



# FLD

# Connection

## NOVEMBER 2022

### FALL ISSUE

This year's PNW fall has looked a little more like our San Diego days with 80-degree weather and sunshine! Gina was happy her dahlias were still in full bloom into late October! More recently, however, the colorful leaves and the brisk morning air has reminded us why we love Autumn in Washington.

As the holidays quickly approach, we wish you a season full of joy and beautiful memories with family and friends. Check out the recipe section for a delicious fall meal that is meant to be shared!

As always, we are proud to present James' original economic commentary discussing the current market trends, and we look forward to serving you in 2023! Happy Thanksgiving!

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# ECONOMIC COMMENTARY

## WHERE'S THE LIQUIDITY?



by James Pafundi

Here in the Pacific Northwest, summer was late to arrive. Mid-July was still wet with temperatures in the mid 60's. Just as I was beginning to wonder if summer would ever get here, it did, and what a beautiful summer season it was! It was also a little late to leave. Mid-October is usually 50's and rainy, but not this year. It was blue skies and mid-80's for a lot of the month. A lot of the locals were beginning to wonder if it would ever rain again. One thing I have learned about the PNW (after living here for the past 10 years) is that by the end of the summer, all the plants and trees are screaming for water. Even some of the mighty Evergreen trees start to show signs of water stress. Regular rain is very important to this area.

And that got me thinking. Liquidity is also very important in the financial markets, too. In a financial sense, liquidity is measured by the ability to match a buyer with a seller, or a seller with a buyer, in an orderly way. This makes for a market that flows like water. When this happens, you would say the market is "liquid."

I've been getting a lot of questions from clients recently asking, "Is this another 2008?" And my best answer is, "No. I do not think this is a repeat of 2008." Let me explain:

During the 2008/2009 Great Financial Crisis (GFC), interbank lending seized up, causing a **liquidity crisis between banks**, forcing the Fed to create an entirely new market mechanism called Special Purpose Vehicles. This allowed the Fed to step in with the \$750 Billion Troubled Asset Relief Program (TARP). This capital injection by the Fed liquified the banks again, allowing banks to lend to each other without the fear of not being paid back.

If liquidity makes the world go round and the lack of liquidity caused the worst of the 2008 crisis, then it makes sense to ask, "Do we have any signs of liquidity issues in financial markets now?" No, not currently. "What about the banks? Do they have liquidity issues today?" No. Because of the Dodd Franck Act, a direct result of the GFC, Banks now have over \$3 Trillion in reserves. They only had \$35 Billion in 2008.

So, if we are not seeing liquidity issues in the banks, are we seeing it anywhere else? And if so, where? Let's take a little trip across the pond, shall we?

### THE BANK OF ENGLAND

Recently, you may have heard that the Bank of England (BoE) had to intervene as an unlimited buyer of British Government Bonds or Guilt. They were forced to do this because the value of government bonds owned by pension funds dropped in value, triggering a capital call that the pensions could not meet. Pensions then went to the Government and asked for a bailout. Kinda demanded, really. The BOE, to avoid bankrupt pensions (because that would be good for nobody), agreed to **start buying an unlimited amount of Government Bonds** for the next few days, thus increasing prices and avoiding additional capital requirements. In this instance, they were providing **liquidity to the system**.

And the Bank of England can do this because they own a printing press, which provides them with unlimited British Pounds. If they need more money, they simply print more of it. And they did.

Now, there are consequences for printing more money and adding it to the system. It devalues all the other British Pounds currently in existence. That is why the British Pound is at an all-time low against the US Dollar.

### Pound against the US dollar



Source: Bank of England, Bloomberg

Okay, so there were liquidity issues in England and the BOE injected liquidity into the system. Any other liquidity issues? Yep.

