Wealth & The Four Horsemen

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EXECUTIVE SUMMARY

- **Monetary Policy:** Neutral. The Federal Reserve has kept short-term rates high, but this has led to declines on the long end of the yield curve.
- **Fiscal Policy:** Inflationary. The CBO projects federal budget deficits to average 5.5 percent for the next ten years.
- **Economic Vital Signs:** Inflationary pressures have moderated but have once again turned higher. Oil, at current prices, will start showing flat reading in the third quarter which will help with the "inflation rate" but not overall price levels.
- **Yield Curve Watch:** The yield curve continues to be inverted.

Q1 2024: Biggs' Wealth, War, & Wisdom

Q: Allen, why title this WMQ "Wealth & The Four Horsemen?"

Recently while looking through my bookshelves for something to read, I saw my copy of Barton Biggs' *Wealth, War, & Wisdom* with the Foreword by Yale Endowment CIO, David Swensen. Barton Biggs served as Morgan Stanley's research director and Chief Global Strategist from 1973-2003. Given what I am seeing in financial markets, I thought it would be timely to explore how Biggs answers the main question of the book which is **"How do you preserve wealth in times when the Four Horse-men (Pestilence, War, Famine, and Death) are on the loose?"** I highly recommend the book to both casual market readers and anyone interested in history.

Q: Can you share with us how markets respond to the Four Horsemen?

The first horse of the Apocalypse in biblical tradition is the white horse. The rider holds a bow and is given a crown. By historical interpretation, he represents "Conquest" and/or "Pestilence." There is some debate regarding how the common association with pestilence came into being. I suspect it is derived from the fact that many cultures used poisoned arrows as part of their hunting and military tactics prior to guns. Notably, arrows enabled attacks from a distance, and archers would be used early in battles to weaken an enemy before direct engagement with calvary and foot soldiers.

Covid introduced investors to this first horseman. It also provided a great opening lesson for investors in how to deal with the four horsemen. The initial reaction to the arrival of the four horsemen of the Apocalypse sounds extremely bearish, and that was true with Covid's poisoned arrows, as equity markets initially plunged. The market then came to the realization that pandemic responses would help certain businesses and hurt others and those effects are still ongoing.

For example, we regularly meet with each other by Zoom or Teams calls now. The technology was there before the pandemic with apps like Facetime and Skype, but utilization rates were low. Another example is Covid's disparate impacts within the real estate sector. Remote work and political differences have led to a large migration between states. At the same time, the Millennial demographic aged up and became the primary buyer of new homes. These trends along with government stimulus have led to large increases in the prices of residential real estate. Conversely, the same trends are causing significant issues in commercial office real estate.

Covid's economic impact also brought much higher levels of spending by the governmental crown. Covid shutdowns initially produced the worst economic decline since the Great Depression. The government then responded with an incredible amount

Major Asset Class Returns	2024 YTD
T-Bills	1.33%
Investment Grade Bonds	-0.78%
Large-cap Stocks	10.56%
Mid-cap Stocks	9.95%
Small-cap Stocks	2.46%
International Stocks	5.93%
Emerging Market Stocks	2.44%

Source: Morningstar Direct, As of 3/31/2024

of stimulus, which surprisingly also made the contraction the shortest on record. The Federal Reserve Bank of St. Louis's summarizes:

"By almost any measure, the 2020 recession began with sharp declines in economic activity, employment, and equity prices that rivaled or exceeded the initial declines of the Great Depression...The 2020 contraction might turn out to be the sharpest, but also the shortest, in modern times and perhaps of all time in the United States."

While increased government spending is common and non-inflationary during recessions, the stimulus has not slowed since the economy re-opened. As a result, inflation has become a market pest for consumers and companies alike. Using Federal Fiscal years, in 2022, 2023, and 2024, deficit spending has been 5.4%, 6.3%, and 5.6% against a long-term average of 3.4%. Financial markets keep looking for a cooling in inflation, but for that to happen, either the private market economy needs to contract or public spending needs to slow. Our projections are that inflation will become a more secular problem. Currently, the U.S. government is continuing to run deficits at levels commonly associated with recessions and war, which leads us to the second horse.

Q: What is the second horse investors should consider?

The second horse is the red horse of "War." He takes peace from the earth and brings bloodshed. We see the red horse most directly in the conflicts in Ukraine and Israel. On the war financing front, the U.S. just approved $95.3 billion for Ukraine, Israel, and Taiwan for long-range missiles, the Iron Dome, and underwater defenses. To put the numbers into perspective, the U.S. defense budget in 2023 was $916 billion. The recent bill therefore represents a 10.4% increase in U.S. defense spending. By comparison, Russia had the world's third largest defense budget at $109 billion, so the U.S. just created the fourth largest defense budget in the world with a single bill.

