MRP CAPITAL INVESTMENTS, LLC

# What's Next?

11/12/2023

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## Introduction

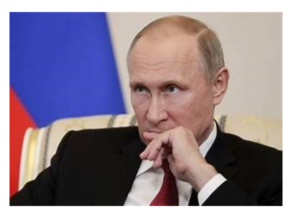
This weekend I spent a lot of time researching the markets: stock markets, bond markets, commodity markets, you name it, I looked into it.  I felt like so much of the happenings in the World were occurring with no rhyme or reason.  Many trusted people I talked with over the last few months seemed to think one thing was happening and others thought completely differently.

Given this, I hit the pause button on my wildly exciting life and stayed in all weekend and looked at the markets.  I needed to take some time and just read, think, read/listen, think some more.  Finally, things started to come together and make total sense.

What a feeling that is!

In the next several pages of this report, I hope to articulate my findings in such a way that you too have that sense of relief that, at least, you feel like you know why what is happening is happening.

As we go down this road, we will talk about interest rates, stock prices, geo-political events, history, and the future.  I hope reading this report is as enlightening for you as it was for me writing it.

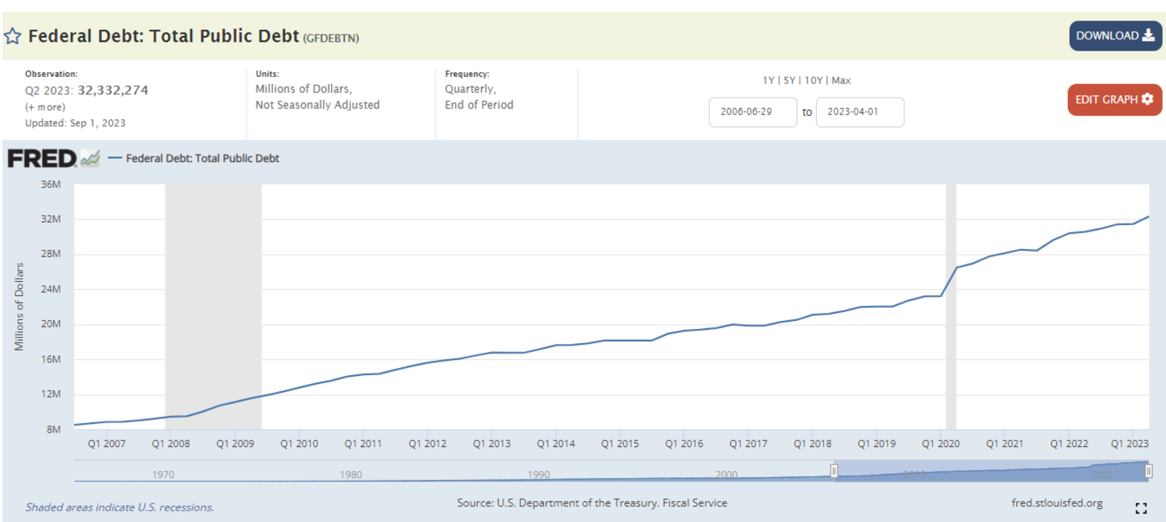


# Financial Situation

Before we get into all the moving parts of our current state of affairs, I think it is important to layout the background regarding our global financial situation.

Since The Great Financial Crisis, the United States' financial foundation has been deteriorating. In fact, 2011 was the first time U.S. debt was downgraded from AAA when Standard and Poor's moved it to AA+. COVID put further stress on the financial situation of the United States and this year, 2023, US debt was downgraded by Fitch.

To get a sense of the deterioration, the debt of the U.S. Government went from $9 trillion in 2007 to $32.2 trillion in 2023. Total Global Debt went from $97 trillion to $327 trillion over that same time frame. As you can see, this deterioration wasn't limited to the U.S.




Any believer in traditional economic principals was most likely shocked when the United States printed $5 trillion in an effort to save the economy from the COVID crisis. Maybe this saved us from really getting annihilated during the crisis by savings jobs and bailing out businesses, no one will ever really know. But we do know that it setup the framework for the avalanche of inflation that began to hit the world in 2022.

This massive rate of inflation, which peaked at 9% in the U.S., led the Fed to raise interest rates in an attempt to slow down the inflationary avalanche and regain price stability. And, of course, the Ukraine/Russian War broke out during this time and further exasperated inflation as it destroyed supply chains.

Nevertheless, the Fed kept their fight against inflation going and kept raising rates and performing Quantitative Tightening measures to help improve their own balance sheet.

