ROCKEFELLER
GLOBAL FAMILY OFFICE

CIO MONTHLY PERSPECTIVE

MARCH 2024

Life Imitating Art

The Godot recession and political theatre

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Market Watch

Equity Market Indices[1]	1/31/24 Price	2/29/24 Price	MTD Change	YTD Change
MSCI All Country World	731	761	4.2%	4.7%
S&P 500	4846	5096	5.2%	6.8%
MSCI EAFE	2248	2286	1.7%	2.2%
Russell 2000®2	1947	2055	5.5%	1.4%
NASDAQ	15164	16092	6.1%	7.2%
TOPIX	2551	2676	4.9%	13.1%
KOSPI	2497	2642	5.8%	-0.5%
Emerging Markets	976	1021	4.6%	-0.3%
Fixed Income				
2-Year U.S. Treasury Note	4.21%	4.62%	41	37
10-Year U.S. Treasury Note	3.91%	4.25%	34	37
BBG U.S. Agg Corp Spread	0.96%	0.96%	0	-3
BBG U.S. HY Corp Spread	3.44%	3.12%	-32	-11
Currencies				
Chinese Renminbi (CNY/$)	7.17	7.19	0.3%	1.2%
Brazilian Real (Real)	4.96	4.97	0.3%	2.3%
British Pound ($/GBP)	1.27	1.26	0.5%	0.8%
Euro ($/Euro)	1.08	1.08	0.1%	2.2%
Japanese Yen (Yen/$)	146.92	149.98	2.1%	6.3%
Korean Won (KRW/$)	1334.65	1331.40	-0.2%	3.4%
U.S. Dollar Index (DXY)	103.27	104.16	0.9%	2.8%
Commodities				
Gold	2040	2044	0.2%	-0.9%
Oil	75.9	78.3	3.2%	9.2%
Natural Gas, Henry Hub	2.10	1.86	-11.4%	-26.0%
Copper (cents/lb)	391	383	-1.8%	-1.4%
CRB Index	272	275	1.0%	4.3%
Baltic Dry Index	1398	2111	51.0%	0.8%

Source: Bloomberg

INTRODUCTION

February 22 was a special day for human ingenuity and perseverance. America celebrated its first lunar landing in 52 years, executed by a private company, Intuitive Machines, whose share price has also gone to the moon leading up to the landing. Investors rewarded Nvidia's technological ingenuity with the biggest ever single-session increase in market value – $277 billion – following the company's blowout earnings report. The euphoria sent major stock indices around the globe to fresh new highs. Japan's Nikkei 225 Index finally surpassed the prior peak reached on the last trading day of 1989, albeit by only 0.47%. Imagine having to endure 34 years of losses to finally eke out a small gain; it's not what we mean by investing for the long run.

While investors were feeling bubbly, former Treasury Secretary Larry Summers warned that markets have been underestimating political and social risks. Fed Governors Jefferson and Waller both cautioned against premature easing. The Fed's recent backpedaling on the timing of rate cuts has pushed up bond yields and nudged the market to now price in only three cuts for 2024, in line with the Fed's guidance.

With AI-related stocks having gone parabolic, there is the worry that a market bubble may be forming. However, it's hard to characterize the entire stock market as a bubble when the Russell 2000 Index is still down 16% from its peak. While equities may be due for a pullback for a variety of reasons – frothy sentiment, narrow leadership, back up in bond yields – the downside risk in the first half of the year might be limited as investors will look to the Fed's eventual rate cuts as a security blanket. Washington will also shower the economy with more fiscal stimulus ahead of the November elections.

The market outlook will get more complicated by autumn when elections come more into focus. With the U.S. economy having been propped up by unprecedented procyclical fiscal largesse, elections are now far more consequential. Given the tightness of the key races and a wide ideological gulf between Republicans and Democrats, policy uncertainties, such as the size of the fiscal cliff and trade policies in 2025 and beyond, will remain elevated until the electoral outcomes are known.

Lastly, a day after the Intuitive Machines' lunar landing, it was revealed that the lander had tipped over on its side during touchdown. The news sent the company's share price down nearly 40%. Let's hope that it is not an omen for other market highflyers.

