

# The Future of Money

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## Today's Questions:

1. What is Money?
2. What is the Changing World Order?
3. What is the Paradox of Interest?
4. What is the Paradox of Value?
5. What is the Present Condition?
6. What are prospective future conditions?



# What is Money?



Medium of exchange?



Unit of account?



Store of value?



Standard of deferred payment?



Social Phenomena?

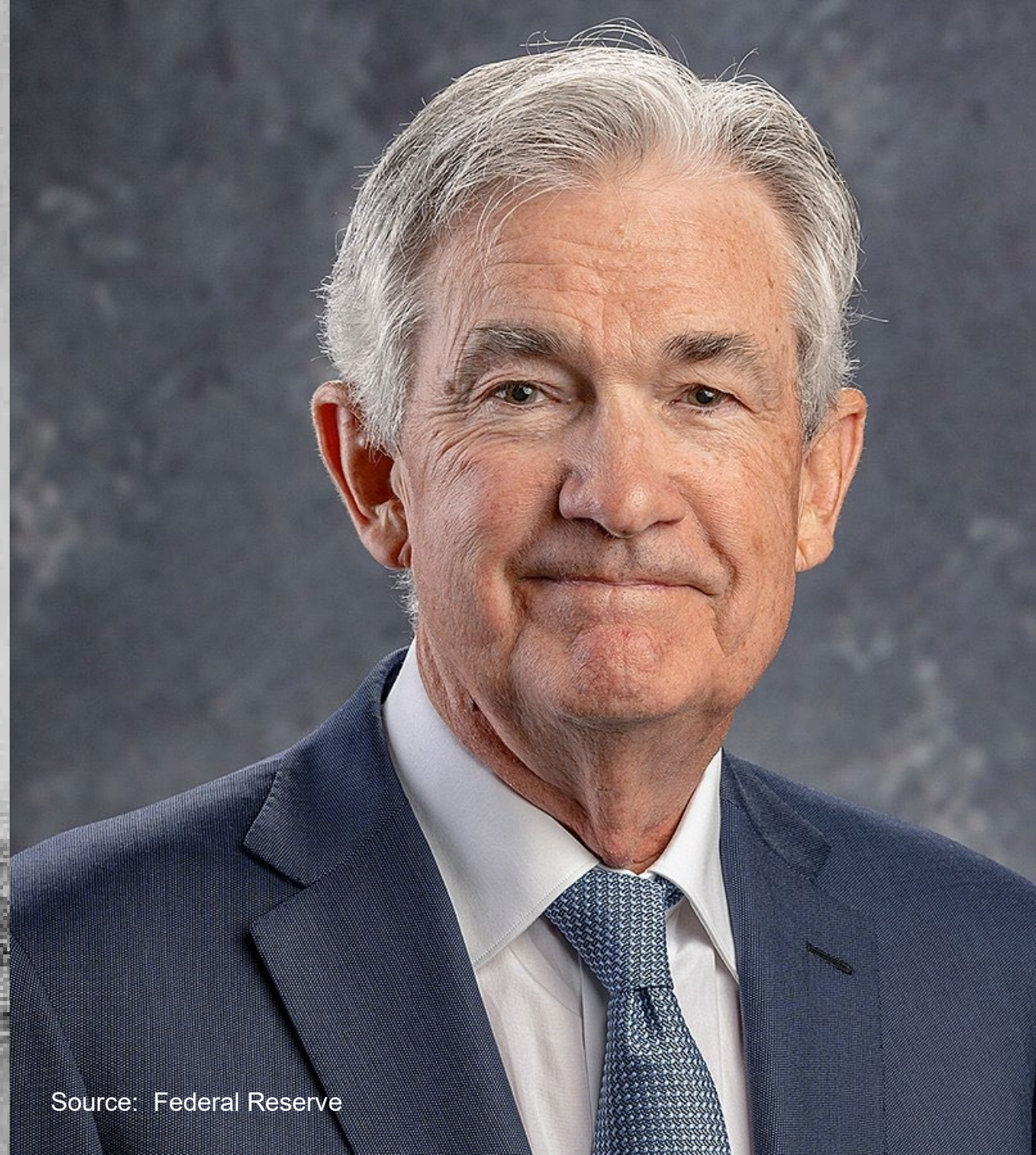


Source : Tripadvisor.com





Source: Brtitanica



Source: Federal Reserve



# What is the Paradox of Interest?



What is Interest?



