Lessons from Baghdad Bob

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July 2020 — Remember Baghdad Bob, the indefatigable Iraqi Information Minister who would not admit Americans were anywhere near Baghdad? This was the second Gulf War, under George W. Bush Jr. "There is not an American within 100 miles of Baghdad!" Bob would very convincingly declare, and yet you could see an Abrams M1 tank just over his shoulder. The average person sees this and thinks, this guy is crazy! But Bob was suffering from cognitive dissonance.

This is the condition where what you are witnessing with your senses cannot be aligned with your worldview – almost like a sound wave that your ears are not capable of hearing. Yet your inability to perceive it does not preclude its existence. Just because Bob could not ever believe US tanks would roll on Baghdad did not mean they were not right behind him. "Just turn around, Bob!" didn't you want to scream?

This is somewhat similar to the stock markets today. There seems to be a chasm of difference between what the markets are perceiving and what is actually occurring in the economy today.

You don't need me to rattle off a list of all the lay-offs, job losses, bankruptcies, and closed businesses that have suffered due to the Coronavirus fallout; you hear about it every day. You also may be hearing about the almost certainty of another wave of stimulus – economic help in the form of cash to taxpayers, or more specifically, tax-filers.

The virus numbers continue to rise, the deaths continue to mount, protests and riots also continue into the early morning in several cities, the crime and shootings in New York and Chicago and even Atlanta, the senseless horrific deaths of innocent children. How did we get to this? And where do we go from here? Is this the new normal to be incorporated into our society, like face masks and social distancing?

With all the yelling and screaming, has anyone stopped to consider the hopelessness of the average worker? Working sixty hours a week at $10 per hour, or even $15 per hour? Even if your tax rate is zero, look at all the withdrawals! Federal taxes, state taxes, local taxes, Social Security, Medicare. They can't afford to contribute to a retirement plan because of all these other deductions. I'm not even going to talk about healthcare or childcare.

At the end of the day, after working ten miserable hours doing meaningless labor, having woken up at 5 A.M. to sit through the morning commute, and another hour and a half commute home to look forward to, they arrive home at 8 P.M. utterly exhausted. What has this person done to promote their future, or their children's future? What savings have they been able to put away? What share in the American dream have they been able to claim? And all the while, insidious inflation. The most silent of thieves: unmerciful, unrelenting, unstoppable.

Here is the champion of inflation himself, Sir John Maynard Keynes, describing inflation honestly, as a tactic to reduce the *real* wages of workers:

> "...since there is, as a rule, no means of securing a simultaneous and equal reduction of money-wages in all industries, it is in the interest of all workers to resist a reduction in wages in their own particular case. In fact, a movement by employers to revise money-wage bargains downward will be much more strongly resisted than a gradual and automatic lowering of real wages as a result of rising prices."

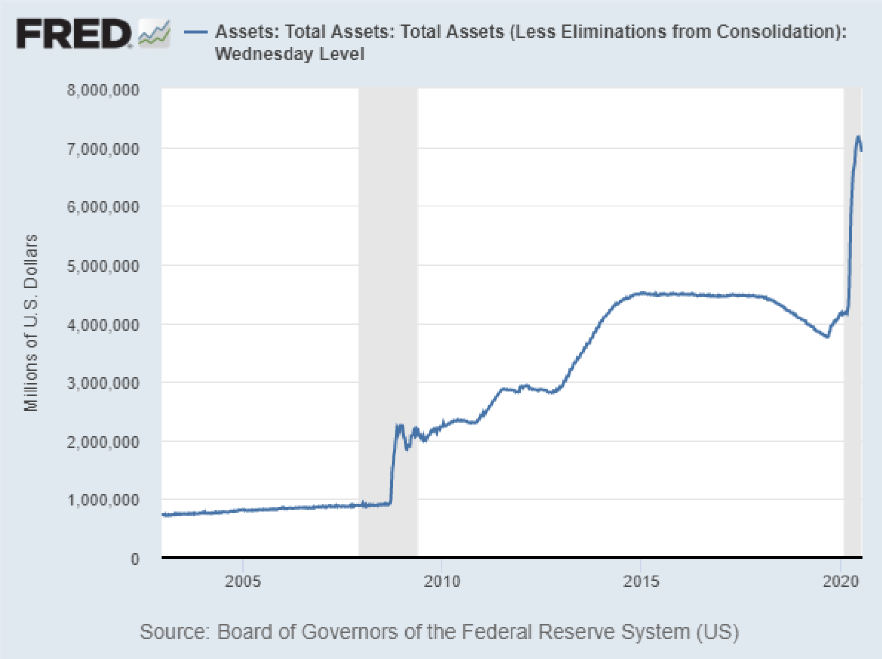
There you have it from the man himself. It is much easier to reduce the real-wage through inflation and loss of purchasing power than to reduce the money-wage because…

