

WEEKLY ECONOMIC UPDATE NOV. 25, 2024

Stocks advanced last week, powering ahead with pre-holiday optimism despite geopolitical tensions and two disappointing Q3 corporate updates.

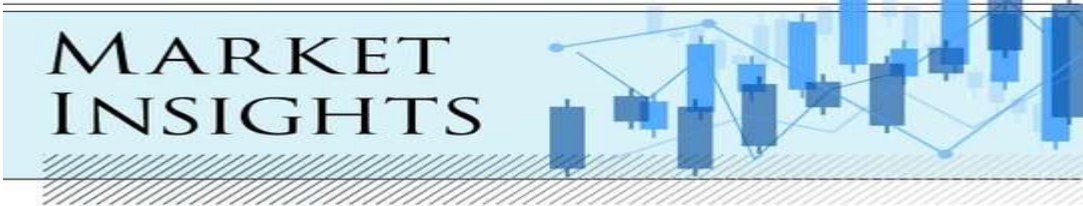
The Standard & Poor's 500 Index rose 1.68 percent, while the Nasdaq Composite Index gained 1.73 percent. The Dow Jones Industrial Average led, picking up 1.96 percent. The MSCI EAFE Index, which tracks developed overseas stock markets, was flat (-0.05 percent).^{1,2}

Stock Push Ahead

Stocks showed mixed results during the first half of the week due to geopolitical tensions that boosted precious metals and put pressure on Treasury yields.³

The Dow Industrials jumped out in front midweek and never looked back. Disappointing earnings on Tuesday from a large box retailer held back some gains in the broader S&P 500. A mixed Q3 update report from the nation's leading AI chipmaking company also tempered gains a bit.⁴

Year-end optimism, especially around consumers driving a healthy holiday shopping season, supported the rally for much of the week. Fresh data that weekly jobless claims dropped to a seven-month low also lifted spirits.^{5,6}



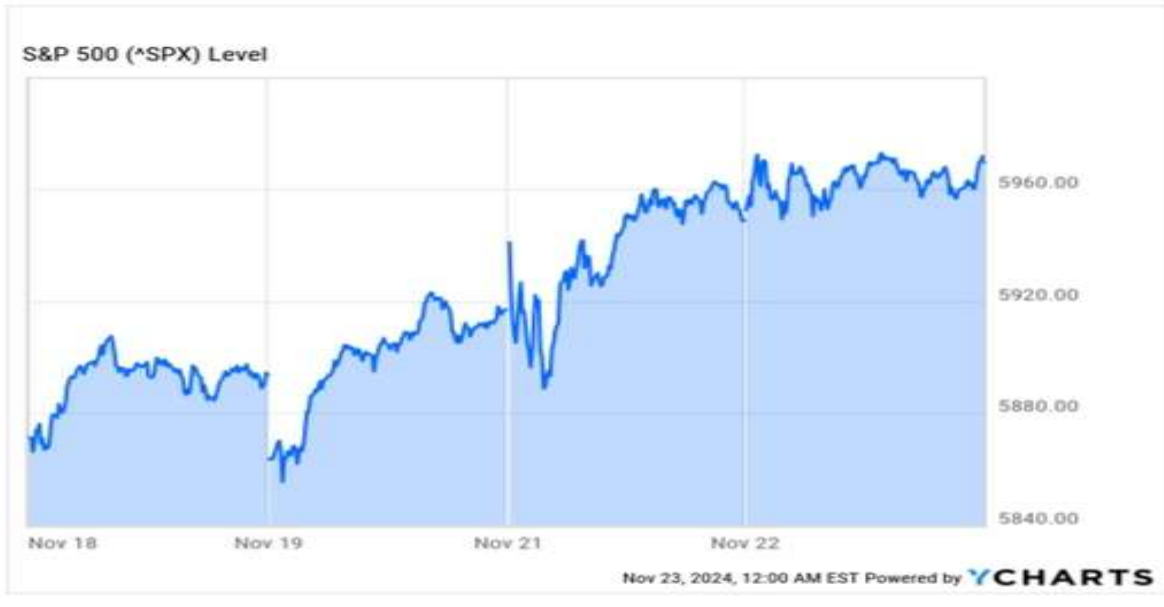
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Weekly Market Insights (WMI)

Major Index Return Summary

Name	1M TR	YTD TR	1Y TR	5Yr TR
Dow Jones Industrial Average	2.33%	18.34%	27.41%	75.09%
MSCI EAFE	-4.86%	4.66%	11.04%	34.50%
Nasdaq Composite	2.41%	27.20%	34.59%	132.0%
S&P 500	1.74%	26.26%	32.93%	107.6%

S&P 500 Daily Close



10-Year Note Review

Indicator Name	Latest Value	1M Ago	1M Change
Date		3M Ago	3M Change
		1Y Ago	1Y Change
10 Year Treasury Rate	4.41%	4.20%	5.00% ▲
11/22/24		3.86%	14.25% ▲
		4.42%	-0.23% ▼

Small-Cap Focus

For several weeks, investors have favored small-cap names over larger-cap issues. This trend was again on display last week.