There are other potential flashpoints and hot zones like Niger which are not getting much press but could be important. Niger just ended military cooperation with the U.S. amidst a coup there. The U.S. has had about 1,000 people stationed in the country on anti-terrorism efforts. The concerns with Niger and terrorism are that the country is responsible for about 5% of global uranium production.

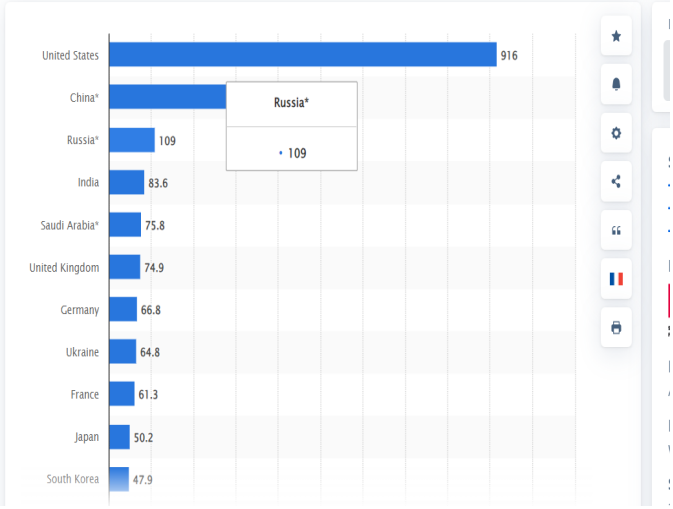
Beyond traditional military spending, markets are also focused on the importance of artificial intelligence ("A.I.") semiconductor chips. To illustrate our changing world, Nvidia chips are now being used as collateral for multi-billion dollar loans. Given their importance to defense, in 2023, the U.S. limited the sale of high-end chips to China but China is building out its own capacity.

"Nvidia chips are now being used as collateral for multi-billion dollar loans."

Economy & Politics › Politics & Government

Countries with the highest military spending worldwide in 2023

(in billion U.S. dollars)



Source: Statista.com

Top Producing Countries

Wheat

Market	% of Global Production	Total Production (2023/2024, Metric Tons)
China	17%	136.59 Million
European Union	17%	134.15 Million
India	14%	110.55 Million
Russia	12%	91.5 Million
United States	6%	49.31 Million
Canada	4%	31.95 Million
Pakistan	4%	28.2 Million
Australia	3%	26 Million
Ukraine	3%	23.4 Million
Turkey	2%	19.5 Million

Source: usda.gov

Municipal and Treasury Yields (%)

Maturity	Treasury	AA Municipal	A Municipal	BBB Municipal
1 Year	5.139%	3.353%	3.51%	4.159%
2 Year	4.814%	3.141%	3.293%	3.941%
5 Year	4.468%	2.711%	2.87%	3.472%
10 Year	4.456%	2.736%	2.90%	3.525%
30 Year	4.613%	3.955%	4.272%	5.025%

Source: Bloomberg as of 3/31/2024

Q&A with the Research Team

Incidentally Alan Turing, who is considered the founding father of A.I., led the effort to break the Nazi's Enigma Code during World War II. The "Turing Test" constitutes one of the primary measures of artificial intelligence. Given the nature of modern warfare, our readers may want to watch the movie *The Imitation Game* which is based on Alan Turing's life.

Economically, war spending inflation has historically ushered in the third horse that markets must occasionally to face.

Q: What is the third horse?

The third horse is a black horse of "Famine." Its rider holds a pair of scales for wheat and barely, basic foodstuffs of the ancient world. He calls out, "two pounds of wheat for a day's wages, and six pounds of barely for a day's wages, and do not damage the oil and the wine." If we make the economic adjustments, it suggests that in times of famine the price increases for key commodities may approach 10x.

The quote from the third horseman teaches investors that commodities generally do well in war times. As a result, I suspect this decade will bring a bull market for commodities and commodity trading strategies. Beyond just the possibility of war related food production disruptions, there have been large farmer protests occurring in the E.U. related to certain policies there. Meanwhile, in the U.S., there is also a debate related to new rules. For example, the USDA is spending $19 million more due to complaints related to the costs associated with the new RFID animal tagging rules which were passed in April. The updated tagging rules follow on the heels of other new regulations related to animal health.

