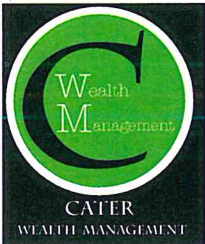


Gregory E. Cater CWS®
Certified Wealth Strategist

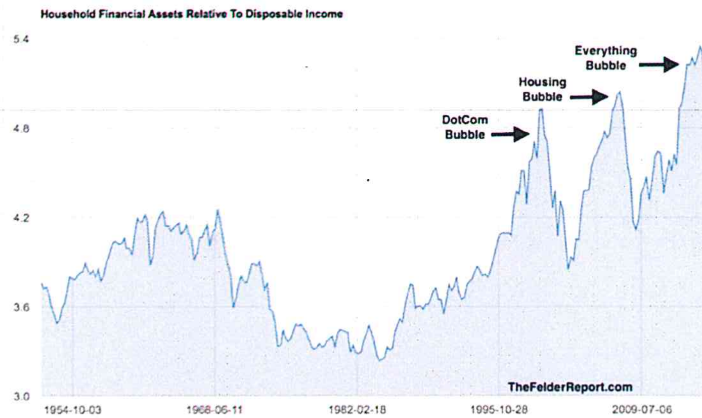
6411 Ranch Park Drive
Magnolia, Texas 77354
www.firstallied.com

936-321-1542
877-433-9218 Toll Free
936-271-0801 Fax
gcater@1stallied.com

Greg Cater Sr. & Greg Cater Jr.
Prices vs Cash Flow
10/4/17

Have you noticed that your stock portfolio has been increasing in value lately? What about your salary? If you are like most Americans, the value of your assets has increased dramatically, while your cash flows from wages and other earned income have increased modestly if at all.

"Since 2009, households have seen their holdings of stock and mutual funds nearly double, to $20.6 trillion. Only 6 percent of that gain can be ascribed to new flows of money into the funds or share purchase...The rest is due to price appreciation."(1)



So what's wrong with this picture?
To increase in value, someone had to purchase shares of your stock for more than you paid for them. If everyone's assets are increasing in value, but in the aggregate we have the same amount of disposable income, who is bidding up all of our assets, and, more importantly, how are they paying for them?

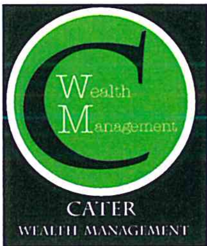
If the previous two times that the ratio of household financial assets to disposable income were this high are anything to go on (chart 1), a private-debt-fueled bubble is causing the increase in asset prices.

Private vs Public Debt

We have too much debt. Common sense would dictate that the solution to our problem is to balance the federal budget. After all, if we are in debt, the ~$20 trillion at the Federal Government seems like the best place to start. Unfortunately, in the complex world of global economics, common sense isn't always helpful. The truth is, because of Wynne Godley's concept of sectoral balances, (ignoring foreign trade effects for simplicity) private sector financial assets cannot increase in value without an equal increase in public debt(2). Because of this, the only viable path to increased private wealth is to increase government debt. But what about the danger of too much debt? While it is true that the US has the ability to print money, this free spending comes at a price.

Securities offered through First Allied Securities, Inc., Member FINRA/SPIC
Advisory services offered through First Allied Advisory Services, Inc.

www.caterwealthmanagement.com



Gregory E. Cater CWS®
Certified Wealth Strategist

6411 Ranch Park Drive
Magnolia, Texas 77354
www.firstallied.com

936-321-1542
877-433-9218 Toll Free
936-271-0801 Fax
gcater@1stallied.com

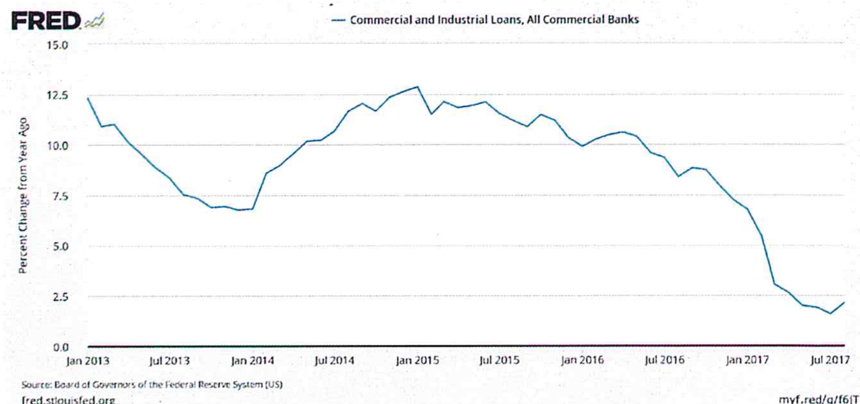
Inflation

The major risk associated with increasing government debt is inflation. As with just about anything, too much inflation can be a very bad thing. At this time, however, runaway inflation is not something to worry about. The Federal Reserve's target for yearly inflation is 2%, and despite pumping trillions of dollars into the economy through QE the Fed has been below its target for the last 6 years(3). If the Fed can't increase inflation to meet its goals on purpose, it is unlikely that we will reach dangerous levels of inflation by accident.

