Wealth Management Quarterly

FINTRUST® CAPITAL ADVISORS

The Fourth Turning, Eco-nomics, and The Limits to Growth

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EXECUTIVE SUMMARY

- **Monetary Policy:** Less accommodative. The Federal Reserve has indicated an intention to raise interest rates in 2022.
- **Fiscal Policy:** Accommodative. The Democrats intend to make one more budget push before the mid-term elections.
- **Economic Vital Signs:** energy prices are reaching levels associated with past economic slowdowns.
- **Yield Curve Watch:** The yield curve remains positively sloped, indicating a continued recovery.

Q1 2022: Eco-nomics and The Limits to Growth

Q: Allen, why title this WMQ "The Fourth Turning, Eco-nomics, and The Limits To Growth?"

Based on our data, 2022 will be a very important year. This year, US economic demographics start to turn upward again, after having turned increasingly negative since 2000. The total transition will take another 10 years to complete, but secular economic trends will really start to change this year.

Q: Can you walk us through these key economic demographics?

The peak years for births during the Baby Boom years were 1957-1961 with the absolute peak in 1957, when 4.3 million babies were born. Well, all those 1957 babies will turn 65 this year (1957 + 65 = 2022).

Meanwhile, the low year for US births during Generation X was 49 years ago in 1973, when 3.14 million babies were born. This is important because according to the US Consumer Expenditure Survey, peak household spending occurs around age 49/50. We just do not have many people at the peak spending demographic.

When you look at the 49/50 year old demographic, you can understand why the downturn in 2008-2009 was so bad (1957 + 49 = 2006) —Boomer spending had started to slow. The decline in Boomer spending is why the secular economy has been soft.

Following Generation X, there was another baby boom that began in the early 1980s. The peak years for births during the Millennial baby boom were 1989-1993 when there were again over 4 million births per year. The absolute peak during the Millennial era was 1990, when 4.1 million babies were born. When you roll that forward to today, you can see that many millennials between the ages of 29-33 are in the key first time home buyer demographic 29-33.

In 2019, Millennials became the largest living generation. Now, with the 2022 demographic inflections, **we are at the point where the consumer preferences of the millennials will be the primary driver of the economy for the rest of our lives.** Of course, there will still be cyclical ups and downs, but the slow moving secular trends of the economy are changing forever after 2022.

Q: How do the demographics relate to "Eco-nomics and *The Limits to Growth*?"

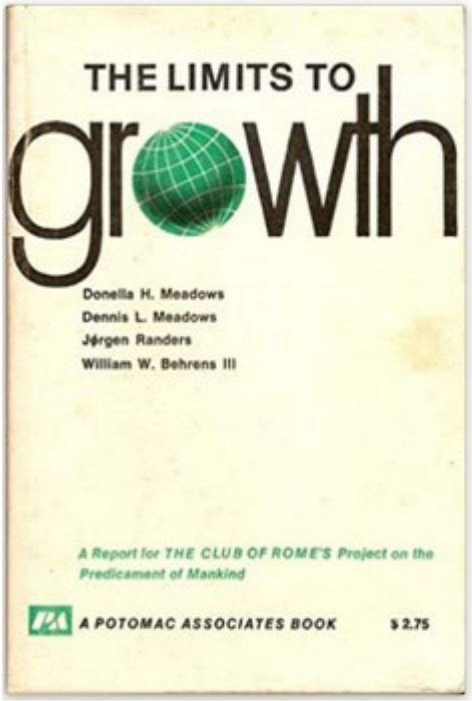
Economics is the social science that deals the trade-offs associated with the production, distribution, and consumption of goods and services, and the material welfare of mankind. In classical economics, market prices incentivize market participants to

Major Asset Class Returns	2021 YTD
T-Bills	0.05%
Investment Grade Bonds	-1.54%
Large-cap Stocks	28.71%
Mid-cap Stocks	24.76%
Small-cap Stocks	26.82%
International Stocks	11.78%
Emerging Market Stocks	-2.22%

Source: Morningstar Direct, As of 12/31/2021 react to scarcity or overproduction. Firms and consumers adjust their production and consumption, and thereby restore a market equilibrium. In classical economics, consumers and firms are the primary decisions makers.

