CIBC PRIVATE WEALTH

“ANOTHER ONE BITES THE DUST”

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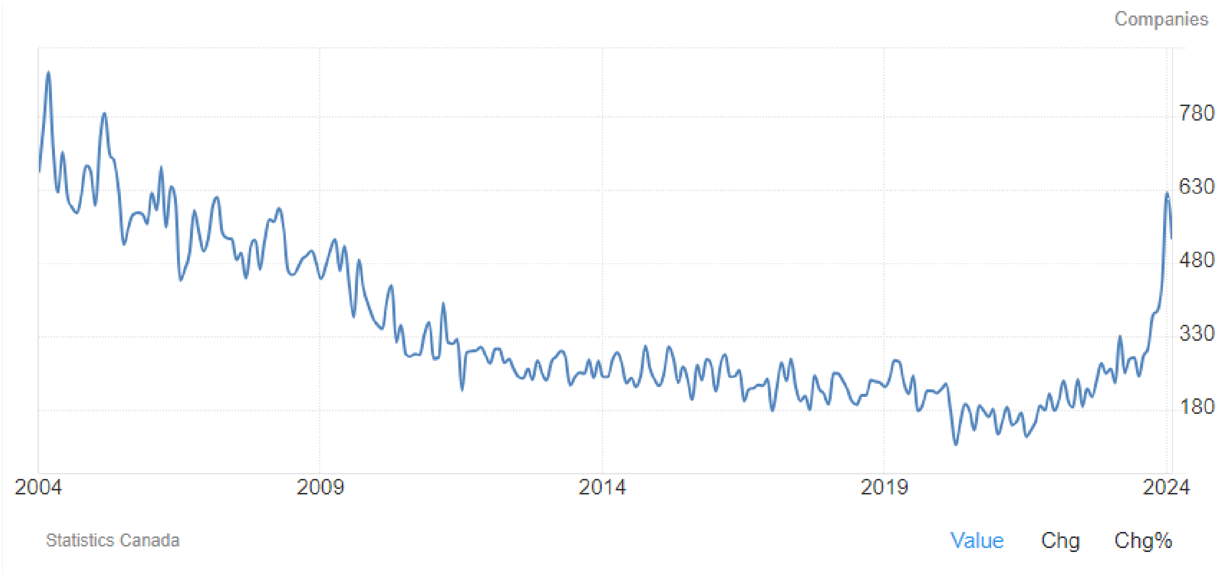
By Brahm Satov

Trade wars, technology wars, cold wars, and military wars, we have seen an escalation of conflict in many parts of the world. Historically, wars have been a stimulus for the economy as nations increase spending to buy military-related equipment. I am not an advocate for war, nor taking hostages, I am saddened by the bloodshed, and worry about the rise in violence and hate. I am also concerned about clashes that are more difficult to see, such as the strife between fiscal and monetary policy as well as extremely high debt levels. Furthermore, we have seen an escalation in bankruptcies and although it may not be the company you own, or work for, this is greatly affecting someone’s lifestyle. Thank you to the courageous rock band, Queen, for the title, “Another One Bites the Dust”.

Let’s think about debt for a minute. Usually, when we take on debt, we buy something now that we will pay for down the road (when we eventually pay back the debt). As our debt grows, interest payments increase correspondingly, and when interest rates rise, this has the same affect. Moreover, when debt levels are high, even a small increase in interest rates can make debt, difficult to afford. By the way, the cost of debt has increased from about 2% to over 6% as central banks have raised interest rates. When this happens, debt can become unaffordable and cannot be repaid. This is when bankruptcies often start to escalate. Albeit debt restructuring companies have likely been busier since early 2023. I believe that many, including individuals, businesses and governments, took on additional debt through Covid, and are now, unfortunately, paying the price. U.S bankruptcies hit a 13 year high in 2023, even more than during Covid (S&P Global Market Intelligence Jan 2024) with growth in business insolvencies up +36% year-over-year (according to well-known economist David Rosenberg (Breakfast With Dave 4/30/2024). For the Canadians looking at that statistic and thinking that we are more fortunate, I have some bad news, it looks even worse here.

