May You Live in Interesting Times

-J. Kevin Meaders, J.D., CFP®, ChFC, CLU*

July, 2018 — So says an ancient Chinese proverb. Well, if that's the goal, I think we can all check that box. If you thought it was going to be a quiet summer, the planet has other plans. The Trump / Kim Jung Un summit was one for the ages. Just when we thought we were going to have a military conflict, the North Koreans vowed to completely denuclearize. I am hopeful, but also skeptical. We'll see.

The stock markets have been jittery all year after a terrific run in 2017. Here you can see the sharp dip at the beginning of the year as markets generally sell off when a new fed chair is coronated. That dip was in response to the installation of Jerome Powell. Nothing material, mind you, only uncertainty.

And speaking of uncertainty, that is definitely the word these days in Washington, DC. It seems all year long—just as the market gains a little traction—some new news bomb explodes. The headlines recently have been, you've no doubt noticed, all about the so-called "trade wars."

Remember that the mainstream media sells commercials. They can charge three times more for their commercials when they are reporting bad news, because Americans are much more likely to turn on and tune in for bad news rather than good news. Their job—and never forget this—is to take whatever news might be available and sensationalize it sufficiently to get you to tune in. Spinning it in a negative way is much more marketable; and so it has been with the "trade wars." The truth is, the so-called trade wars are just an extension of the currency wars that have been going on for over two decades now, mainly waged by the Chinese.

See, if you want to sell more widgets, you need to make them cheaper. One great way to make sure that your widgets always remain cheaper than your competitors' widgets is to manipulate the currencies involved in the transaction. Back in 1994, the Chinese fixed the value of their currency, the Yuan (or Renminbi), at 8.28 to the U.S. dollar. So, for every dollar spent in China, an investor would get 8.28 Yuan.[1] Intense pressure from China's largest trading partners, especially the U.S., have convinced the communists to gradually let it appreciate, but today it remains near 6.5 Yuan to the dollar.

The recent sell-off in the stock market has been due to the uncertainty surrounding our efforts to "work this out" since other efforts over the last two decades have failed. I believe this is not something to worry about, and not something that will end this bull run, although as you have repeatedly seen, uncertainty is enough to shed a couple of thousand points off the Dow. Which brings me to the "something" that I think *will* end this bull run and set us up for another recession.

If you've been reading my periodic market letters, then you know we blame the Federal Reserve for expanding and contracting the money supply—creating credit and reducing credit. When they create it, through lower rates and expansion of the balance sheet, the economy booms. Likewise, once they start the contraction process (which is where we are now), a market downturn has occurred in every instance since 1913.

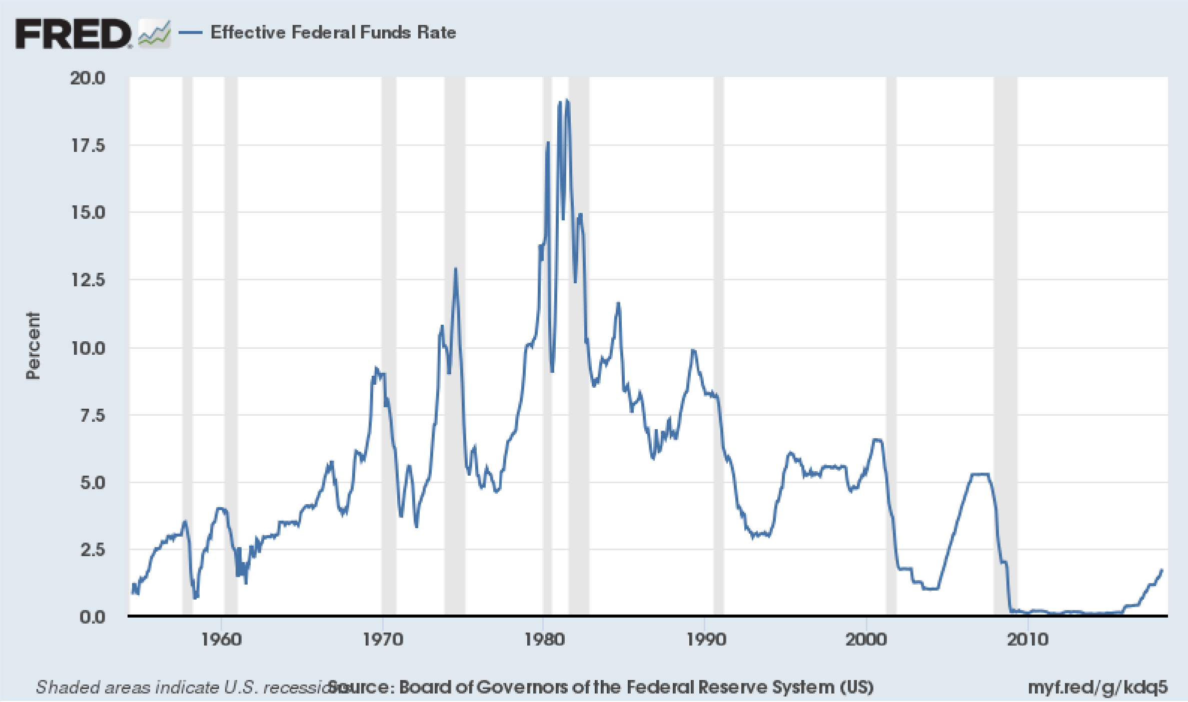
Why not before 1913, you ask? Simple. Because there was no Fed before then. You don't even have to believe me, just believe former Fed chairman Ben Bernanke when, on November 8, 2002, in a speech given at a conference to honor Milton Friedman on his 90th birthday, Bernanke admits: "Regarding the Great Depression, …we did it. We're very sorry. …We won't do it again."[2]

It's an uncomfortable truth that some professionals in my industry may not like to confront. After all, the Fed is sacrosanct. That's what we were all taught from day one. Even today, criticizing the Fed is a big no-no.

