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Q1'2024 – AWAIM® Research Highlights

Published by Investment Committee Chair:

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In an upcoming [Forbes](#) article tentatively entitled, "It's Normal That The Stock Market and Economy Are On Different Pages", I share a study on the relationships between U.S. GDP, M2 Money Supply, S&P 500, and DJIA across four distinct, non-overlapping, ten year time periods. The data analyzed were from the following decades: 1972 to 1982 (*Figure 1*), 2000 to 2010 (*Figure 2*), 1990 to 2000 (*Figure 3*), and 2010 to 2020 (*Figure 4*). Each of these ten-year periods contained at least one economic recession which supports some fairness between them.

The concluding observations mildly surprised not only myself but my Investment Committee colleague, Jacob Weston. The reason for the unexpected observation is likely due to the fact that so many people (professional and non-professional alike) readily refer to the state of the economy through the lens of prevailing capital market conditions - particularly how well the stock market may or may not be doing at that moment in time. However, what these four time periods reveal is that no such indicative relationship exists between the underlying health or malaise of the U.S. economy and its main stock market indices (e.g., the S&P 500 and the Dow Jones Industrial Average). As a matter of observation, we might even deduce that there's an inverse-to-neutral correlated relationship between the health of the economy and its stock markets, over longer-term periods.

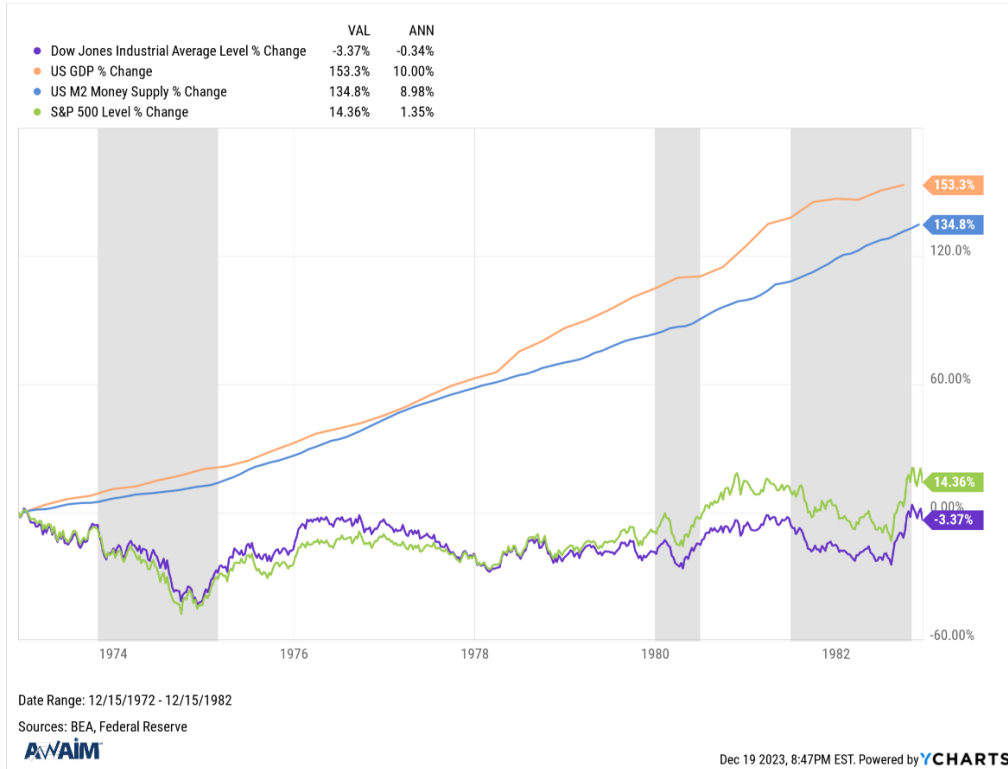
Decades in *Fig. 1* and *Fig. 2* illustrate robust economic growth while stock markets languished. Conversely, *Fig. 3* and *Fig. 4* show robust stock market performances relative to mediocre-to-weak economic growth.