The Russell 2000, an index of 2,000 small-cap companies widely used as a benchmark for U.S. small-cap stocks, rose 4.50 percent for the five days of trading. In the month-to-date through November 22, the Russell is up nearly 9 percent.⁷

This Week: Key Economic Data

Tuesday: Consumer Confidence. New Home Sales. FOMC Minutes.

Wednesday: Gross Domestic Product (GDP). Durable Goods. Pending Home Sales. Personal Income and Outlays.

Thursday: Markets Closed—Thanksgiving Holiday.

Quote of the Week



“Many are destined to reason wrongly; others, not to reason at all; and others, to persecute those who do reason.”

– Voltaire

Of Note



Should the U.S. national debt be considered an actual crisis? Does it have the destructive power of a hurricane, tornado, earthquake or other crisis? The short answer is yes but the full explanation requires a financial history lesson. The first point to understand is that debt can be good or bad. Deciding which depends on two criteria: What is the cost of the debt relative to the returns that can be gained from investing it wisely? And what is the size of the debt relative to the income available to repay it or roll it over?

These points can be illustrated with simple examples. If a government borrows for 10 years at an interest rate of 4.0% (the current rate on 10-year Treasury notes) and builds infrastructure that will produce economic gains of 10.0% or more for an indefinite period of time (with maintenance), that's clearly a good use of borrowed money. That example applies to major projects such as the interstate highway system launched under Eisenhower and the moon landing project launched under Kennedy.

The U.S. national debt today is about \$35.7 trillion. (Note: That figure is Treasury debt only. It ignores contingent liabilities for unpaid student loans, Social Security, Medicare, mortgage guarantees, unfunded FDIC insurance liabilities and much more). Is that a big number? It depends.

Suppose you owe \$50,000 on a revolving credit line of Mastercard. Is that a problem? If you make \$30,000 per year and don't expect a big raise or a business success, then it's a huge problem.

On the other hand, if you make \$500,000 per year, the debt is entirely manageable, and you can probably pay it off just by writing a check. In other words, debt's a problem (or not) depending on the income available to pay it off.

The same is true for countries. The national debt is a problem (or not) depending on the income available to pay it off.

A good proxy for national income is the gross domestic product (GDP). By expressing the national debt as a percentage of GDP ($\text{Debt}/\text{GDP} = r$, where r is the ratio), you get a good idea of whether the debt is excessive.

Economists agree that a 30% debt-to-GDP ratio is entirely comfortable. It's like owing \$150,000 when you make \$500,000. As the debt-to-GDP ratio climbs, two adverse conditions result. The first is that the return on investment (sometimes called the Keynesian multiplier) declines.

Borrowing and spending a dollar at a 30% ratio might produce a 140% return. Borrowing and spending the same dollar at a 60% ratio produces only a 110% return. This is why the Maastricht Treaty that governs EU fiscal policy places a cap of 60% on the debt-to-GDP ratio of member states. (This cap is widely ignored.)

The U.S. has reached the point of no return(s). There's only one way out, but it's just as bad as the problem. Research

makes it clear that a debt-to-GDP ratio of 90% is a threshold. That is the point at which the return of each dollar borrowed and spent is less than \$1.00. This means that not only do you not get your dollar back, but you also add more to the numerator (debt) than you do to the denominator (GDP), which makes the ratio even worse and lowers the return on the next dollar borrowed and spent.

That's a mathematical way of saying you can't borrow your way out of a debt trap. Where does that leave the United States today? As noted, the national debt is \$35.7 trillion. GDP is estimated at \$28.7 trillion. That produces a debt-to-GDP ratio of 124%, the highest in U.S. history.

Obviously, that ratio is well above the 90% red line and is getting worse by the minute as U.S. deficit spending skyrockets while growth stalls. The U.S. debt-to-GDP ratio will soon be pushing toward 130% and higher. That's a level reached by failed states like Lebanon and super-debtors like Greece.

