INVESTMENT STRATEGY NOTE

The Trade After the Election Trade

NOVEMBER 2024

I'm going to save you from another piece about the election. We wrote a couple of pieces about it and who we thought would win. If you have any questions about the election, please feel free to reach out to clientservices@poxono.com.

TLDR: Trump won. Now the trade after the election trade may be to navigate a dead decade of muted equity performance due to demographic challenges and bloated debt numbers stifling growth similar to what occurred in Japan in the 1990s and 2000s. That being said, there is hope for the US because of immigration and a potential technological revolution in AI that will stimulate growth.

Let's talk about how the US has created growth and why the middle class can't FEEL it. Our wages don't keep up with the things that we buy that matter – items that we can't import. The lagging wages create poor incentives for key economic factors such as household formation and birth rates - both key factors that drive GDP growth. This chart assumes everything in 1995 is normalized to a $100 basis. Wages haven't kept up with housing costs, childcare, or college costs.

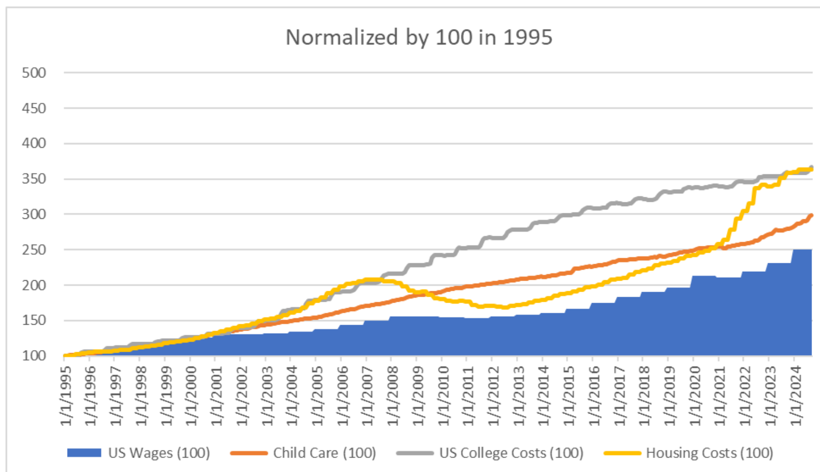

Chart 1: The above chart includes information from Bloomberg Professional - USHIUNST Index, CPWXCHRS Index, CPIQCTFN Index, UKHCCPIH Index

Every second that you wait to buy a house or have a child (both daycare and future college costs), you are losing ground. That is terrifying.

How did wage growth lag over the last 30 years?

Was it labor supply putting a lid on wage growth? You can point to the internet increasing productivity so much that it may have destroyed more jobs than it created, leading to labor supply which dampens wage growth. You can point to globalization, which exported labor demand, leading to labor oversupply, which dampens household income. Maybe – I think these are small factors.

I think it's liquidity driven. The Fed and the US gov't have used Federal Debt and the Federal Reserve's balance sheet to flood the market with liquidity, which stimulates demand for all assets and services – especially the assets and services that can't and won't benefit from globalization.

Why does it feel like wages are falling further behind?

Prior to 2008, massive Federal Reserve intervention and massive fiscal deficits were reserved for wars and protecting western society. Now we use them to fix mistakes like over levered-banks and COVID policies.

The issue may also be that we have shot the only types of bullets available in the gun that don't have crippling inflation and national debt consequences. In 2008, we used our Fed intervention bullet – The Fed's balance sheet was used to absorb banking system leverage so the losses wouldn't reverberate through the economy for years. In 2020, we shot the Fed balance sheet intervention bullet to prop up bloated corporate balance sheets and we fired a second bullet of money supply into the system using fiscal stimulus bills to keep small businesses open.

