

# the Connection

A Quarterly Review

3rd Quarter 2023

## 60/40 PORTFOLIO BACK FROM THE DEAD AND OTHE SCARY STORIES

It's almost Halloween. Sometimes spooky things happen around this time. Things that don't make sense or seem arbitrary. There are a few things in this global economy that are not rational, and there is one thing that we are happy to say is back. First, U.S. Fiscal and Monetary policy are totally at odds. This has happened other times, most recently in the early 2010's, but if left unaddressed will turn our deficit into a major issue for the U.S. going forward. Second, China's push to become a reserve currency. It's odd because they are pushing to become a reserve currency by pegging their currency to U.S. dollars. That would seem to just strengthen the U.S. position as the reserve currency of the world. And last, certainly not least, 60/40 portfolios make sense again: Finally, some good financial news!

U.S. Fiscal Policy is in shambles. Fiscal policy is government spending and tax revenue – or in the U.S. the mismatch between government spending and tax revenue. Monetary policy is dictated by the Federal Reserve, and primarily controlled by the fed funds rate, or the rate the Fed charges banks to borrow money for short term liquidity needs. We have all felt monetary policy tightening over the past 18 months. The Fed is trying to pull excess liquidity out of our economy so that excess liquidity doesn't drive prices up too much. It's important to stop inflation before it starts, because as companies charge more, they end up having to pay workers more, then the workers have more money etc. Inflation will spiral out of control.

The real issue is that the government has been outspending its revenue for 10 years. While the Fed is trying to pull liquidity out, the government is printing the money and dumping it right back in the system. An intelligent government would either cut spending or raise taxes. Preferably a smart government would do both. Currently there is a case to be made for the government to raise taxes. We find ourselves embroiled in two global conflicts with a third potentially on the way. Now is not the time for the U.S. to step down as world peacekeeper. The government will probably need to raise taxes on corporations (direct beneficiaries of a stable world) and the primary beneficiaries of corporations, the wealthy. Pairing modest tax increases with some spending cuts related to unemployment and excess Covid spend will allow the Government to help fight inflation by pulling liquidity out of the system as well. The last time we had a mismatch it was the opposite under Obama. The fed dropped rates to be accommodative to pull our

economy out of the 2008 banking crisis. Yellen was begging the U.S. government to cut taxes and increase stimulus as the Fed was out of conventional levers to help the economy. The scary lesson is that the U.S. Government, its citizens, and the Fed need to get on the same page to heat up or cool down our economy in a rational way. Otherwise, we get these wild swings in interest rates and equity prices.

The next headscratcher isn't good or bad, it just doesn't make sense. It's understandable that the PRC (People's Republic of China) would want to have their currency treated as a global reserve currency. It makes sense that they want to be a large part of global trade. What makes no sense is trying to have a reserve currency with no open market exchange rate and transfer controls on how much of the currency can go offshore. The whole purpose of a reserve currency is a highly liquid store of value that is easily exchanged or transferred. The PRC pegs their currency to the dollar, and to keep it pegged they are out in the open market actively buying and selling U.S. dollar denominated assets and controlling how much of their currency goes offshore. What country or company wants to hold a currency that they can't move or deploy freely? This is the single most oxymoronic government idea we have ever seen. Store your money in our currency at our banks, but you can only spend what we let you spend in our country, and we have even more barriers if you want to take it to your country and spend it. We all overestimate the sophistication of certain governments, sometimes because they are great at creating chaos (Russia and Iran), or because they have come to dominate manufacturing like China. China has a deeply sophisticated manufacturing presence, but their financial wherewithal is bottom tier. We think China has a long way to go to replace or compete with the U.S. on a global stage beyond just assembling iPhones. Ludicrous ideas like trying to take over world reserve currency status from the U.S. by pegging their currency to the U.S. just reinforces our opinion of their financial sophistication.

