Mar 21, 2022 | 09:00 AM EDT DOUG KASS

When It Comes Time To Sell... You Won't Want To

** The asymmetry of Federal Reserve policy responses and the misguided fiscal/regulatory actions are joined at the hip*

** It remains my view that inflation will be far stickier and more elevated than the consensus expects*

** The conflict between Russia and Ukraine further exacerbates supply chain dislocations and lengthens logistical problems*

** "Slugflation" lies ahead - global economic growth and U.S. corporate profitability (profits and margins) are likely to disappoint relative to expectations*

** More on the $23 pastrami sandwich...*

Without arguing about how appropriate the Fed's policy response was to 2008, which like 2001 was a crisis they actually helped to create by being too loose in the first place, and Covid, both in terms of actions - including buying risky public debt in violation of the Federal Reserve Act via an SPV set up with BlackRock (BLK) - and the duration of those actions, an analysis of the 2019 rate cuts is more instructive and simpler.

In 2019, GDP was 2.3%, unemployment was 3.5%, and inflation was 1.9%. And the Fed still cut rates 3x, by 75 bps total, and dropped the Fed Funds rate from an already below trend 2.5% all the way down to 1.75%. In case it is not clear, GDP was still okay, unemployment was low (below target), and understated gimmicked CPI inflation was at target levels which means in real life it was above target levels. Yet all it took was the theoretical, but yet to be realized, threat of slowing growth for the Fed to go on a rate cutting spree.

I could understand the rate cutting spree if rates were at 5% then, but they weren't. Policy was already extraordinarily accommodative by any standard, and things were fine. Yet cut they did. Probably because President Trump told the Fed Chairman to do it, because an election was coming up. Chairman Powell went right along with it because he wanted to keep the job. So much for an apolitical Fed, but that ship sailed a long time ago sadly thanks to President Nixon and the then Fed Chair Arthur Burns, and was made worse by Greenspan, Yellen, Bernanke and Powell. All products of politics, "group stink" and a broken system.

Compare then to now. Inflation is through the roof, and has been for a long time, including gas prices, well before anything in Ukraine happened. Yet with inflation running at 1970s levels when calculated the same way, we are still pouring gas on the fire. QE stayed in place, until now, and Fed Funds was kept at effectively zero, and basically still is at effectively zero with the single 25bp increase.

If this is not a completely asymmetric set of policy responses, I don't know what is. Frankly, the Fed is and has been in gross violation of its mandate.

There are a lot of reasons why this has happened. None of them good, and none of them are true to the ideals of the system we are meant to have. Part of the problem is politics and short-termism and vote buying. Part of it is the avoidance of short term pain. Cutting a rotting limb off a tree hurts, but ultimately the rest of the tree grows stronger. Getting cancer does not hurt in an acute fashion for a long time. In fact, many cancers are not noticed for years. Often a slow death follows, and it does not even become acutely painful until the end. It seems we prefer cancer to cutting off tree limbs.

The policy asymmetry has also been justified by fake self-serving models. Amongst other things, these models show that the pain from a mild recession is never made up by the recovery that follows. I call BS on this too. Although aggressive monetary and fiscal policy responses can mute volatility in economic cycles, they also come with a cost. Imbalances build up over time, many of which we are seeing now, societal, structural, and economical. And interference with capitalistic cycles only robs the system of longer term growth in GDP, employment, and wages.

The proof is in the pudding. GDP grew at an average rate of 5.2% from 1934-1970, with a standard deviation of 6%. When the activist Federal Reserve kicked in starting with Arthur Burns, average GDP growth has been halved since 1970 to about 2.5% in 1971-2022, and the standard deviation also dropped to 2% and change. I can't prove this is the fault of activist and political monetary policy, but those who disagree and would argue this is due to other factors cannot prove otherwise either. All I know is that the data is the data, so advantage me and my perspective! We have in part (not fully) stagnated due to the combination of terrible fiscal and monetary policy.

As for what to do know, it is complicated, and will take too much space. For the time being it is easier to talk about what *NOT* to do.

What not to do are things like below, where [Maine is going to start] handing out gas and food relief checks to residents. At least in Maine's case, this is acceptable. They have a budget surplus. But whatever this surplus was, it is now worth less, due to inflation. And now they have to spend what remains of the value on entitlements as opposed to improvements.

At any rate, the Federal Government, and many states, do *NOT* have a surplus. Any money printing to try and cover for the problem will only make the problem worse. We cannot do these things.

The correct way to solve for these problems is better policy, better fiscal discipline, and having an apolitical Fed that is grounded in reality as opposed to *group stink* and monetary experiments.

Stupid gimmicks to try and solve for problems that are caused by poor policy only make the problems worse over time, and can lead to disasters. Over the short-term, how did President Nixon's price controls work out? Many also forget, President Nixon was also faced with soaring food prices. To solve for that he introduced the corn subsidy. That led to high fructose corn syrup going into all of our food.

Now the average American is 30lbs more than they were in 1970, and healthcare has gone from 7% of GDP to 18% of GDP. Obese Americans did not cause all of this, but they are a big part of it. Obesity, coincidentally is a big part of the Covid problem as well. Now in order to trying and bring oil price down for the short term will we give Iran Nukes for the long term? The obesity problem will be small potatoes in comparison to this one, or sadly well done potatoes!

Gimmicks and laying blame on Putin or U.S. corporations do not work, they only cause bigger problems. The only thing that works is pragmatic common sense policy. (Side note, this thread is interesting on our universities, and student debt.)

The picture at the bottom of this missive is another example of where we are now. $11 for a burger, fries, and diet lemonade. Not a habit for me, every now and then I can't help myself. This might be more offensive than the $23 pastrami sandwich - which I had discussed in a previous column all the way back in mid-November. This is all out of control.

If this is not a wage price spiral, I don't know what is. And, no, the people making $17-$20.50 per hour are not better off all the sudden - at the expense of the wealthier - they are actually getting screwed the most. Frankly, I am even surprised they can afford to drive to work. In fact, many can't afford a car anymore, and take Uber (UBER) instead. But now Uber is adding a fuel surcharge, so that is going to be a problem. Even funnier, the fuel surcharge is in effect for the EV's that drivers have.

As to the equity markets... *when it comes time to sell, you won't want to!*

For me, I plan to expand my short exposure as my baseline view is that:

* Inflation will remain more elevated and far stickier than most expect

* The conflict between Russia and Ukraine further exacerbates supply chain dislocations and logistical problems

* *Slugflation* lies ahead

* Domestic economic growth and U.S. corporate profitability - profits and margins - are likely to disappoint

Position: None

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