How do CB change economics?



What is the effect of inflation?



The Fiction of the Fed



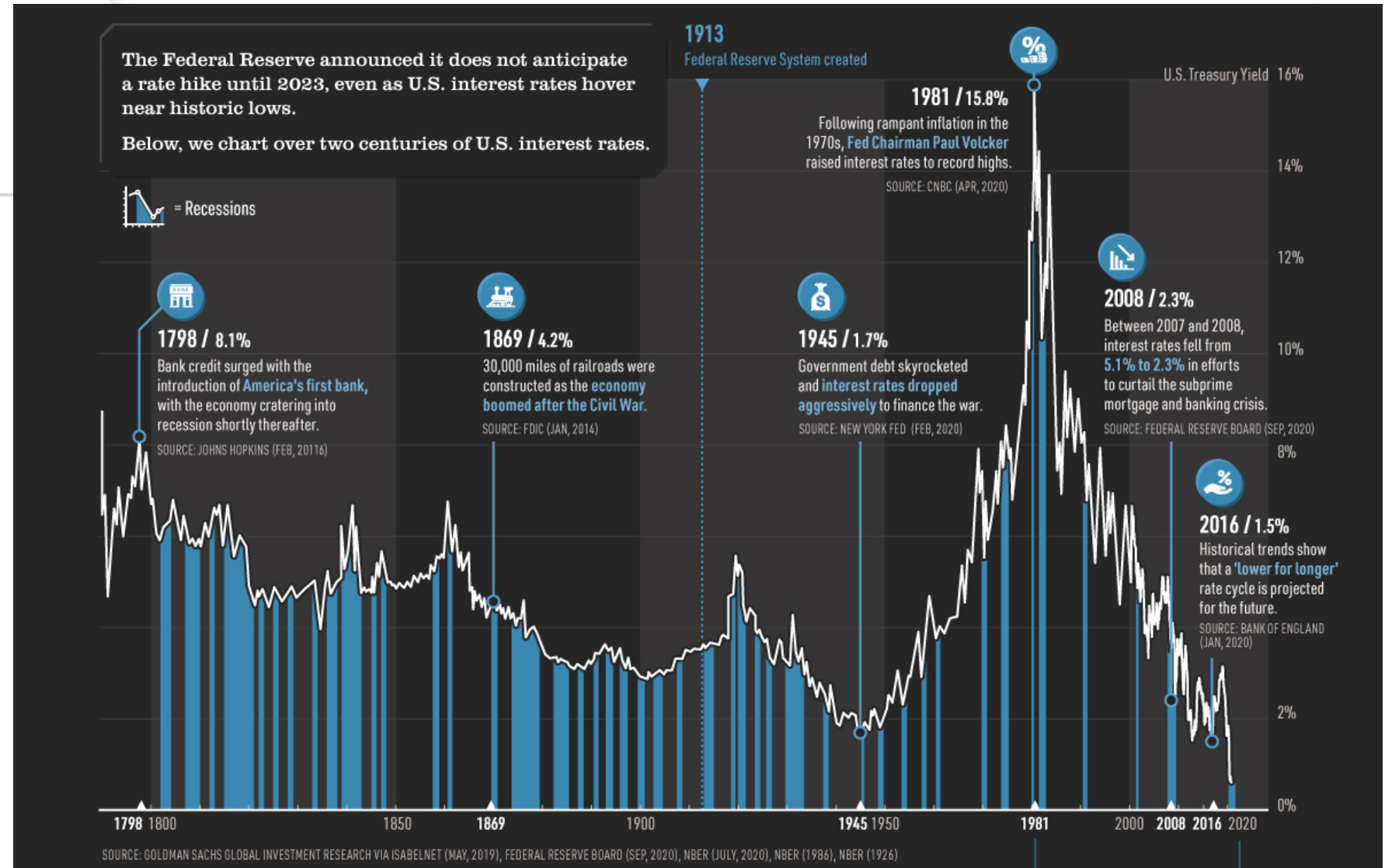


# Central Bank Rates: The Bridge Across the River



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## 200 Years of interest Rates





# What is the Changing World Order?



What has the past taught us?



What is the cycle of cultural/economic dominance?



Where were we?



Where are we?