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The Theatre of the Absurd

It was a bitter cold evening in Paris on January 5, 1953. A light dusting of snow muffled the usual urban cacophony. A line of theatergoers braved the elements and entered a small Left Bank theater called Théâtre de Babylone for the premier of *En Attendant Godot*, a play written by a heretofore little-known Irish writer, Samuel Beckett. After numerous rejections, it had taken Beckett four years to find someone willing to produce the play. Roger Blin, a French actor and director, finally gave it a shot since it was a low-risk production involving only five actors on a rather minimalistic set with a tree made of coat hangers in the center.

The play opened with two vagabonds, Vladimir (Didi) and Estragon (Gogo), meeting by the leafless tree. After the duo rambled on about issues of little significance, it was revealed that both were waiting to meet a man named Godot. Their incoherent dialogue was interrupted by a traveler named Pozzo who was on his way to the market to sell his slave, Lucky. After their departure, a boy showed up and informed Didi and Gogo that Godot would not arrive that night.

In Act II of the play, the duo was once again waiting for Godot near the tree which had grown some leaves. Pozzo and Lucky reappeared, but the former was now blind and the latter mute. No one could recall if they had met the day before. After Pozzo and Lucky left, the boy showed up again and announced that Godot would not be coming. The duo was upset that the boy refused to acknowledge that they had met before. After the boy's departure, they considered suicide but could not find a rope to hang themselves, so they decided to return the next day with a rope.

The surreal play left many in the audience confused; some had walked out before it was over. One critic said, "This is not theater as we know it." Beckett was not at the premier to gauge the reaction, as he later admitted that watching his own plays would make him too self-conscious. While the reactions were mixed, some reviews were quite enthusiastic, with one of France's foremost dramatists praising the play as a masterpiece. The English version of *Waiting for Godot* premiered in London on August 3, 1955, and again elicited strong reactions from admirers and detractors. As the years went by, it became one of the most iconic plays of the 20th century.

Samuel Barclays Beckett was born to an upper middle-class family in the Dublin suburbs in 1906. After graduating from Dublin's Trinity College in 1927, Beckett left for Paris to plow his own furrow. He was introduced

Samuel Beckett (left) with three cast members of Waiting for Godot. January 1, 1975.

Edinburgh International Festival 2018

Marty Rea and Aaron Monaghan perform 'Waiting For Godot' on stage during a photocall for the Edinburgh International Festival 2018 at The Lyceum Theatre on August 3, 2018 in Edinburgh, Scotland.

to renowned Irish writer, James Joyce, who took the young man under his wing. Beckett worked for Joyce as a research assistant on a colossal literary undertaking that was eventually published in 1937 as *Finnegans Wake*, Joyce's opus ultimum.

Beckett returned to Trinity College as a lecturer in 1930 after reportedly breaking off a love affair with Joyce's daughter, Lucia. Beckett soon realized that Dublin's more traditional cultural scene was stifling to his intellectual evolution. He told a friend, "I am not interested in normal; I am interested in the abnormal." He resigned from Trinity College in late 1931 and began traveling throughout Europe. He also underwent two years of psychoanalysis following his father's death in 1933. He continued to write, but his works did not receive much recognition. Beckett's relationship with his mother became strained as she was disappointed at his inability to pursue a steady career and the falling-out prompted him to settle in Paris.

After France's fall to Nazi Germany during WWII, Beckett decided to join the French Resistance. He quipped that he preferred "France in war to Ireland in peace." He and his girlfriend Suzanne Dechevaux-Dumesnil were nearly captured by the Gestapo on multiple occasions. In the latter part of the war, they had to work as farmhands to scrape by. Beckett later downplayed his war efforts as "boy scout stuff," but was awarded two medals by the French government.

During a brief visit back home in 1945, Beckett had a revelation in his mother's bedroom. He realized that he would always be overshadowed by James Joyce unless he pursued a different literary direction. He began writing mostly in French about the downtrodden with the recurring theme about the failure of humans to overcome "absurdity" – that everything people do is essentially pointless as the end result will be the same and beyond our control.

THE THEATRE OF THE ABSURD

The unexpected success of *Waiting for Godot* catapulted Beckett to literary stardom, but he remained intensely private. In October 1969, while on vacation in Tunis with Suzanne whom he married in a secret civil ceremony in 1961, he learned from his long-time publisher, Jérôme Lindon, that he was awarded the Nobel Prize in Literature. When Swedish Television requested an interview, Beckett agreed but on the stipulation that no questions could be asked. The TV crew wound up shooting a 90-second "interview" with Beckett staring into the camera in silence. He also declined to attend the award ceremony and instead sent Lindon to accept the honor.

