The Chance Financial Quarterly

This is the third issue of my newsletter and covers the second quarter of 2023. Feel free to pass this on to others, and they can request a free subscription. In this issue, I am going to cut down on the number of words I use to recap the economy and try to give you the highlights, emphasizing what is most important. Also, go further down for the educational piece I provide on making sense of this stupid debt ceiling debate we saw last quarter and will see again in the not too distant future.

Making Sense of the Market and Economy

The second quarter was pretty good, though the Fed is taking credit for it, and it doesn't deserve it. Like an overturned kayak, economies have self-correcting mechanisms to right themselves. I'll explain that in a future issue.

We saw the S&P 500 increase 8.3%, making the year-to-date increase be a little less than 16%, Now, keep in mind this is way too high on a historical basis, so don't be surprised if there is a modest correction or at least a slowdown in the second half. On the other hand, another 8% rise would get us to the all-time high, which you should understand was unjustifiably elevated. Of course, we'll take it but don't expect to keep setting records.

With respect to GDP, that number you hear often and of which economists are gaga over, we don't get the second quarter numbers until August 30, so we can only now report the first quarter number, which was 2%. This was lower than the previous quarter number, 2.6%. Many economists freak out over changes like that, but in a later issue, I will explain GDP and why it is not that important.

The unemployment rate for June was 3.6% and has been mostly unchanged for about the last year.   The unemployment rate is a good indicator of whether the economy is overheated, which is what makes the Fed keep interest rates high. The unemployment rate has not varied much in a year and a half, during which time the Fed believed the economy was overheated. But the economy had about the same rate in 29018 and 2019 and faster GDP growth, during which time the Fed did not believe the economy was overheated. But now it's punishing us with high interest rates to cool off something that isn't hot.

Inflation is coming down, no thanks to the Fed, which thinks its policies are achieving this result. Inflation has dropped from 4.34% in April to 3.85% in May to 3.00% in June. Prices are still rising, just at a lower rate. We need that number down to below 1%.

Mortgage rates are still high, at around 7%. The average house price peaked about a year ago at $307,000 and fell to $283,000 in January. It's at $301,000 in April, the latest date for which this information is available. Not a great time to be borrowing money to buy a house.

And speaking of borrowing money, don't keep your money in bank CDs and savings accounts. No, they're still safe, but you're lending money to banks and they're paying you a ridiculously low rate of interest. Let me give you an example from Chase. A federally insured one-month CD, which ties up your money for the month, pays 0.01% for under $10,000, and 0.02% if you give them more money. Vanguard's Federal Money Market Fund is currently paying 5.18%, and you can get your money out at any time. It's technically not FDIC-insured, but it invests in U. S. Treasury securities. This is de facto the same guarantee as the FDIC gives. It's all backed by the federal government. Don't leave money on the table by being one of those ignorant customers banks depend on to make billions in profits.

Now, back to the story. Fortunately, the Fed put a temporary hold on its ridiculous policy of jacking up interest rates. In a future issue I'll explain what it means when you hear about the Fed raising interest rates and why it's bad policy.

My overall take on the economy is that it is ever-so-slightly improving. If that continues, the Biden administration and the Fed will take plenty of unjustified credit. The government and the Fed can hurt an economy and do a few things to nudge it forward. But economies largely move in cycles that self-correct. I expect the stock market to slow a bit in the second half of the year. While you all want it to keep up the pace, an excessively exuberant Wall Street is not a good thing and will come back to haunt us. If the market were flat the rest of the year, we'd still make about 16%, which is considerably higher than the long run average, and we'd not likely face a massive correction later.

A Teaching Moment: The Insanity of the Debt Ceiling Debate

So, during the second quarter of 2023, one of the biggest financial stories was the standoff between Republicans and Democrats over the debt ceiling. As you know, this happens every few years. Congress sets a limit on the total amount of debt the federal government can take on. When we get close to that number, both sides try to act like champions of the American people, instead of the politicians they really are. But this whole debate is so misguided, it's hard to overemphasize how stupid both sides were.

$31 trillion. That's the federal government debt. Does that bother you? It probably does, but then, if I asked you if you think Apple, with about $300 billion of debt, is in trouble, you'd think probably not. You'd likely just look at one of your Apple products and figure they can handle it. Just so you know, the value of Apple's equity is around $3 trillion. They can handle it.

But no one ever looks at the size of the US economy. GDP, which I'll cover in another newsletter, doesn't even come close to showing the real picture of how truly BIG this economy is.

We as taxpayers are responsible for the debt, so let's find out what is the combined wealth of all US citizens. Credit Suisse produces an annual estimate of that number. The last figure it reported was $145 trillion.

Moreover, most of the federal debt is owed to ourselves. The Social Security Administration parks $6.9 trillion of your payroll deductions in government bonds. The Federal Reserve owns $5.9 trillion. We, ourselves, own $11 trillion. So that leaves the real debt at about $7 trillion, which is owed to foreigners. (By the way, think China is our biggest creditor? Nope. It's Japan.)

So, when netting out all we owe to ourselves, the US government is roughly $7 trillion in debt, which is backed by wealth of $145 trillion. This ratio is roughly equivalent to a person owning a $300,000 house and having about $14,000 of debt on it.

Now, it's true that the debt has been growing at too fast of a pace. Since 2000, federal debt has grown at a rate of 8%, while wealth, as estimated by Credit Suisse, has grown at a rate of about 6%. We need to slow the rate of growth of debt but not by having this debt ceiling standoff every few years. A better method would be to allow debt to grow at a fixed rate of 5-6% a year or so, provided wealth can continue to grow at about that rate.

But that would make too much sense, because, well, it would pretty much solve the problem permanently and take away the chance for politicians on both sides to look like they're champions of the American people.

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