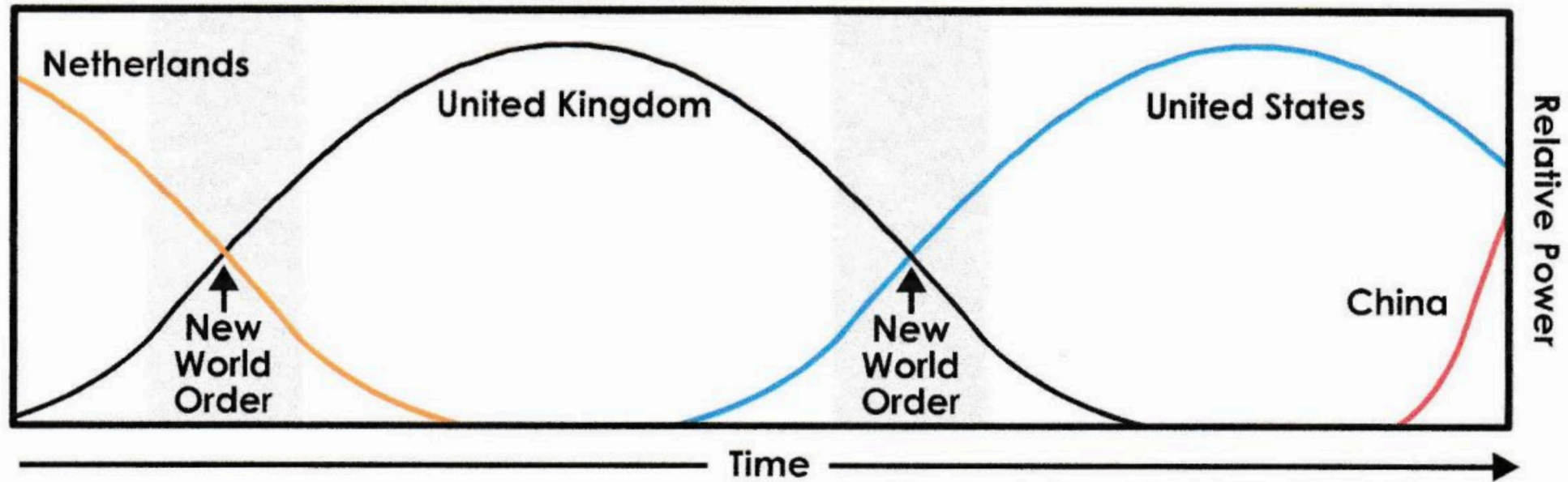
# Stages of the Changing World Order



•Source: Ray Dalio: **Principles for Dealing with the Changing World Order: Why Nations Succeed or Fail**

# Dutch Empire to British Empire to U.S. Empire

## CHANGES TO THE WORLD ORDER (CONCEPTUAL EXAMPLE)



Source: Ray Dalio: *Principles for Dealing with the Changing World Order: Why Nations Succeed or Fail*



## What is the Paradox of Value?



What is perception?



What is reality?



How do measurements work?



The Fictions



# S&P Multiples Fall Below 25-Year Average

S&P 500 Index: Forward P/E ratio



Source: J.P. Morgan

Markets can overshoot in both directions as sentiment shifts. With multiples now below 25-year averages, investors are eyeing earnings seasons for clues about future growth.