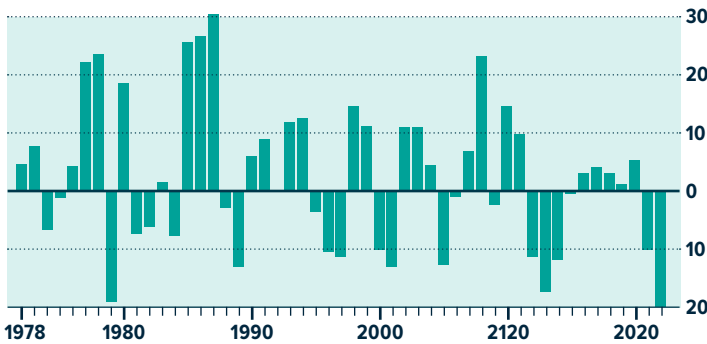
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## BANK OF JAPAN

In April of 2022, the BOJ intervened in their currency market to defend the Yen and **offered to buy an unlimited amount of Japanese 10 yr. bonds**. They bought more bonds than they had ever purchased since the BOJ started buying bonds back in 2002. They injected liquidity into their financial system. Then, a few weeks ago, value of the Japanese currency (Yen) again was dropping significantly against the US Dollar.

### Japan's Yen in Historic Drop

Annual % change against US dollar



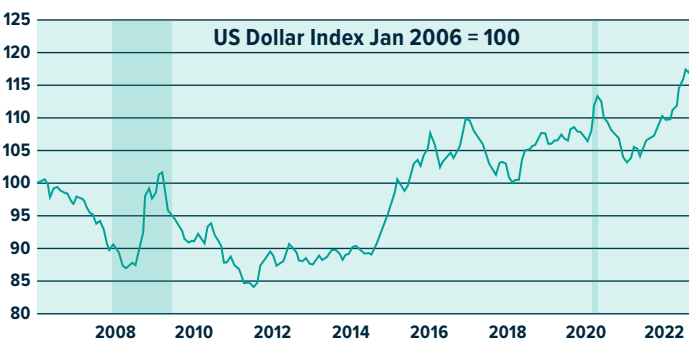
According to Bloomberg, on Friday, October 24th, Japan likely conducted its biggest ever currency intervention to prop up the yen late Friday...

The size of the suspected market action is estimated to be as much as 5.5 trillion yen (\$36.8 billion).

Only this time, they didn't buy their own bonds with printed Yen from the BOJ. They couldn't without devaluing the Yen, which is exactly what they wanted to avoid. They did it with their US Dollar reserves. As of April 2022, the BOJ had \$110B in Dollar reserves. So how many more times can BOJ intervene on this level before they run out of Dollars? Two more times? Then they will need to start selling their \$5.5T worth of U.S. Treasuries.

## FEDERAL RESERVE

### U.S. Dollar Index



Shaded areas indicate recessions.

Source: Board of Governors of the Federal Reserve System (US)

With what's going with the other central banks, rumors started to circulate that the Treasury market might have some liquidity issues, especially if foreign countries start selling their Treasuries. The Treasury market is the driver of the entire global system.

One of the top fixed income analysts is from Bank of America, Mark Cabana. In a recent piece, Mark said, "In our view, declining liquidity represents one of the greatest threats today and despite its importance, the sector has had limited information which has made it difficult to fully understand its total market and size."

Then, on October 24th, according to Reuters, the same day as the Bank of Japan's \$36B currency intervention, Janet Yellen said, "The U.S. Treasury is taking steps to strengthen the resilience of the Treasury debt market and private money market and bond funds, but the U.S. financial system is functioning well, despite elevated global volatility."

It looks like the Fed is moving in advance of what could be some tighter liquidity in the US Treasury market. Remember, they've already been through something like this in 2008, but this time they are prepared. And remember, the Fed has a printing press too. They could always, as a last resort, start printing more dollars to plug the holes in the liquidity issues.

