Pandemic, with year-over-year money growth exceeding 25%. The last time this occurred was during the 1930s Great Depression and the 1940s during World War II. While many observers expect the Federal Reserve to normalize policy over the next 12 – 18 months to pre-pandemic monetary policy, in which the Federal Reserve shrank money to attempt to offset the massive increase created by QE after the 2008 – 2009 Recession, this seems unlikely. That attempt to rein in money led to shrinking money supply for several years, producing a significant economic slowdown starting in 2018, once the positive impacts from the 2017 tax cuts ended.



This stands the exact opposite of policy goals today. Given geopolitical realities, the US must accelerate both Nominal GDP Growth, to normalize US Debt to GDP, and Real GDP Growth, to support government objectives and increase Real Incomes. In effect, the US must run a wartime economic policy, much as China did over the past decade to boost its growth, in which the Federal Government runs massive budget deficits and the Central Bank finances the government. In addition, such policy would see the government manage interest rates at the same time as it creates significant inflation. And while the Federal Reserve may talk of “normalizing” policy, the political reality stands opposed to such actions. Thus, normalization likely means a return to early 2000’s money growth to ensure Nominal GDP Growth remains strong or the type of policy followed from 1937 until 1949.

China may stand the exception of the larger economy Central Banks. The PBOC expanded money supply at a steady rate over the past decade, without interruption, and continues to do so. This supported, along with government spending, strong steady GDP Growth. The following chart illustrates the steady continued money growth:



Given China's continued GDP Growth Rate of 6%+, as dictated by the Communist Party leaders in Beijing, monetary and economic policy likely will maintain a steady course for the foreseeable future, as this will continue China's march to becoming the most powerful economy and country in the world no later than 2050 and the largest economy in the world by 2030.

For EM Central Banks, such as Brazil, the reality of their economies and inflation, will force their Central Banks to act. Already, a number of EM Central Banks have announced rate hikes. And more are expected to follow as inflation accelerates in many of these countries. This will put the EM economies much closer to "orthodox" monetary policy than Developed Market (DM) economies or China. The question that EM Central Banks will face over the next few years relates to the continued decoupling of the Chinese and US economies and the economic fallout. The EM economies benefitted as China grabbed global market share to goose its economy at the expense of the rest of the world. As the rest of the world organizes to put an end to this policy, EM economies and Central Banks will face difficult policy choices in terms of driving future economic growth. All of this will make Central Bank policy decisions difficult and continued rapid growth a challenge for many Emerging Market economies.

Layered on top of Global Central Banks enacting A Turn in Policy stands China's Made In China 2025 economic plan. This plan seeks to make China independent of the rest of the world economically and to enable China to create surplus production in its Command Economy to export goods to the rest of the world and to undercut foreign companies and thus foreign economies from geopolitical rivals. And for those who think China stopped stealing global IP and ceased expanding production in China to displace foreign production over the past few years, as foreign nations protested this policy, nothing could exist

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further from the truth. This policy continues apace across multiple industries as China attempts to localize all production across supply chains, excluding raw materials, in a classic implementation of Mercantilist economic policy. A simple example of MLCC's will make this clear.

MLCC stands for Multi-Layer Ceramic Capacitor. MLCCs are critical components in almost all electronics. And thus, stand as one of the key building blocks to manufacture technology products. China plans to follow the same game plan it followed with Ceramic Inks and with LCD Panel Production. China's "localization" of Ceramic Inks stood at less than 10% in 2011. As China had developed a large end market for Ceramic Inks, the government decided that production should become localized, with Chinese companies supplying the vast majority of the domestic market. In order to accomplish this, China established a number of national champions. By 2016, these companies achieved a localization rate in excess of 85% and had established market share outside of China through exports of these products. LCD Panels exhibit a similar story. From less than 10% of global production in 2014, China grew its global share to almost 50% today. Funded by the Chinese government, China continuously expanded production over the past 7 years, even when the global industry lost money in 2019 on a cash basis. This forced competing countries to shutter capacity in the face of an onslaught of Chinese capacity.

