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Lessons for a 7-year-old

By Richard Cluver

It was with a sense of deja vu that I wrote last month of the inevitability of a global economic catastrophe sometime within the next 14 years.

The expression is, of course derived from the French, meaning "already seen." When it occurs, it seems to spark our memory of a place we have already been, a person we have already seen, or an act we have already done. And in my own case it was as a seven-year-old that I read of the first-hand experiences of a young boy of my own age whose parents were among the one in five who lost their jobs – and everything else they possessed – in the aftermath of the economic melt-down of 1929 that became universally known as the Great Depression.

So vivid was the author's tale of the hardships he was forced to endure and such was the impression that it made upon me that much of my own future motivation was a determination that I would never be a victim of a catastrophe like that. And it led, indirectly to the development many years later of the ShareFinder computer system. So it might be tale a few would want to read!

Naively, at age seven I was convinced that were I to save enough of my pocket money – a princely florin a week – I would be sufficiently insulated against such a catastrophe. I say "naively" but in fact that was the formula that was to provide me with precisely the cushion I would need for, in the process of my subsequent savings campaign, I was to learn the incredible power of compound interest.

But I over-run myself! There was a second factor at work. Around that time my paternal grandmother had died leaving me with a lump sum of a hundred pounds which, in the manner of their time, my parents invested for me on call at five percent interest.

Those of you who have been around long enough to do the calculation might work out that a florin a week; or 20 cents in Rands and Cents, saved for 52 weeks a year would give me five pounds and four shillings. So, I had to save for a whole year just to equal the five pounds that my call investment provided me.

It took no great leap of my imagination to realize that lump sums of capital could liberate one from the hard work of life. Aged seven, I knew nothing about compound interest but by the time I came to be taught about it, it was already old hat because I had long since worked it out for myself as I set about building the fortune that I hoped would insulate me against another Great Depression.

Getting together multiples of my hundred pounds capital seemed an impossible objective given that my total income for a year was ten pounds and four shillings….a problem which confronts most starting-out investors because of the seemingly sheer impossibility of it all. But with the sublime optimism of youth, I set out anyway.

You can see for yourself that at the then going rate of five percent it would take forever. My initial savings of ten pounds would become just 16.28 in ten years if I re-invested every penny. There had to be another way.

Like many young investors, I was also distracted along the way by some short-term desires such as a wish to own a new drop-handlebar bicycle which cost me nine pounds and, another year a bedside radio which cost me ten pounds.

So I was forced to get innovative. I won’t bore you with all the projects that brought in money. I sang in a church choir for 12 pennies a week, had a sweet shop in primary school and a fireworks company and, later built Hi Fi amplifiers for my friends. But it was all slow work until I discovered the share market at age 16 and, armed with an initial capital of eleven hundred pounds, started to make real money.

The discovery that changed everything for me was that quality shares like De Beers, SA Breweries and Anglo American whose existence I was well aware of because my parents were investors, enjoyed an annual price cycle. The Stock Exchange Handbook published annually at that time, always published the price high and the price low for the year and, I read with fascination, that the swing between the two was nearly 50 percent in those far off halcyon days.

So armed with a large sheet of graph paper tacked onto the back of my bedroom door I would once a week plot the JSE prices of about 20 shares whom, my parents informed me, were Blue Chips.

It would be years before I formulated my own rules for identifying a Blue Chip and, by then, I was already the owner of my own home on two acres of land for which I had paid cash at the age of 26. But from age 16 I found myself on a wealth trail by the simple process of buying whenever my graphs turned upwards and selling when they turned down.

Once or twice I lost some money when I wrongly judged shares were at the bottom of a cycle but I soon learned that the bottom of a cycle usually coincided with the annual profit announcement and, provided an increased dividend was declared the shares always rose in price. But if profits were not as good as usual and the dividend was reduced or, worse, skipped, the share price continued falling. So I soon learned not to buy unless a dividend increase was announced. Early on then I formulated my first rule of investment which was NEVER buy a share which has not produced at least five years of steadily-rising dividends

Sometime along the line I had by then also learned that there was a person known my many as the “dreaded Receiver of Revenue” above the entrance door of whose office in Durban was mounted a fresco of an eagle soaring with a lamb in its claws. And while it is probably true that the Receiver had little interest in the share market trading activities of a young boy using his pocket money which, by the age of 17 had grown to a massive ten shillings a week, he very definitely might have considerable interest in a young man who was by then making thousands from share trading.

Happily, at the time that an accountancy articled clerk friend told me that I would likely find myself being heavily taxed for my activities, I had sunk most of the capital I had built up into buying a derelict farmhouse on the outskirts of Durban and most of the balance on re-building it, and so my trading days came to an abrupt end.

Not having to meet a monthly mortgage bill or, like most of my friends who had moved out on their own, a landlord’s rental, meant that I always had cash in my pockets and a feeling of wealth. But by then the savings habit was so engrained that I had a rule to save at least that amount that I would have spent on rent. I had also read a book entitled The Richest Man in Babylon by George Samuel Clason which, first published by Penguin Books in 1926 which explained a simple formula for achieving wealth by always saving a tenth of your income.

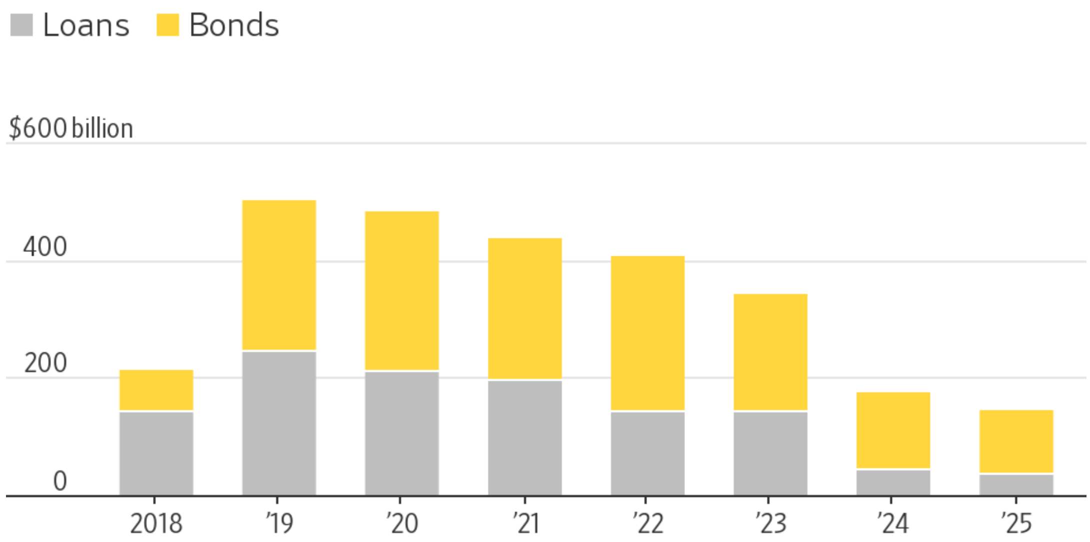
Thus, as I set about re-building my investment capital after the house purchase and, wary about being labeled a trader, I thus embarked upon the financial journey of, hopefully, buying only those shares that I would never need to sell. I thus developed a series of quality rules which I have detailed at length in many of my books and which I eventually built into what is now known as the “Quality List” within the ShareFinder share market software range. Those lists detail the financial statistics of all conforming shares listed on the stock exchanges of South Africa, Britain, Australia and two in the United States.