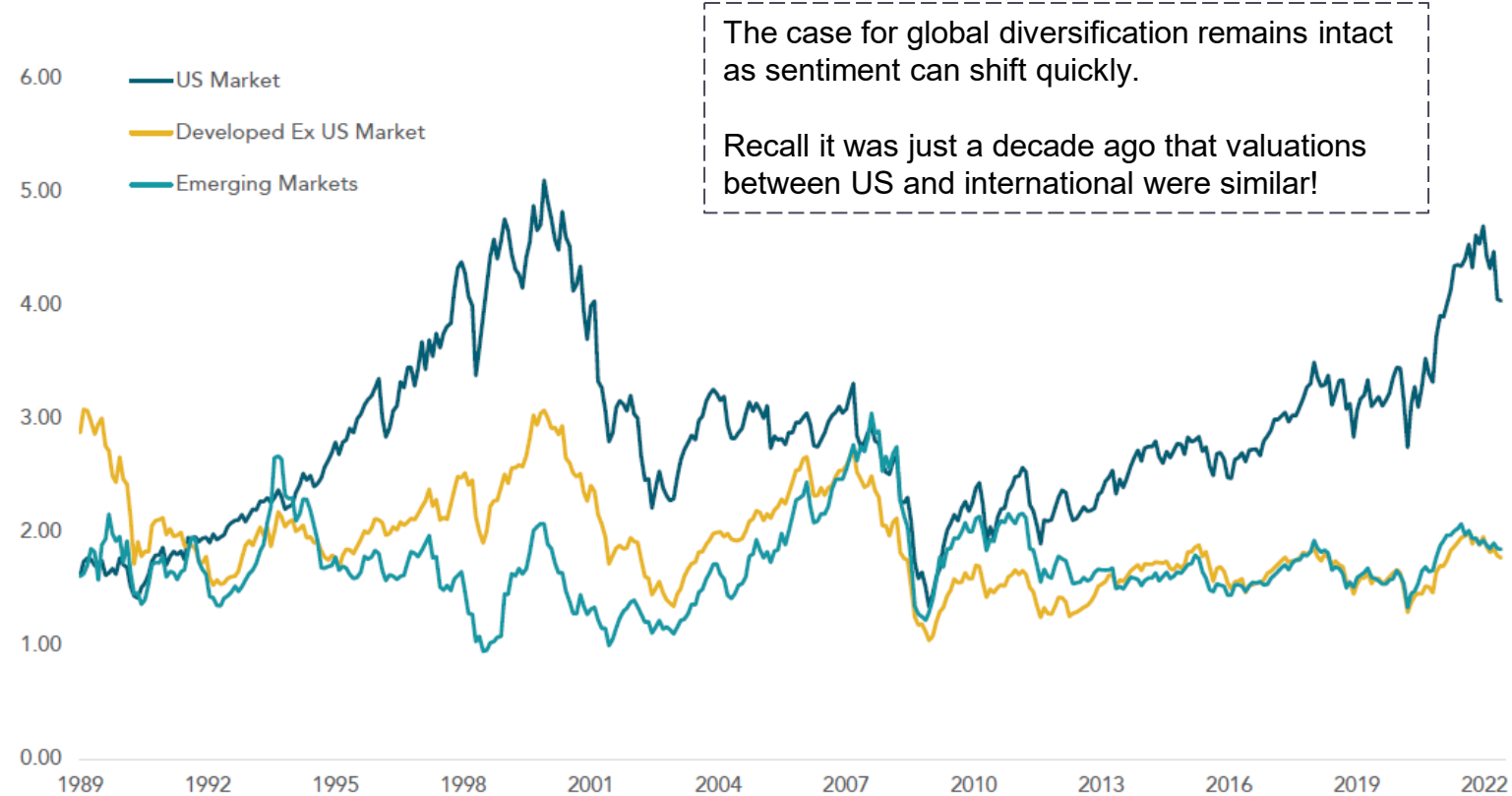




# U.S. Markets Trade at Significant Premium

## Historical Valuations: Regions

Price-to-book ratio, June 1989–May 2022



Source: Dimensional Funds

YOY 8.3% For Aug Next Release 13 Oct 08:30 Survey --  
CPI Urban Consumers YoY NSA Bureau of Labor Statistics

