Where Are We Going, Where Have We Been?

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Over the past few weeks my life has been turned upside down. Prior to the election, I thought of myself as a typical, repressed businessman, an outlaw guilty of capitalistic thoughts in a going-socialistic western world. At times I would break into night sweats, concerned about the potential problems coming my way via another government induced love-letter: notice of another income tax audit, another fake lawsuit from an employee looking to game our intentionally complex rules, or word of a new fee pushed by a special interest hiding under the guise of justice. It was always something.

Like millions of others, I too found myself fed up with the system, deprived of the enthusiasm necessary to expand my rental real estate business. In the eyes of the elites, we businessmen are perpetrators who should be punished appropriately for our success – success which our "devoted" leaders believe to have come at the expense of the working class. Nothing could be further from the truth. Rather, it is the "success" of our political leaders through their dysfunctional government policies that has impoverished labor. And what do our elitist political leaders do when their policies fail abysmally? They demand even more power – more taxation, more regulation, and more "fairness." Why break precedence? What a crock!

Yet one unforeseen election result on a Tuesday in November suddenly delivered hope – hope that tax rates will roll back meaningfully for the first time in more than a decade, hope that the monstrous machine of socialism will be slowed or perhaps even blown-up (just *kill the beast*!), hope that medical reform will actually include true market reform rather than mere giveaways both to the large drug companies and free-loaders with little skin in the game, and hope that one day my young children will enjoy the same opportunity that this great country offered me at a young age through a system that much more resembled capitalism. At least temporarily, my night sweats have now subsided and have been replaced with a newfound sense of optimism. No doubt there are others who are dissatisfied with the election results, but where have they been for the past thirty years while our government has perpetually expanded, destroying nearly every aspect of our lives by meddling in housing, healthcare, and education?

The biggest irony about my newfound relief is that I did not even vote for Trump. In good faith, I couldn't convince myself to support a candidate who presents as an egomaniac and who often flies off the handle. Nor did I vote for former Secretary of State Clinton, who at times seems to be not only an anti-capitalist but also just another facilitator of a foreign policy despised by the rest of the world. In perhaps a weak spiritual moment, I conducted a pre-Thanksgiving Day séance within the voting booth, cathartically casting my write-in ballot for "The Corpse of Ronald Reagan," our last remaining vestige of American Political Capitalism. What momentary relief! (The one beauty of any organized religion, no matter how absurd, is that it offers the promise of hope.)

With a little luck, a bombastic Trump might bring national unity, removing governmental incentives which pit citizens against each other. Perhaps employees will no longer be given a blank check to sue their employers for alleged wage theft without just cause (the idea of wage theft by employers is nearly comical in relation to the number of hours employees spend on the clock surfing the net at their desks.) Just maybe President Trump will live up to his promise to pressure the Fed to desist from money-printing and remove zero-cost interest, a policy which benefits the rich who hold assets while torturing the middle class whose wages cannot possibly keep pace with rabid asset-price inflation. It's even conceivable that the consumer might benefit from choice, something long denied by a big-government justice department that routinely allows crony corporations to monopolize.

I know some have taken to the streets to protest a Trump presidency. (*"Relax," said the night man*. The Eagles, 1977.) Some are naturally afraid of his incendiary political rhetoric, while others just cannot accept the outcome of a legitimate election, mainly because they have either bought into the evil, repressive concept of socialism or have been bought off by its naturally divisive ways. Make no mistake about it, nothing is as it seems. We live in an immoral society where special interest groups hire people to create havoc and turn public opinion. In a world in which a mere three companies control the internet (Google, Facebook, and Microsoft) and a handful of other conglomerates shape the traditional media, it's not unthinkable to believe that we are but the puppets of a few!

No doubt that Trump is a big risk. He is a crafty politician without a track record, one who blatantly lied to capture the White House (which he now candidly admits). Like Trump, the heralded revolutionary Malcolm X adopted Machiavellian principles, acknowledging that sometimes the end justifies the means. ("By any means necessary" is a translation of a phrase used by the French intellectual Jean-Paul Sartre in his play *Dirty Hands* which was employed in the 1960s civil rights movement.) If indeed the polarizing, "nasty" Trump abandons his campaign pledges and instead grabs the elusive middle ground so desperately craved by average Americans, should he too be hailed as a revolutionary? Just askin'.