So, I can say with confidence that the event that I first learned to fear a lifetime ago as a six-year old child, might now be imminent but, armed with my ShareFinder programme and a portfolio of ultra blue chip shares, I am likely to be as safe as the best when economic Armageddon inevitably comes. I trust, dear reader that I have given you enough in my writings to ensure that you are similarly safe!

Debt threatens world economic stability

Meanwhile, Ben Eisen of The Wall Street Journal has reported *that* Turkey's escalating financial crisis is spotlighting the giant stockpile of foreign-currency debt held by emerging markets, a build-up that threatens to throw those economies off course in the coming years.

Emerging market debt denominated in U.S. dollars, by year of maturity



Note: 2018 figures include remainder of year.
Source: Institute of International Finance

Governments, financial firms and other companies in emerging markets have $2.7 trillion in U.S. dollar-denominated debt that comes due between now and the end of 2025, according to the Institute of International Finance. These countries will need to pay off or refinance their loans and bonds as they come due.

The trouble: a slide in emerging-market currencies against the U.S. dollar makes it tougher to pay back that greenback debt, particularly for countries where more revenue is generated in local currencies that are suddenly less valuable on a relative basis.

Turkey has more foreign-currency debt as a share of gross domestic product than many of its peers, a key source of concern for emerging-market investors at the moment. The country's currency, the lira, is down 45% against the dollar so far this year, as President Recep Tayyip Erdogan and U.S. President Donald Trump continued their war of words. That will make it more expensive to repay dollar debt.

For now, there's little evidence that all emerging-market currencies will be hit with the same ferocity as Turkey, where recent troubles have been sparked by its unique economic policies and questions about the government's willingness to quell the crisis.

But even outside Turkey, emerging markets have grown their foreign-currency debt sharply in recent years as they took advantage of low rates that made borrowing cheaper and lifted demand for risky assets like the bonds of developing economies.

Hungary, Argentina, Poland and Chile all have foreign-currency denominated debt that stands at more than half of gross domestic product, according to Deutsche Bank. That could become more difficult to refinance as rates keep rising. Any reduction in foreign capital inflows may also make borrowing more difficult.

That outlook has played a role in the decline of emerging-market currencies around the world in recent days. It's worth watching as foreign-currency debt matures in the years ahead in an environment that's increasingly less hospitable to borrowers.

CFs and High Rollers

The following are both true statements:

- You should save until it hurts.
- Money is meant to be enjoyed.

A couple of weeks ago I dove into ***The Millionaire Next Door***. I got frustrated with it after about 45 pages. Story after story of people wearing awful suits, driving s---box cars, and living in 1,200 square foot houses, with multiple seven figure bank accounts.

Admittedly, those people are rare. More commonly, we find people with expensive suits, expensive cars, and giant houses—crushed by hundreds of thousands of dollars in debt, and with no savings.

You do not want to be either of these people.

Category 1: The CF

Don't write me asking what CF stands for. If you can't figure it out from the context, I can't help you.

Saving money and living below your means is good, especially early in life, when you are better able to tolerate cheap clothes, cheap food, and cheap apartments. Live below your means, save money, pay down debt, invest, and build wealth. I do not have a problem with someone under the age of 45 living below their means.

I do have a problem with someone over the age of 45, who has accumulated lots of wealth, living below their means.

The Millionaire Next Door is full of stories of people who live like they are poor, even though they are actually rich. These are people who are close to or in retirement. It is not an issue of financial security—they have plenty of money. Spending it would simply give them no pleasure. They just like to watch the number in the bank account get bigger.

I have a moral problem with that. If you earn money, you had better ------- enjoy it. Maybe not when you are 35, or even 45. But by the time you are 55 (and hopefully before), you had better be enjoying the product of all the work and good risk-taking you have done over the course of your life.

Not many people will openly admit this: ***money allows me to buy material things, which give me pleasure.*** What the authors of ***The Millionaire Next Door*** don't get, is that a suit is not a suit. The cheap ones are not the same as the expensive ones. I have a few people give me grief about my shirts, which are not cheap. They say I could buy $29 shirts at Charles Tyrwhitt. Admittedly, Charles Tyrwhitt makes decent shirts, but screw you—I like my shirts. They give me pleasure. They are better than Charles Tyrwhitt. They look better, too. And they last forever.

I had a friend who was a very senior investment banker. He is a CF.

One day I asked him, "Are you still wearing the JoS. A. Bank suits?"

"Oh yeah," he said.

"You go to fundraisers and political functions and closing dinners in those suits?"

"Of course. Nobody cares."

"They ***do*** care," I said. "People can tell."

"Nobody can tell," he said.

I was getting nowhere. It is pretty rare that you have a CF who changes his mind and stops being a CF.

But optimally, that is how it is meant to work. You're supposed to be a CF early in life, accumulating assets, and then ***not*** a CF later in life, ***decumulating*** assets. The problem is, most people can only do one or the other. Born a CF, always a CF. Or, you could be the opposite—a high roller.

Deep down, in many ways, I am still a CF. It pains me to pay for dry-cleaning—I did all my own ironing for years after college. To this day, I have never paid for a shoe shine.

Category 2: The High Roller

Some people are the opposite of CFs.

My wife and I went to Safeway in our 20s and bought all generic brand stuff. Lots of people don’t do it that way. They go to Whole Foods.

There is a big difference between a Safeway grocery bill and a Whole Foods grocery bill. It could be a difference of a couple of hundred bucks a week.

Is there a quality difference between generic brands at Safeway and the stuff at Whole Foods? Of course. Is it worth $10,000 a year? Your call.