YOY Index 94) Suggested Charts 96) Actions 97) Edit

1980 - 08/31/2022 Last Px Local CCY Mov Avgs Key Events

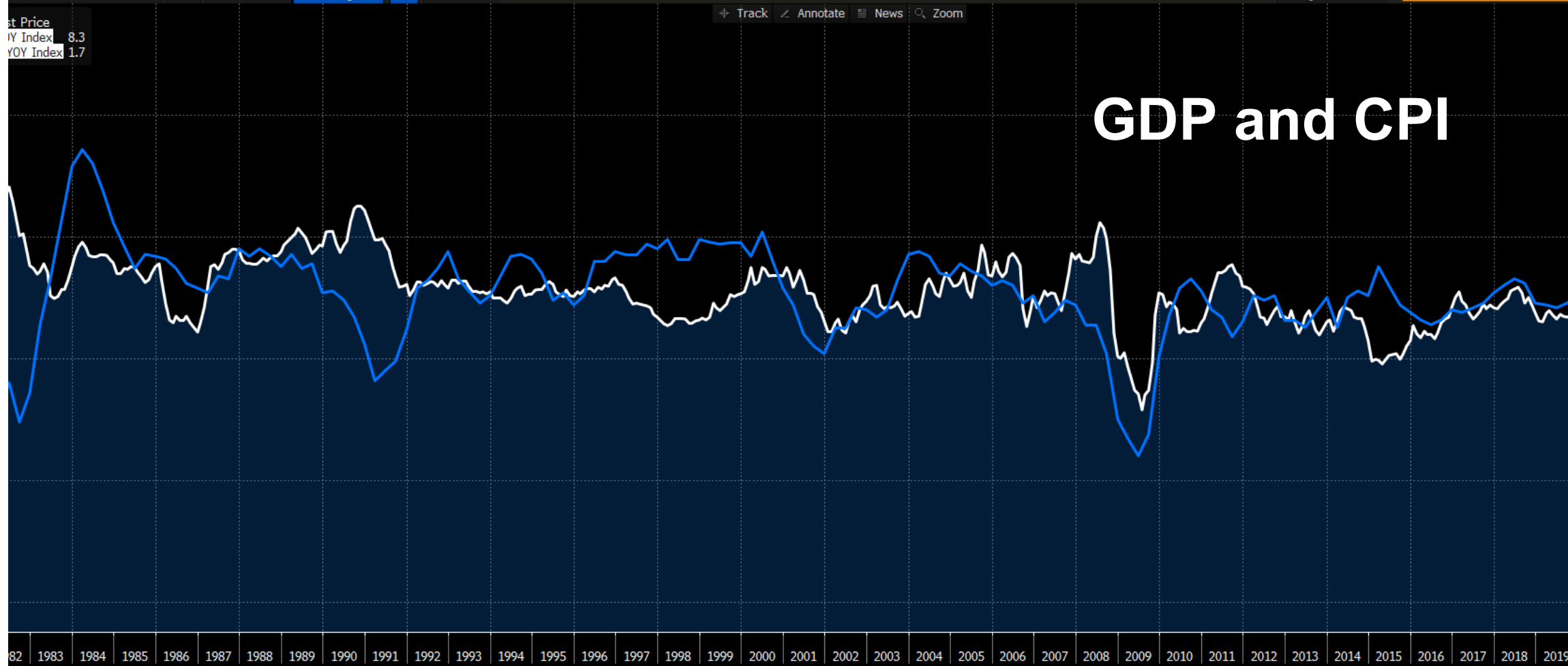
1D 1M 6M YTD 1Y 5Y Max Monthly Table

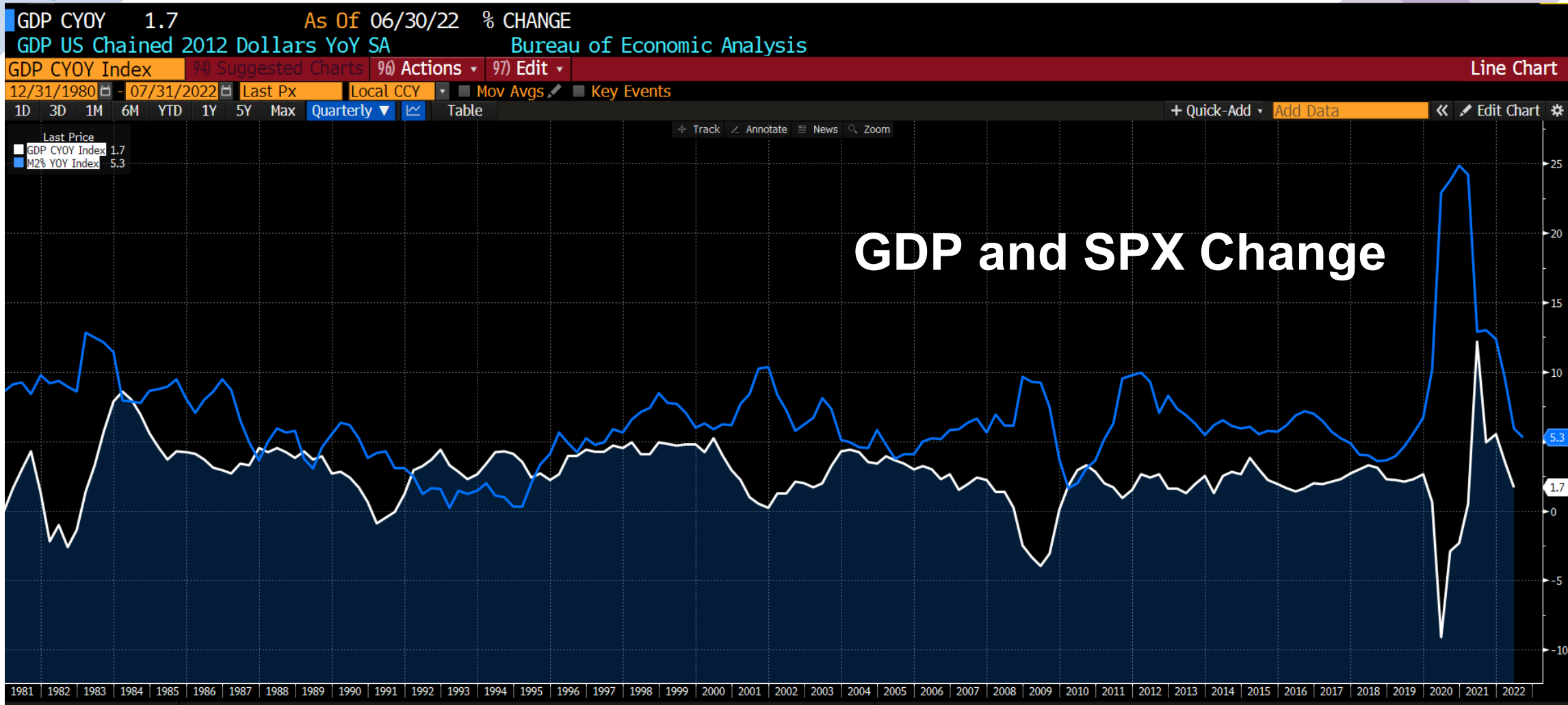
+ Quick-Add Add Data

Track Annotate News Zoom

st Price  
YOY Index 8.3  
YOY Index 1.7