Understanding this dichotomy matters profoundly to financial advisors and retail investors who are referencing economic data as an input to guide decision making on capital allocation decisions. In my soon to be published article in *Forbes*, I offer some suggestions on where instead an investor should focus their attention for more prudent indication of what may be coming next in the capital markets.



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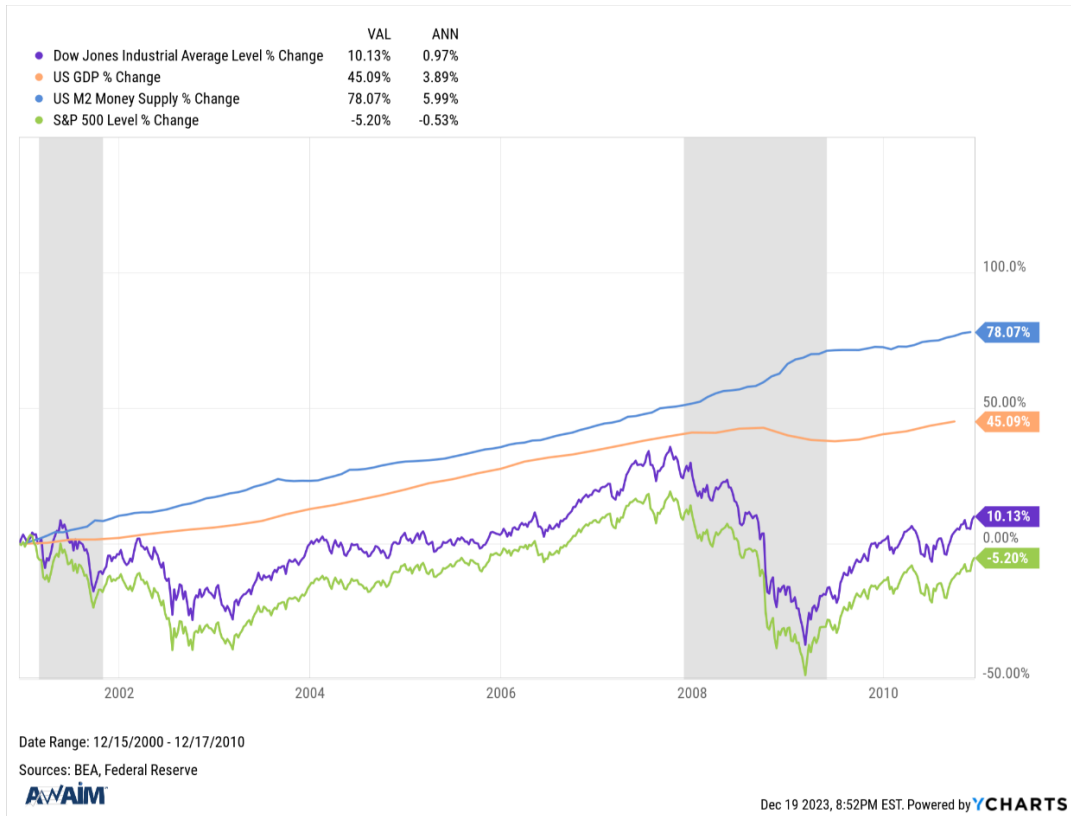
Figure 1