Has it always been this way? Not at all. It would be nice to believe the U.S. began under George Washington in 1789 as a debt-free nation, but that was not true. The U.S. agreed to assume the Revolutionary War debt of the individual states and the Continental Congress instead of allowing that debt to go into default, so the country began in debt.

It was Alexander Hamilton's great insight that the U.S. could borrow more money through the U.S. Treasury to pay off the war debt. That would establish the U.S. as a good credit and

enable the country to keep borrowing, both for new investment and to retire maturing debt by rolling over old debt for new debt.

That was the origin of the U.S. Treasury securities market, and it has been going strong for 235 years. The First Bank of the United States (1791–1811) and the Second Bank of the United States (1816–1836) were each established to facilitate the process of buying Treasury debt for bank notes, a type of bank money that allowed the government to pay bills and conduct business.

Most assume the U.S. national debt has been going up continuously since George Washington. That's not true. In fact, President Andrew Jackson took the national debt to zero in 1835. The national debt (adjusted for inflation and expressed as a percentage of GDP) has moved in more of a sine wave than a straight line. That wave corresponds to the fact that debt goes up in times of war and is then reduced in times of peace.

This pattern of increasing debt to fight wars then decreasing debt during times of peace was remarkably consistent for most of American history (from The War of 1812 through Vietnam).

The debt increases were widely supported as necessary to win wars. The debt consolidation stages were widely viewed as times of wealth creation and prosperity (with brief exceptions for bank panics).

The sine wave pattern was perhaps best illustrated during the 45-year period from 1945–1990. In 1945, at the end of World War II, the U.S. debt-to-GDP ratio was 120%, the highest ever before today. Between 1945–1980, the ratio dropped from 120% to 30%, an entirely comfortable level. This was done on a bipartisan basis. Democrats (Truman, Kennedy, Johnson, Carter) joined Republicans (Eisenhower, Nixon, Ford) in a multidecade effort to get the ratio under control. Importantly, this was not done by reducing the debt. It was done by growing the economy. If you expand the GDP denominator faster than the debt numerator, the ratio drops even if the debt grows.

Between 1980 and 1988, the ratio grew again under Ronald Reagan. President Reagan had a reputation as a fiscal conservative, but he was actually a big spender. To his credit, the money was spent on a 600-ship Navy, technology and the missile-interceptor program mocked as “Star Wars” but actually realized today in Patriot anti-missile batteries and other defense technologies.

Most importantly, Reagan won the Cold War. The Cold War was fought continuously from 1946–1991. George H.W. Bush was president when the Soviet Union dissolved.

Still, Reagan was the decisive actor because his defense buildup convinced Soviet General Secretary Gorbachev that Russia couldn't keep up with the U.S. and needed to reform through glasnost (“opening”) and perestroika (“restructuring”). Those and other reforms led quickly to the

collapse of the Soviet state and the emergence of the Russian Federation.

Still, the cost was high. The U.S. debt-to-GDP ratio rose from 30% when Reagan took office to 53% when he left office. From there, the historic pattern would have called for gradual reduction in the ratio. That didn't happen.

The best that can be said is that George H.W. Bush and Bill Clinton kept it under control from 1990–2000. It rose slightly to about 56% but did not surge. From there, the ratio ran off the rails.

It went up to about 82% under George W. Bush (still below the 90% critical threshold), then exploded under Barack Obama. The debt-to-GDP ratio reached 100% by the end of Obama's two terms in 2017. This trend continued under Trump and Biden to bring us to the 124% level today.

There were wars during the period 2000–2024 (War on Terror, Iraq War, War in Afghanistan and U.S. support for the wars in Ukraine and Israel) but the U.S. did not win any of those wars. At best, they were fought to a standstill (War on Terror) and at worst they ended in humiliating defeat (Afghanistan). There was also wasteful spending that had nothing to do with wars, including pandemic relief, illegal immigration and the Green New Deal.

The U.S. had lost its ability to win wars and lost the will to reduce spending in times of peace. The debt-to-GDP ratio is now a steeply pitched slope instead of a gently curved sine

wave. There's no need for default because we can always print the money. There's no way to grow out of it because the high debt ratio inhibits real growth. The only solution is high inflation where the nominal debt may go up, but the real value of the debt shrinks dramatically. Unfortunately, the value of your stock portfolio will shrink dramatically as well. The remedy for this crisis and threat to your wealth and well-being is a portfolio of inflation-proof assets including land, gold, silver, fine art, natural resources, alternative investments, annuities and cash.

Don't expect your stocks to save you. They won't.⁸

Footnotes and Sources

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7. The Wall Street Journal, November 22, 2024
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