



MEDALLION
WEALTH MANAGEMENT

February 2021 Market Commentary

Carry On My Wayward Son

*“Once I rose above the noise and confusion
Just to get a glimpse beyond this illusion
I was soaring ever higher
But I flew too high”
-Kansas*

<https://www.youtube.com/watch/P5ZJui3aPoQ>

It’s 1977, the year I graduated high school. *“Carry On My Wayward Son”* hit #11 on the charts. Star Wars was the number one movie. The 1st personal computer came out, the Commodore PET, and Apple Computer was incorporated.

The Gross Domestic Product of the United States reached \$1.9 trillion, more than double what it had been just ten years before. Though the ‘70’s were pretty cool, most of the GDP growth didn’t come from a strong economy, just the opposite actually. Most of the GDP growth came from inflation, the ‘70’s were a period of economic stagnation and inflation, better known as “stagflation”. Inflation hit a peak of 14% in 1980. Bonds were referred to as “Certificates of Confiscation” since their value declined every year.

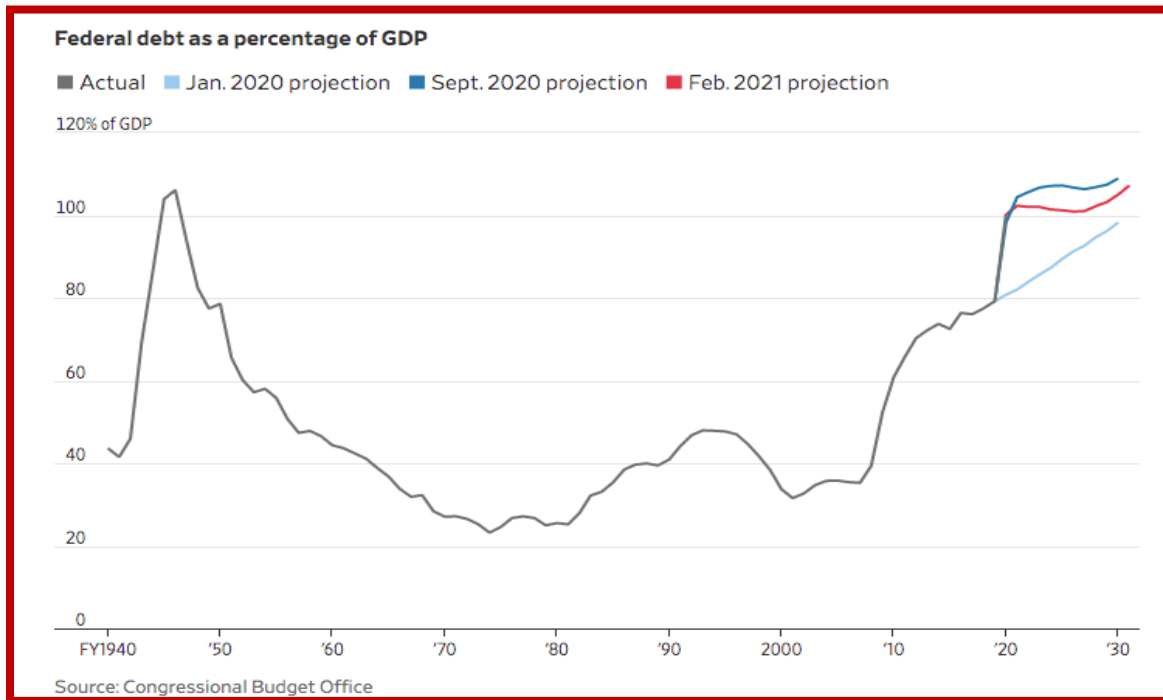
What brought me back to the ‘70’s, and 1977 in particular, is the figure \$1.9 trillion. \$1.9 trillion just happens to be the size of the Biden administration’s latest Covid-19 stimulus bill. **That’s right, the new proposed Covid-19 stimulus bill is the same size as the entire U.S. economy in 1977!**

Even today, \$1.9 trillion is a lot of money. It is nearly 10% of the size of the U.S. economy, and is roughly 50% of expected tax revenues.