While Beckett's plays and novels often conveyed an attitude of not taking things too seriously – life is absurd after all – he was highly meticulous and protective of his works. He had steadfastly refused to put *Waiting for Godot* on the big screen despite the financial incentives. In 1988, he sued a Dutch theater company for casting women in *Waiting for Godot*. Since his passing in 1989, his estate has continued to forbid any productions that deviate from Beckett's original intents and precise instructions. Beckett's posthumous grip on his works will last until 2059, with the copyright lasting 70 years after his death. This strict adherence to originalism has led some venues to cancel productions of "*Waiting for Godot*" in recent years for not being inclusive. Ironically, the cancellations may be apropos in the tradition of Beckettian absurdism, as he once wrote prophetically, "All I say cancels out, I'll have said nothing."

The Exorbitant Privilege

As a result of its immense success and popularity, *Waiting for Godot* has entered the English lexicon as a phrase to describe the futility of an endeavor or unfulfilled expectations; the elusive Godot has come to embody something that is eagerly anticipated but never arrives.

In 2023, many economists and investment strategists probably felt like Didi or Gogo as the most anticipated recession in decades failed to materialize. Not only did the U.S. economy avert a recession, real GDP growth accelerated way above trend in the second half of the year. In early 2024, Treasury Secretary Janet Yellen declared that the U.S. economy had achieved soft-landing, and most investors have quit waiting for the Godot-like recession.

While "Godot" did not show up in the U.S., it has made its presence felt in several other major economies.

In 2023, China, the world's second largest economy, experienced a shrinkage in nominal GDP in U.S. dollar terms as it was hit with deflation as well as renminbi depreciation. With the Chinese economy beset with structural challenges, capital flew out of the country and landed in neighboring Japan on the thesis that its corporate governance has materially improved to benefit shareholders. However, despite a strong market that excited foreign investors, Japan officially entered recession in the second half of 2023 as domestic demand succumbed to the shrinking purchasing power of households. The sinking yen – having weakened nearly 30% over the past three years, from 107 to 150 yen per dollar – dragged the global ranking of Japan's economy in U.S. dollar terms to fourth place behind Germany.

The German economy's ascendancy to third place felt like a pyrrhic victory – Germany's real GDP has flatlined in real terms for nearly two years and finished the final quarter of 2023 at an annualized contraction of 1.1%. The Bundesbank has warned that the economy may have already slid into recession. Another European economic powerhouse, the United Kingdom, which ranks sixth in the world, has officially entered recession with two consecutive quarters of GDP contraction.

While pundits often play up the U.S. "exceptionalism" due to America's strong economic performance in the post-COVID period, what really sets the U.S. economy apart from the rest of the world is the exorbitant privilege of printing the world's reserve currency. Washington has been able to raise a huge amount of debt to stimulate the economy without stoking sustainably higher interest rates, an advantage that most other countries can only dream of. With Congress having suspended the debt ceiling until 2025, the federal government ran up $2.6 trillion of net new debt in 2023 – roughly $300 billion was added to the Treasury General Account (akin to the federal government's checking account), and the rest funded the economically stimulative fiscal deficit and grants. Relative to the prior year, Uncle Sam's deficit in 2023 went up by roughly $1 trillion.

Political Theatre

Economics 101 and common sense dictate that fiscal policies should be counter-cyclical. That is, the government's budget deficit should rise during tougher economic times and fall during boom times. That was exactly what had happened in the U.S. before 2017 – federal deficit measured as a percent of GDP rose and fell with the unemployment rate (Chart 1). As the U.S. economy weakened and unemployment rate rose, lower tax receipts and higher fiscal stimulus would push deficits higher. On the other hand, as the economy expanded with the jobless rate heading steadily lower, deficits declined as a result of higher tax revenues and lower stimulus spending.