I don’t really have a budget (more on budgets shortly), but I do keep track of how much I spend, usually by looking at my credit card statements at the end of the month. If I normally spend ***x***, and one month I spend more than ***x***, then I’ll usually tighten the belt for the following month.

Budgets are annoying, but guess what—some people, like the high rollers, need budgets. Not spending money doesn’t come naturally to some people.

What really needs to be taught to these people is ***austerity***—the idea that you can make do with less. If you explain to them that the choice is either ramen at 25 or Alpo at 75, they will think it’s a false equivalence and spend the rest of their lives knocking on Door Number 3, trying to earn more money so they don’t have to undergo austerity.

The problem with high rollers earning more money is that the spending usually expands along with the money, leaving them no better off than they were before. And once you expand your spending, austerity is hard. Increasing your standard of living is easy. Decreasing it is one of the hardest things to do.

As much as I deplore ***The Millionaire Next Door***, I have to concede there is some wisdom in the book. The little things, taken in accumulation, do matter. The example people typically use is skipping the venti caramel macchiato at Starbucks every day, which saves you 6 bucks. Multiply that by 252 work days, and that’s real money. It adds up.

I should also point out that if you have seven figures in the bank, you can have the venti caramel macchiato if you want. You’ve earned it.

It’s a Balance

It’s tough to sell centrism.

Dave Ramsey has made a living selling extreme austerity as an antidote to spending like a sailor. That works for a lot of people, because an all-or-nothing solution is easier to implement than some middle ground solution.

My solution is two-fold:

1. Implement austerity while you're young and building wealth, and for the love of God, spend your money once you've accumulated it.

2. Remember that it's a ***balance***. Being cheap affects relationships. People remember that stuff.

You know how every once in a while, you hear these stories about some 90-year-old lady who dies and leaves $7 million to a cat shelter? And nobody realized she was sitting on 7 million bucks?

I have mixed feelings about those stories. I'm happy, of course, that she saved 7 million bucks (and I'm happy for the cats) but I'm bummed when I think of all the things she could have done to enjoy herself, but didn't. Save money, but don't save it without a purpose. As Saul Bloom famously said in ***Ocean's Twelve***:

"I want the last check I write… to bounce."

Jared Dillian

Time to define debt!

By John Mauldin

Many of us define "debt" way too narrowly. A debt occurs when you receive something *now* in exchange for a promise to give something back *later*. It doesn't have to be cash. If you borrow your neighbour's lawn mower and promise to return it next Tuesday, that's a kind of debt. You receive something (use of the lawn mower) and agree to repayment terms – in this case, your promise to return it on time and in working order.

One reason you try to get that lawnmower back on time and in the proper condition is that you might want to borrow it again in the future. In the same way that not paying your bank debt will make it difficult to get a bank loan in the future, not returning that lawnmower may make your neighbour a tad bit reluctant to lend it again.

Debt can be less specific, too. Maybe, while taking your family on a beach vacation, you notice a wedding taking place. Your 12-year-old daughter goes crazy about how romantic it is. In a moment of whimsy, you tell her you will pay for her tropical island beach wedding when she finds the right guy. That "debt," made as a loving father to delight your daughter, gets seared into her brain. A decade later, she does find Mr. Right, and reminds you of your offer. Is it a legally enforceable debt? Probably not, but it's at least a (now) moral obligation. You'll either pay up or face unpleasant consequences. What is that, if not a debt?

These are small examples of "unfunded liabilities." They're non-specific and the other party may never demand payment… but they might. And if you haven't prepared for that possibility, you may be in the same kind of trouble the US government will face in a few years.

Uncle Sam has made too many promises to too many people, with little regard for its future ability to fulfil them. These are debt. Worse, some of them are ***additional*** debt on top of the obligations we already see on the national balance sheet.

Even worse, entire generations have planned their retirement lives around the government fulfilling those promises. If those promises aren't met, their lifestyles will indeed become a potential train wreck.

Assumptions Everywhere

Let's start with what we know. The official, on-the-books federal debt is currently about $21.2 trillion, according to the US National Debt Clock. I say "about" cautiously because ***decimal points really matter*** when the numbers are this large. The difference between $21.1T and $21.2T is $100 billion. That used to be a lot. Now it's a rounding error.

Anyway, $21.2T is the face amount of all outstanding Treasury paper, including so-called "internal" debt. This is about 105% of GDP and it's ***only*** the federal government. If you add in state and local debt, that adds another $3.1 trillion to bring total government debt in the US to $24.3 trillion or more than 120% of GDP. Then there's corporate debt, home mortgages, credit cards, student loans, and more. Add it all together and total debt is about 330% of GDP, according to the IIF data I cited in Debt Clock Ticking. We are in hock up to our ears.

But it's actually worse than that, due to the kind of promises I mentioned above. Prime among them are Social Security and Medicare. Strictly speaking, these aren't "unfunded" because they have dedicated revenue streams: payroll taxes. Most Medicare recipients also pay premiums. To date, these revenue sources have covered current expenditures and more, allowing the programs to build up reserves. But that's about to change.

As of this year, both programs are in negative cash flow, meaning Congress must provide additional cash to pay the promised benefits. It will get worse, too. The so-called "trust funds" are going to run dry sooner or later, and it may be sooner. This month's annual trustee report estimated Social Security will run out of reserves in 2034, and the hospitalization part of Medicare will go dry in 2026.

Just for the record, those "trust funds" don't exist except as an accounting fiction. It is like you saving $100,000 for your child's education and then borrowing all the money from your children's education fund. You can pretend in your mind that you have set aside $100,000 for your child's future education, but when it comes time to make those payments, you'll have to pull it out of current income or liquidate other assets.

The US government has borrowed (or used or whatever euphemism you want to apply) ***all*** the money in those trust funds. So, talking about running out of reserves in 2034 or 2026 is rather meaningless. We've already run out of reserves. I was talking with Scott Burns about this and other facts over the unfunded liability (he wrote a book on it with Professor Larry Kotlikoff) and he gave me the great line, "The only truly bipartisan cooperation in Congress is that both sides lie." Any time a politician talks about putting a “lock box” around Social Security or Medicare trust funds, he or she is either staggeringly ignorant or lying.

But, going with their terminology, these estimates of when the trust funds run out depend on a slew of assumptions. To estimate revenue, they must know how many workers the US has, their wages, and at what rates those wages will be taxed. To estimate expenses, they must know how many retirees will be drawing benefits, the amount of those benefits, and how long the retirees will live to receive them. They also have to assume an inflation rate on which the cost-of-living adjustment is based. A small deviation in any of those can have huge long-term consequences.