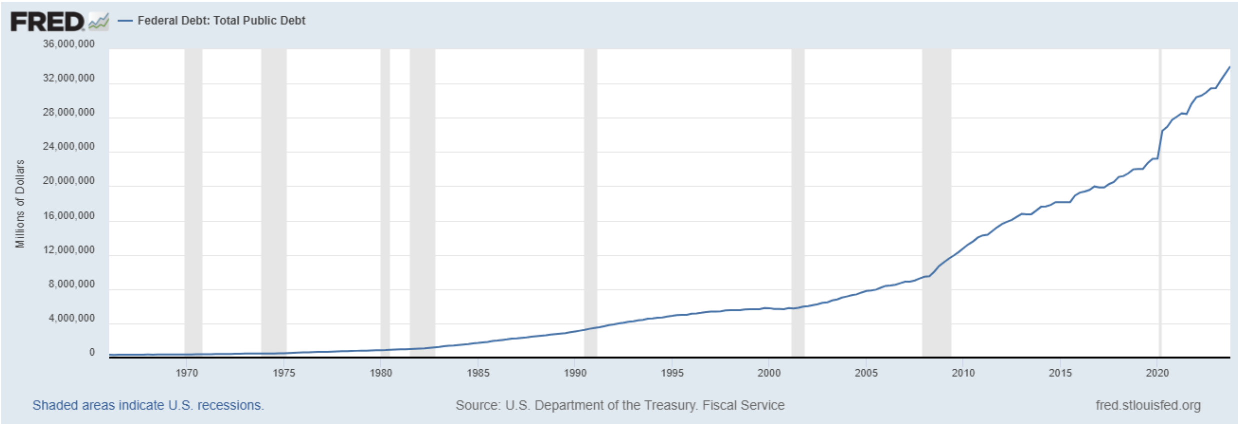
Canada Bankruptcies



Source: https://www.imf.org/en/Publications/fandd/issues/Series/Back-to-Basics/Fiscal-Policy

Due in part to the fact that debts have become uncomfortably high, it is now commonplace for governments to have deficits. In my grandparent's day, when the economy was good, nations would have a budget surplus and for the most part only in recessions was deficit spending used to reinvigorate the economy. This is no longer the case as deficits and debt have continued to grow pretty much year after year**,** as it is not just consumers that overspend.

Debt, both public and private has exploded and although mortgages entered the U.S. marketplace back in the 1930's, I believe it was not until Bank of America launched the first credit card in 1958 and it was about 10 years later for Chargex to come along with the first credit card in Canada that started the escalation in non-housing related consumer debt. Essentially, my grandparents likely lived with very little debt and the only debt they did have was on their home, for many families that is not the case today.



I am looking for a choppier year as fiscal policy and monetary policy are pushing the economy in opposing directions. The government (fiscal spending) is still injecting massive amounts of capital into the economy and this helps fuel growth. However, monetary policy and higher interest rates, slows the economy. I would compare it to a car pressing hard on the gas and the brakes at the same time. I expect that after an extended period, something is going to happen to the car.

As governments have become “better” spenders if you will, especially after the Great Recession in 2007 as well as Covid-19, their debt has grown to uncomfortable levels. With current total government debt in the U.S. over $38 trillion, this is considerably higher than their GDP at approximately $28 trillion and when debt levels get to extremes, this can signal challenges in meeting financial obligations, potentially leading to economic instability. Moreover, the rise in bankruptcies is not a healthy sign for the economy. It may be easy to say, “Another One Bites the Dust”, but for those going through it, it can be incredibly difficult. Furthermore, I would expect that as more businesses fail, eventually this will affect the employment rate and the economy. Given the greater than normal levels of uncertainty, I continue to recommend that investors should be more cautious at this time.

Thank you for taking the time to read this, please feel free to e-mail me any feedback or comments.

Sincerely,

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