



MEDALLION

WEALTH MANAGEMENT

September 2022 Market Commentary

Wayward Son



*Once I rose above the noise and confusion
Just to get a glimpse beyond the illusion
I was soaring ever higher, but I flew too high.*

Kansas - <https://www.youtube.com/watch?v=P5ZJui3aPoQ>

As a nation, have we flown too high? Have we become the **Wayward Son**, so arrogant in our handling of crises that we actually believe that no one ever needs to fail?

Sometimes it's important to take a moment and reflect on how we got here. The "**here**" I'm referring to is our inflationary economy, a society where everyone is bailed out, and an investment world where moral hazard is commonplace.

Much of this started 14 years ago. After a frenzied weekend of tense and complex negotiations between senior leaders of the US government and the CEOs of the big Wall Street banks produced no viable alternative path for Lehman Brothers, the company filed for bankruptcy on Monday, September 15, 2008. The filing set off one of the most memorable weeks in the history of finance. Concurrent with the failure of Lehman was the forced sale of Merrill Lynch to Bank of America, a move so rushed and dramatic it's incredible to think it was the **second** most important headline on that fateful day.

In a rare public appearance at the White House later that afternoon, then US Treasury Secretary Hank Paulson assured the nation that this crisis would pass, that he never considered bailing out Lehman using public funds, and that Wall Street would have to fix its own problems – there would be no further bailouts. The **very next day**, the government would bail out American International Group (AIG), an insurance giant with nearly \$1 trillion in assets.

White House says no more bailouts on the way

The Bush administration signaled strongly on Monday that troubled Wall Street shouldn't expect more rescues from Washington.



Henry Paulson at the White House | image credit: NBC News

It is said that the events of those few fateful days were so stressful that Hank Paulson actually threw up in his office trash can, he contends that he did not throw up but was simply dry heaving.

Within days of the AIG bailout, Paulson championed and helped shepherd through Congress the Troubled Assets Relief Program (TARP), a massive \$700 billion bazooka full of money designed to inject confidence into the banking system. It was an unthinkable high number for the time. Paulson famously quipped, *"If you've got a bazooka, and people know you've got it, you may not have to take it out."*

During this tumultuous time, my team and I were managing more than \$2 billion in large-cap core and growth equities for National City Bank, the venerable 163-year-old Cleveland institution. For decades Nat City was run as a conservative midwestern bank, but that ended in 1999 when they purchased First Franklin Financial of California, a major subprime lender.

The bank expanded rapidly into high-risk/high-reward subprime lending, and by 2003 National City was making a profit of \$2.6 million a day from its mortgage business. But as rates started to rise and housing started to decline, profits started to fall. In 2006 they sold First Franklin to Merrill Lynch for \$1.3 billion, but had to retain about \$10 billion in problem loans.

Profits then turned to losses, including a \$333 million loss in the fourth quarter of 2007. In early 2008, the company announced that it would cut its dividend by 49% and lay off 10% of its 32,000 employees. Amazingly, the company actually bought back \$1.6 billion of stock at \$38.75 per share in early 2007.

By September 29, 2008 National City stock had fallen by 96% to \$1.25 per share, as the company sought a portion of the \$700 billion TARP bazooka to bail themselves out. This is where the story gets interesting, on October 23, 2008 National City's TARP request was rejected

and the following day PNC Bank was given \$7.7 billion in TARP assets with the specific order to acquire National City for \$5.2 billion in stock, or \$2.23 per share.

Like thousands of others employed in finance, my team was given severance packages and cardboard boxes by PNC. To say this was a stressful time is an understatement, but even though the Government bailouts and orchestrated buyouts protected the economy from a much deeper recession/depression, I still believe that it set a horrible precedent. Before we knew what happened, everyone was **“too big to fail”**.

The precedent was set, the public and many bandwagon politicians saw the 2008 TARP program as a big bailout for the fat cats on Wall Street, and **now they wanted theirs**. Fast forward to 2020 and the pandemic, the government shut down the economy and then opened the spigot wide by throwing trillions of dollars at anyone and anything with a bank account. Arguably, much of this was necessary in the face of a global emergency, though the magnitude and the true need of many recipients is open for debate. The government acted like Oprah Winfrey, “you get a check, and you get a check, and you get a check.” And with that free money came inflation.

Now our President, through executive order, wants to **“forgive”** \$10,000+ in most student loans. This is not “forgiveness” this is simply a transfer of debt from one group of citizens to another. The 50% of the population that actually pays taxes will pay about \$2,000 more in order to “forgive” the debt of the fiscally irresponsible. This is totally immoral because:

- It rewards bad behavior.
- It punishes good behavior.

This executive order does not attempt to fix the core issue of runaway inflation in college tuition, it will actually lead to more tuition inflation as colleges feel emboldened to continue raising tuition since their clients will be bailed out.

So, the precedent has been set, what’s next? Rent relief, mortgage interest relief, car loan relief, energy bill relief, you name it. People who have made good responsible choices are being made to look like fools. Wealth is being transferred from those who have made tough choices to live within their means to those who live above their means.

***Though my eyes could see, I still was a blind man
Though my mind could think, I still was a mad man
I hear the voices when I'm dreaming
I can hear them say***

You may ask, why this matters. The answer is simple. The US has earned the right for its dollar to be the world’s reserve currency. It was earned because we had the strongest free market economy. There is a very good reason why most innovation doesn’t take place in Europe or Asia, but in the US. We are the country where people want to take risks, enjoy the fruits of their successes, and pay the price of their failures. A free-market economy cannot exist without

failure. As Serena Williams said, ***“I really think a champion is defined not by their wins but by how they recover when they fail.”***

Success cannot be had without failure, and a country that doesn't allow failure will soon be one without success.

The reason companies fail and empires collapse is simple – they become arrogant. They forget that their success was earned by sweat and paranoia. They start taking it for granted. They become fat, lazy, and happy. Just like companies and empires, the US is not absolved from the laws of economics.

As our government adds more debt, raises taxes, and chooses winners and losers, inflation will not be transitory but will become a nightmare of everyday life, and our economy will weaken. With every “forgiveness,” the US dollar will become a less attractive currency, as it will buy fewer and fewer goods. It will be less differentiated from the currencies of other troubled countries.

I am hopeful that as a nation we will soon see the errors of our ways. It may take a very difficult period of high inflation and lower standards of living, but maybe that economic shock will awaken us from our arrogant ways.

Even though I'm hopeful, sometimes that hope needs to be reinforced so I'm heading out to Yellowstone to do some fishing. Someone once said that the beauty of fishing is that it gives a man hope. Each cast builds a little hope and if the fisherman can lose himself to that hope, then the worries and the heartache of life fade to the background.

***Carry on, my wayward son
There'll be peace when you are done
Lay your weary head to rest
Don't you cry no more***

Be careful out there,

Chris Wiles, CFA

383648



Where Trust is Earned

This is intended for informational purposes only and should not be used as the primary basis for an investment decision. Consult an advisor for your personal situation. Asset allocation and diversification strategies cannot assure profit or protect against loss in a generally declining market. Indices mentioned are unmanaged, do not incur fees, and cannot be invested into directly. Past performance does not guarantee future results. These are the opinion of the author and not necessarily those of Cambridge Investment Research, Inc.

Securities offered through Registered Representatives of Cambridge Investment Research, Inc., a broker-dealer, member [FINRA/SIPC](#). Advisory services offered through Investment Adviser Representatives of Cambridge Investment Research Advisors, Inc., a Registered Investment Adviser. Cambridge and Medallion Wealth Management, Inc. are not affiliated.