### WHAT DOES THIS MEAN?

For now, The Fed wants to blindly pursue their quest to get inflation down and has stated emphatically that they "are committed to it." But deteriorating market functioning could force them to intervene. "It is our goal. It is going to be very challenging," Powell said. "The question of whether we're able to accomplish that is **going to depend to some extent on factors that we don't control.**"

They are committed to it unless something else happens. If liquidity dries up, then all things may change.

So, is this like 2008? Not even close. Why? Because where we are seeing liquidity issues is on the Sovereign level, not the local or bank level. And that is a huge difference. The Federal Reserve of the United States, like the Bank of England and the Bank of Japan, have the power of the printing press, which can be used at their discretion. That does not mean that markets can't go down, or that there won't be some other type of crisis. In my opinion, it's just not going to be a liquidity crisis like 2008.

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# China Has Some Big Problems

China has some big problems.... Food, energy, demographics, trade wars since the Trump era. Has China just been sent back to the Dark Ages by the Biden Administration? If so, what does this mean to you?

This is some big news with massive implications. Wealth of a nation has always been based upon the resources that they have, such as oil.

## Semiconductors... The new oil.

### A little history

Bell Laboratories developed the transistor in 1947. Integrated Circuit was created by Kilby of Texas Instruments and Fairchild semiconductor. It marked the dawn of the IC era. 1967-1970 began the age of the microprocessor. TI developed the desktop calculator, a huge step forward. Now semiconductors are used in every corner of our society, and we rely upon them in our everyday life.

Video games, mobile phones, computers etc.... All started in the USA. Demand has grown and continued growth is expected. Below shows how the supply of semiconductors are currently used:

- **11% Auto**
- **30% Communications**
- **12% Industrial**
- **35% Data Processing/servers**
- **11% Consumer Electronics**

Anything that powers on has some type of a chip in it. And we are going to need more chips and more advanced chips.

China has massive demand for chips, too. In 2020, China spent almost twice the amount of money on imported semiconductors than they did on imported oil. China must import about 85% of their energy. Conversely, the U.S. is the largest exporter of energy. So, China is a huge importer of energy, and they still spend almost twice the amount on semiconductors. Why? They manufacture everything. But, if you think China is leading the race, you might be wrong. The top 20 semiconductor companies are:

 NVIDIA USA	 Analog Devices USA
 TSMC Taiwan	 Micron Technologies USA
 Samsung South Korea	 Lam Research USA
 ASML Netherlands	 KLA USA
 Broadcom USA	 SK Hynix South Korea
 Texas Instruments USA	 Synopsys USA
 Qualcomm USA	 Tokyo Electronics Japan
 Intel USA	 NXP Semiconductors Netherlands
 AMD USA	 Microchip Technology USA
 Applied Materials USA	 Infineon Germany

### There are three main types of semiconductors....

Tier 1 – most advanced and go into high end electronics like the iPhone, Artificial Intelligence, Robotics, Defense, data storage, communications

Tier 2 – cars, smart thermostats, washer/dryer

Tier 3 – basic watches, calculators, alarm clock.... Real basic

Most are tier 1 and 2.

### Tech arms race is on!

Since the end of WWII, the world has been in a relative state of calm. This has been a period of globalization, marked by increased peace and prosperity for most, if not all, nations of the world. The United States provided protection of the shipping lanes with our vast Navy, allowing the world to work with each other... resulting in free trade. The current iPhone has parts from 6 different **continents** inside that phone. You read that right, **continents!** Now, we did have an arms race and cold war with Russia, but that ended some thirty years ago. Today, we could be entering into a tech arms race.

### U.S. drops the hammer...

Most people think China has an opportunity to take over the world. You hear people lamenting all the time about how powerful China has become. And why not? Their economy is/was growing exceptionally fast, having led the world out of the Great Financial Crisis of '08/'09. But now? Let's take a closer look.