Let us fast forward to today. In 2015, Chinese manufacturers of MLCCs possessed less than 2% global market share. By 2019, Chinese manufacturers of MLCCs held 8% of global capacity. By the end of this year, 2021, these same companies will grow their global share to 23%. In addition, with continued subsidies from the Chinese government, these companies continue to undercut pricing of Japanese, American, and European firms in global markets by 10% or more in order to gain share. China's policy projects Chinese companies achieving a 40% - 50% global share by 2025 through continued capacity expansion funded by the central and local governments, creating a dominant global position at the expense of foreign rivals. In the immortal words of Candidate Ronald Reagan, uttered in 1980, "There you go again."

Such economic policies continue to not play well in Washington, Paris, New Delhi, and Tokyo. With China focused on its Made in China 2025 policy, rising economic conflict with its trading partners seems inevitable. Companies continue to move the next generation of production out of China, lest they get caught in the crossfire. And with Washington, D.C. officially warning U.S. companies about the risks of doing continued business in Hong Kong, such next generation production flight should accelerate. Should the public in Western democracies become aware of these Chinese policies that are undermining Western companies and jobs, pressure will rise on Western governments to accelerate company exodus and to act to stop the impact on their economies from these Mercantilist policies. For companies such as Nike and Apple that have major operations in China, that continue to expand their presence there despite government requests to rethink these policies, the future may become difficult as they are forced to change their modus operandi. And for those who thought the Biden Administration policy towards China

would ease compared to the Trump Administration, such ideals were crushed by the reality of China's economic policy, leaving the Biden Administration little choice but to ratchet up Trump Administration policies. For Emerging Markets in Asia, this will produce some short term gains. However, with the U.S. focused on reshoring production across critical industries, pressure will grow on U.S. companies to relocate factories back to the U.S. for national security reasons. And with rising technology export controls, future technology production will have to occur in the U.S. across many new products, regardless of company profit goals. For China, without the domestic consumption base to support its massive production, such a change in policy will create significant economic problems. And Chinese economic growth should decelerate sharply after 2025, as the lagged impact of capacity relocation and an acceleration of decoupling come full swing.

Given the above, assumptions about Central Bank policy and Global Growth must endure deep inspection. Else, it will become easy to assume that the policies and economic growth in the 2020s will look much like the decade of the 2010s, when the fundamentals dictate a different outcome. With numerous cross-currents likely to effect everything from where basic parts for cars are manufactured to the location of high tech production across semiconductors, fiber optics, advanced materials, biotech, and robotics as well as other critical technologies, along with Central Banks more beholden to supporting national economic and geopolitical goals, country winners and losers will differ dramatically this decade. And with DM economies more focused on National Security and Geo-Politics, little will seem the same. For those used to the familiar guideposts of the past 20 years, it will come as a shock as they must adjust to the reality of A Turn in Central Bank Policy and There You Go Again.

## **A Nation of Immigrants: The Constitution, The Bill of Rights, & E Pluribus Unum**

*Not like the brazen giant of Greek fame,  
With conquering limbs astride from land to land;  
Here at our sea-washed, sunset gates shall stand  
A mighty woman with a torch, whose flame  
Is the imprisoned lightening, and her name  
Mother of Exiles. From her beacon-hand  
Glowes worldwide welcome; her mild eyes command  
The air-bridged harbor that twin cities frame.  
"Keep, ancient lands, your storied pomp!" cries she  
With silent lips. "Give me your tired, your poor,  
The wretched refuse of your teeming shore.*

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*Send these, the homeless, the tempest-tost to me,  
I lift my lamp beside the golden door!"*

The New Colossus

By Emma Lazarus

Published November 2, 1883

Inscribed on a Plaque At the Base of The Statue of Liberty, 1903

Racial politics have moved to the foreground over the past few years through movements such as Black Lives Matter and the adoption of ideas espoused by such philosophies as Critical Race Theory in colleges and universities as well as the public schools. These movements and their leaders focus on equality of outcome and assume other racial groups in the United States are racist due to either the color of their skin or their ethnic background. They focus on redistribution of wealth within the society, following the philosophies espoused by former Black leaders, such as Malcolm X. In addition, they decry any opposition to these policies as racist, in order to forestall public discussion of the policies and how they might impact other minority groups, such as Asians or Hispanics. As part of this philosophy, these groups have moved to prevent those who oppose their goals from stating their views. Over the past several years, they have run speakers off stage, moved to suppress the publication of books and articles, and forced the resignations of those who oppose their views by labeling them as racist.