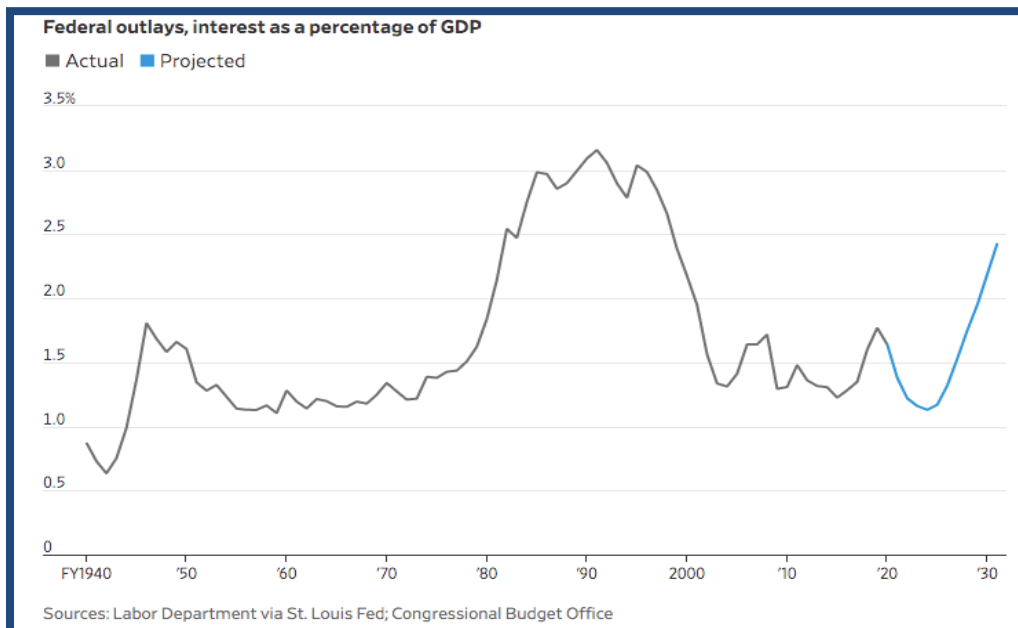
In early January, the Congressional Budget Office estimated that the 2021 budget deficit would be \$2.3 trillion; this is before the proposed \$1.9 trillion of additional stimulus. That would bring the deficit up to \$4.2 trillion.

The national debt of the U.S. is currently \$28 trillion, and will soon be over \$30 trillion. This is about 110% of GDP, and more than what we had during WWII. After WWII debt as a percent of GDP shrank quickly, as money allocated to the war effort was quickly funneled into economic growth. Today mandatory outlays for Social

Security, Medicare, etc., make up 75% of the budget, so it's pretty hard to see debt/GDP shrinking rapidly.