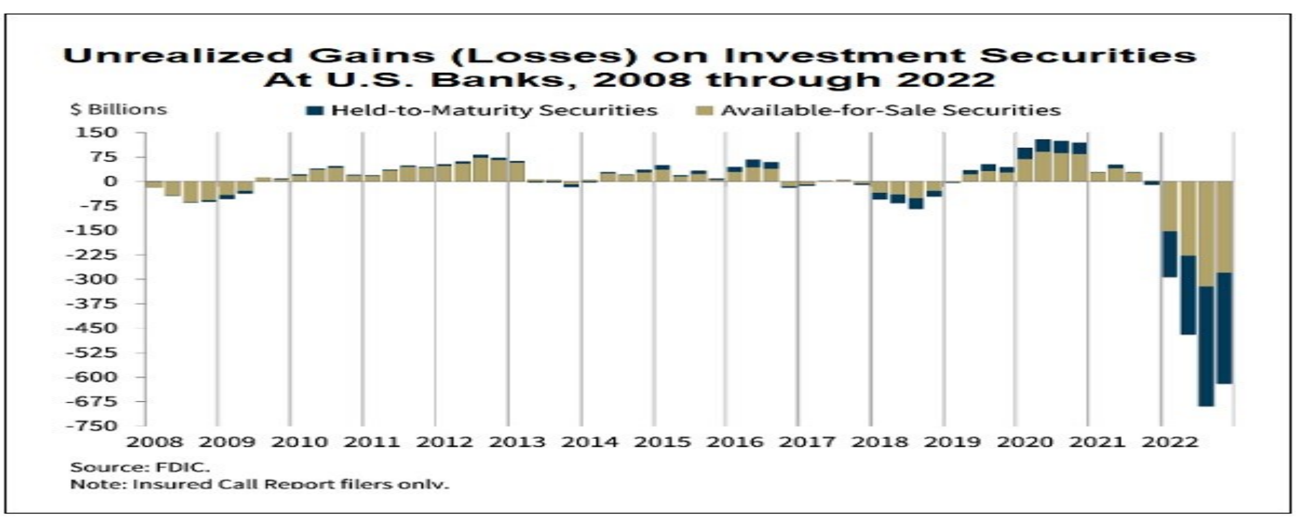
Entering 2023, the market was waiting for a slow down regarding the pace of the rate hikes and was hoping for a normalization of the economy. These hopes seemed to be close to becoming reality when during the Fed's September meeting, Powell essentially said that the Fed is very close to being finished with its rate hike campaign. The Fed called off the dogs but, interestingly enough, the US Treasury market reacted by selling off sharply. This sent yields moving even higher.

A phenomenon seen throughout financial history had begun: the dreaded "bear steepener". A "bear steepener" occurs near the end of a hiking cycle when the long-end rises more than short-end and un-inverts/normalizes the yield curve. This is a result of the market's anticipation of a weaker economy in the future with no sign of the Fed cutting rates in the foreseeable future.

If that weaker economy turns into a recession, the "bull steepener" can occur. As you would think, it is the opposite of the "bear steepener." In this scenario, the market knows the Fed will cut rates to address the economic issue, or the Fed is already doing so, and long rates come down. This keeps the curve normal in terms of shape as rates across the curve move lower.

Right now, there is no US recession and no financial calamity and the "bear steepener" has made its first appearance. This appearance makes the massive amount of debt the US Treasury must sell to fund the government's operations very relevant. Remember, as rates rise, bond prices fall and long bonds lose money in rapid fashion. With this and the fact that banks hold a lot of their capital in US Treasuries, their trading desks are showing massive losses.

To stop the bleeding, these banks all must trade the same way. They extended the duration of their portfolios to capture more yield in an effort to offset the losses. But the more they extend, the more they lose due to the bear steepener. Partially as a result of this, the US banking system is sitting on close to $700 billion of unrealized losses on US Treasuries and those losses will accelerate if long-end bond prices continue falling/rates continuing rising.



The Fed knows the issues the banks are having with their balance sheets. And this is why they are highlighting that their rate hiking program operates with a lagged impact and, therefore, they must pause rate hikes in order to give them time to work their way through the system. Maybe that is true, but it is also true that if rates stop going up the bear steepener's progress stops too. This is precisely what the banks need in order have a chance to tidy up their messy balance sheets.

And this is where we stood on October 6th.

# Hamas Attacks

But then Hamas attacked on October 7th.

