THE CALDER QUARTERLY

July 2023

We are currently observing a nationalizing of the economy. What does this imply? The brunt of the monetary collapse and rate hikes is disproportionately borne by households and small businesses, while large corporations and governments remain relatively unscathed.

As a result, when a significant entity like the state, which typically accounts for 40% to 60% of GDP in most economies, continues to consume wealth and spend, the gross domestic product does not exhibit signs of a recession, despite a decline in real terms of consumption and private investment. Bloated government spending masks the recessionary conditions in the private sector, including the decline in real disposable income, real wages, and margins of small and medium enterprises. Additionally, the external factor of weakening commodity prices is bolstering the contribution of gross domestic product from abroad.

These factors are the primary causes of the ongoing recession and the erosion of private wealth and wages, even though the official data fails to reflect this reality. As the government's influence on the economy grows at an accelerated pace, technical recessions might not manifest in the official data, but people still experience their effects. One might perceive this as positive news since government spending directly benefits citizens through social programs. However, everything the state provides is ultimately derived from the private sector, either in the present or the future – current deficit spending entails future consequences of higher taxes and lower real wages. Therefore, the flip side of "no official recession yet" is "more public debt now and in the future."

The alarming decline in global money supply is evident, with a contraction of -3.4% by the end of the first quarter, as reported by Longview. Concurrently, in the United States, money supply is contracting at the fastest rate since the Great Recession. It is crucial to consider that during the same period, global government indebtedness has risen by 3%, and the United States' borrowing has outpaced real GDP growth. Moreover, these deficits are financed despite higher costs. Governments exhibit little concern for rising borrowing expenses since it is the populace who foots the bill.

Essentially, this implies that the drain of liquidity from the private sector will persist for an extended period. Central banks are puzzled as to why inflation remains persistent despite the complete resolution of supply chain disruptions and the return of international commodity prices to their initial levels. Consequently, they continue to raise interest rates, which directly and negatively impact families. Large corporations generally encounter minimal issues with higher rates, as they can access credit effortlessly, secure more favorable rates than many sovereign entities, and often possess substantial cash reserves due to prudent balance sheet management. While some may face bankruptcy, the mega caps are mostly shielded from the monetary tightening. The YTD equal weight S&P 500 is up 4.55% (and that includes the 7 FANG stocks) compared to the market weighted S&P 500 up 14.8%. This equal weight gives an equal weighting to all 500 companies in the S&P and serves as a better reflection of S&P performance as opposed to a market cap weighting that weights each company according to how large they are. Market cap is defined as the number of shares of stock outstanding multiplied by current stocks' price.

So why doesn't inflation, particularly core CPI, respond more swiftly to rate hikes? It is because the largest economic actor, the government, remains unconcerned and does not rectify its imbalances. Bloated governments continue to consume an increasing number of newly created money units, thereby preventing aggregate prices from reflecting the price contractions observed in external factors such as freight or energy. Additionally, as evidenced by the gross domestic product figures of several European nations, the tax revenue component of GDP displays a substantial increase, while the value added by businesses and the gross wage component remain below pre-pandemic levels. This situation can be attributed to the consequences of diminished real wages, reduced real disposable income, and lower real savings.

Indexes & Indicators

Cumulative Total Returns YTD	
S&P 500	15.6%
DJIA	2.9%
NASDAQ	31.1%
Russell 2000	6.7%
Foreign Stocks	9.8%
Emerging Markets	4.5%
Top 3 S&P Sectors	
IT	40.7%
Communications	36.1%
Consumer Disc	32.6%
Bottom 3 S&P Sectors	
Energy	-6.1%
Utilities	-5.8%
Healthcare	-4.3%
Bonds	
10 Year Treasury	-0.3%
US Bonds	0.8%
Global Bonds	0.8%
Municipal Bonds	2.3%
Market Indicators	
Fed Funds Target	5.25%
Inflation (Core CPI)	5.3%
Unemployment	3.6%
GDP (3/31/2023)	2.0%

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Given the current slump in money supply, inflation should be half its current level, even when accounting for the adjustments made to official CPI calculations. However, the velocity of money remains unaffected due to the government.

Factory Orders: Yesterday's May data showed the first year-over-year decline since October 2020, marking the 8th consecutive month of deceleration. This aligns with the ISM Manufacturing Data and the Fed Regional Survey data, both indicating a clear industrial recession occurring globally.

Real Rates: Real Rates have surpassed 2% for the first time since 2008, and the Prime Rate now stands at 8.25%.

Trap Door Risk: The increase in real rates and the continuous rise in the prime rate exemplify the cyclical nature of the economy. Let's imagine it's the second quarter of 2022, and you have both excess savings and a Home Equity Line of Credit (HELOC). Suppose you decide to use your HELOC, tied to the Prime Rate, to purchase land or property worth $200,000. With a HELOC structured at Prime + 2%, at a 3.0% Prime Rate, you would be paying 5.0% interest, amounting to $833 per month. Now, fast forward through an exceptionally rapid tightening campaign, and the Prime Rate has more than doubled to 8.25%, resulting in an 11.25% interest rate on your HELOC, equivalent to $1,876 per month in interest expenses. This scenario demonstrates how the progression of the cycle can lead to precarious situations, where debt service capacity and discretionary consumption become challenging to sustain.

ISM: Later today, we will receive the ISM Services data. The Fed Regional Services Surveys have shown 13 consecutive months of contraction, while both the ISM and S&P Services PMI have consistently trended lower. It is evident that demand conditions have taken the lead from the supply-side in influencing price trends across the goods economy. Furthermore, the services economy typically follows the trajectory of the goods economy with a lag, which implies a similar pattern for the services sector.

Labor: The surprising increase in payrolls comes despite the Federal Reserve's efforts to cool down the job market through interest rate hikes. Despite the high number of open positions compared to available workers, the strong payroll numbers will likely put pressure on the Fed to continue its hawkish rate hike campaign. This, in turn, is expected to further slowdown the economy. Private sector jobs surged by 497,000 for the month, well ahead of the downwardly revised 267,000 gain in May and much better than the 220,000 Dow Jones consensus estimate. The increase resulted in the biggest monthly rise since July 2022.

New Home Sales/Construction: Given low levels of resale inventory, new home construction remains a primary beneficiary in the current economic conditions. The uptick in activity in the new home market will support Residential Investment and contribute to GDP.

Auto Sales: June saw a month-over-month increase of 4.19% and a year-over-year increase of 20.6% in auto sales. With automobiles accounting for over 20% of Total Retail Sales, this growth will contribute positively to the reported June.

Okay, so what does this all mean? Well, here's what we are doing. We remain patient and cautious. We have made investments into gold, silver, and Japanese large cap ETFs, all reflected in our models. We continue to maintain large positions in money markets (yielding approximately 5% annualized) and FDIC insured bonds.

*The statistical data, interpretation and quotes were provided by Keith McCullough and the Hedgeye team.

THE CALDER TEAM

You've got the entire Calder team serving you with our collective thought leadership and diverse expertise. We're here for you.

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