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The United States, Again

It's interesting that the date of this communication should fall on America's Independence Day, because America is once again my central topic—not by design, but by default. How else could it be? Whether we look at America's neighbors, trading partners or military allies, frustration with an utterly unpredictable U.S. administration and legislature runs higher than ever.

Here, because it's so relevant, is a short reminder of what once mattered most to the United States. Consider the following words spoken by Secretary of State John Quincy Adams on July 4, 1821. After reading the full text of the Declaration of Independence to Congress, he reflected on what had made his country successful during the first half century of its existence:

“She [America] has abstained from interference in the concerns of others, even when the conflict has been for principles to which she clings, as to the last vital drop that visits the heart. She has seen that probably for centuries to come, all the contests of that Acedama, the European World, will be contests between inveterate power, and emerging right.

Wherever the standard of freedom and independence has been or shall be unfurled, there will her heart, her benedictions and her prayers be. But she goes not abroad in search of monsters to destroy. She is the well-wisher to the freedom and independence of all. She is the champion and vindicator only of her own. She will recommend the general cause, by the countenance of her voice, and the benignant sympathy of her example.

She well knows that by once enlisting under other banners than her own, were they even the banners of foreign independence, she would involve herself, beyond the power of extrication, in all the wars of interest and intrigue, of individual avarice, envy, and ambition, which assume the colors and usurp the standard of freedom. The fundamental maxims of her policy would insensibly change from liberty to force. The frontlet upon her brows would no longer beam with the ineffable splendor of freedom and independence; but in its stead would soon be substituted an imperial diadem, flashing in false and tarnished lustre the murky radiance of dominion and power. She might become the dictatress of the world: she would be no longer the ruler of her own spirit.”

Alas, John Quincy Adam’s America is no longer, nor has it been for a long, long time. The world has changed. And, in the process, the power that was once widely applauded as the upholder of a new, better vision, has descended into political chaos, grave social inequality, economic disorder, and military adventurism. Only 30 years ago, as Communism collapsed, the speed of America’s descent was unimaginable. On the contrary, much of the world was looking forward to a uni-polar arrangement, in which a *Pax Americana* would reduce geo-political tensions and more capital could be deployed towards economic wellbeing, social security and education. Now, contrast that notion with what’s actually happened. America’s ‘defense’ budget tops \$800 billion a year as the country’s forever-war seeks ever more battlefronts; the disparity of wealth is greater than in any other developed nation; and the only way economic growth can be perpetuated is by bringing government, corporate and personal debt to ever greater heights.

MAJOR U.S. DISPUTES AROUND THE WORLD

COUNTRY	DISPUTE	PRETENSE	SEVERITY*
Russia	Alleged interference in U.S. elections	National Security	Slight
	Crimea presence	National Security	Slight
	Trade with Iran, North Korea	Sanctions Violation	Serious
China	Trade Disagreements	Economic Distress	Acute
	Trade with Iran, North Korea	Sanctions Violation	Serious
	Confrontation over 5G Equipment	National Security	Acute
North Korea	Missile Development	National Security	Serious
	Bypasses U.S. sanctions	Sanctions Violation	Serious
India	Trade Disagreements	Economic Distress	Serious
	Trades With Iran	Sanctions Violation	Serious
Iran	Regime Unacceptable	National Security	Acute
	Alleged violations of agreement on uranium enrichment	National Security	Acute
	Bypasses U.S. sanctions	Sanctions Violation	Acute
	Supports U.S. enemy factions in Middle East	National Security	Acute
Syria	U.S. supports rebel groups against Syrian government	National Security	Serious
Turkey	Russian Armaments Purchases	National Security	Acute
	Trade With Iran	Sanctions Violation	Serious
Yemen	U.S. supports Saudi Arabia in war against Yemen	National Security	Slight
European Union	Trade Disagreements	Economic Distress	Serious
	Trade with Iran	Sanctions Violation	Serious
	Developing 'INSTEX' Alternative Payments System	National Security	Serious
	Uses Huawei Equipment	National Security	Serious
	Ignores U.S. sanctions on Venezuela, Cuba	Sanctions Violation	Serious
France	Uses Huawei Equipment	National Security	Serious
	Trade with Iran	Sanctions Violation	Serious
Germany	Uses Huawei Equipment	National Security	Serious
	Trade with Iran	Sanctions Violation	Serious
	Developing Nordstream Gas Pipeline	National Security	Serious
Canada	Uses Huawei Equipment, Extradition of Huawei executive	National Security	Serious
	Ignores U.S. sanctions on Venezuela, Cuba	Sanctions Violation	Serious
	On again, off again trade disagreements	Economic Harm	Serious
Mexico	Major Illegal Immigration Portal	National Security	Serious
	On again, off again trade disagreements	Economic Harm	Serious
Venezuela	Regime Unacceptable	National Security	Acute
Cuba	Regime Unacceptable	National Security	Slight
	Ignores U.S. sanctions on Venezuela	Sanctions Violation	Slight

*Severity ratings are based on the negative **global** economic and political impact if the problem is not speedily resolved.

