

# INVESTMENTS & WEALTH MONITOR

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## And Now You Know ... the Rest of the Story

*By Ronald J. Surz*



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# And Now You Know ... the Rest of the Story

By Ronald J. Surz

*Editor's note: The opinions expressed below are those of the author alone and don't represent the positions or policies of the Investments & Wealth Institute.*

**T**he Rest of the Story was a popular feature of Paul Harvey's week-day program on ABC Radio from 1976 until his death in 2009. In his distinctive, punctuated radio voice, Harvey concluded each vignette with a variation on the tag line, "And now you know ... (dramatic pause) ... the rest of the story."

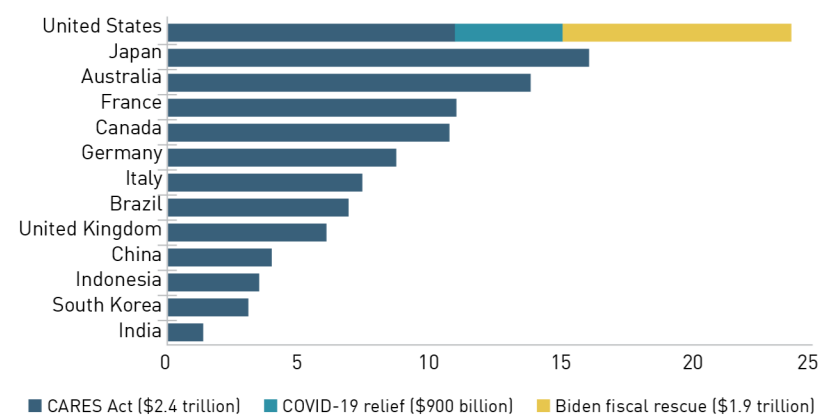
Today, with all eyes on Russia's invasion of Ukraine as well as the dramatic upward trend in inflation, the rest of the story needs to be told about the following issues:

- Current inflation is due in part to supply chain disruptions caused by COVID-19, but the rest of this story is that inflation will continue to increase and will last a long time because it's not just a matter of supply shortages.
- The Federal Reserve has announced a plan to control inflation through interest rate hikes, but the rest of this story is that the Fed is just pretending to be in control.
- Russia's incursion into Ukraine is testing NATO resolve, but the rest of the story involves China and the reserve currency status of the U.S. dollar.
- The U.S. stock market story is at a precipice, but the rest of the story is that it is tipping from greed to fear.
- The retirement crisis is becoming even more critical because 60/40

Figure 1

## UNITED STATES OUTSPENDS ON COVID

Fiscal support, percent of 2019 gross domestic product



Source: Moody's Analytics

stocks/bonds are risky and so are target-date funds. The rest of this story might surprise you.

Buckle your seatbelts. You're about to go on a wild ride.

## INFLATION

There are two kinds of inflation. One is called demand-pull inflation. It is caused by demand for goods or services exceeding supply, which is occurring now because supply chains have been disrupted by COVID-19 and people have been slow returning to work. This has increased the costs of goods and labor and has generated most of our current 7.5-percent inflation. This form of inflation should dissipate as people return to work and cargo ships are unloaded. It should be transitory.

The other form of inflation, called cost-push inflation, is not transitory. It is

classic inflation caused by too many dollars chasing too few goods. It happens when a government prints too much money, which has been happening globally over the past 13 years. Argentina and Venezuela are rich countries that still are suffering from hyperinflation, defined as inflation greater than 50 percent, because their governments made serious monetary mistakes.

The world is running on unprecedented levels of debt, to the tune of \$200,000 per capita.<sup>1</sup> The United States enjoys a special status as the "cleanest dirty shirt in the laundry basket" because the U.S. dollar is the world's reserve currency.

But the United States has printed more money during the COVID-19 pandemic than any other country (see figure 1), exposing it to cost-push inflation that will last longer and drive inflation above the current 7.5 percent.

Who is paying for COVID-19 relief? When was the last time you heard the words “balanced budget”?

Modern monetary theory (MMT) is the justification for the money the United States has “printed” over the past 13 years. MMT says that governments that own the printing press can print all they want to solve economic crises, unless it causes inflation, in which case that money needs to be taken back with taxes.