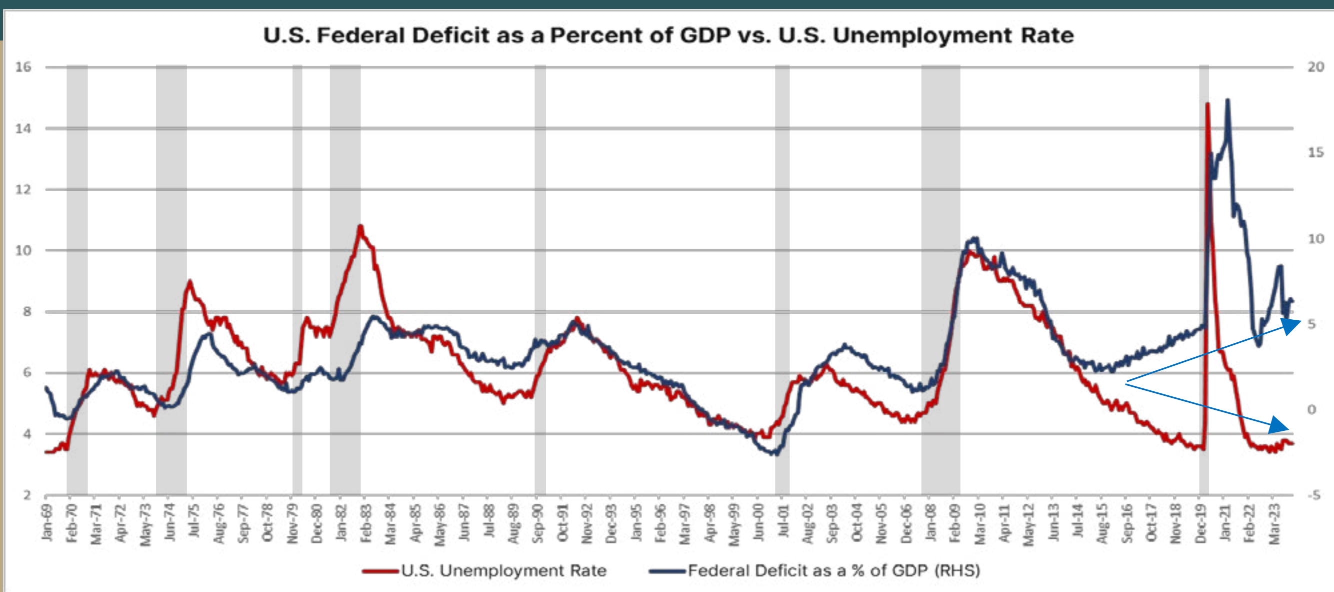
Since 2017, this common-sense fiscal management was abandoned in favor of juicing the economy fiscally even during boom times, as shown in the growing divergence between the deficit and jobless rate (excluding the pandemic period).

From September 2016 to February 2020, the unemployment rate dropped from 5% to 3.5%, yet the federal fiscal deficit ballooned from 2.6% of GDP to 4.9%. This rise in deficit was largely due to President Trump's procyclical tax cuts, which prompted Senator Rand Paul to accuse his GOP colleagues of being "hypocritical" for passing both tax cuts and spending increases. However, self-styled fiscal hawks in Congress never second-guessed voting for tax cuts knowing full well that there would be no offsetting spending reduction.

POLITICAL THEATRE

In 2021 and 2022, with Democrats having gained control of both chambers of Congress, President Biden wasted no time implementing ambitious spending initiatives. The result is that the federal government's outlays have been raised structurally from roughly 20% of GDP over the six years prior to the pandemic to 23% and higher over the next ten years, according to the Congressional Budget Office (CBO). The outlays and deficits would have been even greater had two Democratic senators – Kyrsten Sinema of Arizona and Joe Manchin of West Virginia – not pushed back against the audacious Build Back Better Act, which had an original price tag of $3.5 trillion. It now appears that neither Manchin nor Sinema will return to the Senate in 2025; the former has decided not to seek reelection, and the latter, now an independent, is experiencing fundraising issues.

In 2023, Washington increased the fiscal deficit to over 7% of GDP even with the unemployment rate dropping to a 54-year low of 3.4%, which is unprecedented during peace time. With the general election just eight months away, it does not appear that Washington will lift its foot off the gas pedal. The gridlock-prone House has managed to pass a $78 billion bipartisan tax cut deal – boosting child tax credit and restoring some business tax breaks – that is actually front-loaded to the tune of $136 billion in 2024. The White House also defied the Supreme Court's ruling against student debt forgiveness by approving debt cancellations for 227,000 more borrowers so far in 2024. It has proudly announced that, under the current administration, over 3.9 million borrowers have had their student debt cancelled, totaling nearly $138 billion. On the frivolous side of political grandstanding, congressional members have advocated unrealistic perks such as universal basic income ($43,000 annual payments to a family of four) and minimum wages as high as $50 per hour.