Retreat to Isolationism

Sadly, this outcome leaves not only the U.S., but also its friends, trading partners and allies, in a difficult position. As a seemingly out-of-control America makes ever greater demands, long-existing trade and security arrangements become questionable. The result: Washington’s aggressive posturing is quickly damaging bi-lateral and multi-lateral understandings and spurring a retreat to isolationism. Importantly, it also seriously undermines trust in the economic arrangements and security alliances that have persisted since the end of World War II. When it comes to U.S.-controlled organizations like NATO, the WTO and the IMF, perspectives vary. America feels it is paying too heavy a price to sustain these supra-nationals. Most other nations can’t relate to that viewpoint, pointing out that they’ve long benefitted the United States more than any other nation, along with global payments systems like SWIFT and the dollar’s reserve currency status. The idea that the U.S. has been taken advantage of appears ridiculous.

In the end, it’s irrelevant what any one nation thinks. What does matter is that the global economy, the social fabric and conventional military alliances are all in for a serious test. Yet, if you looked at the U.S. stock market, you wouldn’t know it. Day after day, the talking heads on television keep rattling off the “bad-news-is-good-news” mantra, suggesting that negative developments can only spur the Federal Reserve to lower interest rates. Interestingly, that narrative has also boosted bonds and gold, two traditional harbingers of financial unrest.

DISRUPTIVE FORCES THAT THREATEN THE ECONOMY, SOCIAL STABILITY AND PEACE

AREA	PROBLEM
Global Economy	Europe and many emerging economies are already in precarious shape. Meanwhile, the U.S. and China are showing distinct signs of weakening.
Trade	U.S. initiated trade spats will have massive repercussions around the world. There are no winners (other than in the shortest term)—in time everyone loses. Companies can no longer rely on their global supply chains.
Monetary Policy	The current expansion has been kept going because of an ocean of liquidity. Interest rates have lost their role as a reflection of risk. The goal of central bank “normalization” has been ditched. Since 2008, government, corporate and personal debt have grown dramatically.
Military	U.S. initiated demands on economic grounds undermine historical alliances. U.S. security relationships with key European allies and others are weakening. Inability to trust America is bringing China, Russia, India, Turkey, etc. closer. Military capability is rapidly moving toward cyber space, leaving the U.S. vulnerable. Nuclear capacity is being sharply increased, including through faster delivery systems.
Politics	The prospect of impeachment proceedings against Trump continues to loom. Conspiracy investigations by the Justice Department add a new uncertainty. A highly politicized U.S. media complex ensures ever deeper polarization. The European Union’s structure is being challenged by market forces and politicians. Populism is sharply on the increase in Europe. The growing momentum of EU and U.S. socialism is a negative for markets.
Markets	Investment in productive capacity has been anemic for years. Corporate borrowing for stock buybacks and dividend hikes is unproductive. Valuations are stretched; corporate profits have been stagnating for some time. Globalization, once a huge tailwind for markets, is in reverse.
Demographics	Rapidly aging populations spell trouble for social programs and pension regimes.
Technology	Technology innovations threaten employment at a time when personal incomes stagnate.

Given the unusually large number of catalysts that may derail the current state of complacency, our strategy remains very defensive. We continue to hold 55% in cash, fixed income securities and physical gold, with a sharply reduced 45% exposure to stocks, the lion’s share of which is allocated to high-quality companies with defensive characteristics that pay a respectable and secure dividend. We are not the least concerned that we may miss some of “the action”—on the contrary, there are moments when we wonder if we’re cautious enough.

What troubles us most is the potential for confluence between one or several black swan events and developments that have been in the making for years. For example, a military confrontation or a financial accident could quickly escalate into something that's broadly destabilizing—and that, in turn, would significantly worsen a large number of clearly unsustainable social, economic and political trends. Pension liabilities would become even more underfunded, unsound central bank policies would become ever more precarious, and what's left of the political center would quickly shrink. In the fifty years of my financial career, I have never encountered more complacency at a time of greater all-round stresses.

Right now, the lines fed by politicians and their parrots in the mainstream media keep the market mirage alive quite nicely. Flagging economic and corporate fundamentals are easily dismissed—because a huge trade deal may yet happen, because the Federal Reserve may lower interest rates, or for whatever other convenient reason. Eventually, the narrative will change and the likelihood is that it will happen much faster than expected.

Best regards,

A handwritten signature in black ink, appearing to read 'Peter Cavelti'. The signature is fluid and cursive, with a large initial 'P' and a long, sweeping tail.

Peter Cavelti