“Printing” is not actually running the presses. The U.S. Treasury borrows money as Treasury bonds and bills. In ordinary times, there are plenty of buyers for these bonds, but recent times have not been ordinary, so the Federal Reserve buys them, manipulating bond prices to

execute a zero interest rate policy (ZIRP). Money is created out of thin air.

According to the Federal Reserve, its balance sheet has skyrocketed from normal levels of less than \$1 trillion before the Global Financial Crisis to about \$9 trillion, with most of the increase occurring during the pandemic (see figure 2).

MMT appears to have “worked.” A recession in 2008 was short-lived, stock prices soared, and inflation remained near zero—or did it? The fact is that \$4.5 trillion in quantitative easing (QE) artificially increased the prices of both stocks and bonds, so we’ve had asset price inflation that is not reflected in the Consumer Price Index.

Investors suffer from a behavioral bias called “money illusion.” It leads them to believe that this price manipulation has made stocks worth more, even rising in the face of a pandemic; recall that after a brief setback in the first quarter of 2020, stock prices rose as earnings plummeted.

Money printing accelerated in 2020 to pay for a COVID-19 relief bill in excess of \$5.5 trillion, and more recently another \$3 trillion was approved for infrastructure. Plus, another \$3 trillion is now making its way through Congress.<sup>2</sup>

One trillion is 1,000 billion or a million million—it’s a huge amount of money. According to CNBC:<sup>3</sup>

*If you paid out \$1 per second, to settle a \$1 million debt would take less than 12 days. To pay off \$1 billion would take 32 years. Paying off \$1 trillion at a dollar per second? 32,000 years.*

*A trillion is a 1 followed by 12 zeros, like this: 1,000,000,000,000.*

*A trillion square miles would cover the surface of 5,000 planet Earths.*

*A trillion people would be 10 times more than have ever lived (based on the Population Reference Bureau’s very rough estimate of 108 billion humans ever).*

*A trillion dollars is enough to give \$3,195 to every man, woman, and child in the United States.*

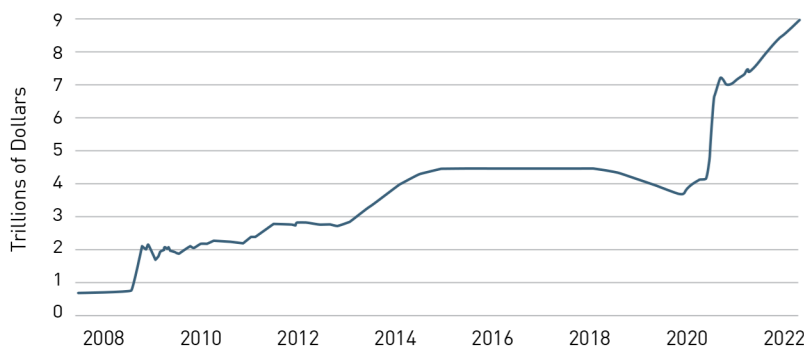
*For a typical U.S. household, making \$50,000 per year, to earn enough to pay off a \$1 trillion debt would take 20 million years.*

Figure 3 shows the magnitude of recent money printing by comparing it with our most expensive wars.

But that’s not the entirety of the rest of the story. We (through our government)

Figure 2

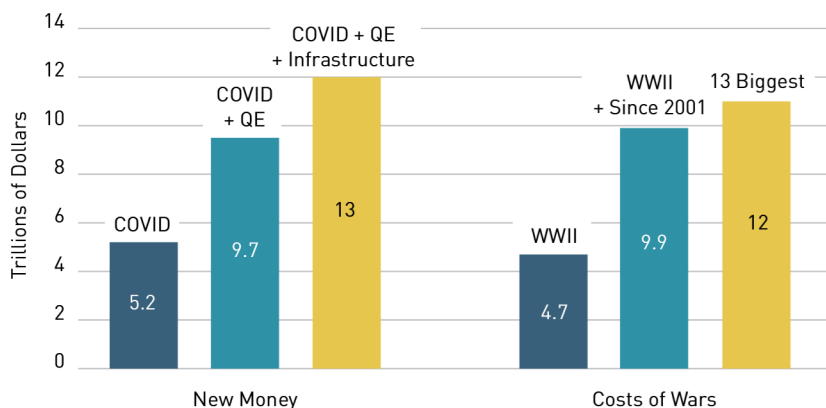
### FEDERAL RESERVE BALANCE SHEET, 2008–2022



Source: Federal Reserve

Figure 3

### TRILLIONS IN NEW MONEY COMPARED TO SPENDING ON WARS



Source: Glidepath Wealth Management and Congressional Research Service

have made promises for Social Security and Medicare that are unlikely to be kept, and QE has widened the wealth divide beyond comprehension.

