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Are You Hedged For An "Economic Hurricane"?

- Carol Roth

In this informative newsletter, Carol covers what a hedge is; factors portending long-term inflation; the impact of “normalized” Federal Reserve policy; and the concerns about our national debt as well as other major countries around the globe.

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Are you hedged for an "economic hurricane"?

You don't need to be an economist to know that the economy today presents a lot of uncertainty. Jamie Dimon, CEO of JPMorgan Chase, has said that an economic "hurricane" is coming. Other Wall Street insiders and economists are predicting a coming recession. Some of the issues we are dealing with are clear and have been discussed widely, such as inflation, but other issues may lead to longer-term uncertainty in the economy and markets.

Given this economic landscape, if you haven't been focused on creating hedges in your portfolio, or don't have enough of your portfolio hedged, you may want to consider the following factors and how they may impact your investments.

Before I get into that, I think it's important to talk about what a hedge is. In the most easy-to-understand terms, the idea of a hedge is one or more investments that are positioned to offset the other investments in a portfolio. These are investments expected to go up or remain constant, or at least lose less value, when others in the portfolio go down for any number of reasons.

Some people think of hedges as insurance policies against the growth areas of their portfolios. I like to say they are positioned on the "FOLM" side of your portfolio vs. the "FOMO" side of your portfolio; they are meant for those with the "Fear of Losing Money" to provide stability vs. the "Fear of Missing Out" on the high-flying, growth-oriented and/or more speculative assets and investments.

Many people have trusted gold as a hedge because of its long history of stability. While it is meant as a hedge vs. a growth asset, gold has gone up in price as other asset classes have increased, more than quadrupling its dollar price over the last 30 years.

Also, sometimes individuals forget to expand their hedges as their portfolios grow over time. You may have, for example, bought some gold or other metals as a 10% hedge of the value of your portfolio many years ago. However, as your portfolio has grown, you may have let the hedge slip percentage-wise and you may need to buy more to keep the hedge at a level with which you are comfortable.

So, while everyone's financial objectives and risk tolerances are different, and you should consult a financial advisor, below are a few things to think about as you consider buying gold for the first time,

increasing your gold position or any other possible hedges to your portfolio.

Long-term inflation

We all know by now that inflation is here, but where is it going? While some of the top-line numbers that you see may come down as consumers switch their purchasing choices from goods-heavy to more services, as well as tap further into their savings and take on more debt, inflation will still likely run at elevated levels.

This is because of a number of structural economic issues; we have almost double the job openings of job seekers right now. Energy policy has put substantial pressure on pricing, with more demand expected to come online as China transitions away from lockdowns. These costs flow through almost everything in the economy, and will likely remain elevated for some time. We don't have enough food globally because of natural and geopolitical factors, and we also have supply shortages in a variety of commodities.

So, even if headline CPI inflation comes down to 6% or 5%, it may still outstrip wage gains and still create pressure on a variety of asset classes.

Also, the Federal Reserve's antidote to high inflation is "cooling demand". So, if the consumer spends, inflation may remain high, but if they don't and inflation subsides, we could end up in a recession, which then has further impacts on investments and could create more desire for stability.

Markets normalizing to Fed policy

The Fed has indicated that they are moving away from accommodative monetary policy, after historic actions that took interest rates to near zero percent and loaded their balance sheet with almost $9 trillion in assets (and, of course, factored into the historic inflation with which we are dealing). The Fed's policy disrupted risk in the markets and created asset bubbles that have been deflating since their reversal of course.

Should the Fed continue to raise rates and decrease their balance sheet holdings (the latter which began in June), particularly if the changes are larger or faster in scope than investors anticipate, it will add more volatility to the markets.

Also, should the Fed stay less accommodative, investors will have to go back to valuing companies based on old-school valuation analysis instead of accommodative policy conditions. These valuations may be further impacted by the inflationary environment (in layman's terms, companies and investors are expecting certain earnings, but inflation or a recession may mean these expectations are overinflated, which would mean that valuations today are too high). This could further impact markets.

Long-term national debt

We have obviously seen the severe impacts of central bank printing and government overspending over the past couple of years. The long-term outlook doesn't look particularly rosy, unfortunately.

The US national debt is out of control. Interest on that debt is out of control. The Congressional Budget Office ("CBO") in their "The Budget and Economic Outlook: 2022 to 2032" expects the national debt held by the public to surpass $40 trillion in the next decade and expects net interest paid on that debt to almost triple to over $1 trillion by 2030. There is no real plan for government spending or debt reduction and the current path shows more debt expansion. With the government's unfunded liabilities and obligations, the projected amount is estimated at tens of trillions of dollars more; plus, CBO estimates tend to be conservative (especially if interest rates remain elevated).

It is likely that to address this, the government will print more money and further devalue the dollar.

Michael Burry, the famed investor from "The Big Short" who was an early predictor of the 2008-2009 Great Recession, tweeted, "When you see mention of the strong dollar, the almighty dollar, please remember this is only in relation to other fiat currencies. The dollar is not at all strong, and it is not getting stronger. We all see it every single day in prices of everything."

As he alludes to, money printing and currency debasement is not just an issue in the US, but with major central banks around the world. Central banks like the ECB and the Bank of Japan have combined printed trillions of dollars' worth of their respective currencies in recent years. Countries including Japan, Italy, France, Spain, Greece, Canada, Portugal and Belgium, among others, have public debt that exceeds their GDP. They will all be contending with the same issues the US is

facing, but in many cases, with less underlying economic strength, which could materially impact the global economy.

Carefully consider your risk tolerance and whether you feel you need to add more hedges, including gold, to your portfolio to help you manage your investment risk.

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