China has been around a very long time, going back many thousands of years. In modern history, Mao came to power and communism took over in the 1950's. As many as 50MM people died in China with that Communist Revolution, and it's been that communism that held them back all this time. Why? In comparison to the United States, things like individualism, creativity, freedom of speech (and other freedoms enshrined in our constitution) allow us to see problems and come up with solutions. We share them, we sharpen them, we produce them. When you're in communism, you have no free thought. Everyone must think the same thing. So, after the Mao takeover, China couldn't compete on the world stage until they added a little bit of capitalism in the 80's. And that little bit expanded under the World Trade Organization in 2002.

They started to import technology over the past few decades, and they have become more and more advanced. You hear about them taking over the world with their AI, ballistic missile systems and their quantum computing. But that's only because we've allowed it.

Starting in 2020, tariff wars began. Why did Trump do it? Because of the technology they were stealing, not developing. Now in 2022, Biden ratcheted it up. On October 11, 2022, the Commerce Department implemented new export controls on advanced computing and semiconductor manufacturing items to the People's Republic of China. They are now unable to import any type of chips, tools, or equipment for tier 1 semiconductors. Additionally, all firms and companies are forced to choose... leave China or lose your U.S. citizenship. Everyone left.

### What does this mean?

China will now have a much more difficult time advancing technologically. It cannot import, buy, make, or repair the chips. So, any industry that needs advanced hardware is potentially at risk.

How damaging the controls are will depend on how stringently the policy is enforced. In theory, the U.S. Government will allow U.S. companies to apply for licenses to sell the proscribed products to China. But the purpose of the policy is quite clear: to hobble China's quest to catch up with the U.S. in crucial industries of the future. Most experts agree that Biden's controls will likely have a fairly large impact on China's ability to make advanced semiconductors and their related products.

# Book Corner

by James Pafundi

## The Book of Five Rings

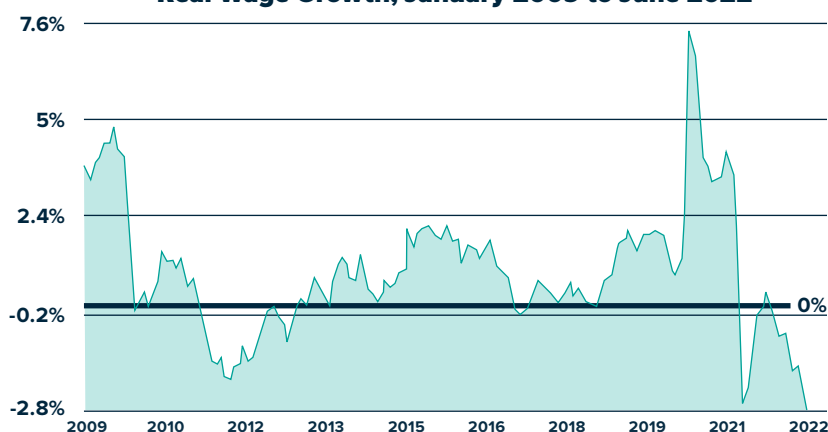
By Miyamoto Musashi

Written in 1645, the Book of Five Rings was the dying work of one of the greatest Japanese Samurai to ever raise a sword. He had an undefeated record of 61 duels. The next closest Samurai had only 33 winning duels. He completed this book just a few months prior to his death. His final work is broken down into the five chapters or “elements” that Musashi thought were essential for his students to understand.

The “Earth” chapter is the introduction to martial arts, leadership, and training. The “Water” chapter describes his thinking strategy, philosophy, and spirituality. He describes that like water, we need to be flexible; to be able to change our form without boundaries. In the “Fire” chapter, he talks about strategic concepts for fighting, like having the high ground, or attacking at times when your enemy does not expect. The “Wind” chapter talks about how important it is to know your enemy, as well as yourself. The “Void” chapter deals with things you cannot see, “...by knowing things that exist, you can know that which does not exist.” His writing draws upon classical Buddhist theory and common themes in Zen Buddhist meditation. It’s a fascinating quick read.