In contrast, "eco-nomics" starts with the collective "ecological" or environmental system. The focus on collective systems, resource constraints, and externalities, creates a much larger role for the "state" or "centralized forces" than it is given in classical economics. "Eco-nomics" devalues the role of the individual in the economy and in society. Importantly, eco-nomics views the resource pool as fixed, focuses on the economics of externalities, and promotes the idea that there are "*Limits to Growth.*"

Survey data shows that the Millennials are concerned about environmental and social issues. This trend is part of the push behind environmental, social, and governance ("ESG") investing. I think, however, Millennials are also starting to wake up regarding some of the issues embedded into *The Limits to Growth* assumptions about the role of the state.



Source: Amazon

Q: Can you tell us more about *The Limits to Growth*?

The Limits to Growth was a 1972 research project on the "predicament of mankind" led by Dennis Meadows, based on the models built by Jay Forrester of MIT, which the Club of Rome sponsored. The original paper saw 2020 as the crisis year in which "the condition of the planet becomes critical." The Green New Deal and the Build Back Better agendas are not recent creations—they have been a long time in the making.

I have provided links to a couple of 1970s videos which discuss *The Limits To Growth* project that I think everyone—particularly Millennials- should watch. As you do, consider what you learn and what is going on in Australia.

https://www.youtube.com/watch?v=cCxPOqwCr1I

https://www.youtube.com/watch?v=lPD-ONHhuuc&t=221s

In the basic model, the exponential growth in population and resource utilization raises the pollution level and decreases the quality of life, and eventually causes a catastrophic population collapse.

Thus, "eco-nomic" thinking is not new, but it certainly seems to be more in vogue today than in the 1970s. Today the standard bearers of "eco-nomics" would be Klaus Schwab's World Economic Forum and the Bill Gates and Melinda Gates Foundation.

In fact, if one watches Bill Gates's Ted talk video on the environment, one will realize that his **CO_2 = (P)eople x (S)ervices x (E)nergy x (C)arbon** equation is the same basic concept as the original *Limits to Growth* models.

https://www.youtube.com/watch?v=JaF-fq2Zn7I

Q: I sense you question some of the ideas behind *the Limits to Growth*, can you expand on that?

Population is a core variable in "eco-nomics," so there is a population control aspect to it—whether that be in the size of the population, the services used by the population, the distribution of those services, and there are assumptions regarding who gets to make those decisions. For more liberty minded people, or anyone with some appreciation for history, alarm bells go off when centralized authorities seek to control "populations." Obviously, people prefer to control their own decisions, so when they learn about or experience population control policies, it does not necessarily sit well with them.

"Eco-nomics" starts with the collective "ecological" or environmental system."

Municipal and Treasury Yields (%)

Maturity	Treasury	AA Municipal	A Municipal	BBB Municipal
1 Year	0.383%	0.299%	0.357%	0.897%
2 Year	0.734%	0.374%	0.430%	0.963%
5 Year	1.264%	0.749%	0.851%	1.362%
10 Year	1.512%	1.176%	1.363%	1.882%
30 Year	1.904%	1.720%	1.888%	2.488%

Source: Bloomberg as of 12/31/2021

Q&A with the Research Team

The scarcity mindset embedded in the *Limits to Growth* raises important questions, but I also find it sells people, their intellect, and their capacity for creative problem solving short.

As people learn more about the "eco-nomic" agenda, they are growing more skeptical. I believe this is why we are witnessing a growing backlash around the world. The pushback is occurring because people realize that there are important national sovereignty and personal liberty issues that also need to be addressed along with climate policy.

As a result, the Big Fourth Turning issue, which will increasingly be answered by the Millennial Generation, is —how much centralization verses decentralization through government and corporations do you desire in your life? It is the same basic question whether one is discussing the goal of zero Covid, zero CO_2, cryptocurrencies, decentralized financed (Defi), solar power, or big tech censorship.

Q: What does the debate between centralization and decentralization mean for portfolios?

There are no perfect solutions, so in portfolios, I think diversification is key, but a balance between legacy centralized and innovative decentralized solutions will enhance a portfolio's resilience. The best economic solutions, however, will be those that find the correct balance between society's needs and individual liberty.