The caricature named Donald Trump – bombastic, conceited, and often childish – is not exactly the spirit that I had hoped to summon through my voting booth antics. Nevertheless, this is what our representative democracy has produced, and it hardly can be considered a total surprise given Brexit. For more than two decades, the normally tolerant, symbiotic relationship between the major political parties has gradually given way to a more rebellious presidency increasingly predicated on imposing government intrusion into our daily lives, often through the stroke of an executive pen. President-elect Donald Trump is the epitome of voter frustration; the electorate has grasped at the proverbial hope for a benevolent king as its best chance to restore a broken system.

What is lost in most academic analysis is the role played by our chief regulator – the Fed – in stoking our extreme political and economic polarization. By permanently instituting the "temporary" stop-gap measure of money printing and allowing the unsustainable to persist, the Fed has unwittingly discouraged the major parties from confronting reality in a joint, cooperative effort. Instead, the Fed has ignited an American populism, with each political party invoking retaliatory policies in order to restore its skewed version of justice. Trump's national election is merely an extension of the populist trend, long at work at the local level, to mitigate the negative consequences of the Fed's academic-based, ivory tower crusade against deflation.

THE GROUND FLOOR POLITICS AND ECONOMICS OF THE FED'S REAL ESTATE INFLATION

Whereas the 1970s kick-started a cost-push inflation that primarily afflicted the Main Street economy, today's inflation is precisely the converse (mainly because of the backdrop of globalization), emanating in the asset markets and slowly seeping into the general economy. The unevenness of the Fed's inflation is seen in America's supply-constrained real estate markets – along its coasts and in its big cities where the majority of liquidity pools – as opposed to the fly-over parts of the electoral map where it can barely puddle (high-paying jobs, along with access to loans, is relatively scarce). Lovely Long Beach, located in the heart of Southern California, perfectly exemplifies this trend.

Money is pouring into the city, searching for yield wherever it can be found. Consequently, prices have been bid higher on multi-residential apartment buildings, and the new owners have been delivering existing tenants notices to vacate in order to fix up the units and secure higher rents. Rising rents spur yet higher resale prices for apartment complexes, thus creating even more potential liquidity to be borrowed and re-invested, often culminating in a bubble which spins out of control. In theory, the renovated units attract high-income tenants who spend money in the local economy, stimulate business and create a virtuous cycle of rising incomes and rents. However, the reality is that only a real estate boom triggered by an increase in productivity can sustain itself, whereas a boom initiated under false pretense (read: money printing) is nothing more than a zero sum game which solidifies some areas while hollowing out others.

Long Beach City officials make the classic mistake of incorrectly analyzing the root of their problem: they perceive local rents to be too high when in fact it is local incomes that are too low. They take no blame for their poor planning which has led to epic failure after epic failure: twice building a massive downtown mall in the same location, both times failing to attract customers; allowing for builders to construct high-density, poor-quality units in the 1980s that quickly became instant ghettos; failing to attract large private employers like Disney and instead relying on government-dependent industries like aerospace that could easily be unionized and later "shockingly" would abandon the city; banking on naval shipyard jobs which would fall victim to predictable defense cuts; and so on. But this should come as no surprise to a city that allows paid protestors, hired by the unions, to engage in daily shout-outs at 9am sharp on the sidewalks in front of the non-union hotels with the hope of bringing their business to its knees and forcing them to unionize by disrupting the stays of their paying customers, customers who bring with them sorely needed money to spend in a poor city. (The police, who are union members themselves, turn a blind eye to the disturbances.) If it is high rents and not low wages that are the city's core problem, then why is it that politicians never ask themselves why local freeways are routinely busy in one direction only – out of town to start the workday and back to town at night? Just askin'.