Figure 4 shows that the total U.S. debt is more than five times gross domestic product (GDP) when the total includes off balance sheet promises for Social Security and Medicare.

Tax receipts for Social Security have been insufficient to pay all the benefits since 2018. The Government Accountability Office reports that Social Security will be bankrupt in 2026, followed by Medicare in 2034. Many say that owning the printing press means you can't go bankrupt, but the reality is that inflationary forces already are out of control.

*MMT has poked the inflationary bear and the bear is infuriated. It's time to take that money back with taxes, not print more of it.*

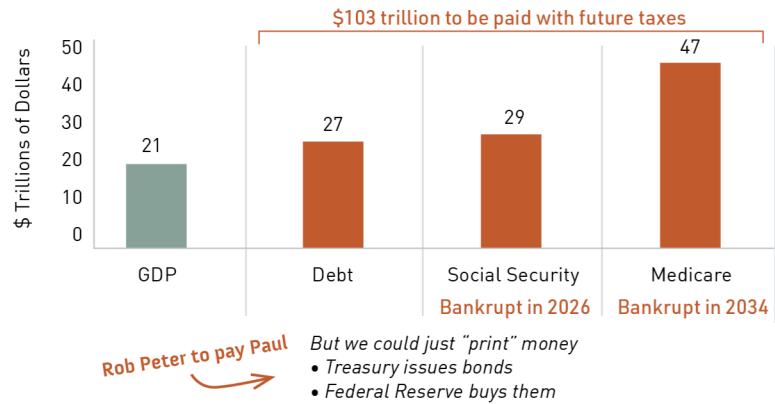
MMT has poked the inflationary bear and the bear is infuriated. It's time to take that money back with taxes, not print more of it. Cowboy wisdom instructs "when you find yourself in a hole, stop digging."

The last part of the rest of the inflation story is the great wealth divide and the social unrest it creates. The bottom half of the U.S. population by wealth owns only 2 percent of the country's tremendous wealth (see figure 5). It's no wonder that Senator Bernie Sanders (I-VT) has supporters—half the population wants what the other half has.

In summary, the rest of the inflation story is that excessive amounts of money printing will cause an extended period of rising inflation amid unaffordable debt and social unrest caused by a huge wealth divide. It's an ugly picture.

Figure 4

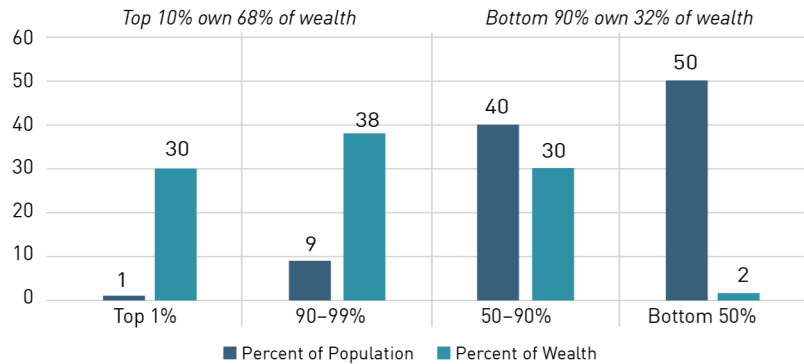
**SOCIAL SECURITY AND MEDICARE GOING BROKE**



Source: Target Date Solutions

Figure 5

**WEALTH DIVIDE CAUSES SOCIAL UNREST**



Source: Statista

**THE FEDERAL RESERVE**

It's ironic that the Fed is coming to the rescue to control inflation when it is complicit in creating inflation. As described in the inflation section, the Fed is the key to printing money, and therein lies the Fed dilemma, as summarized in figure 6.

The Fed does not have a dial that it can turn to achieve a desired level of interest rates, but it has managed to suppress interest rates by buying bonds at premium prices. When the Fed lets its foot off the brake by tapering its bond buying, interest rates will go up and bond prices will go down.

No special Fed meeting is required to set an interest rate—rates rebound toward a fair market price when they are not being manipulated. A fair market

price in a 7.5-percent inflationary environment yields 10.5 percent.