The last topic at least is a positive development, that we didn't see coming back to life as fast as it has. There are several caveats to being bullish about the 60/40 portfolio (60% stocks, 40% bonds), but even with caveats it has life that it hadn't had really since the mid 2000's. The main caveat is that the bond side must be short duration – 5 years and under. There is still a lot of duration risk for instruments 10 years out or longer. The benefits though for 60% equities and 40% bonds at a risk-

free return of 5% are enormous. That allocation allows your equities to take a 4% loss before the portfolio even feels it. A barbell approach of high growth equities and zero risk treasury bills allows longer term investors to use the treasuries for their cash needs. An important consideration in investing is liquidity risk – what can I get for an asset when I need it, today – that risk is greatly diminished when you have a liquid instrument earning 5% to cover liquidity. Give a monkey 10 years to make money in the stock market, they will make you money 90% of the time. As we reach out and start our quarterly meetings, every client approaching retirement and in retirement should be asking themselves and us if they should be moving more cash into safe assets. If you asked the question, then the answer is undeniably yes.

## THE ACT OF GIVING

Below is an updated list of some organizations our clients are helping today.

All Local Food Banks  
[www.sfmfoodbank.org](http://www.sfmfoodbank.org)  
[www.shfb.org](http://www.shfb.org)  
[www.foodbankccs.org](http://www.foodbankccs.org)  
[www.refb.org](http://www.refb.org)

Bloom Marin  
[www.bloom.org](http://www.bloom.org)

Maya's Music Therapy  
[www.mayasmusic.org](http://www.mayasmusic.org)

Friends of the Urban Forest  
[www.fuf.net](http://www.fuf.net)

Guide Dogs for the Blind  
[www.guidedogs.com](http://www.guidedogs.com)

Doctors without Borders  
[www.doctorswithoutborders.org](http://www.doctorswithoutborders.org)

The Nature Conservancy  
[www.nature.org](http://www.nature.org)

National Kidney Foundation  
[www.kidney.org](http://www.kidney.org)

Guide Dogs of America  
[www.guidedogsofamerica.com](http://www.guidedogsofamerica.com)

Golden Gate National Parks Conservancy  
[www.parkconservancy.org](http://www.parkconservancy.org)

Fine Arts Museums of San Francisco  
[www.famsf.org](http://www.famsf.org)

Canine Companions for Independence  
[www.cci.org](http://www.cci.org)

Alzheimer's Association  
[www.alz.org](http://www.alz.org)

The Foundation for Rotary International  
[www.therotaryfoundation.org](http://www.therotaryfoundation.org)

Wildcare  
[www.wildcarebayarea.org](http://www.wildcarebayarea.org)

Homeward Bound of Marin  
[www.hbofm.org](http://www.hbofm.org)

Vivalon  
[www.vivalon.org](http://www.vivalon.org)

FINCA  
[www.finca.org](http://www.finca.org)

Sonoma Land Trust  
[www.sonomalandtrust.org](http://www.sonomalandtrust.org)

Friends of the Earth  
[www.foe.org](http://www.foe.org)

The American Friends Service Committee  
[www.afsc.org](http://www.afsc.org)

Amnesty International  
[www.amnestyusa.org](http://www.amnestyusa.org)

Eastside College Prep  
[www.eastside.org](http://www.eastside.org)

Northern Sierra Partnership  
[www.nothernsierrapartnership.org](http://www.nothernsierrapartnership.org)

American Bird Conservancy  
[www.abcbirds.org](http://www.abcbirds.org)

The Cornell Lab of Ornithology  
[www.birds.cornell.edu](http://www.birds.cornell.edu)

Mono Lake Committee  
[www.monolake.org](http://www.monolake.org)

California Trout  
[www.caltrout.org](http://www.caltrout.org)

Tahoe Rim Trail  
[www.tahoerimtrail.org](http://www.tahoerimtrail.org)

Ocean Conservancy  
[www.oceanconservancy.org](http://www.oceanconservancy.org)

Global Fund for Women  
[www.globalfundforwomen.org](http://www.globalfundforwomen.org)

Marin Agricultural Land Trust  
[www.malt.org](http://www.malt.org)

Walk to End Alzheimer's – San Francisco, CA  
[www.act.alz.org/sanfrancisco2019](http://www.act.alz.org/sanfrancisco2019)

UCSF Foundation – Sarcoma Research  
[www.giving.ucsf.edu](http://www.giving.ucsf.edu)



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