Not to worry, though, for our beloved politicians never miss an opportunity to compound a government-instigated problem. Rather than accepting the ramifications of the nation's misguided monetary policy and letting it play out entirely, local politicians often try to correct the market's inequitable reactions. Spurred on by local activists, the City of Long Beach recently passed the Proactive Rental Housing Inspection Program (PRHIP) allegedly to protect the city's housing stock from dilapidating under the neglect of slumlords who are taking advantage of a "tight" rental market along the coast. If that were indeed the goal, a reasonable approach simply might be to drive the streets and identify obvious slum buildings by their peeling paint, bare landscape, and nonexistent window coverings. Instead, empire builders have hired a legion of new city employees to inspect every apartment in town – no matter its condition – thereby wasting valuable resources through bureaucratic overkill instead of just picking the low hanging fruit. Typical government.

Emboldened by their initial success, socialist activists are now lobbying politicians for even greater "rights" under the soon-to-be formed Office of Justice where, behind the scenes, they are seeking a real estate escrow program (REAP) to sanction owners of substandard buildings. In Los Angeles, for example, the city reduces rent by fifty percent and then confiscates it, having tenants deposit their rents into an impound escrow account controlled by the city until repairs are made. Smaller property owners do not have the capital to withstand such an onslaught and eventually lose their buildings both to tenants who are motivated by a reduction in rent and to bureaucrats who welcome the opportunity to convert the private housing stock into city-owned property which then can be run less effectively by government or resold to the crony friends of local politicians. (How quickly we forget the lovely, lovely city-built projects of the 1960s that were eventually condemned.) Also, activists are pushing for "Just Cause Eviction" which forbids a property owner from issuing a notice to vacate except for non-payment of rent.

On the surface these policies seem innocuous – just as assigning a government official to police every businessman might seem like a reasonable idea to the socialist mindset. In practice, these unreasonable policies strip property owners of their ability to police their own buildings and to run an orderly business, while simultaneously imposing unnecessary costs. The right to ask non-cooperating renters to peacefully co-exist with others is essential, even if they are paying their rent. Inevitably, poor policy merely drives up costs, forcing seemingly unaffordable rents even higher. Ultimately, these "progressive" steps lead down the regressive, radical road to rent control. Effectively rent control is a subsidy from the owners, who receive less than market rent for the rent-controlled units, and future tenants, who are forced to pay astronomical rents for the few units that actually are vacated. (Even the neo-communists recognize that responsible landlords would boycott a city and its housing stock would deteriorate overnight were a provision that takes vacancies to market rent not allowed.)

The stated purpose of rent control is to make rent affordable, yet rent control cities such as Santa Monica, San Francisco, New York, and Los Angles are among the highest rent districts in the country. Never underestimate the power of bureaucrats to achieve the opposite of their stated intentions! In short, what real estate investors and prospective renters should realize is that the capital cops are coming, and it probably ain't for our protection! Perhaps we should take solace in the thought that, unless dramatic changes were to take place, we will not be alone in being offered government "support."

THE *DON* OF A NEW ERA

Pox on the House of Kennedy. Pox on the House of Bush. Pox on the House of Clinton. Goodbye to the aristocracy. Bienvenidos to the nueva Casa Blanca – El Hotel De Trump – *such a lovely place, such a lovely face*! Yet so, so *Tiffany-twisted*. Enter President-elect Donald, the self-proclaimed King of debt. *What a nice surprise* for such a deserving world, a world stuck in the mud left by the infectious Keynesian policy of near zero interest rates. What a US legacy – Greenspan's bubbles, Bush's war, Bernanke's dream of a Great Global Recession, Obama's lost opportunity, Hillary's destiny, and Yellen's interest-rate box, all thrown out the window by the simple stroke of the voting pen.

While the dejected establishment denounces Donald's heart of darkness, their Keynesian economists are labeling as irresponsible Donald's "think big" way – the deficits that his policies will run up, the inequity that he will create. What numbers have these wacks been watching for the better part of two decades? Was it not their convoluted world that created our mess – their policy of federally guaranteeing private sector debt and creating the mortgage fiasco, their policy of mailing away free stimulus checks to jumpstart a moribund economy, their policy of federally insuring student loans thereby putting our future innovators in a deep hole with suspect training, their policy of paying people to stay out of the workforce and wondering why the labor participation rate has dropped to generational lows, their policy of zero interest rates which has enticed corporations to arbitrage the cost of borrowing against their own stock's earning's yield and has set the stage for yet another stock market bubble, their policy of self-funding an unprecedented government expansion by way of quantitative easing, and their policy of invoking Dodd-Frank which nearly guarantees that the liquidity spigots would funnel only to a select few and thereby create a global wealth divide? And yet Donald, who threatens their corrupt disorder, is the dangerous, irresponsible loon? Now look who's fired. LOL! *We haven't had that spirit here since nineteen seventy-nine [sic]!*