Before ZIRP, bonds were priced to yield 3 percent above inflation, or 10.5 percent in the current 7.5-percent inflationary environment. But increases in interest rates do a lot of damage, as we learned in the 2013 "taper tantrum."<sup>4</sup> Higher interest rates escalate the interest payments on our \$30-trillion government debt. Interest at 10 percent would require spending all tax receipts on debt service and borrowing to pay for military spending and social programs such as Social Security and Medicare. Tax receipts are about \$3 trillion per year.

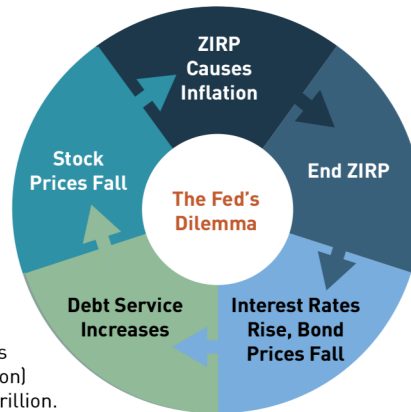
What's worse is the stock market will crash, as it did in the 2013 taper tantrum, because bonds become a reasonable alternative and corporate

Figure  
6**A VICIOUS CYCLE**

Stock market losses put pressure on Fed to lower interest rates, so they do, as they did in the 2013 Taper Tantrum.

Rising interest rates cause stock prices to fall because earnings are discounted at a higher rate and borrowing costs increase.

Interest on \$30 trillion of federal debt increases from 1% (\$300 billion) per year to 10% (\$3 trillion) per year. Total tax revenues in 2021 were \$3.9 trillion.



Massive money printing is required to manipulate bond prices to zero interest rate policy (ZIRP). This causes cost-push inflation that is added to supply shortage demand-pull inflation.

Tapering bond buying reduces money printing and inflation and allows interest rates to return to normal without official rate hikes.

**The Fed must keep some manipulation.** When all manipulation ends, yields revert to inflation +3%, or 10% when inflation is at 7%. A 9% increase in yields generates a 54% decrease in bond prices.

Source: Target Date Solutions

earnings are discounted at a higher rate. At this stage in the cycle, the Fed will be encouraged to stop tapering and resume its bond buying.

But this time is not like 2013, when inflation was near zero. This time bond buying will fuel the very inflationary fires that the Fed says it will extinguish.

The rest of the Federal Reserve story is that it cannot simultaneously continue to manipulate interest rates under ZIRP and continue to subdue inflation. It will have to choose. The better choice is to control inflation and allow bonds to return to market-driven prices, increasing interest rates and driving down stock prices. Allowing market forces to work is usually the better choice.

**RUSSIA**

Russian President Vladimir Putin has suggested that we think back to 100 years ago when empires were built by conquest, making his invasion of Ukraine simple old-fashioned empire building.

More to the point, Putin's invasion is a move toward restoring the former Russian empire known as the Union of Soviet Socialist Republics, which disbanded in 1991 when Putin was head of external affairs for the city of

*In grifter jargon, China might be playing a "long con" on the United States (the mark) that takes years and patience.*

St. Petersburg. Putin then became the prime minister of Russia in 1999 under Russian President Boris Yeltsin, who appointed Putin as his successor.

But this isn't 100 years ago. Today, such conquests are judged on moral grounds as costing countless lives and punishable with financial sanctions and the possibility of war. Russia will suffer economically, but its relationship with China has changed the rules, emboldening Putin to make his move.

Russia and China got married and held a worldwide wedding reception in Beijing during the 2022 Olympics. Each brings an estranged child to the marriage: Russia has Ukraine and China has Taiwan. The Russian invasion of Ukraine is a tactic in the geopolitical war with the United States, a war that carries the unthinkable threat of mutual nuclear annihilation. China will watch, learn, and proceed in some way to grab Taiwan.

But the most important part of the rest of the story is the mighty U.S. dollar, which is threatened by a Thucydides Trap,<sup>5</sup> the inevitable discombobulation that occurs when a rising power threatens to displace a ruling power. China is positioning to become the dominant world economy and is executing a clever strategy that is similar to the tactics employed in the TV series *Hustle* where con artists exploit their "marks."<sup>6</sup>

In grifter jargon, China might be playing a "long con" on the United States (the mark) that takes years and patience. It's conceivable that China is promoting MMT to encourage massive U.S. spending and money printing. The "convincer" is that MMT worked in the form of QE, so more is good. The "closer" in this hustle is a resurgence in COVID-19 that necessitates unprecedented additional money printing.