Beyond agriculture, modern warfare is also heavily informational. It also involves more complex economics given supply chains structures, so I think investors can think far beyond just buying defense stocks. For example, I think cybertechnology, biotech, semiconductors, technology, artificial intelligence, agriculture, infrastructure, and infrastructure safety are all solidly part of defense spending. War inflation also pressures interest rates higher, so big expensive wars can be very negative for long-term bond and fiat currency holders. I think war concerns are driving part of the demand for bitcoin, gold, and silver.

Unfortunately, the U.N. estimates 10% of the world's population lives on the edge of starvation. Higher agricultural prices would impact these 735 million people the most. War and famine in time bring us to the fourth horseman.

Q: Who is the fourth horseman?

The fourth horse is the pale horse of "Death" and Hades was following close behind him. They were given power over a fourth of the earth to kill by sword, famine and plague, and by wild beasts.

Economically, we can see global defense spending increasing, so death by sword is likely to increase We have already discussed direct human diseases like Covid, but I think the more dangerous diseases for the global population are those associated with agricultural crops. Crop failures would likely bring famine to much of the world.

Plagues, like Malaria which still kills over 600,000 people per year in Africa, generally involve unclean water and mosquitos. Consequently, The Bill & Melinda Gates Foundation has been involved in mosquito research and funding and Malaria efforts for decades. Genetically modified mosquitos are being used in research efforts around the world, including in the U.S. in states like Florida and Texas. Regarding death by wild beasts, I think paying attention to animal health stories like the bird flu, swine flu, and crossover risk to humans are also important stories of which investors should be aware.

Finally, as it relates to the fourth horse, much of the death late in the decade will just come from natural demographics and causes. I believe this will result in a bubble then a crash in later life stage healthcare. The crash then will be followed by a strong recovery and shift in focus to nutrition, preventative, and early stage healthcare by the early 2030s. Demographers like Neil Howe have documented that *The Fourth Turning* demographics give the country a U shaped population. We have lots of older boomers (age 60-78) the earliest of which are now 78, relatively few Gen Xers (44-59), then we have a lot more Millennials (age 28-43) and Gen-Zers. The boomer demographic is really going to pressure Medicare and Medicaid expenses and stress government budgets for the foreseeable future. Millennials, however, are going to prefer that healthcare dollars go to toward health and wellnesses programs for younger people.

Q: Allen, any final thoughts for investors on Wealth and The Four Horsemen?

I believe I can best summarize our conversation by leaving you with a few closing thoughts directly from Barton Biggs. In 2008, he wrote the following:

"The trigger event could be a massive terrorist or nuclear attack that disrupts the economy for months and maybe for years. A power failure that lasted not a day but a month would paralyze a modern economy. Or it could be a plague, a massive SARS epidemic in which hundreds of millions die, or an electronic explosion that cascades into a complete breakdown of the world's accounting systems. Whatever happens, it most likely will be an event that is both unexpected and we will not have prepared for…. **What can you do? In the simplest terms, the conclusions are to diversify your fortune both as to asset class and location...equities (global) are the place to be in the long run because of their proven and virtually unique ability to increase purchasing power of capital, …[but] another, much smaller part of your diversification strategy should be to have a farm or ranch (or commodities) somewhere off the beaten track**...Even in America and Europe there could be mo-ments of riot and rebellion when law and order temporarily completely breaks down…I repeat that history suggest the rich almost always are too complacent, because they cherish the illusion that when things start to go bad, they will have time to extricate themselves and their wealth. It never works that way. Events move much faster than anyone expects."

Most interestingly, Biggs closes his book with a quote from Confucius, "Study the past if you would divine the future."

Sincerely,

Allen R. Gillespie

QUICK TAKE

MAJOR ASSET CLASSES

Cash and Cash Equivalents

According to the CBO, the Federal deficit as a percentage of GDP was 6.3% in 2023, so short-term interest rates are in line with inflationary spending levels. Cyclically, inflation measures are well below short-term interest rates, so the market has begun to price in interest rates cuts. We believe the Federal Reserve policy is now neutral to restrictive, so allocation to short-term cash and cash equivalents may produce competitive returns over time.

Investment Grade Fixed Income

The yield curve has inverted to levels last seen in the early 1980s. We are expecting the yield curve to return to a normal shape during 2024. The normalization of the yield curve will likely create some short-term pressures on investment grade fixed income markets, but we believe core bonds reasonably reflect both recessionary and inflationary pressures. As a result, we believe tactically rebalancing within the space will be increasingly attractive over the next few quarters.