What Donald has done in just a matter of days, omniscient central bankers and their political cronies could not manage to do over a period of years – to begin the transition away from a failed interest-rate socialism by disrupting the status quo. Seemingly overnight the world has morphed from a low-octane, money-supply-dependent, debt-ridden Keynesian place into a potentially new environment re-engineered to achieve money velocity by way of a businessman's proposed common-sense reforms of low taxation, deregulation, and the future dismissal of the latest enabler when her fed term expires in 2018, all peppered by the promise of a sorely needed infrastructure spend. Almost immediately, interest rates have climbed and the stock market has zoomed. Fathom that! Who'd a thunk it?

The initial market reaction is completely logical given the circumstances. Should Trump's proposed reforms pass, bonds likely will have embarked on the first phase of a prolonged, gradual bear market, albeit with fits and starts. When velocity compounds with the chief ingredient of lots of money, the monetarist's inflationary recipe for a spiral cake is in the oven. The broiler, though, may remain on low for quite some time, primarily because of two factors: the effect of a huge debt overhang dampening the global economy and the reality that much of the world is still clinging to a broken model of zero interest rates. For US equities, however, the prospect of a "really big" corporate tax cut could translate into significantly higher net earnings and could continue to lift stock prices higher – perhaps much higher – especially if money flees bonds and gravitates in earnest toward equities on the promise of a better future. According to a recent *Barron's* article, a corporate tax cut to a 22% federal rate would be revenue neutral due to the Laffer effect. If passed along with regulatory reform, such a cut could usher in the final phase of our latest US stock market bubble, perhaps reaching an interim high this spring before the reality of the rising cost of borrowing strengthens the dollar too much, crimps US profit margins generated overseas, and squeezes the dollar-denominated foreign debt. However, as the effects of Trump's policies take hold, we cannot rule out one final stock market bloom sometime in the next two years; much depends on how the globe reacts to Trump's changes.

All stocks simply cannot be painted with the same brush during periods of interest rate indigestion; the discounted future cash flows of growth companies are far more sensitive to rising rates than the low price-to-earnings multiple of industrials whose prospects in theory should improve with an improving Main Street economy. Yet, what distinguishes the Trump revolution from the Reagan revolution is the starting point of today's ultra-high valuations. Reagan took office after a prolonged bear market highlighted by double-digit interest rates and compelling valuations, whereas The Donald is strolling in on the tail end of a massive stock market boom driven by the Fed's ultra-low interest rates. Emerging markets, on the other hand, offer more enticing valuations that could produce positive returns for years to come after suffering some initial turbulence associated with Trump's reforms. Meanwhile, gold initially suffers from two blows in dollar terms – first, real interest rates are rising because nominal rates have moved up while money velocity and inflation have lagged, awaiting the implementation of reforms; and second, the belief that in the long run Trump's free markets will be inherently more stable and thus less-gold friendly.

All of the previous market conclusions seem rational, given the status quo. However, the US economy is likely to slow once the initial rise in interest rates ripples its way through the system but before the effects of reforms are felt because they often lag by months. At that point, it's likely that the dollar will top out, at least for a while. It is then that I expect the real Donald – Donald-the-deal-maker – to emerge in full force with a "really big" stimulus package and thereby expose his truly Keynesian roots. What that will mean for the trajectory of interest rates depends much on the international reaction. If foreigners are complacent with their failed zero-rate and QE policies, then perhaps King Donald will be given the opportunity of a lifetime, a golden ticket to fund a US infrastructure build with low-yielding, long-term bonds as the world looks to arbitrage the differential between more capitalistic US rates and the largely subsidized alternative. However, if the supply-siders are right to think that Trump's reforms will pick up the US economy, it is but a matter of time before other nations join in on this "revolutionary" thinking. Like quantitative easing, true reforms are at first kind to the early adopters but when mimicked in mass eventually can lead to a whole new set of unanticipated problems.