Source: Bloomberg

The Art of Treasury Issuance

In November 2017, as the Trump tax cuts were debated in Congress, then Fed Chair Janet Yellen was asked about the rising national debt at a congressional hearing. With gross public debt at $20.6 trillion at the time and the CBO projecting annual deficits to exceed $1 trillion, Yellen said she was very worried about the sustainability of the U.S. debt trajectory and added, “It’s the type of thing that should keep people awake at night.”

A little over six years later, our national debt has topped $34 trillion, with last year’s fiscal deficit amounting to over $2 trillion on a cash basis. Compared to November 2017, our national debt has increased by 66% in nominal terms and 33% in real terms. However, now as the Treasury Secretary who is responsible for financing our national debt, Yellen has been sounding rather sanguine about the nation’s finances.

In recent interviews, Secretary Yellen said the key metric to judge our fiscal picture is the net interest as a share of GDP, which has “remained at a very reasonable level.” She also blamed the Trump tax cuts for elevated deficits and suggested making corporations and wealthy individuals “pay their fair share” as a remedy.

Despite the reassuring official talking points, there are some disconcerting developments, even for a country enjoying the exorbitant privilege of having the global reserve currency.

One warning sign is that foreign central banks, the most interest-rate insensitive buyers of U.S. Treasuries, have stopped accumulating our debt. At the end of 2013, the total foreign official holdings of U.S. Treasuries amounted to $4.1 trillion, or 23% of the $17.4 trillion U.S. national debt at the time. Ten years later, the U.S. has nearly doubled the national debt to $34 trillion, yet foreign official holdings of U.S. Treasuries have declined to $3.8 trillion, or just 11% of our debt outstanding. It indicates that foreign central banks have been reducing their dependence on the U.S. dollar.

With foreign central banks having reduced their holdings of U.S. debt, the Federal Reserve’s purchase of Treasuries has become more important in recent years. At the end of 2013, the Fed was in the midst of the third round of quantitative easing (QE) and held 13% of the outstanding Treasuries. The subsequent quantitative tightening (QT) brought the Fed’s holdings to 9% of Treasuries outstanding by August 2019. The drain of liquidity then triggered a repo market crisis and forced the Fed to restart bond buying in September 2019. Six months later, the COVID crisis sent the Fed’s QE into overdrive to save the financial market and fund the government’s massive debt issuance. The Fed’s de facto debt monetization kicked off the current era of fiscal dominance. By late 2021, the Fed’s holding of Treasuries had risen to 19.3% of total federal debt outstanding.

With the Fed having initiated quantitative tightening since mid-2022 to battle inflation, the Treasury Department must sell more debt to private investors who are more interest rate sensitive. The Treasury keeps a fairly steady pace of coupon issuance (notes and bonds with maturities of 2 years or longer) each month to avoid disrupting bond yields. The balance of debt financing is met by bill issuance, which swings wildly based on seasonality and other factors, though their yields are well anchored by the Fed funds rate.

THE ART OF TREASURY ISSUANCE

Given the elevated level of budget deficits in 2023, the Treasury Department was planning to gradually increase the volume of notes and bonds issued each month. However, following the Fitch Rating's downgrade of the U.S.'s credit rating on August 1, bond investors started to demand higher yields. The 10-year Treasury yield surged from 4% to as high as 5% in less than three months, and equities pulled back by as much as 10% during that period.

In the face of rapidly rising bond yields, the Treasury Department changed course by issuing fewer bonds than investors had feared while the Fed pivoted to a more dovish policy stance. This one-two policy punch managed to bring the 10-year yield below 4% by year end 2023 and triggered a big equity rally.