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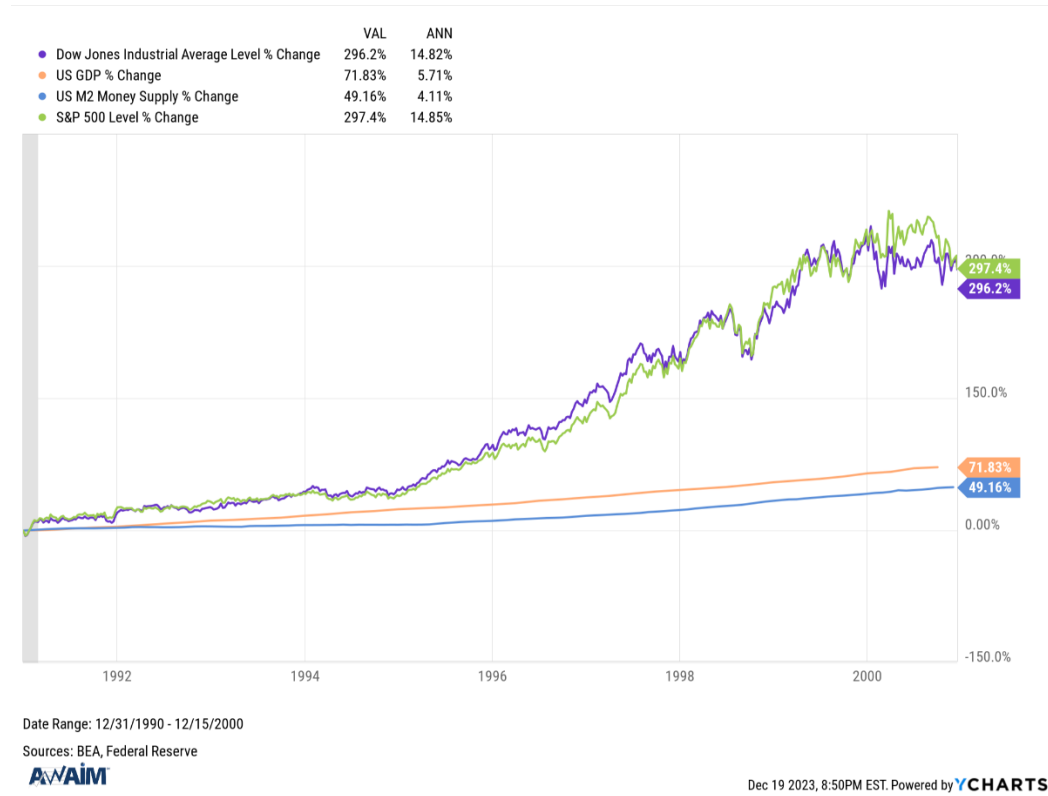
Figure 2





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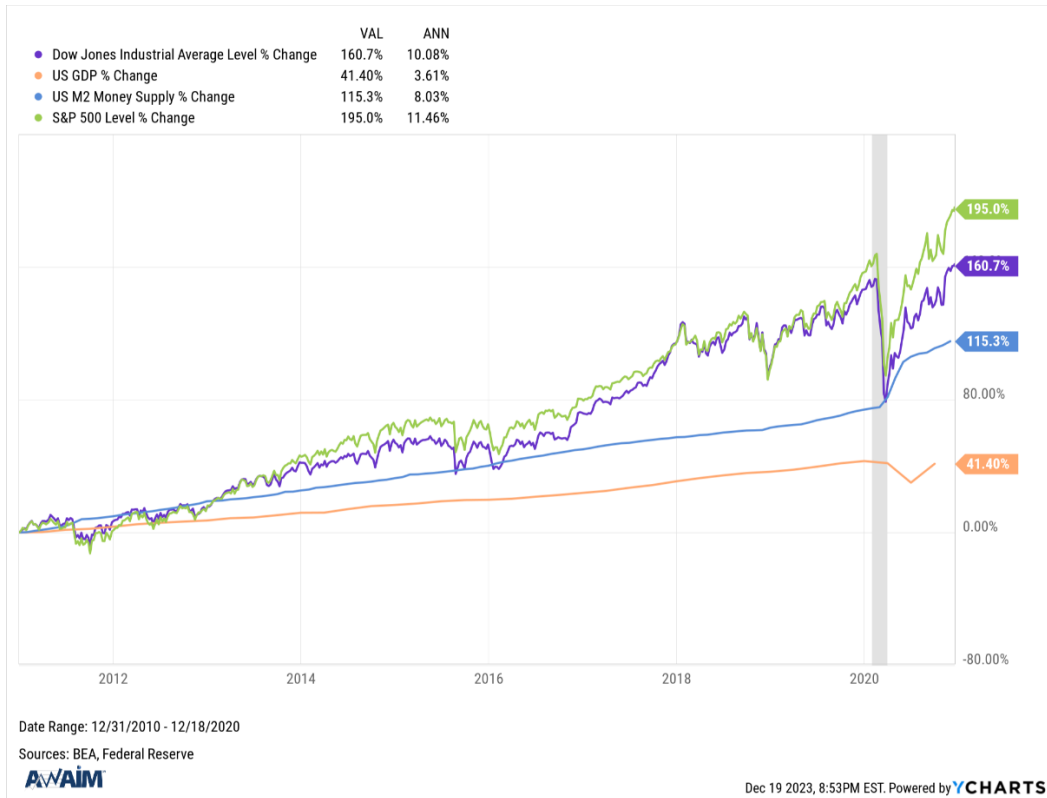
Figure 3