In other words, the con is tricking the United States into devaluing and debasing its currency (see the discussion on inflation above).

The rest of the Russia story is that the mighty U.S. dollar is in danger of losing its position as the world's reserve currency, potentially replaced by China's digital yuan. The U.S. government appears to not grasp the gravity of

a weak dollar, as evidenced by its plans to continue spending trillions. Has the United States been conned? Might the United States suffer hyperinflation?

**U.S. STOCK MARKET**

The U.S. stock market is very expensive, and a correction is long overdue. As shown in figure 7, the U.S. stock market has grown consistently over the past 13 years, increasing 600 percent.

This has been the longest bull market on record, so a correction is long overdue. In fact, a correction is more than 7.5 years overdue (see figure 8).

But who said the stock market is expensive and, if it is, why?

There are several measures of stock expensiveness. The most common are the price/earnings ratio and Warren Buffett's stock market value/gross domestic product (see figure 9).

The Buffett measure has never been higher and is currently more than twice the trendline.

Many factors explain the high price of U.S. stocks. The two most important explanations are investor behavior and Fed stimulation. Table 1 outlines some of the investor behaviors that are driving stock prices.

These behaviors tune out shocking news that should cause price declines. For example, on February 24, 2022, when Russia invaded Ukraine, the Dow Index went up, recovering from morning losses, and then it soared 834 points the next day as the capital of Ukraine came under attack.

The Fed has added to this investor behavior by stimulating the stock market with QE. There's a lesson to be learned from China's stimulation of its stock market in 2015.<sup>7</sup>

As shown in figure 10, the Chinese stock market quickly declined when its

central bank took its foot off the gas. In the meantime, the U.S. stock market has soared well above China's as the Chinese economy has grown faster than the U.S. economy.

It would appear nothing can stop the U.S. stock market's upward trajectory, but the place to look is the price-to-earnings (P/E) ratio because it captures

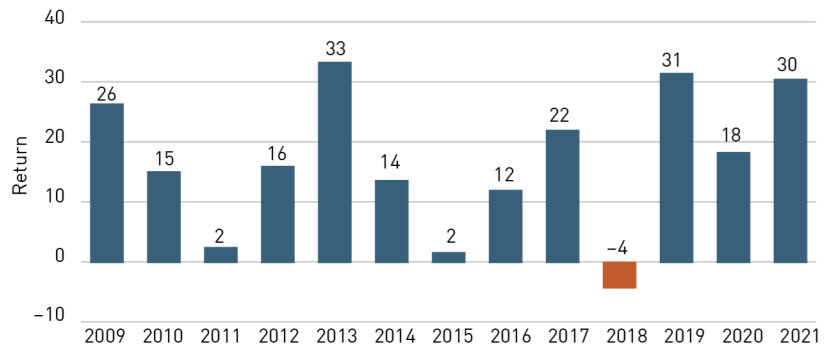
investor behavior—specifically, how much investors are willing to pay for future earnings. P/Es currently are above 30 but if they decline back to 15, the stock market will crash 50 percent—a big loss.

But what could cause a decline in P/E? As shown in figure 11, P/Es historically have been low when we have either