Q: Can you give us examples of winning economic solutions?

Yes, let's start with currency and banking. Bitcoin and decentralized finance (or DeFi) solve some basic problems that arise with centralized financial systems. Does that mean Bitcoin can completely replace centralized fiat currency systems? I don't think so, just as Linux (open source software) has not replaced Windows. They co-exist.

Cryptos are compelling enough to convince me that a diversified portfolio should maintain some exposure to them. If you doubt me—ask a millennial if they know someone who owns gold coins. Then ask them if they have a friend that owns cryptos. For clients, we have researched the various ways to obtain crypto exposure and we educated our advisors on how to work with clients on it. Just be prepared—it's volatile.

Another example of a winning economic solution would be solar energy. Solar solves certain externality problems.

Q: What are externality problems?

The classic externality problem is pollution. Classical economics and "eco-nomics" agree on this. The basic idea is that when a firm pollutes the air or water, the full costs of eventual clean-up are not properly reflected in the cost of the good or service. The price, because it is too low, encourages excessive consumption and resource depletion.

Therefore, if we properly priced in the externalities associated with extraction industries like oil and gas, the price of energy would be much higher. High energy prices, unfortunately act as a regressive tax on the economy, so we don't like high energy prices. In fact, 11 of the past 12 recessions in the United States have been preceded by large increases in the prices of energy.

The question then becomes how can we generate the energy we need, while polluting the environment less, while also not hurting the economy and those who are less wealthy.

One solve for energy pricing then is to use more solar, which is accelerating. Personally, I am really excited about the decentralized nature of solar.

For example, I recently agreed to put solar panels on the back of my house. I liked the idea of going solar because once I take the house solar, it will be 85% off the centralized utility grid. In essence, the house will be more independent and more self-reliant, but with modern conveniences.

The cost of the house solar project, however, was lowered through both federal and state subsidies. While I appreciate that the subsidies cut the cost of the project, and that I had an opportunity to direct my tax dollars, subsidies are an economic distortion. Therefore, if they are to be used, I rather they be used in a progressive, rather than regressive manner like today.

I also recently purchased a portable Yeti 6000 solar powered generator. It weighs about 80 lbs, and all I need to recharge it are a few solar panels, so I am long-term charged up on solar.

Q: Any final thoughts?

I think Covid as an economic issue will fade away this year. The important fundamental questions regarding the proper balance between individual liberties and the needs of collective society, however, will still be with us for years to come.

Here is why I say that. If you just looked at the numbers—in the United States, Covid deaths are approximately 350k per year, which is a big number. It would only rank, however, as the fourth leading cause of death behind abortions (>750k per year), heart disease (>750k per year), and cancer (>590k per year). The difference between Covid and these other diseases, however, is that it is not limited to the individual. If someone has Covid, then he may spread it, whereas if someone has heart disease, it will only impact them and their family directly. Communicable diseases and "eco-nomics" naturally raise questions regarding what obligations does an individual owe to society and what obligations can society enforce on the individual? I close then with John Donne's <u>*For Whom The Bell Tolls*</u>,

No man is an island,
Entire of itself.
Each is a piece of the continent,
A part of the main.
If a clod be washed away by the sea,
Europe is the less.
As well as if a promontory were.
As well as if a manor of thine own
Or of thine friend's were.
Each man's death diminishes me,
For I am involved in mankind.
Therefore, send not to know
For whom the bell tolls,
It tolls for thee.

We should seek to protect the individual while realizing we are part of the whole, else we will be the less.

QUICK TAKE

MAJOR ASSET CLASSES

Cash and Cash Equivalents

The Federal Reserve has indicated that it intends to raise short term rates in 2022. While most asset classes have a negative correlation to short-term rates, we would point out that real interest rates continue to be negative as the 10-year realized inflation rate sits at approximately 1.82%. As a result, we believe alternative currencies like gold and cryptocurrency offer positive carry against cash, but they will be volatile as the Fed increases the attractiveness of cash at the margin.