# GDP and CPI

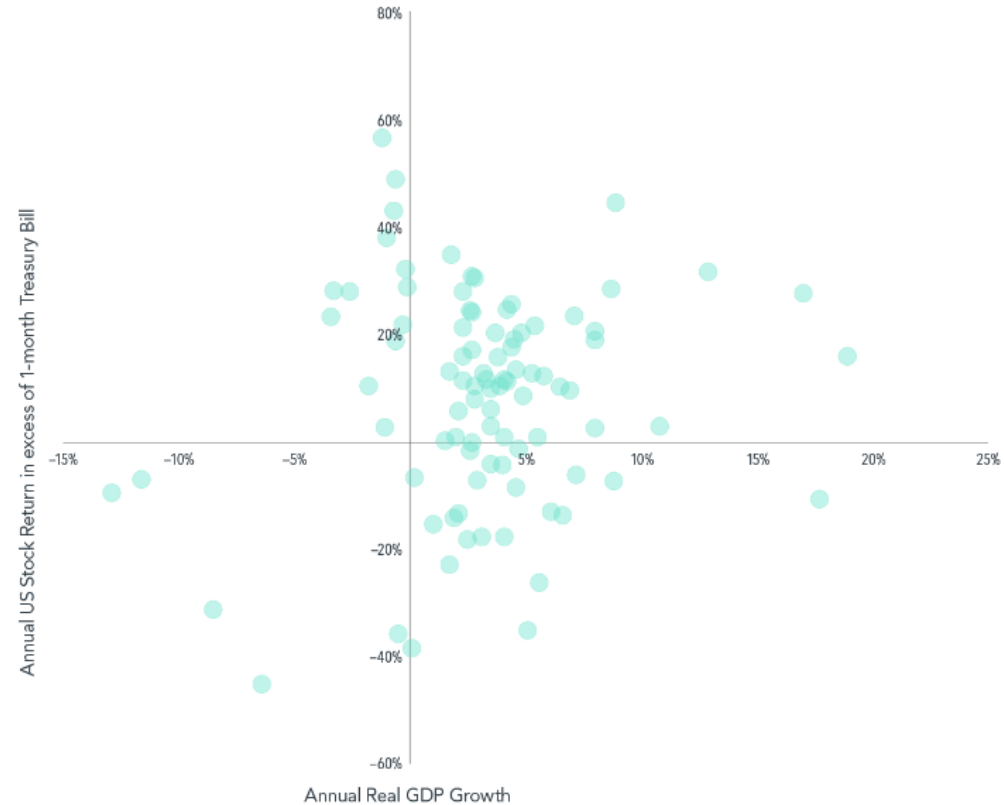






# GDP Growth and Real Market Returns

- The upper left quadrant illustrates all the various periods where annual **real GDP growth was negative while market returns were positive**.
- This is a great illustration of the **forward-looking nature of markets**. If you're worried, other investors are too.