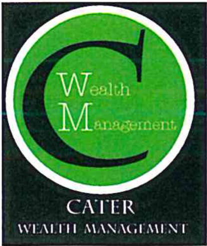
An increase in the money supply is not necessarily inflationary. If people suddenly have more money, they are likely to demand more goods and services. If the amount of goods and services remains unchanged, inflation occurs. Fortunately, producers pay attention to demand levels, and the first line of defense is usually not a price change. Producers are more likely to sell more goods than raise prices due to still existent competition, and will only raise prices when labor, raw materials, and production capacity in their factories become scarce. Right now we are at around 76% utilization(4), wages are fairly stagnant(5), and raw materials haven't been this cheap since the '08 crisis(6). In all likelihood, an increase in the money supply will cause an increase in sales rather than an increase in prices...at least until metrics in capacity utilization, wages, and raw materials change.

Private Debt

Ok, government debt is fine, at least for now. What about private debt? That depends on what type of debt we are talking about. Not all loans are created equal. Good loans expand our production power or productivity. An example of this is a loan taken out to build a factory. In theory, production from the factory will pay back the loan principal, interest, and continue to produce long after the principal has been repaid. Bad loans, on the other hand, trade current purchasing power for reduced future purchasing power. An example of this is a car loan that allows you to purchase a new car you can't afford, and has the net effect of weakening your future purchasing power. On top of that, because cars depreciate so rapidly, these loans leave you with an asset worth much less than the total cost of the loan.



Securities offered through First Allied Securities, Inc., Member FINRA/SPIC
Advisory services offered through First Allied Advisory Services, Inc.

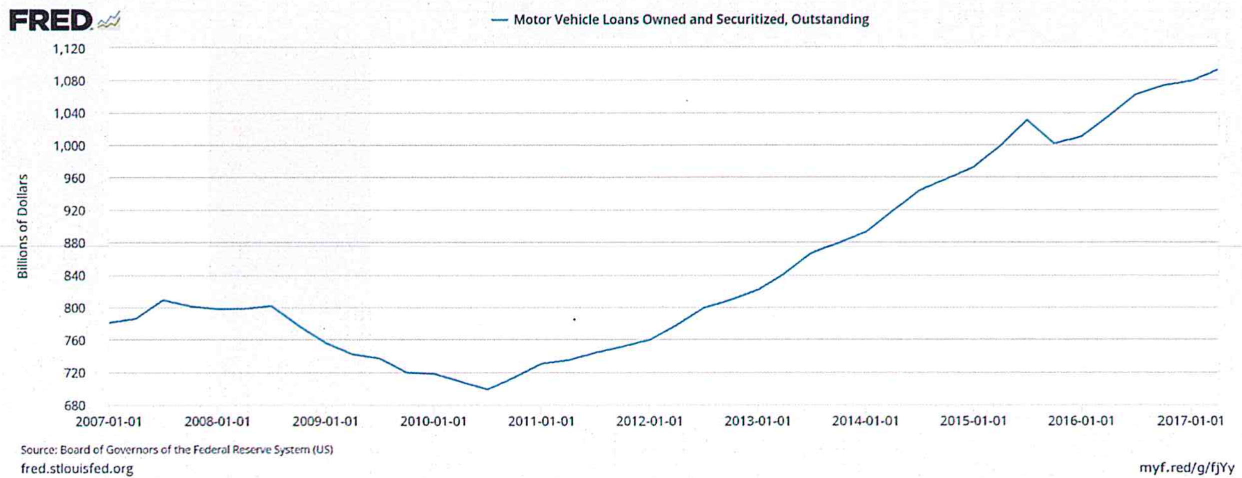


Gregory E. Cater CWS®
Certified Wealth Strategist

6411 Ranch Park Drive
Magnolia, Texas 77354
www.firstallied.com

936-321-1542
877-433-9218 Toll Free
936-271-0801 Fax
gcater@1stallied.com

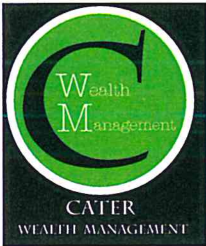
A key issue in the United States is that in the last few years, growth in “good” productive loans has slowed down significantly (chart 2), while many forms of “bad debt” are at high levels (Chart 3). This increase in debt puts extra money into the market, allowing the bid-up of equities.



All of this leads to one important question. With the decreased investment in commercial and industrial loans, and the high levels of private loans outstanding, will the economy as a whole have enough cash flow to pay off our total private debt when it comes due?

Securities offered through First Allied Securities, Inc., Member FINRA/SPIC
Advisory services offered through First Allied Advisory Services, Inc.

www.caterwealthmanagement.com



Gregory E. Cater CWS®
Certified Wealth Strategist

6411 Ranch Park Drive
Magnolia, Texas 77354
www.firstallied.com

936-321-1542
877-433-9218 Toll Free
936-271-0801 Fax
gcater@1stallied.com

Citations

(1) Rich Miller, Bloomberg Terminal

(2) Wikipedia - https://en.wikipedia.org/wiki/Sectoral_balances

(3) New York Times - https://www.nytimes.com/2017/06/14/upshot/janet-yellen-and-the-case-of-the-missing-inflation.html?mcubz=0

(4) Trading Economics - https://tradingeconomics.com/united-states/capacity-utilization

(5) St Louis Federal Bank - https://fred.stlouisfed.org/series/CES0500000003

(6) Index Mundi - http://www.indexmundi.com/commodities/

(First Chart) The Felder Report - thefelderreport.com

(Second and Third Chart) The Federal Reserve Bank of St. Louis - fred.stlouisfed.org

Securities offered through First Allied Securities, Inc., Member FINRA/SPIC
Advisory services offered through First Allied Advisory Services, Inc.

www.caterwealthmanagement.com