Investment Grade Fixed Income

The yield curve has begun the year with a sharp move higher. Investment grade fixed income markets reflect an economic recovery and credit spreads remain tight. The 10-year treasury yield is once again equal to the 10-year realized inflation rate, but inflation readings have been coming in hot, and we continue to hear about additional price increases in the pipeline. Given the still historically low yield levels, we believe investment grade bonds will be a challenging asset class. We think investment grade bonds still have a defensive roll to play, but we would not expect capital appreciation from bonds going forward.

Tactical Fixed Income

Historically, fixed income and equity arbitrage strategies earn a risk premium above cash yields. Given that equity market neutral strategies historically are positively correlated to higher interest rates, we continue to favor these types of strategies.

Core Equities

Since our last report, equity prices have appreciated in the large capitalization stocks, which people are using as bond proxies, while the number of advancing stocks to declining stocks has turned materially negative. After adjusting for recessionary recovery, we believe equities are slightly overvalued relative to historical valuations, and we are beginning to grow concerned about rising energy prices. Given high levels of volatility, we would not overweight equities beyond investor risk determined allocations. Given our inflation outlook, we are also more constructive on small cap 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 believe tactical equity strategies are becoming increasingly attractive on a relative value basis given low interest rates and the likely structural changes to the economy.

Other Markets

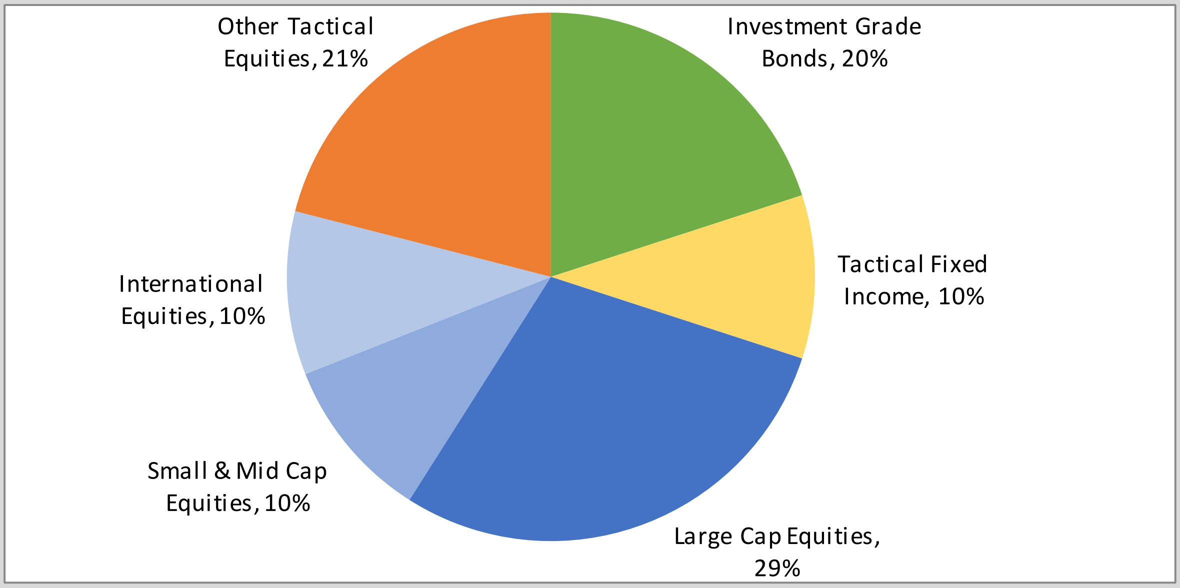
Other markets like gold, cryptocurrency, and real estate may offer diversification benefits to traditional portfolios, but some suffer from the same valuation issues as stocks and bonds.

Index Snapshot

	Earnings Yield	Dividend Yield	Price to Book
Large-cap Stocks	3.82%	1.27%	4.90
Mid-cap Stocks	4.89%	1.36%	2.75
Small-cap Stocks	5.08%	1.38%	2.17
International Stocks	5.72%	2.63%	1.85
Emerging Market Stocks	7.15%	2.40%	1.81

Source: Bloomberg as of 12/31/2021

FinTrust Allocations (70/30 Risk Profile) with Tactical



Positioning as of 12/31/2021. 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 limit 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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