When the markets opened on October 7th, US Treasury bonds rallied, yields fell, gold was slightly lower, and oil slightly higher. The commentary was that investors were fleeing to the safety of US Treasuries. All of which is standard protocol for how markets have historically reacted when a conflict breaks out.

The muted reaction of oil meant the market didn't believe this conflict would bleed over into the wider Middle East. With this, investors bought more US Treasury bonds. A return to an evermore inverted curve, as highlighted by the spread between the 2 year Treasury and the 10 year Treasury, showed that the buying continued to be focused on the long end of the curve and rates began falling pretty hard.

It seemed like the banks caught a break from the Bear Steepener that was destroying their balance sheets and pushing another economic catastrophe into existence.

But it soon became clear that Israel would not go quietly in the night. Instead, Israeli prime minister Netanyahu proclaimed the Israel Defense Force (IDF) would hit back at Hamas hard and strong in an effort to 'wipe Hamas off the map."

This got the market's attention!

If Israel hits back too hard, would Iran and its proxy Hezbollah engage in open conflict with Israel?

If Iran's in, does that mean America is in? Israel's aggressive foreign policy is predicated on unwavering American support and Biden keeps repeating that the US stands by Israel.

And then what about Russia? Does she get involved by proxy if her ally Iran is facing down America?

And if Russia is involved, how does China respond?

With these fears circulating, the flight to safety continued. Concurrently, rates were falling and, the man in charge of the entire U.S. banking system, was probably breathing a bit easier. These falling rates took the pressure of the Bear Steepener off our banking system's neck.

# Enter Yellen

On top of the worries of global kinetic warfare, market participants thought if America spent $8 trillion on Afghanistan, how much would America spend supplying the Israelis to fight Iran, who would have the implicit or explicit backing of Russia and China?

Could America even afford to fund this war? But if we couldn't fund it, wouldn't we be weakening our place in the global power hierarchy by losing the trust of our allies if we left Israel alone after we vehemently promised to walk arm-in-arm with her?

The question of 'Could we afford to fund two wars simultaneously?', was asked of Treasury Secretary Janet Yellen. Her response was:

*"America can certainly afford to stand with Israel and to support Israel's military needs, and we also can and must support Ukraine in its struggle against Russia. The American economy is doing extremely well."*

Almost as soon as she uttered those words in such a nonchalant, almost flippant, manner, the markets were visibly rattled. It was as if the markets thought, there is nothing that will keep America from borrowing and borrowing and borrowing and all the while thinking their economy is in great shape.

And with that the Bear Steepener was back on and rates were headed higher in a hurry as U.S. Treasuries, which just a few minutes ago were the flight to safety asset, were being sold as fast as they could be.



# What's Next?

Maybe all of this craziness was necessary to get everything lined up for Fed Chair Jay Powell to take centerstage on November 1st and not hike interest rates. Just prior to Yellen's comments, rates were coming down. Maybe too quickly. And, maybe, Powell might have felt compelled to take a hard stand against inflation, despite the two simultaneous wars, and hike interest rates again.

Who knows?

What we do know is that Treasury Secretary Yellen's comments spiked rates right before Powell's speech. And at that speech he left interest rates unchanged.

Below is a chart of the 10 Year US Treasury's Yield with annotations of when the events mentioned in this report occurred. And you can see, very clearly, the market moved strongly and immediately as soon as they occurred.


Chart of 10 Year Yield provided by Trading View with annotations by MRPCI

Like I mentioned in the Introduction to this report, as I researched and sincerely thought about our current situation, everything became clear. That moment of clarity was centered around the simple fact that nothing has changed.

In my opinion, human beings are driven by self-preservation first and foremost. When you couple that with the belief that I have, and have had for over 15 years, that The Great Financial Crisis completely broke our economic system past the point of repair, you see that those currently in power will do whatever it takes to maintain the status quo and, therefore, their power.

We see proof of this over and over. Russia attacks Ukraine. The U.S. prints money to provide the Ukrainian's support to hold off Russia's advance and maintain the status quo. Regional banks begin to go bankrupt due to outsized losses on their investments in U.S. Treasuries*. Feds move into the save the industry before things get out of hand. Global pandemic threatens economic catastrophe. Government prints an unprecedented amount of money to save the system, again.

So, this time, Israel was attacked. Whatever must be done to maintain the world as we know it, will be done. No matter the long term economic consequences. Why? Most problems can be fixed with more money. With a fiat monetary system, money can be printed at will and at anytime. All that must be done is to make sure the people of the world believe that fiat monetary unit is valuable.