Figure 7

**13 YEARS OF CONSISTENTLY HIGH STOCK MARKET RETURNS**

(A) Post-2008 stock returns: only one down year



(B) S&P 500 returns 600% in past 13 years



Source: Yahoo Finance, Standard & Poor's, and Target Date Solutions

Figure 8

**RECESSION (CONTRACTION) IS OVERDUE BY 92 MONTHS (130-38), WHICH IS 7.5 YEARS**

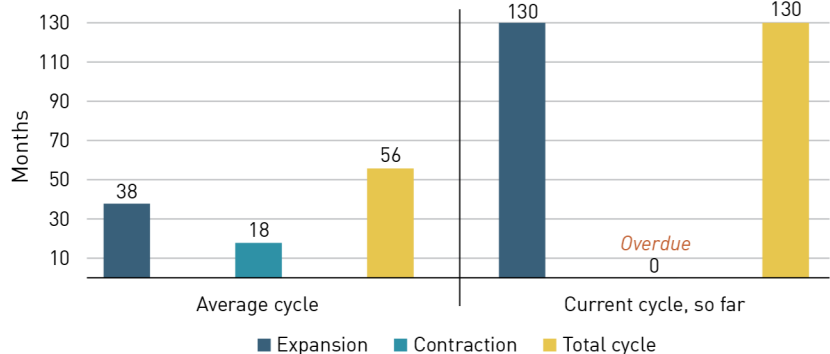
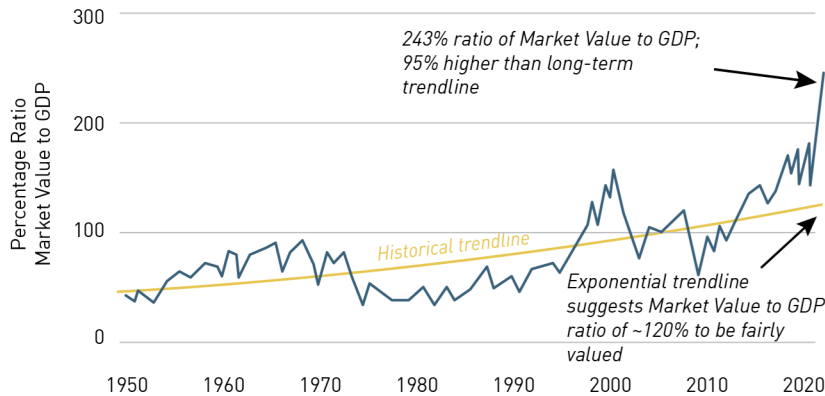


Figure 9

### BUFFETT INDICATOR: COMPOSITE MARKET VALUE TO GDP

The most expensive stock market by a wide margin



Source: Business Insider

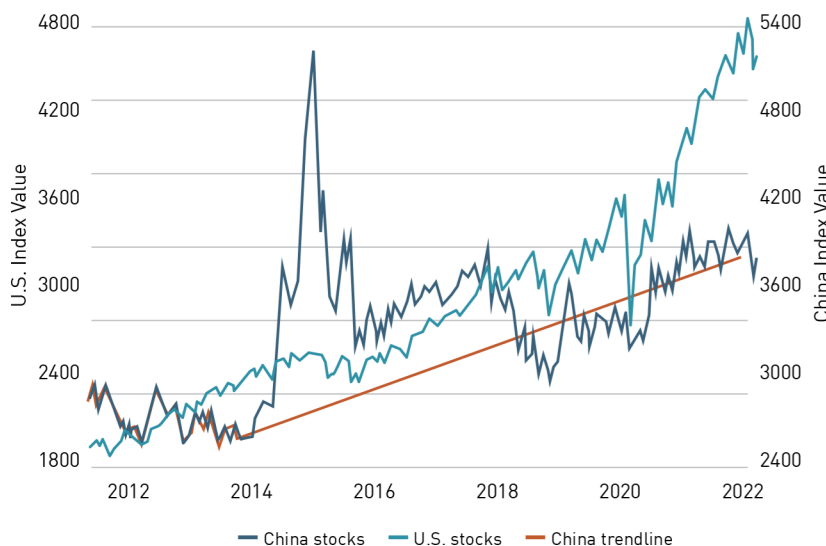
Table 1

### TEN INDICATIONS THAT INVESTORS ARE 'NORMAL,' NOT RATIONAL

Reasons the Stock Market Is Inflating	Behavioral Bias
Federal Reserve to the rescue	Representative
Interest rates will remain low	Recency
Fear of missing out	Hindsight
Economic recovery	Framing
92 million millennials are buying	Herding
Vaccine cures the economy	Loss aversion
FAANG mega companies rule	Narrative
Foreigners are big buyers	Confirmation
"Hopium" the drug that gives hope	Self-attribution
Amateurs can beat Wall Street	Overconfidence

Figure 10

### CHINA LEARNED A LESSON IN 2015



Source: Trading Economics

inflation or deflation. In other words, fear is the driver when inflation deviates away from zero.

Nothing currently changes investor willingness to pay a lot for future earnings. Greed is the current driver. But the rest of the story is that non-zero inflation should shift investor behavior from greed to fear. We already have inflation, but investors are holding out the hope that it is transitory, and that the Fed can control it. This hope is unrealistic.

The U.S. stock market will have its "Minsky Moment," i.e., a sudden, major collapse of asset values marking the end of the growth phase of a cycle.<sup>8</sup> It's likely to be quick and shocking.