For those not familiar with US history, the United States possesses a long history of suppressing free speech followed by public reaction that expands the freedom of expression. These vacillations in the approach to freedom of expression relate to the tension between the rights enumerated in the Declaration of Independence and The Constitution and the political goals of those in the corridors of power in Washington, D.C. or hoping to achieve various political goals. In order to pass the Constitution, the U.S. adopted the Bill of Rights, which includes the first 10 Amendments to the Constitution. They were written by James Madison, one of the key figures in the victorious American side. The Bill of Rights focuses on the basic freedoms all Americans should possess that the British continuously violated during the runup to the American Revolution, from the 1750s to the 1770s. The First Amendment to the Constitution lays out the approach to freedom of expression:

*Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.*

It is from this Amendment that the Supreme Court, along with one of the Amendments passed after the Civil War, expanded freedom of expression in the U.S. throughout the late 1800s and into the 20<sup>th</sup> Century.

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The initial actions to suppress speech reach back to the decade after the Constitution was adopted. This occurred through the Alien & Sedition Acts of 1798. John Adams and the Federalists won the Presidency in 1796. They wanted to advantage themselves against Thomas Jefferson and the Republican Party. In order to do this, they enacted four laws. These laws allowed the government to deport foreign nationals, to extend the time as a resident before citizenship was granted, and to prosecute for sedition those who spoke against the government or opposed any “measure” of the government. Numerous Republican newspaper publishers and even Congressmen were prosecuted under the Act and thrown in jail for opposing the policies of the Federalists. The country reacted negatively to these government actions, electing Thomas Jefferson as President in 1800.

In addition to political attempts to suppress speech, wartime typically led to restrictions on freedom of expression and other liberties. During the Civil War, President Lincoln famously restricted freedom of the press in order to support the North’s war effort. This included jailing dissident publishers as well as confiscating and destroying newspapers that published articles opposed to government policy. If one fast forwards to World War II, the U.S. famously interned Japanese Americans in camps during the war to protect the United States from potential sabotage or spying.

After World War II, another movement arose to suppress citizens’ freedom of expression. This came in the form of the anti-Communist movement identified with the House Un-American Affairs Committee (HUAC) in the House of Representatives and Senator Joseph McCarthy in the U.S. Senate. These actions came about due to the famous Alger Hiss spy case. In this instance, dissenting against the government on communism led to destruction of one’s career. This became especially true for Hollywood where over 300 people were famously blacklisted. Eventually, through hearings, it became clear that the government overreached and accused innocent people. Thus, a huge reversal occurred in personal expression. This led to the 1960s whereby there were numerous anti-war protests, Civil Rights protests, and significant expansion of the ability to express oneself. This culminated in the famous 1971 case of *New York Times vs. United States*, whereby the Supreme Court effectively banned pre-publication censorship.

If we fast forward to today, the Woke Movement and Black Lives Matter bear striking resemblance to prior episodes in U.S. history of attempts to ban opposite points of view. They argue that any point of view that differs from them, should be banned. They believe that any public icon they find distasteful should be removed from view, including those of Thomas Jefferson, who famously wrote *The Declaration of Independence*. They demand that those who publish points of view that differ should find their works removed from both physical and online bookstores. They pressure institutions in order that people who argue against their points of view in academia or the media should be fired. If one steps back and examines these points of view, they bear striking resemblance to those under the Alien & Sedition Acts as

well as McCarthyism during the 1950s. For America, these arguments appear to have come full circle back to the fundamental disagreements in the country that began almost 250 years ago.