Fortunately, or perhaps unfortunately, my character doesn't allow *me* to ignore it. Once I truly believe something, I can't un-believe it. And I can't ignore it either.

[1] https://www.investopedia.com/articles/forex/09/chinas-peg-to-the-dollar.asp
[2] https://www.federalreservehistory.org/essays/great_depression

Luckily, there are some really smart guys who came before me and figured it all out, though they are almost always completely ignored by mainstream media. Professor Mises and Professor Hayek, both Nobel Prize winners in Economics, have laid it all out for us to see. Armed with their insight, my own in-depth analysis of the history of the stock market has proven to me that a significant market sell-off has followed every major interest rate hike in the Fed Funds rate. Take a look at the Fed Funds rate since 1955:



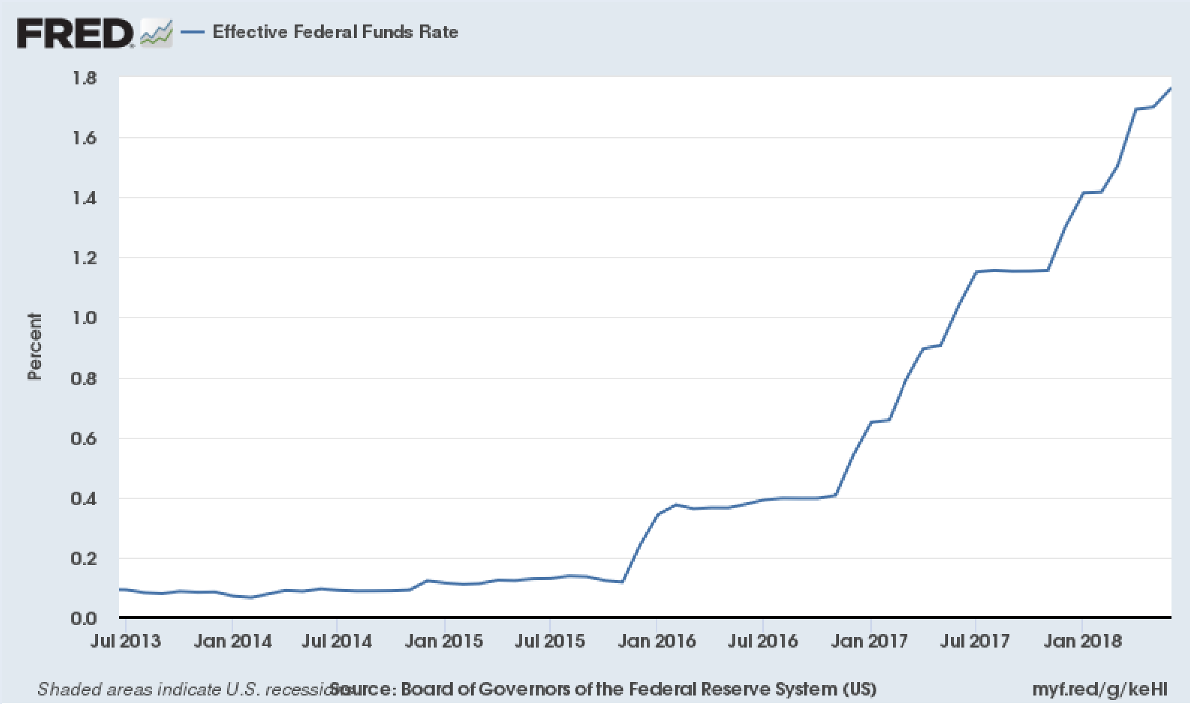
The grey lines running vertically here indicate recessions. Take a look at what happens just before a grey line—rates rise and rise, and then maybe a small plateau, and then a sharp reversal. What's going on here?

There are several important takeaways, not the least of which is that when rates are on the rise, you had better be careful. And friends, this is where we are now. If you look at the far lower right part of the chart, you can see that tail beginning to lift off.

I firmly believe and fully expect that the Fed will continue to raise rates until we slip into another recession. The question in my mind is not when, exactly, but at what rate.

The way I see those rate peaks and reversals is "this is the rate that was needed to crash the market." The last one crashed at 5.25%, the one before that around 7%. Do you see that? I feel pretty confident that it will be less than 5% this time around, but how much less?

In any event, we believe the danger zone (I call it a warning track) is between 2.5% and 3.5%. If we make it to 4%, I will be quite surprised.



Here you can see the Fed in rate hike mode (monetary contraction) and today we are about 100 basis points (1%) away from our warning track.

The point of this letter is to remind you that there will be myriad events that move the market in the short run (like the recent trade wars banter), but the big picture is driven by nothing but contraction and expansion. We are still expanding, and there is probably another 10% or more to be had, but now more than ever, we are watching every move the Fed makes.

If you have not given any thought to how your current investments performed in 2008, and how they might fair in another significant downturn, now would be the time to do it. Don't put it off any longer. We can help. We are only a click or call away.

Have a safe and happy (worry-free) summer!

About J. Kevin Meaders

kevin@magellanplanning.com

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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4170 Ashford Dunwoody Rd. NE, Suite 480
Atlanta, GA 30319
404-257-8811