For what it’s worth, then, Social Security says it has a $13.2 trillion unfunded liability over the next 75 years. That’s the benefits they expect to pay minus the revenue they expect to receive.

Medicare projections require even more assumptions: what kind of treatments the program will cover, how much treatment senior citizens will need, and what those treatments will cost. All these could vary wildly but the “official” assumptions put Medicare’s 75-year unfunded liability at $37 trillion. It could be vastly more or, if we all get healthier and healthcare costs drop, could be less.

This being the government, I think the safe course is to assume their numbers are the best case, resembling reality only if ***everything*** goes ***exactly*** right. And of course, it won’t.

My friend Professor Larry Kotlikoff estimates the unfunded liabilities to be closer to $210 trillion. That’s a far cry from the $50 trillion official estimate.

So, at a minimum, we can probably assume Social Security and Medicare are ***at least another*** $50 trillion in debt on top of the $21.2 trillion (and growing) on-budget federal debt. And then you come to the scary part. This doesn’t include civil service or military retirement obligations, or federal backing for some private pensions via the Pension Benefit Guaranty Corporation, or open-ended guarantees like FDIC, Fannie Mae, and on and on.

Negative Cash Flow

Think back to my example of promising your daughter the beach wedding. That is sort of what is happening with Social Security, if you had accompanied the promise by asking your daughter to save a nickel a week toward paying for it. The resulting $28 after ten years would not begin to cover the cost, but your daughter will rightly argue she did her part. You will be on the hook for the rest, just as Congress will be on the hook with angry retirees who think they “paid” for their benefits.

That means benefits will continue once the trust funds run dry. Maybe they’ll make some minor cuts here and there, but voters won’t allow much, at least until enough Boomers leave the scene to let younger generations outnumber them. But as I continue to argue, Boomers are going to live a lot longer than the younger generations think. The deal each generation makes with previous generations is to die on schedule. The Boomer generation is going to break that deal. We will not go willingly into that good night.

But in reality, arguing over whether it’s $50 trillion or $200 trillion is pretty pointless. Long before we get to testing that hypothesis, we will have to cut spending or raise taxes or some combination of both.

The Congressional Budget Office has released its 2018 Long-Term Budget Outlook. Like the Social Security and Medicare trustees, the CBO makes assumptions, so it's fair to be sceptical of its estimates. In fact, we had all better hope they are too pessimistic because we're in deep trouble otherwise.

Because the CBO thinks federal spending will grow significantly faster than federal revenue, CBO foresees debt as a percentage of GDP will likely be 200% of GDP by 2048. But we will hit the wall long before then. Consider this table from the Committee for a Responsible Federal Budget.

Fig. 2: Projections under CBO's Extended Baseline (Percent of GDP)

	2000	2018	2028	2038	2048
Spending	**17.6%**	**20.6%**	**23.6%**	**26.3%**	**29.3%**
Social Security	*4.0%*	*4.9%*	*6.0%*	*6.3%*	*6.3%*
Health Care	*3.1%*	*5.2%*	*6.7%*	*8.0%*	*9.2%*
Other Mandatory	*2.3%*	*2.6%*	*2.4%*	*2.2%*	*2.1%*
Discretionary	*6.1%*	*6.3%*	*5.4%*	*5.4%*	*5.5%*
Interest	*2.2%*	*1.6%*	*3.1%*	*4.2%*	*6.3%*
Revenue	**20.0%**	**16.6%**	**18.5%**	**19.1%**	**19.8%**
Deficit	**-2.3%**	**3.9%**	**5.1%**	**7.1%**	**9.5%**
Debt	**34%**	**78%**	**96%**	**118%**	**152%**
Deficit with Extensions	**-2.3%**	**3.9%**	**7%**	**10%**	**13%**
Debt with Extensions	**34%**	**78%**	**105%**	**145%**	**200%**

Source: Congressional Budget Office and CRFB estimates.

CBO numbers show that by 2041, Social Security, health care, and interest expenditures will consume ***all*** federal tax revenue. All of it. Everything else the government does (including defence) will require going into more debt.

Yes, making that projection requires an assumption about tax revenue, which requires another assumption about GDP. It could be wrong. But if so, I think it will be wrong in the non-helpful direction because CBO projections don't include recessions. (You think we'll get to 2048 without some years of negative GDP growth? I'll take that bet.)

Note also that the amounts CBO projects for Social Security and healthcare spending may well be low. I think they are ***very*** low. They assume some payment cuts to doctors and hospitals that Congress routinely overrules each year, as well as a different inflation benchmark to govern cost-of-living adjustments. And I have little hope Congress and presidents, now or future, will ever gain control over "discretionary" spending.

Of course, the interest expense depends on interest ***rates***. CBO assumes the 10-year Treasury will go from today's below-2% yield to 3.7% in 2028 and 4.8% by 2048. That might be too high, too low, or just right. Your guess is as good as mine (or CBO's).

The CBO also assumes a fairly robust employment picture throughout that time. However, we are entering a period in which automation will replace mass numbers of human jobs. It might also result in new industries and new jobs, but history shows the transition to create new jobs will take time. Bain & Company's Karen Harris estimates automation could eliminate 40 million US jobs by 2030 ***and*** depress wages for the jobs that remain. That will reduce payroll tax revenue and drive safety-net spending higher, neither of which will help reduce the debt.

It's not just Bain, either. McKinsey, Boston Consulting, and other think tanks all expect similar job losses, which CBO does not consider. Yet, it will mean more people not paying Social Security and taxes, hence large revenue losses and even bigger deficits, and more unemployed people looking for the social safety net to help them.

Note: The bulk of those job losses will come in the latter half of the 2020s as new technologies kick in. And new technologies always bring about new jobs, but unfortunately not in the places where the old jobs were lost nor in the industries for which people are trained. To paraphrase Jerry Lee Lewis, there is going to be a whole lot of retraining going on.

So, take whatever estimates are made about future deficits and debt, and realize they are going to be worse. There will be fewer people working and paying taxes and more people living longer and using benefits. Kiss your assumptions goodbye.

The Threats Go On

So, the on-budget picture looks terrible, and even more so when you add the unfunded liabilities on top of it. What ***else*** could go wrong? Plenty. I'll mention just four more possibilities.

First, at least some of the state and local pension debt I described two weeks ago could easily wind up on the federal government's plate. Enough states are in a pickle to probably get some kind of bailout through Congress. Maybe not this Congress, but when it's a Democratic Congress? It may be a whole other ballgame. This would add trillions to federal spending.