> "…it would be impracticable to resist every reduction of real wages, due to a change in the purchasing power of money which affects all workers alike; and in fact, reductions of real wages arising in this way are not, as a rule, resisted unless they proceed to an extreme degree." Every trade union will put up some resistance to a cut in money-wages, however small. But since no trade union would dream of striking on every occasion of a rise in the cost of living, they do not raise the obstacle…"   **"Thus it is fortunate that the workers, though unconsciously…do not resist reductions of real-wages…"** [1]

Meaning they don't resist rising prices—inflation. Can you believe that? THAT is how our monetary system is set up, and THAT is why people are struggling! Once you can't work any harder and still cannot make ends meet, your future may seem hopeless, and you might feel you have nothing to lose. You don't know what's wrong exactly, but it's inflation.

One of the reasons stocks have recovered so strongly and soared so high with little fundamental reason is because of the unprecedented "stimulus" that Congress and the Fed have engaged in. The Fed never says, "printing money." Instead, they say nice-sounding words like "buying treasuries," "expanding the money supply," "expanding the balance sheet," "creating stimulus." But the truth of the matter is that they are devaluing money for every person and institution that is holding dollars. It has astounded me for two decades that we allow this to continue with so little fuss or discussion.

The following chart represents the "assets" of the Federal Reserve. The "assets" the Fed refers to are US treasuries of all sorts, which are created electronically. The Fed "buys" these treasuries with money they just make up out of thin air—also electronically.



This new money then makes it out into the economy via government checks and thus has the effect of reducing the value of the money that is already there.

Prior to the 2008 recession, the "assets" owned by the Fed were less than $1 trillion. Today, we have topped $7 trillion with no end in sight.

Thus, every new dollar created reduces the value of the dollars in your pocket. This has the effect of hurting the people who have the least of those dollars—the poor, the unemployed, the young, pensioners, the disabled, and those living off Social Security. If Social Security is the cornerstone of your retirement plan, that chart should worry you.

The point in all this (besides ranting on my soapbox) is that our apparently robust stock market is illusory, built on a matrix of electronic money. It's a house of cards. The obvious question is "how much longer can we go like this?" The answer is, "nobody knows."   Things could continue this way for years, or things could collapse tomorrow. Obviously, this creates a serious problem for anyone trying to gauge the direction of stocks.

Another consideration, of course, is the election. I am not taking sides, but the market sure has. If you remember back to the mid-term elections when the Democrats took back the House, the Dow fell 19%. I'm not predicting, I'm not postulating. I'm just stating facts. Maybe there were other causes too, but the election was certainly one of them.

We also learned from the 2016 election and from Brexit that news polls are not always accurate. So, if you know something I don't, I'm all ears. Because I believe the market – save some other unknown factor—will go the way of the election. And it could be a dramatic swing either way. If that creates an inner struggle for you, then I do apologize. Please don't shoot me, I'm just the piano player.

Our position therefore is "cautious participation." One foot on, one foot off. In financial planner speak that means part of our equity position is participating in the growth and associated volatility of global stocks, while the other part is safely tucked away in high quality bonds and treasuries. Note that I said our equity position; this is not the entire portfolio.

That "part" is different for everyone, which is why we work so hard to get to know you and your unique situation and incessantly ask such prying questions. If the market drops significantly, then we have some dry powder. If it takes off, then at least we have half our horses in the race.

In the meantime, there are plenty of things to worry about. Looks like a new trade war with China may be in the works, tensions in the South China Sea are heating up, Trump has closed the Chinese consulate in Houston, Italy now wants their own Brexit, Putin has sealed his dictatorship for life, Jeffery Epstein's cohort may spill the beans on some powerful people, shootings in Chicago regularly top 50 almost every weekend, politicians are considering defunding their police departments, officers are retiring in droves, gun sales have skyrocketed, the list goes on. Piano player, remember?

But don't let it get you down. There have always been problems in the world, suffering and war, loss and heartache. Our part to play is to help others (and animals), love our family and friends while we can, and keep our head high. Life is tauntingly fragile—enjoy every day!

As always, if you have questions or concerns, please contact me at kevin@magellanplanning.com.

My very best to you and yours, Stay Safe!

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About J. Kevin Meaders

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Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through Voya Financial Advisors (member SIPC).

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