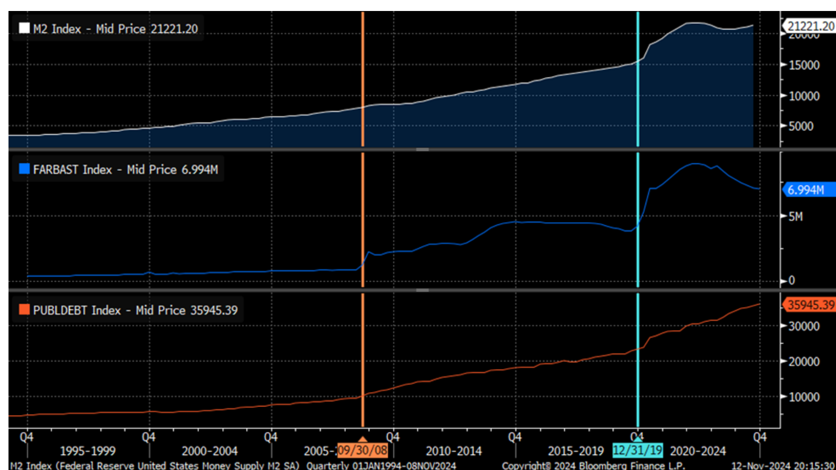

Chart 2: The top panel of the chart is the M2 money supply. Per the Fed's website, "M2 is a broad measure of the money supply, including currency and various sorts of bank and money market mutual fund deposits that are relatively liquid." Simply put – this is the money out on the streets. The middle panel of the chart is the Fed's Balance Sheet. The Fed's balance sheet is a measure of the assets owned by the federal reserve. Simply put – this is the money in the system. The bottom chart is our national debt. The national debt is similar to M2, I just wanted to highlight that.

The COVID round of intervention was different. The COVID stimulus went into the hands of the people and led to goods inflation – which then pushed inflation through the system (which we likely aren't done with). The rate hikes used to stall inflation caused ballooning debt numbers to be exacerbated by higher borrowing rates for the federal gov't.

Overall, the issue isn't that we stimulated the economy in 2008 to prevent a depression or in 2020 to keep the lights on at local businesses during COVID lockdowns. The problem is that the growth created by these interventions and modern monetary policy has left wages lagging key service costs and major asset types, which widens the wealth gap (people with assets invested will grow wealth faster than people without invested assets).

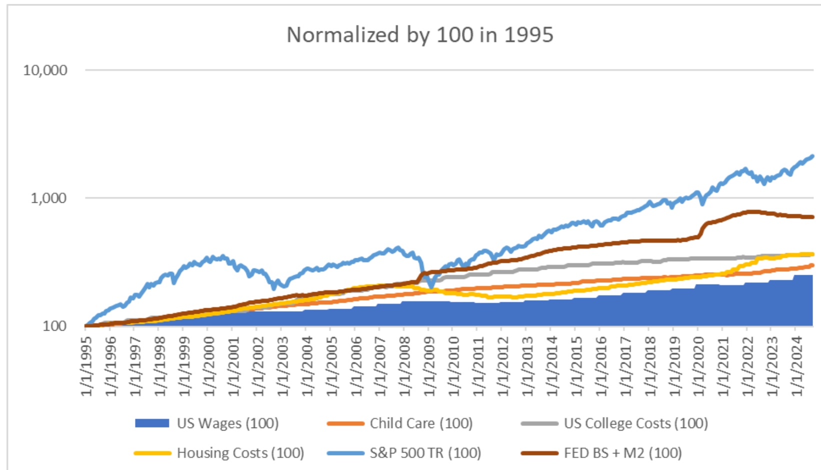

Chart 3: The above chart includes information from Bloomberg Professional - USHIUNST Index, CPWXCHRS Index, CPIQCTFN Index, UKHCCPIH Index, SPXT Index, M2 Index, FARBAST Index

How do we make it stop?

Short Answer: It's going to be very difficult, and it may take time. Innovations in supply that have worked on other factors like Oil/gasoline/natural gas production from US oil/fracking won't apply as easily. The hard part about industries like childcare and housing is increasing output (kids/teacher or homes per neighborhood) usually hinders the quality of the product.

Decreases in demand are an option. For most of the factors in our chart, decreases in household formation and reproductive rates would bring down demand and prices. We are starting to see those downward trends in household formation and birthrates intensify. The problem with shrinking populations is it becomes very difficult to sustain strong GDP growth without a technological or industrial revolution.

Is Trading Japan in the 90s our playbook for decreases in demand?

I'm going to provide some background on Japan's last 40-50 years. In the late 80s/early 90s, Japan's stock market peaked as its Debt to GDP ratio surpassed 1.0x. Additionally, the currency began to lose value while increases in national debt and policies like yield curve control failed to stimulate growth. The population

eventually plateaued in the 2000s, balancing demand in housing and other factors, similar to the ones that we discussed. New highs in stocks were eventually reached ~30 years later in the 2020s.