Second, CBO and pretty much everyone else assumes the world will avoid major wars. Aside from the death, destruction, and resource diversion, wars are ***expensive***. Our relatively minor (in the historical scheme of things) Iraq and Afghanistan involvements added trillions in debt. Will we get through the next two decades without more such actions, whether large or small? I fervently hope so, obviously, but I would not bet on it.

Third, the life extension technologies I think are coming soon will raise Social Security spending because people will live longer. They may also raise payroll tax revenue if people keep working longer, but it's not clear which way the scale will tip. It will likely be a net drain on the budget, at least initially. And by the mid-2030s when true rejuvenation is widely available, kiss your actuarial assumptions goodbye.

Fourth, all this presumes that those with capital to lend will stay interested in lending it to the US government. They may not, as the government's financial condition becomes increasingly precarious. Yes, we've heard this before and it proved groundless. Things change. The fact that people cried wolf doesn't mean no wolves are out there.

The Venus Flytrap of Western Civilization: Entitlements

My friend Dr. Woody Brock, one of the best economists and social commentators that I know, wrote a marvellous essay about part of the entitlement issues. I'm going to close with a few lines from his letter. You can see some of his other work at www.SEDinc.com. His more exclusive quarterly Profiles are a treasure trove of economic insight. Now to the beginning of his latest Profile:

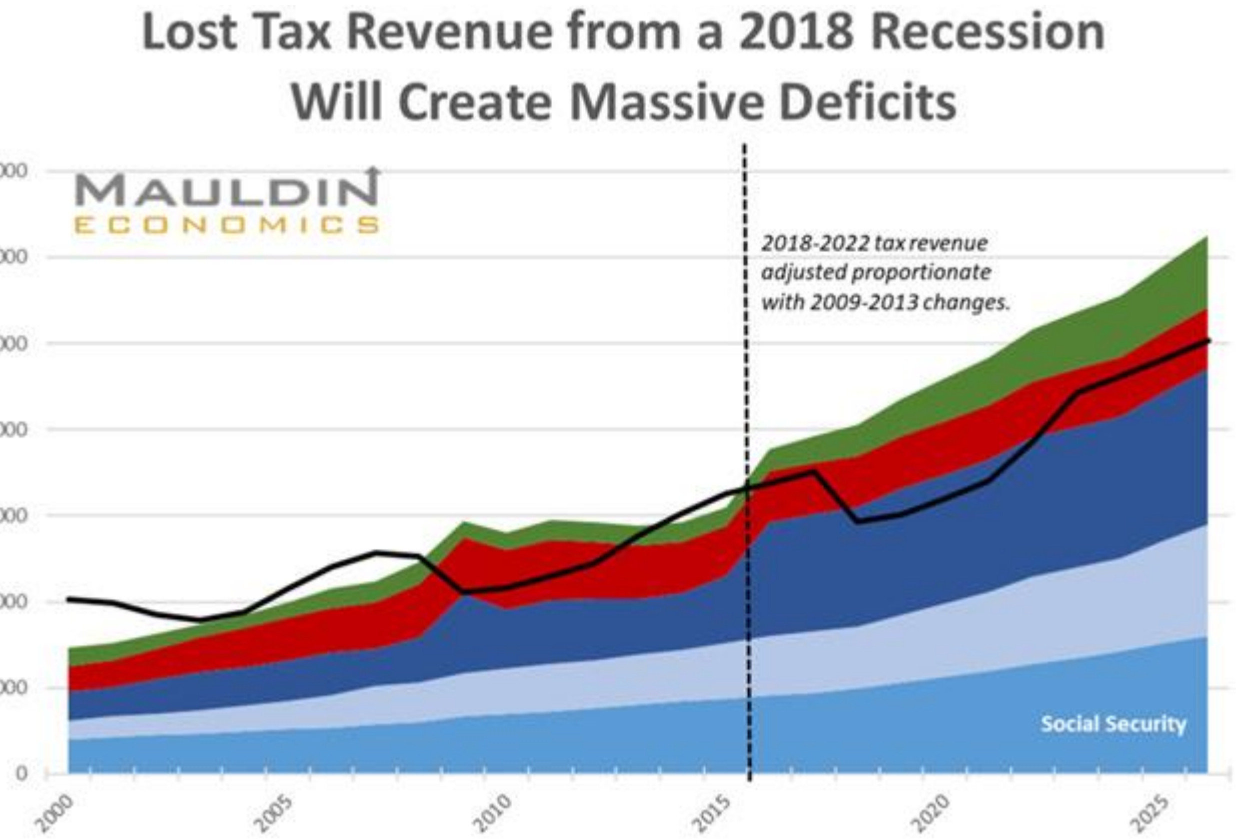
> *The death of the extended family throughout the G-7 nations during 1850-1950 will go down as one of the most momentous developments of past centuries. For it is this development that gave rise to the modern welfare state with its crippling retirement and medical promises*

made to all citizens. How did today's entitlements crisis begin, why does it get ever larger, and what can be done about it?

President Trump's tax reform bill has rightly been criticized for inflating the US fiscal deficit. To many, this was unconscionable at a point when US federal debt is already 100% of GDP. Yet like everyone else, these critics have been mum on the far greater growth of debt that will accrue from ever-exploding entitlements expenditures. This latter prospect was identified a decade ago by the bi-partisan Simpson-Bowles committee as by far the gravest threat to the future of the US.

CBO projections show that within 18 years, entitlements spending will absorb all US federal tax revenues—leaving no revenues even for interest expense on the debt and for the military. In Germany, which proudly pays annually for its expenditures without incurring debt, Deutche Bank has estimated that by 2045, income tax rates of 80% (total, not marginal rates) would be needed for its PAYGO system. The entire workforce of the nation would be in bondage to the elderly. Other nations face even worse prospects.

Those spending projections and massive deficits are going to happen in the 2020s. Here is a graph that we used last year showing what is likely to happen during the next recession (which I now think we will likely avoid this year, but it is coming), if tax revenue falls to the same degree it did in the last one.



We will have ***at least*** a $2 trillion deficit in the next recession, plus a bear market that leaves pensions even more underfunded, and a slower recovery because high debt crowds out future growth. Numerous academic studies back up that statement.