Tactical Fixed Income

High yield commercial real estate markets are beginning to exhibit a few signs of approaching distress. While we moved our tactical fixed income allocations to be more in-line with bond benchmarks, at the margin, we believe investors should begin to extend credit risk over the next few quarters if spreads widen. Convertible securities also might become more attractive to corporate CFOs as a way to lower interest costs.

Core Equities

Given recessionary risks and the inverted yield curve, we would not overweigh equities beyond investor risk determined allocations. We believe a normalization of the yield curve will temporarily impact long-term growth assets. Given our inflation and valuation outlook, we are also more constructive on small cap, value, growth at a reasonable price, and international equities.

Tactical Equities

Due to the extreme conditions in core fixed income and equity markets, we think that tactical equity strategies may offer investors the best risk/reward tradeoffs. Tactical equity strategies, like long/short equity and option-based strategies have historically weathered bad bond markets and buffered bad equity market storms. We investors begin researching and considering whether commodities strategies may be appropriate for portfolios.

Other Markets

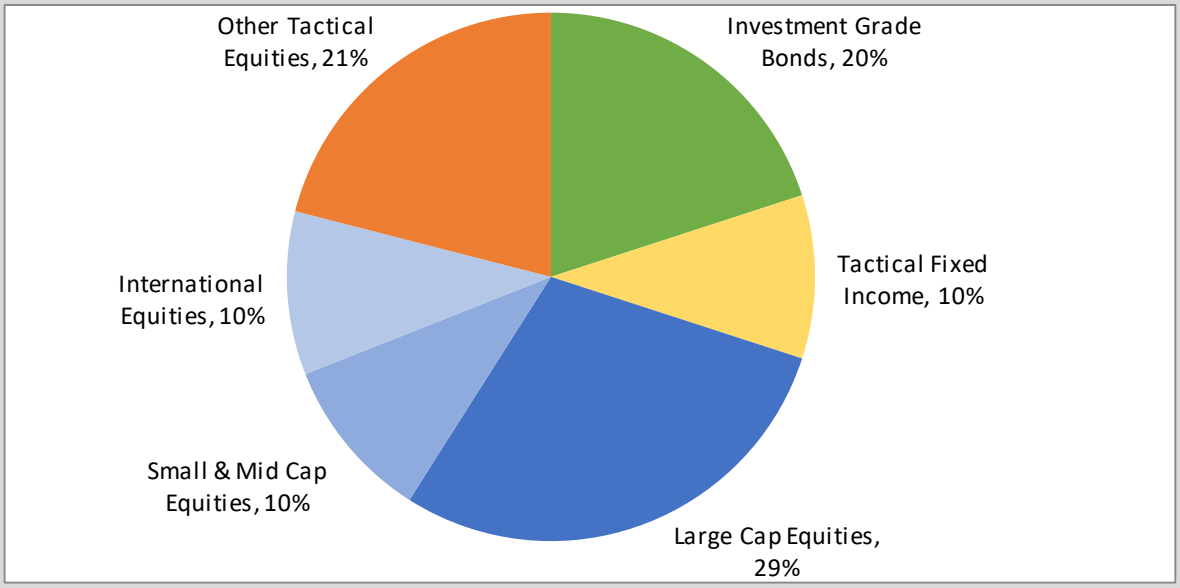
Other markets like gold, cryptocurrency, and real estate may offer diversification benefits to traditional portfolios. We believe commercial real estate in major metro markets may see pockets of distress due to shifts in product and populations. Gold appears to be regaining its status as a safe haven asset and cryptocurrency markets have been supported by favorable regulatory rulings recently.

Index Snapshot

	Earnings Yield	Dividend Yield	Price to Book
Large-cap Stocks	4.25%	1.36%	4.81
Mid-cap Stocks	5.84%	1.54%	2.59
Small-cap Stocks	6.38%	1.86%	1.85
International Stocks	6.98%	2.94%	1.88
Emerging Market Stocks	6.80%	2.79%	1.65

Source: Bloomberg as of 3/31/2024

FinTrust Allocations (70/30 Risk Profile) with Tactical



Positioning as of 3/31/2024. This model displays FinTrust's Funds & ETF Model with Tactical target portfolio guidelines. Each client situation is unique and may be subject to special circumstances, including but not limited to greater or less risk tolerance, classes, concentrations of assets not managed by FinTrust, investment limitations imposed under applicable governing documents, and other limitations that may require adjustments to the suggested allocations. Model asset allocation guidelines may be adjusted from time to time on the basis of the foregoing and other factors.

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