Therefore, as long as the United States has the world's dominant military and economy, people have reasons to believe the U.S. dollar is valuable. This will allow the status quo to be maintained. With that, the U.S. can step in and aid Israel in a variety of ways including help fund their war efforts.

This belief in the U.S. dollar also allows the U.S. to run budget deficits, trade deficits, amass mind-blowing levels of debt, and still stay the World's Superpower. Therefore, the U.S. dollar's strength is very important to track in order to understand our macroeconomic climate.

*As a sidenote, banks were, essentially, forced to load up their balance sheets with U.S. Treasuries when the government over did it with the COVID bailouts. Banks were holding way too much cash and needed something to do with it that wouldn't negatively impact their capital ratios. Treasuries, being "safe" and liquid, were their choice regarding where to put the COVID dollars.

As we move forward from here, there appears to be two main paths the economy can take.

The first is a recession. Everyone in the marketplace is asking, will this be a "hard landing" or "soft landing" type of recession. Frankly, I don't know which of those two recession scenarios is more likely. Neverthelss, there are indicators that suggest a recession is possible.

Regardless of the type of landing, it looks like we will have some labor issues moving forward. The reports I've read say, the deal the UAW struck with the automakers takes the union members per hour compensation from $25 per hour to $88 per hour! And recent comments from the United Airlines CEO, concerning massive and unforeseen issues with labor, support the idea that companies have a labor problem. Two ways to solve labor issues caused by massive wage increases are: layoffs and/or price hikes. Both don't have great near term implications concerning corporate profits and/or growth scenarios for the economy as a whole and would likely move our economy towards recession.

The other path isn't a hard or soft landing, rather it is no landing at all. Some of the Market Strategists that I follow, who are normally pretty bearish, see signs that the profit slowdown is over and they see the economy reaccelerating from here. Instead of a recession, that most people feel is likely, they see expansion.

Time will tell which path the economy takes. As for now, I can say that, historically, the year before a Presidential Election is the best year for market gains. And those gains are the highest in the 4th quarter. Furthermore, Presidential Election years normally don't see a lot of gains until the election is over.

Given this, we should see good gains throughout the remainder of this year and then we should enter a sideways and grinding market until next year's Presidential Election is over. If the economy falls into a recession, or not, will be less important than the looming election.

One historical fact that is important to know: no incumbent President has won re-election if the economy was in, or recently was in, a recession. We need to keep this in the back of our mind as we near the election.

# Future

In closing, I feel it is necessary to say that asset ownership is the key to wealth creation and preservation in an economy like ours.

Debt-based fiat monetary systems should have a tendency to struggle with inflation. Inflation manifests itself in a positive manner when looking at asset prices. For instance, what is the value of your home today? What was its value 5 years ago? 10 years ago? 15 years ago? The odds are your home is substantially more valuable today, in USD terms.

The same type of analysis can be applied to your investment accounts, raw land that you own, commodities, bitcoin, and any other asset and/or asset class.

However, income and/or cash flow without asset ownership will prove, most likely, to be a failing strategy in our current economic environment. Simply looking at the purchasing power of most sovereign nations' currencies prove this point. For instance, a dollar buys you a lot less of, almost, anything than it did 1 year ago, 5 years ago, or 15 years ago.

Just to reiterate, to thrive in our current marketplace, it should prove vital to own assets rather than just have a good paying job. And those assets could be most anything, as long as they are of high quality, including: stocks, real estate, commodities, and bitcoin.

| **Asset Class** | **Value 15 years ago** | **10 years ago** | **5 years ago** | **Today** |
|---|---|---|---|---|
| S&P 500 | $903.25 | $1,848.36 | $ 2,485.74 | $4,415.23 |
| My home* | $435,827 | $437,155 | $573,723 | $1,007,000 |
| Gold | $879.50 | $1,674.96 | $1,282.20 | $1,939.81 |
| Bitcoin | $0.003 | $732 | $3,693 | $37,166 |
| Cost of a Stamp | $0.43 | $0.46 | $0.50 | $0.66 |

The above table is there to illustrate how asset prices have appreciated in our debt-based fiat monetary system over the last 15 years and how much purchasing power the dollar has lost over that time as well. Pricing data was used in a manner to be as consistent as possible across all asset classes.

*The value listed isn't necessarily my home. It is a mix of Case Shiller home price data and my residence's data. It is used to show how a typical home has appreciated over the last 15 years.

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