Access Investment Advisors Inc.
4400 Calumet Avenue, Suite 201
PO Box 697
Manitowoc, WI
54221-0697

920.683.9901
FAX: 262.364.2147
www.accessinvestmentadvisors.com

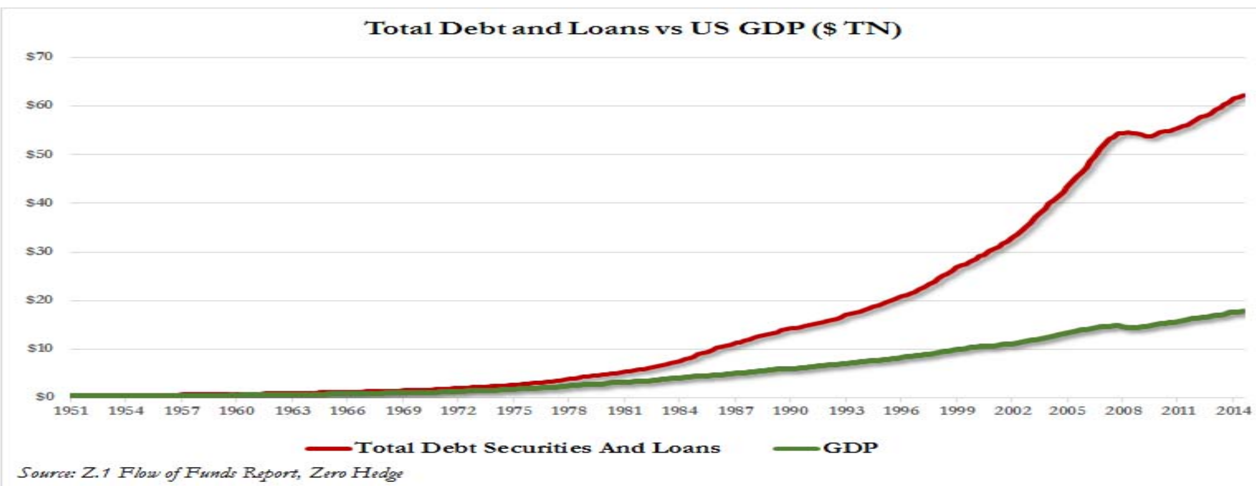
April 2016

Musical Chairs

"I'll gladly pay you Tuesday for a hamburger today" – J. Wellington Wimpy

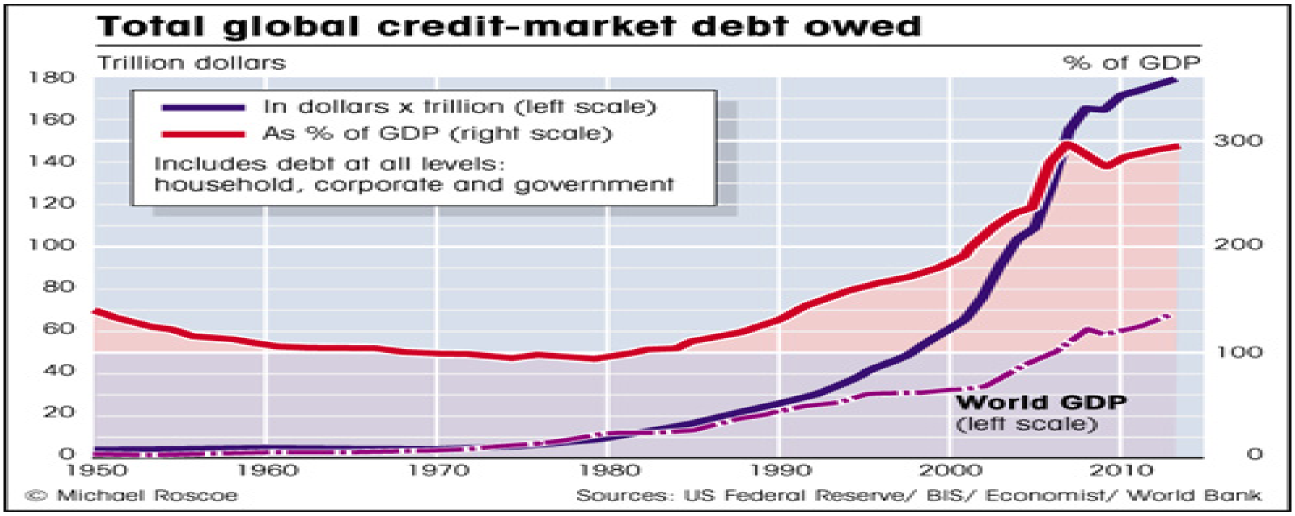
As a kid I watched "Popeye the Sailor" lying on the floor, propped up on my elbows flanked by my sister and brother, staring at a black and white version of the world. J. Wellington Wimpy, or "Wimpy" as he was known, was a recurring character on this cartoon. As a ne'er do well he was aptly named. Wimpy was a conniver, always looking for a way to score a free meal of hamburgers from whatever sucker he could find. The message delivered through him was not subtle, even for a 6 year old. I learned at an early age that people like him were to be avoided. That he represented values that that were not to be emulated.

Fast forward fifty years. Now it appears that the only suckers are those that don't borrow money to buy stuff. In the past four decades, US debt and credit instruments have expanded dramatically. The chart below compares the growth (in Trillions of dollars) of total debt and credit created in the US to the Gross Domestic Product (GDP), a measure of the total of goods and services sold in the US.