Should the Civil Rights leaders of the 1960s or those who allied themselves with these leaders at that time, such as the ACLU, examine recent actions by these groups, they would view such attempts to suppress speech and publications as counter to the basic freedoms for which they fought. In fact, such actions stand counter to much of the philosophy espoused by Dr. Martin Luther King, who focused on equality of opportunity and basic civil rights, harking back to the basic philosophy announced in The Declaration of Independence and The Constitution. This approach led to much of the success of the Civil Rights movement and the adoption of many of the policies it espoused by the U.S. in the 1960s and 1970s against much opposition, as Congress acted and the country moved to right past wrongs. Dr. King most famously stated his view in his I Have A Dream speech, where he laid out his ideal of a color blind America:

*“I have a dream that one day on the red hills of Georgia, the sons of former slaves and the sons of former slave owners will be able to sit down together at the table of brotherhood.”*

*I have a dream that one day even the state of Mississippi, a state sweltering with the heat of injustice, sweltering with the heat of oppression will be transformed into an oasis of freedom and justice.*

*I have a dream that my four little children will one day live in a nation where they will not be judged by the color of their skin but by the content of their character. I have a dream today.”*

I Have A Dream  
Dr. Martin Luther King, 1963

As occurred in past instances of suppression of basic freedoms, a counter-movement has arisen to bring focus back to the Constitution and the Bill of Rights. Various organizations, across the political spectrum, have allied to open up debate and once more allow freedom of speech to occur. New organizations have formed to oppose the teaching that some racial groups are racist just by the color of their skin. Other groups have formed to enable freedom of publication and oppose the banning of works, both scholarly and fiction, by those that oppose their viewpoint. What these groups possess in common is a belief in The Bill of Rights and a long line of Supreme Court cases upholding these basic freedoms that stretches back over 100 years. They hark back to the Jeffersonian tradition, as stated in The Declaration of Independence, “that all men are created equal, that they are endowed by their Creator with certain unalienable rights, that among these are Life, Liberty, and the pursuit of Happiness”. And they believe in the preamble to the U.S. Constitution:

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*We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.*

As has occurred time and time again in U.S. history, those that hold these truths to be self-evident have fought back to re-establish the basic freedoms as granted in The Bill of Rights. And once again, it appears the pendulum has begun to swing towards expanding the basic freedoms of expression including speech and the press. With the pendulum moving once more, as evidenced in recent elections, it appears the motto of The United States of America, E Pluribus Unum, “Out of Many One”, with its cacophony of viewpoints which turns into a soaring symphony, is moving into ascendance once more.

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## **Leaving On A Jet Plane, Over The Top, and Shop Till You Drop**

Finally, we close with brief comments on Leaving On A Jet Plane, Over The Top, and Shop Till You Drop. First, airline travel in the US continues to explode upward. According to airline data, Americans traveled more in July than in July 2019. This represents a full recovery for domestic US travel. And, with international travel starting to reopen, global travel should fully recover over the next year. Given this, we see Americans once more Leaving On A Jet Plane. Second, a new wave of corporate mergers and acquisitions appears underway. With the recovery in the economy and corporate profits coupled with large corporations record cash balances, companies have begun to deploy these balances. However, it appears the prices paid are commensurate with the record cash balances. Recent announced transactions include several whereby the acquiror paid more than 20x EBITDA and others at more than 10x Revenue. The long term history of paying such high prices is typically poor returns for the acquiror. As such, we see corporate acquisitions as Over The Top. And Third, consumers continue to normalize their lives. Recent data confirm the switch to in person shopping. Department store sales exploded over the past six months as vaccinations rolled out. At the same time, online sellers, such as Amazon, have seen a major slowdown in their revenue growth. With consumers hankering to get out, we see a return to the 1980s and Shop Till You Drop.

### **In Closing**

Should you have any questions on how the above issues or the items discussed in our accompanying cover letter impact your family's financial position or your business's future as well as the potential actions you could take in response, please do not hesitate to contact us. We welcome the opportunity to discuss this with you.

Yours Truly,

Paul L. Sloate  
Chief Executive Officer  
& Senior Advisor

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