And Into the Contamination

Mark Grant | August 28, 2023

I begin today’s commentary with a personal experience. Three years ago, I leased my Maserati at 1.80%. It was an arbitrage, of sorts. I was getting more than 10% on my income funds and they all paid monthly. The lease was also payable monthly. It was an easy decision.

The lease had run out and I went back to the Maserati dealer, and he told me that the leases were now 9.00%, paying monthly. Frankly, I was just floored so I got out a check and paid the car off in full. The vehicle only had 9,600 miles on it, but the cost difference was now considerable. Thanks to the actions of the Fed the cost of borrowing money, for anything, for everything, has now skyrocketed through the roof. They only speak of fighting Inflation, but they are causing massive disruptions to our economy, in my opinion, especially in lending.

> “It is the Fed’s job to bring inflation down to our 2 percent goal, and we will do so. We have tightened policy significantly over the past year. Although inflation has moved down from its peak, a welcome development, it remains too high. We are prepared to raise rates further if appropriate and intend to hold policy at a restrictive level until we are confident that inflation is moving sustainably down toward our objective.”
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> -Fed Chairman, Jerome Powell, Jackson Hole

Turn anywhere you like but we have now gone from price Inflation to borrowing Inflation. We have shifted gears, no doubt, but the Fed, in my view, is causing massive disruptions for both people and corporations. Then, on top of this, the Congress and the Fed have both been providing new regulations for the banks which makes borrowing money not only more costly but new and stringent regulations are also causing some very real problems.

Fitch warned it may downgrade the outlook for more than 70 U.S. banks, including some of the largest institutions, a move that could push interest rates for consumer loans higher. Fitch Ratings could downgrade its rating for the U.S. banking sector’s “operating environment” to a+ from aa-, a move that could trigger downgrades to more than 70 individual banks monitored by the agency, including giants such as JP Morgan Chase and Bank of America, a Fitch analyst told CNBC Tuesday.

Sector Borrowing Cost

Prime Rate 8.50%
HELOC 7.75%
Car Loan 7.17%
Mortgage 7.23%

*Data provided by Bloomberg.

Then there is what the Fed is doing to our government's debt. The height of the Yield Curve is now the 6 month Treasury Bill at 5.53%. The two year note also breached 5.00% last week and it closed on Friday at 5.08%. I expect that soon the entire Yield Curve will carry 5.00%+ handles and we may be headed for 6.00%+ handles if the Fed does not stop its relentless rises in interest rates. Just think what that will do to the nation's borrowing costs and to the Dollar as a result. We are in the process of getting pummeled and almost no one in the Press seems to recognize the consequences of the Fed's actions.

> "Restrictive monetary policy has tightened financial conditions, supporting the expectation of below-trend growth. Since last year's symposium, the two-year real yield is up about 250 basis points, and longer-term real yields are higher as well—by nearly 150 basis points. Beyond changes in interest rates, bank lending standards have tightened, and loan growth has slowed sharply. Such a tightening of broad financial conditions typically contributes to a slowing in the growth of economic activity, and there is evidence of that in this cycle as well. For example, growth in industrial production has slowed, and the amount spent on residential investment has declined in each of the past five quarters."
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> -*Barron's*

I also add that all of this is going to make it very difficult for the stock markets. At many companies both revenues and profits are going to be down because of the costs of borrowing money. This will also negatively impact new deals, refinancing's, stock buy-backs, mergers, acquisitions and any growth in stock valuations and prices. The Fed may be beating Inflation but, in the process, they are also beating up the

American economy. Some kind of balance is required, in my view, but none seems to be forthcoming.

> "Turning to the outlook, although further unwinding of pandemic-related distortions should continue to put some downward pressure on inflation, restrictive monetary policy will likely play an increasingly important role. Getting inflation sustainably back down to 2 percent is expected to require a period of below-trend economic growth as well as some softening in labor market conditions."
>
> -Fed Chairman, Jerome Powell

For investors, "Caution" is now THE word, and I would stick to its meaning with vigilance.

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