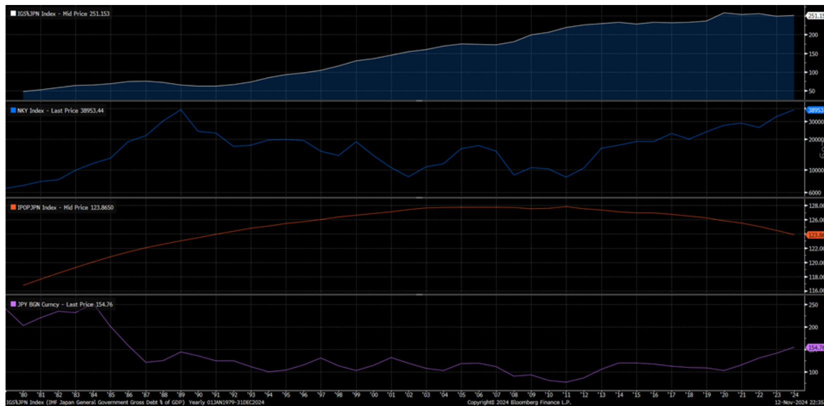

Chart 4: The top panel of the chart is Japan debt to gdp ratio. ~2.5x debt to gdp. The second panel of the chart is the NKY Index. The third panel the Japanese population. The bottom panel is the JPY currency vs USD.

The US is currently similar to Japan in the late 80s. We are running a large fiscal deficit that is adding to the national debt, and the debt is now 1.2+x GDP as the SPX is peaking. Birth rates in the US are falling, and the USD dollar is falling vs gold/bitcoin.

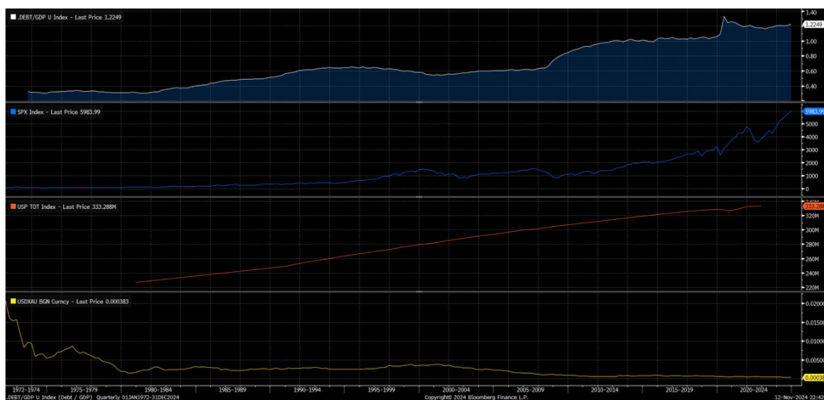

Chart 5: The top panel of the chart is US debt to gdp ratio. ~1.2x debt to GDP. The second panel of the chart is the SPX Index. The third panel the US population. The bottom panel is the USD currency vs Gold.

No two situations are exactly the same but we are using Japan as a potential playbook as we tread into the trade after the election trade. The US is in uncharted territory with its debt. We will continue to look at history to learn about potential outcomes. There are instances where there are dead decades in equity markets, and we are preparing for a possible outcome with a dead decade or two.

What’s the good news?

Our population has the benefit of immigration. The US is an extremely popular place to come and build a life. I don’t see that changing any time soon. Immigration will help us stimulate growth despite a low birth rate.

Japan did not have a potential technological revolution brewing in its economy. The AI boom could lead to massive jumps in productivity and job creation in ancillary industries such as power plants and data centers. Also, when the Fed begins a cutting cycle without a recession (aka “soft landing”), equity markets outperform.

What’s the trade?

We remain long US equities where appropriate. We don’t believe the base case for markets is going to be in a dead decade, but we are focused on understanding all potential outcomes – no matter how bleak. Given the fact that we think a dead decade in US stocks has a reasonable probability, we are positioning appropriate portfolios with quality high yield portfolios to generate income, as well as global equities with tilts towards economies with room to stimulate.

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