All told, the financing of federal debt in 2023 was done through mostly short-term bill issuance: of the $2.6 trillion net debt raised, $2 trillion, or a whopping 77%, was in Treasury bills, and notes and bonds accounted for just 15%. When measured against the net marketable securities issued by the Treasury in 2023 (some securities such as U.S. savings bonds are not marketable), bills accounted for an even greater share at 81%, way above the typical 20 to 22% range. Despite the unusually low share of coupon issuance, the Treasury was barely able to keep bond vigilantes at bay, which is a sign of the market's fragile confidence in Uncle Sam's ability to manage its finances. The key issue now is how the bond market will behave as coupon issuance returns to its normal share in the mid-50% of debt issuance.

Stealth Quantitive Easing (QE)

The market was able to absorb so much Treasury bill issuance in 2023 thanks to excess liquidity in the Fed's overnight reverse repo facility (ON RRP). The overnight reverse repo facility is an arrangement that allows qualified counterparties, such as money market funds, to park their cash at the Fed to earn interest a few basis points higher than the low-end of the Fed funds rate's target range. It became a popular investment option in 2021 as financial institutions were unable to find enough safe short-term investments to deploy the tsunami of stimulus money from the federal government. The size of the overnight reverse repo peaked at $2.5 trillion at the end of 2022. The money in the overnight reverse repo in essence represents excess liquidity in the financial system – it is parked at the Fed to collect interest income rather than being put to productive use, such as financing real economic activity.

In 2023, as the Treasury Department ramped up bill issuance, investors shifted $1.5 trillion from the reverse repo facility to soak up newly issued Treasury bills. After the money went into the Treasury's coffer, most of it was recycled into the real economy and wound up boosting the U.S. banking system's reserve balances at the Fed.

From a market liquidity standpoint, the $1.5 trillion drawdown of the overnight reverse repo in 2023 had more than offset the impact of the $700 billion QT-induced reduction in the Fed's holding of Treasuries securities. The financial system wound up getting a net liquidity injection of roughly $800 billion to absorb the

U.S. Treasury Building in Washington

Treasury's debt issuance. It's no wonder equity valuations expanded materially despite lower-than-expected earnings.

This market-friendly "stealth" QE has continued into 2024, with the overnight reverse repo facility having been drawn down by $516 billion to $502 billion at the end of February. The overnight reverse repo is likely to be fully drained by year end, which would subsequently create a real contraction in market liquidity should the Fed continue to reduce its Treasury holdings. I suspect that the Fed will likely conclude quantitative tightening before the reverse repo facility is drained to avoid a liquidity crunch. Such a move will likely be viewed by market participants as a catalyst to go risk-on.

While excess liquidity has soaked up much of the Treasury issuance, Uncle Sam's interest expenses are running up rapidly. When Secretary Yellen said that the federal net interest expense as a percent of GDP was "very reasonable," the actual figure was 2.4%. The CBO's latest projection has the net interest expense as a share of GDP rising to 3.1% in the current fiscal year, and then climbing steadily higher to 3.9% by fiscal year 2034. The historic high for this ratio is 3.15%, last reached in 1991 when the U.S. economy was coming out of a recession. Three years later, concerns over the deficit and inflation led to the 1994 bond market tantrum that spiked the 10-year Treasury yield from 5% to over 8%. With the net interest expense as a percent of GDP poised to reach new record highs, it may just be a matter of time before bond vigilantes make their presence known once again.

I believe the Fed will need to restart QE in the not-too-distant future to help fund our deficit spending and beat back bond vigilantes. The latest CBO projections actually assumed that QE will resume in fiscal 2026, and the Fed's holding of Treasury securities will roughly double from today's $4.6 trillion to $9.3 trillion by the end of fiscal 2034. My suspicion is that QE will restart earlier than fiscal 2026, and our national debt and the Fed's monetization of it will turn out to be greater than what the CBO has projected.