I think a future Democratic Congress and president, or maybe a split Congress that is desperate for funding, will enact a Value-Added Tax (VAT) in response to this. At least that is what I hope. Woody is a little more pessimistic than I am and thinks, quoting at the end of his analysis, that politics and not demographics is the problem:

> *Furthermore, why need benefits be trimmed much less slashed when the staggering new wealth of the top 10% can be taxed to pay for all promised benefits? Today's obsession with the growth of inequality will significantly impact how the US will resolve the entitlements issue. The nation will not cut benefits because doing so will prove politically impossible, as President Clinton has long stressed.*
>
> *Rather, the nation will fund its promised Social Security and Medicare benefits via the only kind of tax that can raise the staggering sums needed to fund them: a net-worth tax on, say, the top 15% of the population. Raising income tax rates on the rich will not raise anywhere near the amount needed for the next 40 years. Only a net-worth tax can do so.*
>
> *Here are the relevant mathematics. As already stated, the net worth of US households has now reached $100 trillion. The top 15% wealthiest families own 90% of this wealth, or about $90 trillion. When push comes to shove, resistance by the rich against a wealth tax will be swamped by the political reality that a good 60% of Americans will be obsessed with funding their old age. Thus, rich as they are, the very wealthy will have little political leverage with which to fend off an annual net-worth tax.*
>
> *The political logic will be: "Look, you rich people have had a return on your wealth of over 6% during the past hundred years. Why should this change very much? But if this is so, then it is time for you to pay your fair share, that is, to part with 2.5% of your total net worth annually. Your wealth will still continue to grow. With increased annual tax revenue of some $2.5 trillion, it will be possible for Americans to receive their promised benefits."*
>
> *We would expect the same logic to translate into additional net-worth taxes at the state and municipal level.*
>
> *The fallout from such a policy will of course be disastrous.*

Oh, dear gods, I hope he is wrong. It would be beyond disastrous.

The Good News Economy

By John Mauldin

In my business, there is a fine line between standing by your conclusions and being unwisely stubborn. But no matter what I say, people will still label me a perma-bear or perma-bull—often at the same time. It's an occupational hazard to which I am accustomed.

It's really a lot more fair to characterize me as the "Muddle Through" guy. There are always reasons to be bullish or bearish. Admittedly, my letter tends to dwell more on the reasons to worry, but I think that's a sign of the times. We have more to worry about today than in the past (see the 80s and 90s).

Last week, I tried to clarify what some of you perceive as inconsistencies in my outlook. I am long-term very ***bullish***, medium-term very ***bearish***, and short-term ***uncertain to slightly negative***.

If you read social media or the mainstream financial news, you don't need me to tell you the bearish case. Scepticism abounds in the punditry. Positive outlooks are harder to find, even though they have been largely correct recently. That's no accident. They're correct in part ***because*** they are out of favour.

I see some major problems coming in the 2020s (and perhaps a bit sooner), but I also see a lot of good things happening right now. The economic recovery, while still weak by historic standards, is gaining some momentum that ought to carry it forward for another year or two, assuming (as I perhaps naïvely do) that we can put this trade war thing to rest. That's good news because it buys us time to prepare for worse times, but it's also just plain good news.

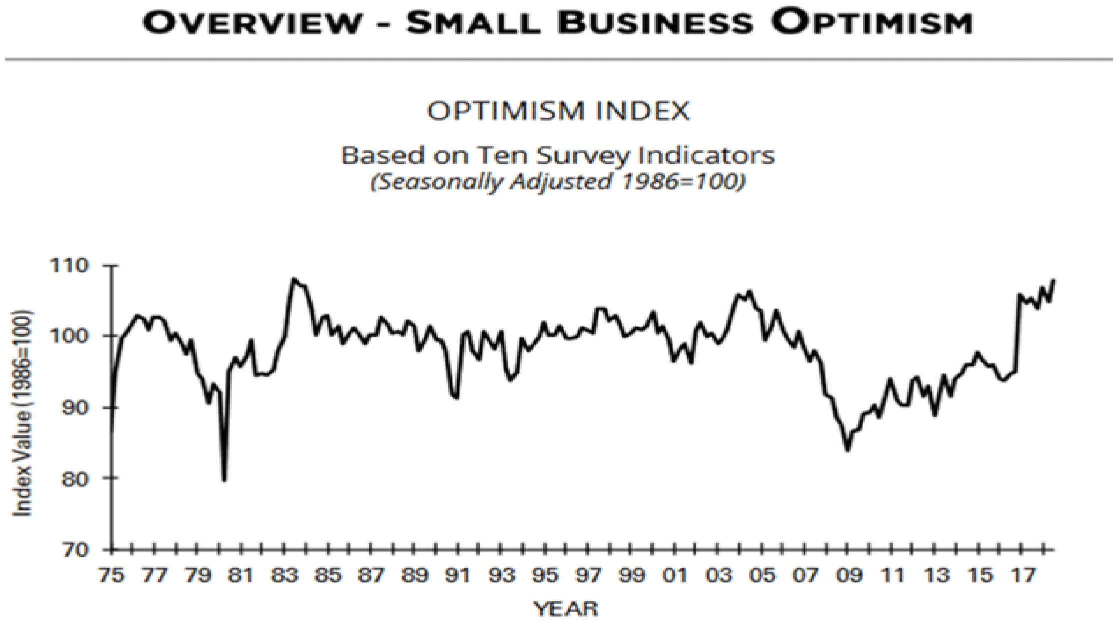
We can get so busy worrying about the future that we ignore positive things happening right here and now. That's not healthy and can make us overlook opportunities. So today, I'll look at some ***good*** economic news that has been lost in the din lately.

Animal Spirits

Economic activity is the collective result of human decisions. We all make choices about what to buy and sell and at what prices we will do so, thereby creating either growth or contraction. These decisions might prove wrong, but they still matter. So do the attitudes and beliefs that lead us to make them.

If, for instance, you're a business owner and you see new conditions that will make growth easier, you will be more likely to hire, expand, and make capital investments. Get enough businesses thinking that way at the same time and you have the makings of an economic boom… which is what the leading survey of small business owners says is happening.

The National Federation of Independent Business has been surveying its small business members since 1973, overseen by my very good friend Dr. Bill Dunkelberg (Dunk to his friends). The NFIB data is a rich, long-term history of small business owner sentiment, both positive and negative. It has varied over time, as you might expect. Presently, their index is near its most optimistic level ever—0.1% below the 1983 all-time high. Considering where we were a few years ago, that is amazing.



Source: NFIB

As you can see, NFIB member optimism had two prior peaks near the current level. One was in 2004, when the housing boom was starting to take off. It would end badly a few years later, but those were good times while they lasted.

The other peak was in 1983. The Volcker Fed had mostly stamped out inflation while Reagan's tax cuts and deregulation were beginning to bear fruit. This marked a boom period that would last even longer; the next recession would not strike until mid-1990.