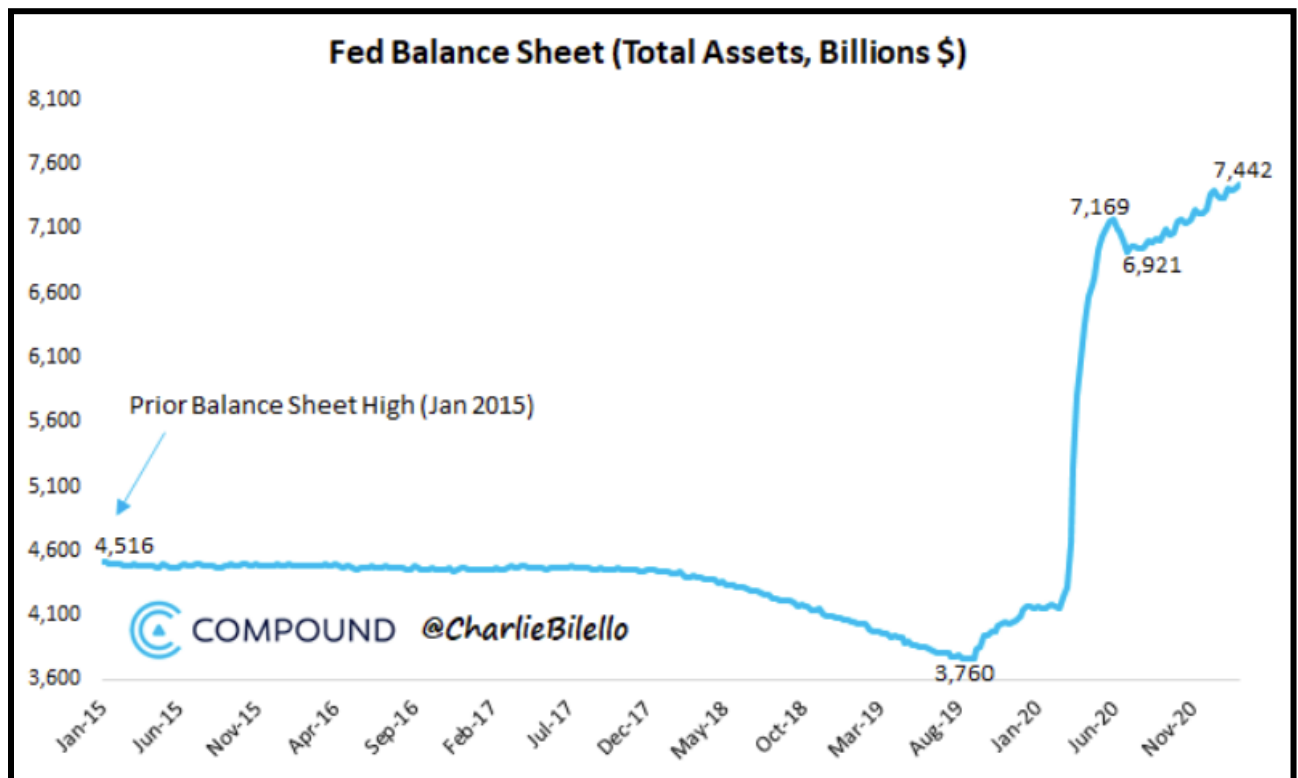


How much debt is too much? No one really knows. Numerous academic studies have shown that when debt approaches 90% of a country's GDP it generally results in stagnation. Of course interest paid on that debt is equally important, if you can keep interest expense to a minimum the debt level doesn't matter as much.



How do you keep interest rates low so you can service your runaway debt? Enter the Federal Reserve. Supposedly the Fed's dual mandate is price stability and full employment, and the way they get there is through interest rate manipulation. On the short-end of the yield curve the Fed sets rates at zero, and to control longer-term interest rates the Fed buys assets, namely Treasury bonds.

Since Covid, the Fed's balance sheet has grown exponentially, and will probably be over \$9 trillion by year-end.



US Federal Reserve - Total Assets			
Year End	Assets (in Billions)	\$ Increase (in Billions)	% Increase
2002	732		
2003	772	39	5.4%
2004	811	39	5.1%
2005	848	37	4.5%
2006	870	22	2.6%
2007	891	21	2.4%
2008	2,239	1,349	151.4%
2009	2,234	-5	-0.2%
2010	2,421	187	8.3%
2011	2,926	506	20.9%
2012	2,907	-19	-0.6%
2013	4,033	1,125	38.7%
2014	4,498	465	11.5%
2015	4,487	-11	-0.2%
2016	4,451	-35	-0.8%
2017	4,449	-3	-0.1%
2018	4,076	-373	-8.4%
2019	4,166	90	2.2%
2020	7,363	3,197	76.7%
2021 YTD	7,442	79	1.1%
	Period	\$ Increase (in Billions)	% Increase
	2002-21	6,710	917%

This is the grand experiment. How long can the U.S. issue debt that the Fed and the rest of the world will buy? How long can we keep interest rates and debt service artificially low? We are gambling with our status as the world’s reserve currency. If inflation rises, will the Fed remember it’s price stability mandate and raise rates to fight inflation?

*“Masquerading as a man with a reason
My charade is the event of the season
And if I claim to be a wise man, well
It surely means that I don't know”*

Be careful out there,

Chris Wiles, CFA



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