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"If I was Darth Vader and I wanted to destroy the U.S. economy, I would do aggressive spending in the middle of an already hot economy. What are you going to get out of this? You're going to get a sugar high, higher inflation, and then an economic bust."

- Stanley Druckenmiller, July 23, 2021

It is hard not to want to quote Stan Druckenmiller, arguably one of the greatest investors of our lifetime, as he has a panache for being correct with his market calls. For a long time, the Federal Reserve has been able to control interest rates, but this ability comes with consequences like escalating inflation, asset bubbles and eventually currency risks, to name a few. During the tenure of former Fed Chair Ben Bernanke, interest rates spent the bulk of his time at the helm suppressed. The current Chair, Jay Powell, is now left with the task of attempting to renormalize interest rates, but he has little to no tools to accomplish this. If Mr. Powell could not find a way to raise interest rates in 2019 when the unemployment rate was very low at 3.5%, why would the market expect him to raise rates moving forward? It seems obvious to us that the Fed is in a box and has been for some time. The debt levels have grown so large that raising interest rates would be too costly and could send the country into a depression if they explode higher. Debt monetization, or the purchase of government bonds by the Fed to finance the spending needs of the government, may be the playbook utilized going forward, yet rising inflation is usually a consequence of this action.

Falling interest rates over the past many years have helped keep consumers spending and the economy seemingly chugging along, at least on the surface. The reason for this is if the interest rates on a mortgage, or a car payment are low and/or falling, then cash is freed up to spend on other additional items. Should those borrowing rates increase, then disposable income is not as prevalent to spend, and belts get tightened because more money must go towards paying off fixed bills. Many believe the Fed does not

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recognize the risks of inflation, but the truth is that they do understand this problem, but they also know they would cause a bigger problem if they did not interfere. This explains why the Fed is still buying $120 billion dollars of treasuries while inflation has spread across the American economy. For example, annual home prices are rising at double digit rates and there is evidence of labor wage increases for the first time in decades, yet the public is being told the inflation that they see is "transitory" i.e: short-term only.

In July, The Washington Post published an article that stated in some areas of the country rents had increased by 33%. Even bidding wars on rentals have become the new norm in cities too, a far cry from the plunging rent prices of 2020 when people were escaping those cities. If the information from the Post article and other publications alike are correct, this could be the beginning of out-of-control inflation.

A lot has been written about the inequality between the rich and the poor in this country. For the past forty plus years there has been an emphasis of capital over labor, where labor wages have been stagnant and those with money to invest were the ones that got to grow their assets. To help close this wealth gap, the current administration has pushed for higher wages, increased unemployment benefits, deferring debt/rental/mortgage payments, and in some extreme cases forgiveness of some student loans. These are the beginning steps of the modern monetary theory we have written about in the past, where it is assumed by some that the government will print and distribute money without having any dire consequences.

Although short-term these actions could have been helpful, in the long run they will not solve this countries' problems, as the dominant issue moving forward is declining productivity. Most of the economic growth that we have witnessed since the depths of the 2008 recession was due to productivity growth rather than restoring jobs. We continue to read that most of the value added from the production of goods and services known as "GDP" growth since then, has been due to output per hour worked. We can therefore assume that the slowing of GDP in the past couple of years is not a misprint and most likely will continue its downward slope. Let's hope Mr. Druckenmiller's prediction is not as accurate as his past market calls and that the force will still be with us.

"Following the leader, the leader, the leader
We're following the leader
Wherever he may go"

-Peter Pan, Disney Movie 1953

Unlike the Lost Boys in Peter Pan, as value investors, we do not need to blindly follow the leader or leaders wherever they may go. Instead, value investing allows us to veer off in any direction and buy what looks attractive to us, even if others do not see its' worth right away.