### RETIREMENT CRISIS

The retirement crisis is real. Most baby boomers have not saved enough for retirement. Seventy percent of baby boomers, or 55 million people, have saved less than \$300,000.<sup>9</sup> But a Securities and Exchange Commission report concludes that the solution is not to increase investment risk.<sup>10</sup> Rather, the solution is modifying behavior by encouraging beneficiaries to save more, which is the intent of new retirement-readiness reporting requirements. This is sound advice for future generations, but it doesn't change the current situation.

Inadequate savings do not warrant increased investment risk. Quite to the contrary, lifetime savings need to be protected no matter how small because that's all there is. Most of our 78 million baby boomers will spend much of this decade in that retirement risk zone where investment losses can irreparably spoil the rest of one's life.<sup>11</sup>

Recent surveys of plan sponsors and their advisors report that the responding fiduciaries want to protect plan participants against losses as they near retirement. A Met Life survey reports "seven in ten plan sponsors are concerned

about the impact of market volatility on those near or in retirement.”<sup>12</sup> A recent PIMCO survey reports that advisors want to protect those near retirement against losses of 10 percent or more.<sup>13</sup>

Yet most of these fiduciaries have selected risky target-date funds (TDFs) that will lose more than 10 percent for those near retirement in about three years out of 10, although you wouldn't know it based on the recent past. The past 10 years have been incredibly lucky for TDF beneficiaries nearing retirement because the odds of avoiding losses in all 10 years with 85 percent in risky assets is only 5 percent, yet none of the past 10 years has experienced such a loss. Fiduciaries should not expect a repeat.

Similarly, people who are managing their own portfolios rather than using TDFs are invested 60/40 in stocks and bonds on average, which is about the same as TDFs near their target dates. They too should expect losses of 10 percent or more in three years out of 10.

The most popular TDFs hold 85 percent in risky assets at the target date, considering equities and long-term bonds as risky (see figure 12).

This is a mix that lost more than 30 percent in 2008, when bonds were far less risky.

The rest of the story for the retirement crisis is that most baby boomers are going to be seriously hurt and will not recover because of the following:

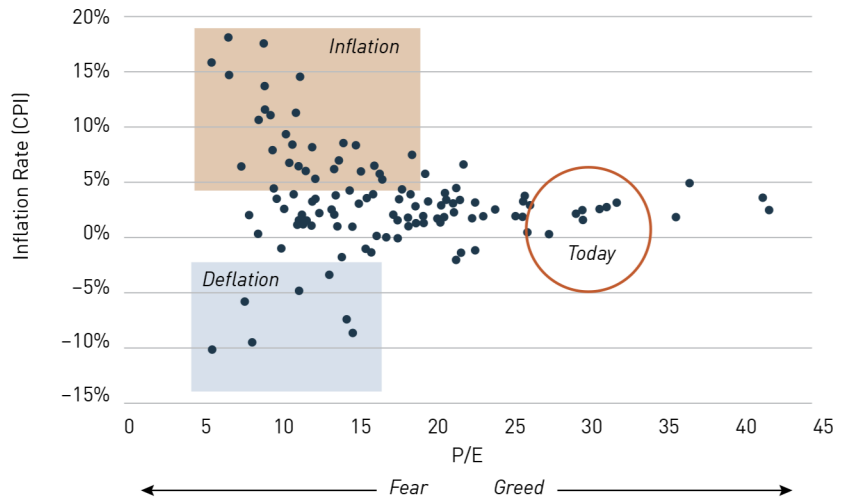
1. A significant market correction is highly likely in this decade.
2. Baby boomers are taking a lot of investment risk, much more than they should at this time in their lives.
3. Baby boomers do not have the time to recover.

