November 17, 2021

End of Year Update

Today's most recent economic news showed a surprise jump in retail sales in October - a trend that will most likely continue throughout the remainder of the year. More than likely, the stock, bond and real estate markets will end the year in positive territory. That said, what's behind this picture and what can we expect moving into 2022?

The underlying factors that the economy is now facing – supply chain issues, inflation, overvalued stock and real estate markets – are beginning to bubble to the surface and will most likely manifest themselves clearly throughout 2022. Furthermore, the cost of this pandemic to the U.S. economy derived from government bailouts, creation of helicopter money, and tax breaks has added close to *$7 trillion* to our national debt in just the last 20 months. This includes the $1.2 trillion infrastructure bill that recently passed into legislation.

We've all heard of the supply chain issues, which have only gotten worse, not better since the problem came to light in late summer. Signifying part of the problem, there are some 116 large container ships anchored off the coast of Long Beach and Los Angeles waiting to unload their cargo, but there aren't enough dock workers and truckers to get the job done. The labor department reported last week that 4.4 million people – roughly 3% of the nation's workforce – quit their jobs in September. That's in addition to the 3 million workers over the age of 60 that decided to retire early last year due to the pandemic. Currently, there are over 11 million job openings.

Inflation in the U.S. hit a 31-year high in October of 6.2% from a year ago – the biggest 12-month jump since 1990. This includes widespread and sizable price increases for everything from groceries to fuel to cars. Consequently, 70 million people who rely on Social Security will receive a 5.9% cost of living adjustment next year. That's the biggest bump since 1982.

How inflated are stocks and real estate? With respect to stocks, the total market capitalization of equities as a percentage of GDP has a historical average of just 80%. Today that percentage is 212%. The previous peak, which was reached at the apex of the great Nasdaq bubble in 2000 was 140%. As a reminder, from that level the S&P lost 50% and tech stocks plunged 80% from 2000-2002. Despite these all-time high values, the historically low interest rates set by the Federal Reserve (Fed) continue to push investment dollars into very speculative ventures. As an example, the market value of

Rivian Automotive - an electric car startup company that went public in October and to date has produced less than 200 vehicles - is worth more than that of Ford Motor company and General Motors *combined*. As far as real estate is concerned, home prices have steadily increased since the beginning of the pandemic. In 2019, the existing median home sales price in the *country* was $258,000. Today, it is $352,800 – almost a $95,000 increase!

After months of denial the Federal Reserve is finally growing uncomfortable with the pace of stock and home valuations. Now that inflation has raised its ugly head, The Fed doesn't want to kill the economy by raising interest rates too rapidly. They are also leery of decreasing the money supply (the monthly printing of $120 billion in treasuries) which helps keep interest rates near zero. The Fed knows that they're boxed into a tight situation of their own doing. They understand that their current policies will continue to fan the flames of inflation as the stock and real estate markets continue to appreciate at dangerously high levels.

Where is all this heading? No one knows for sure but the problems of inflation, supply chain issues, continuing of the coronavirus pandemic, and the Fed's reluctance to increase interest rates and decrease the money supply may be heading us into a period of stagflation. That's a term we haven't heard since the mid 1970's – signifying slowing economic growth coupled with high inflation. Our philosophy remains to protect our clients' assets from large scale declines as we continue to seek growth from reliable and proven investments.

As always, we at Kapusta Financial Group, would like to thank you for the trust and confidence you place in our team.