We tend to be early investors in some "under-loved" ideas, even during times when market leaders continue their rise. If all the investments in a portfolio are rising at the same time, then you are not diversified, and that could wind up being painful when the markets go against you. The leader in a market does not have a bias if it is leading upwards or downwards, it only cares that it always has faithful followers.

Being diversified consists of owning a variety of assets ranging from domestic and international stocks and bonds, currencies, commodities, precious metals, real estate, and real assets. It can also mean holding larger cash positions at times or even taking out insurance against a market movement or sector downturn. Shorting, or betting that the value of a certain asset will fall, is a way to protect a portfolio against downside movement. At times utilizing this tool can help mitigate or protect against sizeable pullbacks in portfolios when an index tumbles.

After a decade of U.S. markets moving up, we are hearing louder and more frequent concerns from money managers and Wall Street pundits that say it may be time to revisit portfolio construction to protect against a correction. We have been actively looking at the proverbial ugly ducklings of investing because to us, started turning into swans, way before the public started noticing. Some of these ideas did benefit from the past market upswings, however they did not get the same attention as the Facebooks, Microsoft and Tesla type of investments.

One such resource that has moved up in price is copper, yet we see a further advance a distinct possibility. Over the past ten years new copper discoveries have slowed dramatically, and since 2010, these discoveries have been reported to have fallen by 80%. Copper is used in so many areas, especially in green energy projects therefore we expect to see demand for copper to outstrip supply over the next few years. One caveat we mention with copper is that it was used as a barometer for the health of equity markets, we think this relationship could take a detour over the next few years with copper coming out on top.

Silver is another resource that intrigues Oak. Historically it has been used for jewelry, photography, mirrors, currency etc. Today its uses have skyrocketed because of how powerful and helpful it is. Silver has the highest electrical conductivity of all metals and as a result it is used in batteries, circuit boards, and attaining solar power etc. As society embraces robots and self-driving cars, the demand for silver will increase even more as it’s a necessary component for this fete. The price of silver is 50% below where it stood in 2011, to us this leaves a lot of room for upside.

Gold acted as a great hedge to equities from the market top in October 2007 to its bottom in March of 2009. Although we are aware that the combination of a rising dollar and rising interest rates have been negative for gold in the past, we expect this to be a positive over the next few years. If we are correct that rising deficits will cause the dollar to decline and the Fed cannot allow interest rates to rise dramatically providing a ceiling for rates, then investors will flock to gold for appreciation opportunities.

Over the past few years green energy demand has broken out. Financial institutions have been pressured by their client base to sell traditional energy related equities because they want a cleaner environment and environmentally conscientious portfolio. Some CEOs of energy related companies have watched this transition take place and drastically cut back money spent on capital expenditures as they think at some point fossil fuels will be a thing of the past. While alongside others, we welcome a much cleaner environment, we have read that it is going to take quite a long time for this transition to take place. The non-clean energy supply could dwindle and demand around the world may increase over the short term, in fact the natural resource experts we follow would not be surprised to see oil prices approach $100 a barrel.

While investors understand the definition of diversification, most are unable to recognize it or execute it when equities are in a bull market, regardless of how stretched that bull market may be. The natural resource examples we mentioned are exciting opportunities for our portfolio over the next decade. We embrace diversification and are especially thankful for utilizing it as timing any market is a difficult task. We believe the market leaders could take investors too deep into the woods and we are happy to be planning out a different course.

**“Only in America,
Can a kid without a cent
Get a break and maybe grow up to be President
Only in America, Land of Opportunity Yeah…”**

-Jay and The Americans

We recently heard this song and it got us to thinking, what if one of the Oak Financial team members went to bed one day and woke up as President the next day. What changes would we want to see happen or make happen occupying the most powerful job in the world. Below is a letter we decided to write to our Presidential selves to make the job easier, just in case…

Dear Mr./Madam President:

I could imagine if you held this office in 2008 many letters must have reached your desk suggesting various solutions for turning around the economy at such a pivotal juncture. Had I penned a letter at that time, it may have mentioned that with the banks failing, the government should be searching for solutions to avoid a depression. A potential idea to fix said problem, would have been to invest ten percent of the social security funds in the stock market in hopes Wall Street followed this move and plowed more money into the markets, providing a safety net of some sorts. While in hindsight this could be considered a great idea, it’s currently 2021 and we cannot dwell on the past.