# Wage Increases Don't Necessarily Mean More Money in Your Pockets

Real Wage Growth, January 2009 to June 2022



A jump in inflation could mean that even with a pay raise, you could have less money in your pocket.

To evaluate wages, there are two factors to consider, nominal wage growth and real wage growth. A nominal wage is simply the wage, in U.S. dollars. A real wage is the nominal wage growth in the context of inflation, adjusted for the level of purchasing power held by the U.S. dollar. For example, \$5 in 1950 has the same purchasing power as around \$60 in 2022. Thus being paid \$5 in 1950 is worth much more than being paid \$5 in 2022.

Both real and nominal wages ballooned in early 2020, and then both also fell tremendously one year later in early 2021. However, since this fall in both wage measures, nominal wages have continued to increase while the purchasing power of these wages continues to fall because of inflation.

In recent months, inflation has grown at an above-average rate, reaching 9.1% in June 2022. This inflation rate is greater than the rate at which wages grow, which means that real wages are actually decreasing relative to inflation. While wages have increased at over 5% for the past 6 months, real wages have decreased over this same time. So, consumers are left with less purchasing power even if their salary has risen.

*Source: U.S. Bureau of Labor Statistics, EPI analysis of Bureau of Labor Statistics Current Employment Statistics.*



# Protecting Against Phishing & Online Attacks



My father-in-law called me the other day to tell me about a telephone call he received from Comcast, his cable provider. They told him about a special they were offering....a 20% reduction on his annual bill if he paid a portion of his bill in advance. The caller knew his Comcast account number and his monthly fees, right down to the penny for the bill he just received. The only thing he needed to do was to pay an upfront portion of \$1000 with a Target Gift Certificate. The 20% reduction and the upfront

payment would be credited on his next statement. The gentleman on the phone gave him a number and an extension but said that anyone who answered could process his payment request. Thankfully the "Target gift card" raised enough red flags that he called Comcast and asked about the discount program. There was no such program. It seems that hackers had obtained his customer information and were trying to exploit it.

**The Federal Bureau of Investigation offers a number of tips to help protect yourself from cyber-attacks:**

- Never divulge credit card information or other personal identifying information online or over the phone unless you initiate the communication.
- Regularly reconcile your financial statements and notify your bank of any discrepancies immediately.
- Monitor your online accounts regularly, reporting unauthorized transactions to your bank, credit card company, and law enforcement.
- Review your credit report annually, notifying the credit bureau in writing if you discover any questionable entries.
- Report any instances of people receiving mail from financial institutions in the names of others to law enforcement.

If you discover that your identity has been compromised, ask the credit bureau to enter that information into your credit report. Finally, review any solicitation from an email or text message for you to update your personal information, activate an account, or enter your personal information. Be careful, too, when downloading any attachment or file from the Internet, and make sure that your computers are protected with cybersecurity software.

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***This material was prepared by LPL Financial, LLC.***

## Productivity Slump

### US Nonfarm Business Labor Productivity Plummet

Over the past two quarters, US employment grew at a strong 4.3% annual rate while output fell at a 2.3% annual rate according to the Peterson Institute for International Economics. Average hours per worker also fell, meaning productivity fell at a 6.0% annual rate.

Productivity growth is a major factor in determining how fast living standards rise. If workers produce more per hour, then employers can afford to pay them more without increasing prices, something that does not cause inflation to rise.

While it is true that productivity has been historically hard to prove due to short term volatility in reporting, the broader trend is clear – output growth is slowing, while job growth remains strong. Simply stated, an increasing number of employees are producing less per hour. In today's post pandemic environment, workers are getting paid more for producing less.

Why don't businesses just stop adding unproductive workers? With such a tight labor market, that doesn't seem feasible at the moment. Businesses will either pass along the rising labor costs to their customers by increasing prices or absorb the higher labor costs and decrease their profitability. Neither choice seems particularly appealing.