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Figure 4





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In my next article for [Forbes](#) tentatively entitled, "Hoping For A Bad Recession To Fix Inflation Is Unfortunately Necessary", I write about one economic metric that's flashing yellow - the Output Gap. Figure 5 illustrates just how extreme the current output gap is for the US economy. I've compared this data to other sources (e.g., [FRED](#)) and found some differences to the current extreme reading relative to the past, but that may be due to the variance in data chaining to a different base year. Regardless, the current extreme measurement according to FRED was last witnessed just before the Dotcom Crash.

Highly positive output gap figures indicate that aggregate demand is so high in an economy that its resources are essentially "overworked" and producing beyond a sustainable capacity given its available resources. This usually occurs near full employment. Other factors that lead to highly positive output gaps are significant levels of consumer spending and government spending, both of which we've seen over the past couple of years.

In short, the likelihood of winning the inflation war is remote without a recession. There are simply not enough factors available to drastically reduce the rate of price increases from its recent surge. Disinflation may be somewhat likely, but remember that disinflation still means inflation, just at a lower increasing rate. Disinflation builds upon the already massive amount of embedded price growth experienced across every sector in the U.S. economy. What the economy would benefit from in the long-term is deflation. Deflation would reduce prices to a lower level. We do not require a reset back to pre-pandemic times, but a nice 10% decline in prices would not even give back half of the 23% cumulative inflation experienced in the past few years. Deflation is a phenomenon that occurs almost exclusively during recessions.

As mentioned, a major driver of the highly positive output gap has been government spending. As shown in Figure 6, the growth of US public debt over the past decade has been colossal - growing more than 88%. Meanwhile, the U.S. economy (net of inflation) has grown a measly 36%. Such a differential could indicate artificially sustained GDP growth at the expense of US taxpayers. Today, the interest expense on this mountain of US debt has increased massively since the implementation of the Fed's quantitative tightening (Mar/Apr'22), government spending. Federal money is now being diverted towards paying interest on debt instead of meaningful and impactful fiscal policy initiatives. By some estimates, the cost of paying interest on U.S. government debt will be a top 3 line-item in the federal budget, just behind social security expenses.



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This backdrop does not bode well for the U.S.'s economic outlook. However, do not confuse economic malaise as a proxy for no capital markets opportunities. As I wrote in my last Forbes article, "[It's Normal That The Stock Market And Economy Are On Different Pages](#)", history shows that the markets and the economy have different reference points. For our investment portfolio strategies, we see many opportunities on the fixed-income side of the capital markets - particularly in corporate debt markets - over this next phase of the monetary cycle.