As I like to say, history doesn't repeat itself, but it often rhymes. This time, the Fed has been working to stamp out deflation, not inflation, and appears to have made some progress. We also have a new, business-oriented administration, similar in some respects to the shift from Carter to Reagan. This encouraged early 1980s business owners, and the Trump administration is doing the same now.

See that big late-2016 leap in the NFIB index? That happened immediately after the election. If you recall, almost everyone expected a Hillary Clinton win, and business owners had resigned themselves to continued high taxes and evermore intrusive regulation. The Trump win was thus a pleasant surprise to many business owners, immediately visible in the data. (Contrary to some, I don't think most business owners were thrilled with Trump. They were more thrilled not to have Clinton.)

Now, why does this matter? It matters because NFIB members create jobs, spend money on capital investments that create even more jobs, and develop innovative products that raise living standards. They are more likely to do all those things when they feel confident... which they have since November 2016.

Notably, this confidence has actually ***grown*** since then despite all the assorted scandals and criticism surrounding the Trump administration, not to mention the Federal Reserve's tightening policy. This would not have persisted for almost two years now if they didn't see reasons for optimism in their own numbers. It is more than blind faith.

In the past, we've seen this index decline gradually over 2–3 years as the economy edged toward recession. We see no such thing now. We see the ***opposite*** as the index moves up. That suggests, as I heard at Camp Kotok, the present expansion will continue into 2019 and beyond.

Could something change the small business outlook? Yes, of course, but no such event is on the radar right now.

Back to Work

One of the NFIB indicators is the difficulty small business owners have in filling job positions. Right now, it's at a record high, with many owners reporting qualified worker shortages as their single greatest business challenge.

Source: [Daily Shot]

This is a consequence of another "good news" item: historically low unemployment. It took way too long after the last recession, but employers are finally willing to expand payrolls. They can do so only because they expect sales to grow beyond their present capacity to deliver, which is why business sentiment is so important.

Moreover, the hardest-to-employ groups (unskilled workers, people with criminal records, those with disabilities) are finally re-entering the labour force. Workers see opportunity to make more money than they can from government benefits or whatever other means of support that have relied on.

Who gets credit for this? It's true that the job gains simply continue trends begun under the Obama administration. Whether Obama policies did it is a different question. The economy was recovering regardless. Trump could certainly have done things to ***interrupt*** the recovery, so give him credit for not doing them. And the business confidence he inspired by being "not Hillary Clinton" helped, too.

My friend—and sometimes debate opponent—Brian Wesbury, who is chief economist at First Trust, has been consistently right about the employment trends in recent years while many of us were sceptical. I'm starting to pay more attention to his outlook. Here is Wesbury's analysis of the July jobs report, with some key points bolded by me.

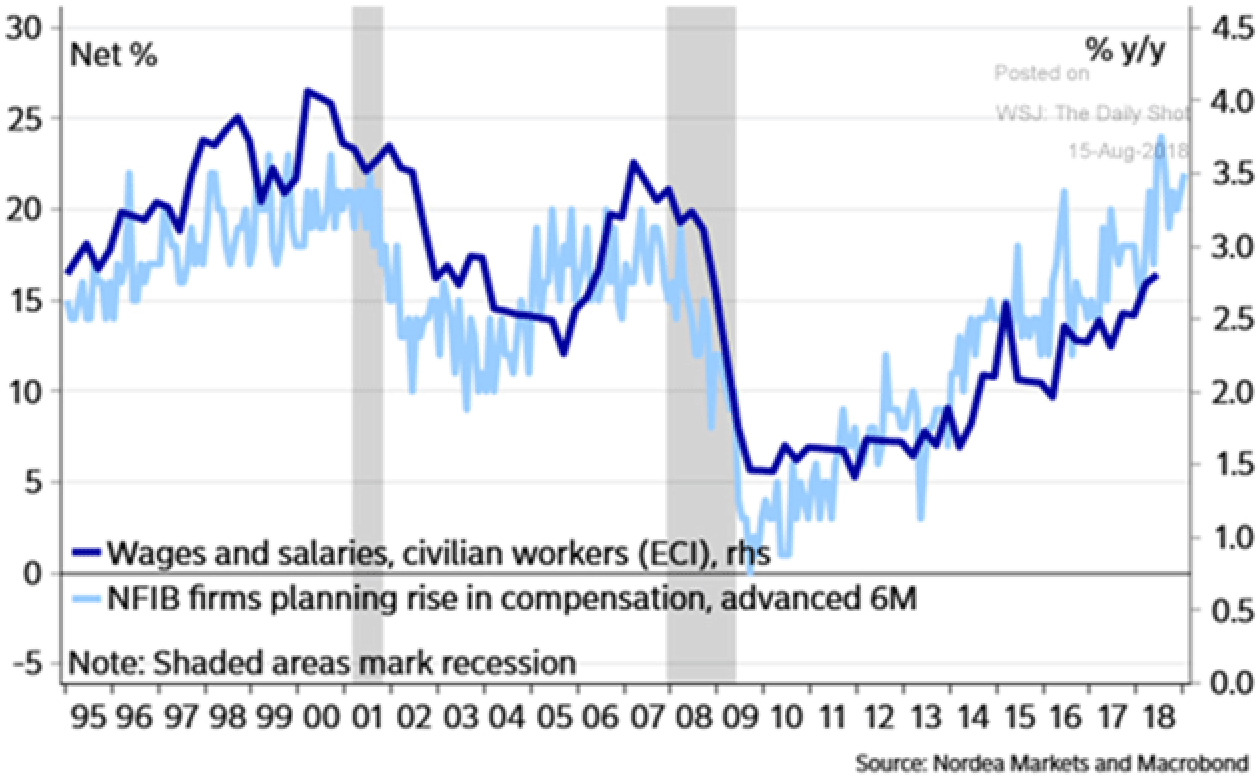
> ***The July employment report was sneaky strong. The big headline was that non-farm payrolls rose 157,000 in July, which was less than the forecast of any economics group. However, payroll growth***

was revised up 59,000 for May and June, meaning the net gain for the July report was 216,000, which beat the consensus expected gain of 193,000. Meanwhile, civilian employment, an alternative measure of jobs that includes small-business start-ups, rose 389,000.

In the past year, non-farm payrolls are up 200,000 per month while civilian employment is up 179,000 per month, both strong numbers. The gain in civilian employment in July helped push the unemployment rate down to 3.9%, despite an increase in the labor force, which is up 1.5 million in the past year. Moreover, the U-6 unemployment rate, which includes discouraged and marginally-attached workers, as well as those working part-time who say they want full-time jobs, fell to 7.5%, the lowest level since 2001. The participation rate remained at 62.9% in July, near the higher end of its past 4+ year range (62.3% and 63.1%). Meanwhile, the share of the age 16+ population that's working hit 60.5%, the highest since 2009.