The One-Stock Market

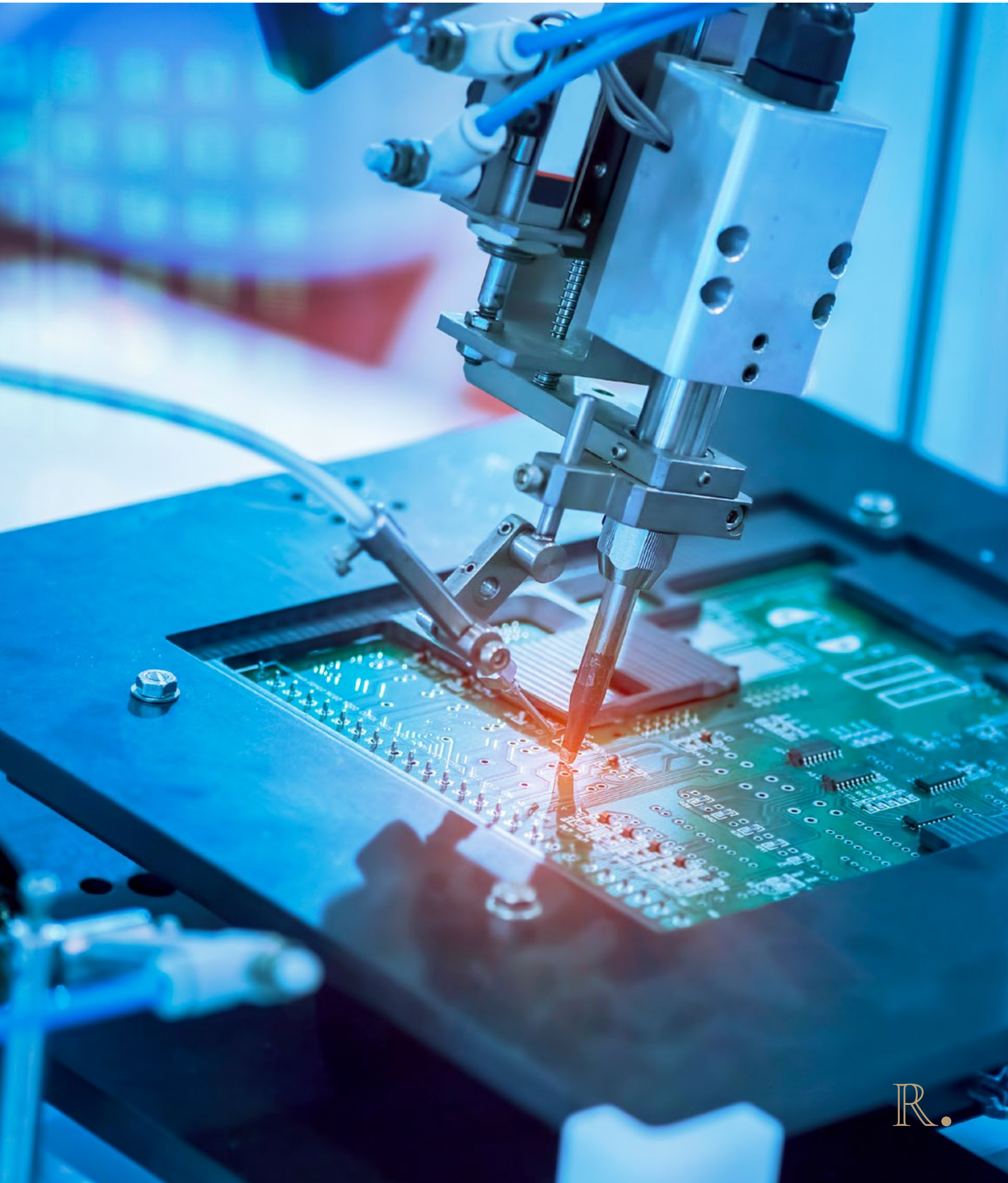
Over the last few weeks, some of the narratives that have powered the impressive equity rally since late October have fallen by the wayside, at least temporarily. The hope of aggressive rate cuts – as many as seven 25-bp cuts in 2024 – was dialed down to be in-line with the Fed's three cut guidance after higher-than-expected inflation readings. Softer-than-expected retail sales and elevated layoff announcements showed that Godot could still arrive uninvited. Investors were reminded that the banking system was far from healed as several banks in the U.S., Japan, and Germany were hit hard by much higher-than-expected loss provisions for their commercial real estate loans. The 10-year Treasury yield has climbed to as high as 4.32% in February, a substantial rise from late December's 3.79% low. However, these developments were brushed off by equity investors as the euphoria over Artificial Intelligence (AI) eclipsed all else.

Since the start of the earnings reporting season in mid-January, stocks enjoying the AI-halo effect have gone parabolic. The quintessential example of AI euphoria has been Nvidia, and its February 21 earnings report was arguably the most anticipated market event year-to-date. Goldman Sachs' trading desk called Nvidia "the most important stock on planet Earth."