What we may rediscover is that the ultimate regulator is not the strong hand of big brother as the establishment believes; rather it is the free market's invisible leash – that thing around our necks, that thing which is affected by interest rates and naturally collars business people, consumers, and investors whenever they stray too far from reality. Inherently, healthy volatility is what keeps the system intact, but it is not always kind to asset prices even when it is kind to Main Street, with the lone possible exception of gold. It would come as no surprise to see gold bottom just as the US equity market tops, the forewarning having come from the recent peak made in both bonds and investment real estate. Funny how the perverted Mr. Market presents once he's free to expose himself.

THE REALITY-PRESIDENCY

It's no wonder that neither the elites nor their socialistic supporters can accept the fact that an informed electorate has embraced a perhaps "pathological" billionaire who ran on a broad platform of seemingly dangerous single stories: that Mexican immigrants are criminals and steal jobs, that Muslims are radical and should be denied from entering the West, that international trade is not free and hurts America, and that our former enemies (strong-men) now should be considered as our culturally close allies. The African author Chimamanda Ngozi Adichie emphatically makes the point that the biggest danger of single stories is not that they are untrue, but rather that they manifest themselves as stereotypes – stereotypes which are incomplete and rob people of their dignity by failing to tell a complete story (see TED Talks, "The Danger of the Single Story"). But what if the media had portrayed Trump's single stories as such: that Mexicans are hard-working but cannot be permitted to pile illegally into the country without repressing wages, that Muslims represent another organized religion which must self-police effectively their radical wing, that even "fair" trade can have displacement effects that, when combined with the vagaries of a massive inflation, can destabilize subsections of the country, and that sometimes the strongman is the one in front of the mirror? The truth is that while the establishment took Trump's rhetoric seriously, many voters did not and chose to recast for themselves the themes promulgated by Trump to garner attention and selectively highlighted by the media to sell stories.

Perversely, Hillary Clinton, too, engaged in stereotyping with her comment that she could lump half of Trump's supporters into a basket of deplorables – the racists, the sexists, homophobes, xenophobes, and Islamophobes, you name it. What Hillary missed is what a broad coalition of average people shared in common – that other thing around our necks. That thing is not just the strong hands of big government strangling us by way of an excessive regulation; a punitive tax structure which favors organized religion, big government and the ultra-rich by endlessly exempting "non-profits" while heavily taxing the non-corporate private sector; and an uneven inflation that punishes hard-working laborers and businessmen alike while rewarding asset holders through its zero interest rate policy. Rather that thing that is tugging at our necks is our heart's yearning to achieve eternal freedom through the opportunity to create our own fate – free from reliance on the chains of big brother. The truth is that enough working people and businessmen are so turned off by big government's bureaucratic brotherhood and its companion crony corporations that we would just as soon roll the dice with the billionaire boys in charge, no matter their personal faults. It's about the policies, not the people.

It seems that the country is now primed to abort our interest-rate socialism, which has benefitted mostly a few, in favor of structural reform, perhaps combined with Donald's infrastructure-socialism that might entail building bridges, roads, airports, power plants and the like. Undoubtedly, some from the far right will scoff at the infrastructure build as just another form of Washington waste, but if such a move helps to keep the peace while facilitating a transition to a more capitalistic society, won't it have been worth the sacrifice? Ideologues need to get over their issues. Surely, this won't be their first loss of innocence.

Undeniably, there is no guarantee that the bond market will cooperate with the deficits that will likely accompany a Trump presidency. Frankly speaking, *this could be heaven or this could be hell.* The road to ruin (modern Greece) is not a pretty one, nor is its detour necessarily smooth. Regardless, while many are sleepless in these coming days, fearing what the future might bring, others cautiously can rest, optimistically awaiting the opportunity for more reforms during the next crisis which is likely to be sparked, either at home or abroad, on Donnie's watch. Let's just pray that where the hell we are going is better than where the hell we have been.