Figure 5



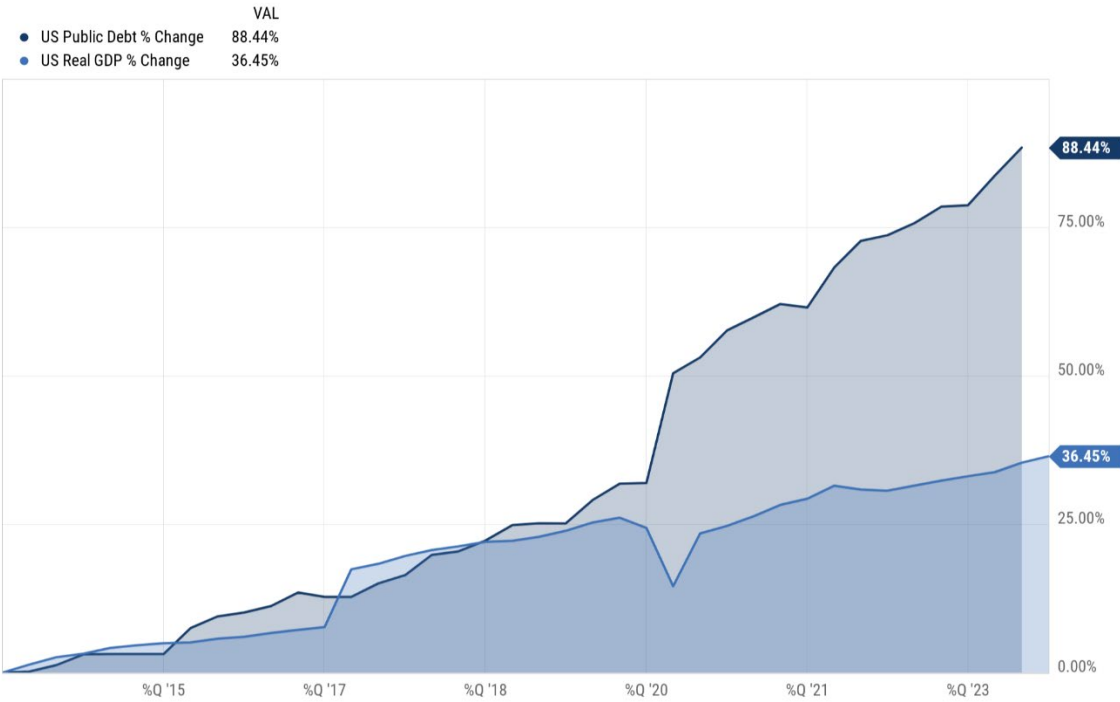
Date Range: 03/31/1949 - 12/31/2023
Source: Federal Reserve Bank of St. Louis

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Figure 6



Date Range: 03/31/2014 - 12/31/2023

Sources: Financial Management Service, BEA



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Date: March 6, 2024

In the past couple of months, there has been newly published economic data illustrating just how challenging maintaining a balanced household budget has become. Credit card debt has ballooned to more than \$1.129 Trillion, while the typical interest rate on that debt hovers at a lofty level of 21.47%. This combination of high debt (likely driven higher by overall price inflation) and the accompanying high interest has meant that households are having a much tougher time making ends meet. The result has been plummeting household savings and rapidly rising credit card delinquency of 90 days or more.

Over the past 20 years (since January 1, 2000), credit card delinquency of 90 days or more has averaged 9.02%, just below the current 9.74% (see Figure 7 for all data referenced). During this time, delinquencies have oscillated from a low of 5.65% in Q3'00 (just prior to the '00-'01 recession) to a high of 13.73% in Q1'10 (following the Great Financial Crisis '08-'09). For most of timeframe, the interest rates on credit cards averaged around 13.73%. Today, rates on credit cards are 56.4% higher than their twenty-three-year average, wreaking havoc on households' disposable income at a hefty 21.47% interest rate.

The current level of credit card debt is \$1.129 Trillion, or 49.3% greater than the long-term average (since Jan. 1, 2000) of \$756 Billion. Though the long-term average of household savings of \$810.24 Billion is very near the current level of \$809.15 Billion, there's been a volatile downward reset since Q2'20 when household savings catapulted to \$4.424 Trillion. The decline of household savings from Q2'20 to Q1'24 represents an 81.7% loss.

Whether it's post-pandemic behavioral issues like "revenge spending" or more correlated economic conditions like widespread price level inflation, the current dynamic is unsustainable. The result of spending most of the pandemic era "helicopter money" and now carrying much higher debt which is subject to much higher interest costs, places most Americans in a precarious situation. The beginnings of which are plainly seen in rapidly rising delinquency rates.



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Figure 7