Modern day brings a new set of problems, and this letter could contain potential solutions for a few of them to help advance our economy. Additionally working on outcomes that all political parties may agree upon is a focus of this letter too. Democrats and Republicans have been opposing each other’s ideas for decades with only few joint accomplishments to show for their efforts, let’s try to tackle that shall we. When the infamous 1930’s bank robber, Willie Sutton, was supposedly asked why he robbed banks, his answer was “because that’s where the money is”. An astute reply, as you see Willie was right even in todays’ society, go where the money is!

My first suggestion is to enact a flat tax rate for corporations and eliminate all tax loopholes. Many companies utilize accountants and attorneys to massage their tax returns (mostly within the legal law) to pay little to no taxes. By following this new policy, companies would redirect their attention and decision-making efforts to ways to elevate their businesses. At the same time the government could receive more revenue to explore ways to grow the economy. A potential win for employees and the U.S. balance sheet.

Two additional standout loopholes in the tax code are the $500,000 capital gain exemption for a couple selling a primary residence ($250,000 for a single person) and the carried interest exemption for General Partners of private equity firms, hedge funds and the likes. The carried interest refers to the primary source of these investors/investments income allowed to avoid being taxed at a reasonable rate. Instead of this money being taxed at the top income rate of 37%, it is treated as a capital gain and only taxed at maximum rate of 20%. By eliminating this provision, it would be extremely beneficial to reducing the debt in this country because the government would get paid almost twice as much from this financial community than they are currently receiving.

The second recommendation is to move to a cashless society. For years the middle class has been paying the bulk of the taxes in this country, as they lack the ability to utilize the same advantages as the wealthier community. The amount of individuals and businesses that trade their services for cash are not a source of revenue for the government, but this could be ratified by both you and Congress. This would also allow for smoother operations across the country as receipts and paper trails will be easily accessible for those that need to confirm payments are made.

Thirdly, although the private sector moved to 401k retirement plans back in the 1970’s, the federal, state and city governments continue to have pension plans or defined benefit plans. They are costing the country an egregious amount of money. Converting these retirement programs into 401k options would be the first step to reduce the deficiencies built up.

My last thought is to cut spending across all levels of government, although this may be an unpopular topic around your watercooler it is vital for the country. Technological advances have increased productivity in the private sector world, yet the U.S. government has sadly been left behind. By implementing technological advances in all aspects of government it will reduce the waste expelled, increase productivity, while at the same time contain the outrageous budget deficit.

As you can see the main theme of this letter is to rein in the budget deficit as we are facing an unsustainable level. I know there are countless other recommendations I can leave you with today, I may pen a follow up letter down the road. Remember, not everyone is going to like these ideas, you cannot please everyone all the time, today is not their day and tomorrow may not look good either!

Sincerely,

The Potential POTUS

CONCLUSIONS

1. Goldman Sachs reported that since the vaccine was announced, 120 billion more dollars flowed into global equities than the preceding twenty-five years combined. At the same time Kiplinger's reported billionaires, hedge funds and other high net-worth investors have been selling stocks in large quantities over the past three months. This combination gives us pause.

1. The current 30-year treasury rate is not an indicator of a healthy economy, instead its range is showing slowing growth, as evidenced by cancellations in airlines, hotels, casinos, and travel etc.

2. The contentious environment in politics today could produce less governmental assistance and less effective infrastructure plans getting rolled out than initially expected.

4. Proposed increases in capital gains tax rates are anticipated to be retroactive and start in 2021 versus taking affect in the new year to prevent an increase in selling off equities/investments before year end.