To the delight of market bulls, Nvidia handily exceeded expectations and assured investors of continued strong growth. The euphoria was felt around the globe as overseas markets also participated in the rally. It seems that the old adage, "As GM goes, so goes the nation," can now be changed to "as Nvidia goes, so goes the market."

I can't help but ponder about the absurdity of a single stock dictating the movement of the entire global market, but I am also cognizant of what the great John Maynard Keynes had warned, "The market can stay irrational longer than you can stay solvent."

One newcomer to the recent global rally party is the Chinese equity market, which had fallen to its five-year lows on February 2. In a signal to investors that the government was serious about boosting the market, Chairman Xi Jinping convened a meeting with policymakers before the Lunar New Year and replaced the country's top securities regulator. China's sovereign wealth fund made it known that it was expanding the purchase of domestic stocks. In recent days, it was reported that regulators have resorted to the Beckettian move of banning net selling of equities during the first and final 30 minutes of each trading session, which allows state-backed funds to push market indices higher. These measures have worked as desired as the CSI 300 Index had only two down sessions since its February 2 trough.



“Ever Tried…Fail Better.”

The parabolic moves in AI-related stocks are reminiscent of the blow-off top of the dot-com bubble in 2000. The difference is that many of today’s market darlings are established companies with growing sales, profits, and free cash flows. That said, their valuations are extended, and it remains to be seen exactly how disruptive AI will be for business models. For example, how will the search business be affected by more use of ad-free chatbots? Will more effective AI-assisted software development empower start-ups to erode the moats that industry leaders have created? Will the open-source semiconductor design trend, the RISC-V standard, enable leading cloud computing companies to create their own AI processors as a bargaining chip with the likes of Nvidia?

Given the tremendous outperformance of mega-cap stocks and the high expectations built into their valuations, it may be time to consider trimming these outsized winners. While timing is always uncertain, extreme market concentration is not sustainable in the long run, so today’s mega-cap leaders will likely go through a period of underperformance against the rest of the market playing catch-up. As a case in point, market pundits have started referring to the “Fab Five” in grouping leading tech stocks as two members of the so-called “Magnificent Seven” have lost a bit of that air of invincibility.

With capital gains taxes often deterring taxable investors from rebalancing, investors should explore various tax-efficient rebalancing methods with the use of exchange funds, tax loss harvesting, and option strategies.

As the earnings reporting season winds down, the market’s focus will shift back to bond yields and Fed watching. Investors will scrutinize every bond auction to gauge the market’s appetite for rising coupon issuance. If Congress manages to pass additional stimulus and the IRS resumes payments of the highly stimulative Employment Retention Credit (which was suspended last September due to fraud concerns), the Fed may push out rate cuts further to avoid fueling a market bubble and inflation. Such a scenario could push bond yields higher and pressure asset valuations again, assuming the historical cross-asset relationships hold.

In time, likely sooner than the CBO’s 2026 assumption, the Fed will be looking for a pretext to restart QE to help absorb the deluge of Treasury issuance. A post-election economic downturn – assuming a drop-off in fiscal stimulus starting in 2025 – would be an ideal time for the Fed to start monetizing debt. Under that scenario, long bond yields will likely be brought down cyclically to temporarily ease the cost of issuing new debt.

Rising Treasury bond issuance and the seemingly inevitable debt monetization portend higher volatility for Treasury bonds – they are becoming trading vehicles rather than traditional hedges on risk assets. It seems that the market is increasingly looking for hedges against future debt monetization, or money printing-induced purchasing power debasement. This trend may help explain why gold has managed to appreciate by 12% since the end of 2021 – slightly ahead of the S&P 500 Index's total return – despite a 300 bps rise in the real 10-year yield and an 9% appreciation in the U.S. Dollar Index. That said, gold has remained a frustrating investment to many, especially compared to the turbocharged Bitcoin, which has taken both market and mind share. Most goldbugs, especially investors in gold mining stocks, can easily relate to one of Beckett's quotes: "Ever tried. Ever failed. No matter. Try Again. Fail again. Fail better." My base case remains that, as the Fed restarts QE in the not-too-distant future to monetize the government's mounting debt, gold will finally break out of its four-year trading range to new all-time highs.

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