The crime is that baby boomers have no idea that this possibility of ruin even exists. TDFs now hold \$3.5 trillion, and

Figure 11

### PRICE-TO-EARNINGS RATIO AND INFLATION (1900-2021)

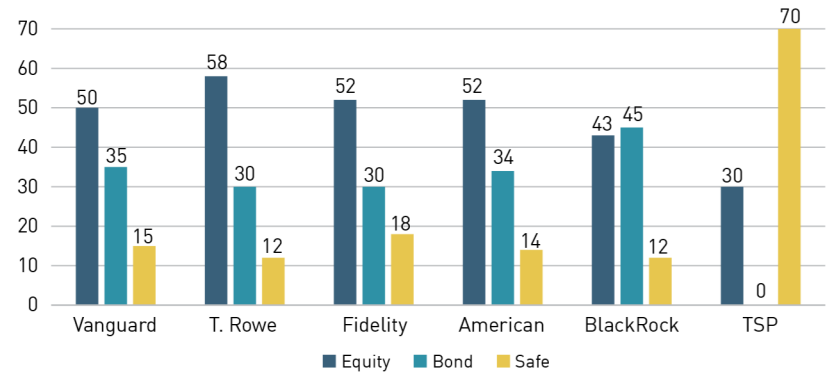
P/E's are driven by investor psychology: greed and fear



Source: Crestmont Research

Figure 12

### 85%+ RISKY AT THE TARGET DATE, EXCEPT THRIFT SAVINGS PLAN



Source: PIMCO Glide Path Analyzer

because where there's harm there's foul, there will be lawsuits aplenty.

### CONCLUSION

When someone says “it's different this time,” they're usually wrong. But I assert that it really is different this time for the following five reasons:<sup>14</sup>

1. Interest rates have never been lower.
2. The U.S. government has never printed more money.
3. Stock prices have never been higher.
4. The wealth divide in the United States has never been wider.
5. There have never been 78 million people in the retirement risk zone.

Now you know, and the future will tell us the rest of these stories. ●

Ronald J. Surz is president of Target Date Solutions. He earned an MBA in finance from the University of Chicago and an MS in applied mathematics from the University of Illinois. Contact him at ron@targetdatesolutions.com.

### ENDNOTES

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2. A couple of YouTube videos explain all this craziness in a clear and humorous way. “Debt Limit - A Guide to American Federal Debt Made Easy” uses household debt



- to explain federal debt (<https://www.youtube.com/watch?v=Li0no7O9zmE>) and "Fred Thompson on the Economy" explains the wisdom of quantitative easing to save the 2008 economy (<https://www.youtube.com/watch?v=RKc4XFK0iVY>).
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  13. See "2021 PIMCO US Defined Contribution Consulting Study," PIMCO, <https://www.pimco.com/en-us/dc-survey/>.
  14. See the introduction in Ronald Surz, "Baby Boomer Investing in the Perilous Decade of the 2020s: How to Live a Dignified Retirement," [https://www.amazon.com/dp/B093N8FVJY?ref\\_=pe\\_24209330\\_416826860](https://www.amazon.com/dp/B093N8FVJY?ref_=pe_24209330_416826860).
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**Damages to target date funds are highly likely & prosecutable. The harm to beneficiaries should not go unpunished**

## **CARPE DIEM**

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### **Grab the opportunities**

1) Prepare lawsuits.

Don't miss another 2008, or worse .

2) Provide a Safe TDF



**Current Crises:** Rising Interest Rates, Rampant Inflation, Recession, COVID, Energy Crisis, China Dominance , Profligate Spending, Nuclear Threats, Outrageous Debt, Gigantic Wealth Divide, Russian War, 401(k) Risk Scandal, Mass Shootings , Open Borders, Iran, N Korean, Social Unrest, Floods & Fires, Social Security & Medicare Going Broke , Stock & Bond Market Bubbles

**Opportunity 1: Prepare to sue for excessive risk**

**Markets will crash.**

When they do, Risky TDFs will hemorrhage, probably worse than 2008

**This time, lawsuits will be applauded.  
Prosecutors will be heroes**





Lawsuits drive \$Trillions out of current Risky TDFs

Opportunity 2:  
**Provide a  
Safe TDF**

An Inexpensive  
and Easy Way to  
Provide a Safe TDF:

Take Over the  
SMART Funds for  
(almost) free



This suite of 20 collective investment funds (CIFs) has been temporarily shelved, waiting for the right opportunity and partner. The OPEIU union fund (same glidepath) is thriving in the current chaos by protecting against losses. Now is the right time to re-launch the SMART Target Date Funds Index .

Here's why SMART is a fantastic opportunity:

- 14-year track record of winning by not losing
- All CUSIPed and NSCC registered
- Extensive marketing materials, including factsheets
- DOL compliant disclosures
- All the legal work is done
- Ideal for union and small plans
- This is a gift for anyone who wants to enter the TDF space or to add superior product
- Uses Ron Surz's patented Safe Landing Glide Path



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