***Source: Bloomberg Finance, LP***

# What's Cooking?

by Gina Pafundi .....

Cooking is my passion, and I love bringing people together over a good, yummy meal!

I have mentioned this Chef before ~ Tiegan Gerard and her food blog Half-Baked Harvest. She does great video stories on Instagram. Often after a long day, I decompress by watching her wonderful videos of delicious recipes. This recipe is one of the best I have made. I served it recently for some friends, and they loved it. We all scraped our plates with some crusty bread! I definitely recommend trying this recipe because it is a one pot meal so clean up is easy! Enjoy and Happy Fall.

## *Creamy Tuscan Chicken with crispy prosciutto*

### Ingredients:

- 1 ½ pounds thin cut chicken breasts
- Kosher salt and black pepper
- ¼ cup all-purpose or gluten free flour
- 2 tablespoons extra virgin olive oil
- 3 ounces prosciutto, torn
- 2 shallots, chopped
- 4 cloves garlic, chopped
- 2 tablespoons Italian seasoning
- ½ cup oil-packed sun-dried tomatoes, chopped
- Red pepper flakes
- 3 cups low sodium chicken broth
- 1 cup peeled and chopped raw potatoes
- ¾ cup heavy cream or canned coconut milk
- 1 tablespoon Dijon mustard
- 3 tablespoons lemon juice
- ½ cup grated parmesan cheese
- 1 bunch Tuscan kale, roughly chopped
- Fresh basil



### Instructions:

1. Season the chicken with salt and pepper. Sprinkle with Italian seasoning. Place the flour in a shallow bowl and dredge the chicken through the flour, pressing to adhere.
2. Heat 1 tablespoon olive oil in a large skillet set over medium-high heat. Add the prosciutto and cook until crispy all over, about 5 minutes. Remove from the skillet.
3. In the same skillet, add 1 tablespoon olive oil and the chicken and sear on both sides until golden about 3-5 minutes per side. Remove from the skillet.
4. Add the shallots and garlic and cook until fragrant, 2 minutes. Stir in the sun-dried tomatoes, Italian seasoning, and a pinch each of red pepper flakes, salt, and pepper. Cook 2 minutes. Pour in the broth. Add the potatoes and chicken. Partially cover and cook over medium heat until the potatoes are fork tender, 10-15 minutes.
5. Remove the lid. Pour in the cream. Add the Dijon, lemon juice, parmesan, and Tuscan kale. Cook until the kale is wilted, 5 minutes.
6. Serve the chicken and sauce with crispy prosciutto and fresh basil.





# Travel & Adventure

## *Overnight Camping Trip: Takhlakh Lake*

by James Pafundi



In August, a friend of over 30 years joined me for a quick Pacific Northwest adventure. I love showing my family and friends the spoils of this area. It is just so amazingly beautiful.

We did a quick overnight camping trip to Takhlakh Lake. In 2013, National Geographic featured a photograph of the lake and wrote about it being one of the 20 places in the world chosen for “Must-Do Trips.” The must-do trip was actually a 35-mile hike around Mount Adams. The trail can be accessed from the lake. I’d love to do that hike too.

If you want to go earlier in the season, make sure to check that the roads are open. This year, the snow didn’t allow access until June. And watch out for the mosquitos! They are on another level. Fortunately for us, by August, they were all gone.

The lake is amazing, and the camping is just off the shoreline. I highly recommend it.

We then met up with 2 other friends and went rafting down the Upper White Salmon River. Because of the technical nature of the river, we used a guided rafting company. This was my third time, and it did not disappoint. Not 30 seconds in, I got ejected from the boat. Man was that glacier-fed water cold! The trip is full of class III and VI rapids and ends with a Class V 14-foot drop. It’s the largest vertical drop run by a commercial rafting company in North America. It was a blast! If you ever want to go, let me know. I’ll do it again for sure.