As always, we like to measure growth in workers' total cash earnings. Average hourly earnings rose 0.3% in July and are up 2.7% in the past year. Total hours worked are up 2.2% in the past year. As a result, total cash earnings—which exclude extra earnings from irregular bonuses and commissions, like those paid out after the tax cut was passed—are up 5.0% in the past year, more than enough to keep pushing consumer spending higher.

We see this in another chart from the NFIB data, showing small businesses' plans to increase compensation. The expectations line is moved forward six months, showing where the trend is going.



Source: [Daily Shot]()

We also see record numbers ***quitting*** their jobs, which is actually quite bullish. You generally only leave a job if you get a better one or at least think one is out there. As Brian said, wages are beginning to grow, too. That is the last piece of the puzzle. We need people to have more disposable income so they can buy the goods and services businesses produce. It finally seems to be happening.

And the simple fact of the matter is that sometimes you have to pay people more in order to attract them. I have been a small businessman for about 45 years and lived through several cycles. Right now, every business owner I'm talking to says they're having to pay higher wages.

Cranking Up

Earlier this summer, my associate Patrick Watson wrote about Overheated Highways clogged with trucks. I see the same in private transportation newsletters I get. US railroads and seaports are bustling, to the point that shipping costs and logistical snarls are now major challenges for many businesses. That's not great… but it's also not consistent with economic slowdown forecasts.

To be blunt, businesses are spending enormous amounts of money to transport enormous quantities of raw materials and finished goods across the country. They are not doing it for fun, or because they enjoy paying truck drivers relatively high wages. They believe someone will buy those goods at profitable prices despite the transport cost. Maybe they're wrong, but that is what they think.

Patrick pointed out in his article, ***"Slow and unpredictable shipping has a domino effect in our optimized, just-in-time economy. One key part that's stuck in a traffic jam can shut down an entire assembly line, idling hundreds of workers. Then whoever is expecting those goods doesn't get them on time."***

This is indeed happening. Last weekend, the ***Wall Street Journal*** reported Parts Shortages Crimp US Factories.

> ***American factories are running short of parts. Suppliers of everything from engines to electronic components aren't keeping up with a boom in US manufacturing, which has lifted demand in markets such as energy, mining, and construction. As a result, some manufacturers are idling production lines and digesting higher costs.***

As business problems go, this is a relatively good one to have. Transportation bottlenecks are often much easier to fix than lagging sales. And some of the "lost" revenue eventually comes in as companies figure out how to deliver.

To me, the bigger questions are why, given all this activity, GDP isn't growing even faster than the 4.1% initial 2Q number, and why rising transport costs aren't yet more evident in core inflation. Yes, inflation is picking up, but not enough to make the Fed change course. Jerome Powell and crew seem content to let the economy run a tad "hot" as compensation for years of not-so-hot conditions. We are beginning to see what "hot" looks like. I think much more is possible.

What Could Go Wrong?

I am well aware of the many less-optimistic signs in the economic data. I also know personally some people for whom the 3.9% unemployment rate is not at all encouraging. They are still digging out of very deep holes, at significantly lower pay than they earned a decade ago.

Likewise, I know inflation is higher than the averages reflect in many places, particularly for housing, health care, and other necessities. Everything isn't great everywhere… but everything isn't terrible everywhere, either. Good things ***are*** happening. We should not ignore them.

Eventually, something will derail this recovery and we will enter that Great Reset period I have described. It could be a credit event, liquidity shortages, currency crisis, war, political turmoil, business scandal—the possibilities are endless.

When? I now think we have another at least 1–2 years. Between now and then we could (and I hope we do!) see an economic boom that will knock your socks off. That is how economic cycles typically end. It's been so long since we saw such a boom that even many old enough to have lived through one have forgotten what it's like. I remember, and I don't think we are there yet.

That means we still have potentially profitable business and investment opportunities. Of course, you want to be cautious and thoughtful about seizing them. You should ***prepare*** for worse times, yes, but don't head for the hills just yet.

And the Really Good News

The above is just some of the economic and financial good news in the US. If you want ***really*** good news, look at what's happening inside many companies and industries. The cost of solar panels is plunging, as is the cost of pulling a barrel of oil out of the ground. The energy business is now a technology business.

Massive leaps are being made in 3D printing, robotics, and artificial intelligence. And not just sporadically, but in literally hundreds of businesses and universities all over the world.

I know Elon Musk is a bit of a lightning rod right now, but he was visionary enough to somehow put a rocket into space, launch a satellite, and then bring that same rocket back to earth. He promises to eventually cut the cost of putting something into space by 90%.

Richard Branson, Jeff Bezos, and Paul Allen are in the same race. Notice a pattern? It is not governments but committed multi-billionaires moving the human race forward. And they are doing it with the bottom line in mind. I know asteroid mining sounds like science-fiction, but there is literally a limitless amount of materials available near Earth. They are visionary enough to see it.

Another billionaire, Bill Gates, has done a masterful job of focusing the world on malaria. Malaria deaths are down by 60% since the turn-of-the-century. There is still much to be done, but it's major progress.

I can cite scores of statistics (and will in my book) about how things are getting better. And they will continue to get better even as we go into The Great Reset's financial turmoil. There are going to be so many new investment opportunities that you will almost feel like you're being whipsawed. And because of the financial turmoil, raising capital will be more difficult, which means you will get better deals for your investment dollars.

And I haven't even begun to touch on biotechnology and the fight against aging. I truly believe cancer will be a nuisance in less than 10 years, as opposed to what is sometimes a death sentence today. There are so many new therapies coming online. I am on the board of a company whose main purpose is to eventually turn back the aging clock and allow us to live much longer and exciting lives.

Cautious optimism has always been the best way to invest and is certainly the best way to live. Someday in the future, I am going to make a list of all the websites and newsletters that I get that focus on new technology. Reading a few of those a week will help lighten your mood.

If you properly construct your portfolio today, you will be able to enjoy this phenomenal future. It's going to be fun if you make the proper plans.

Books to guide your investment

The Philosophy of Wealth

How to identify the long-term share market winners
R130

Footsteps To Fortune

How to identify medium-term investment shares and effectively time the market
R130

Investment Without Tears

Richard Cluver's original best-seller: how to get started on the share market R130

How To Make A Million

A step-by-step guide to the creation of investment wealth R130

300 Ways To Make Your Money Grow

300 Investment growth solutions R130

Making Money With the Mutuals

How to win as a unit trust investor R130