Although the US officially went off of the gold standard in the 1930's, President Nixon's administration officially ended the "pegging" of the US dollar to gold in 1971. Before 1971 every US dollar in circulation was backed by a specific amount of physical gold (held mostly at Fort Knox in Kentucky). When physical gold became scarce, and politicians began to understand the power that could be weilded by expanding a currency untethered to a finite resource, the era of the printing press was born. Look again at the graph above to the period of time after 1971 and compare the rate of growth of our debt to that of our economic growth.

Not wanting to be left behind, the rest of the world has played along and expanded its debt right along with the US. Note that the rapid expansion of worldwide debt (blue line) since 1990 has not spurred a commensurate amount of economic growth (purple dashed line). However, the amount of debt as a percentage of world economic activity has increased significantly (red line). It now stands at 300% of average world GDP.

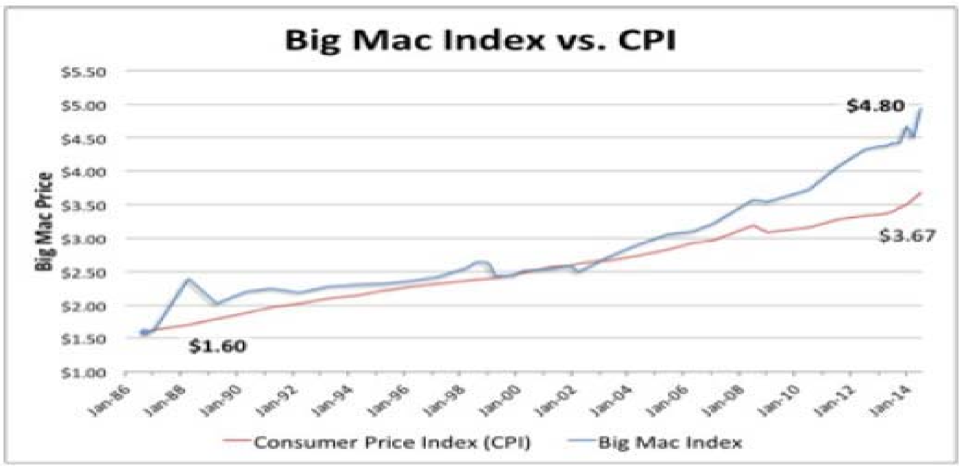


Some would certainly argue that all of this debt was necessary. That without it we wouldn't have the growth in economic activity that we have experienced over the past 43 years. This thesis of course is unprovable and not worth spending a lot of time debating since it's already done. A more relevant exercise is to try to understand the impact that all of this debt is having, and will continue to have, on world economic conditions.

The US stock market is one area that has responded quite favorably to all of this newly created money changing hands. Below is a graph of the S&P 500 for the same time frame as the previous two. With the exception of the two corrections, the slope of the increase has tracked the expansion of credit quite closely.

What are the consequences of all of this debt? No one knows for sure, but one thing is clear. Rising interest rates will make servicing all of this debt problematic. Corporations, governments, and individuals used to expanding and refinancing debt in a low interest rate environment will have to curtail other spending in a rising interest rate environment. Remember also that consumption (spending) happens when the debt is created, not as it is paid back. That, my friends, does not add up to an economically stimulative environment. Although our Federal Reserve would like to raise interest rates so that it has another tool at its disposal for the next economic slowdown, it has painted itself into a corner. Raising rates now would likely stall an economy that is sputtering. Don't count on any significant increases in interest rates for a while. The Fed has already backed away from its promise to raise interest rates by 3% over 3 years. Sorry ~~suckers~~ savers.

Something that confounds even the brightest economists is what impact all of this newly created money has on global inflation. We've experienced the effect that this credit expansion has had on increasing the price of stocks and real estate over time here in the US, but what about other sectors of the economy? According to the US Bureau of Labor Statistics (BLS) the rate of inflation in the US measured by the Consumer Price Index (CPI) is 1% (ending February) for the previous 12 months. The problem with this indicator is that its components change over time, and I'm not convinced that it is an accurate measure of what average americans experience in their daily lives in terms of increased costs. With that in mind I introduce to you another measure – the Big Mac Index (a tear forms on Wimpy's cheek).



This graph compares the cost of a Big Mac to the CPI since 1986. At first you may think this comparison a bit trivial. However, if you think about it, there are substantial economic inputs that are reflected in the cost of a Big Mac over time, namely: wages, food costs, transportation, utilities, maintenance, supplies, interest on debt, and many more. Since 1986 the cost of a Big Mac has increased 25% more than the stated rate of inflation as measured by the CPI, and you can see that since 2004 it is accelerating much faster than the published CPI. One of the Fed's triggers for raising interest rates is a CPI reading rising above their target. If there's little inflation there is one less reason for an interest rate hike. Nothing to see here folks, keep moving…

The grand experiment of creating money through credit, fully embraced by Central Banks in the past decade, has yet to play itself out. Increasing global money supply through the creation of an increasing amount of debt has consequences that we have not yet fully experienced and don't yet understand. It rapidly becomes a race among sovereign nations that don't want to be left behind and in response create more money (debt) of their own to pass around the globe. What happens if the music stops and there aren't enough chairs? No problem, borrow money to buy more chairs. Remember Greece? They will gladly pay back their debt on Tuesday for another loan today.