Source: Dimensional Funds





## What are the Present Conditions?



Where is Inflation?



Where is the Political Environment?



How are Returns Measuring up?



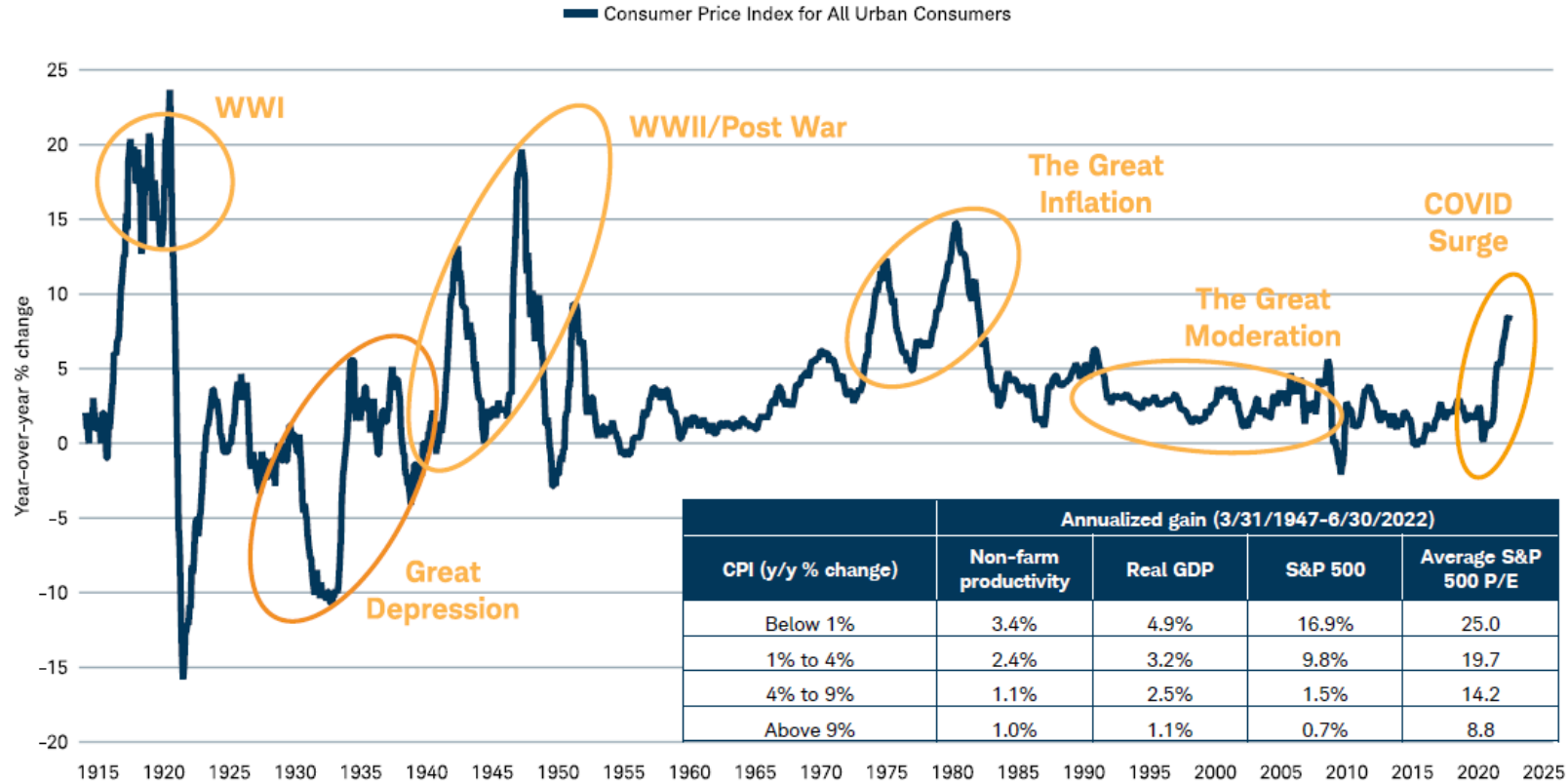
Recession? Shape? Stagflation?



Source: White House



# A Long-Term View of U.S. Inflation



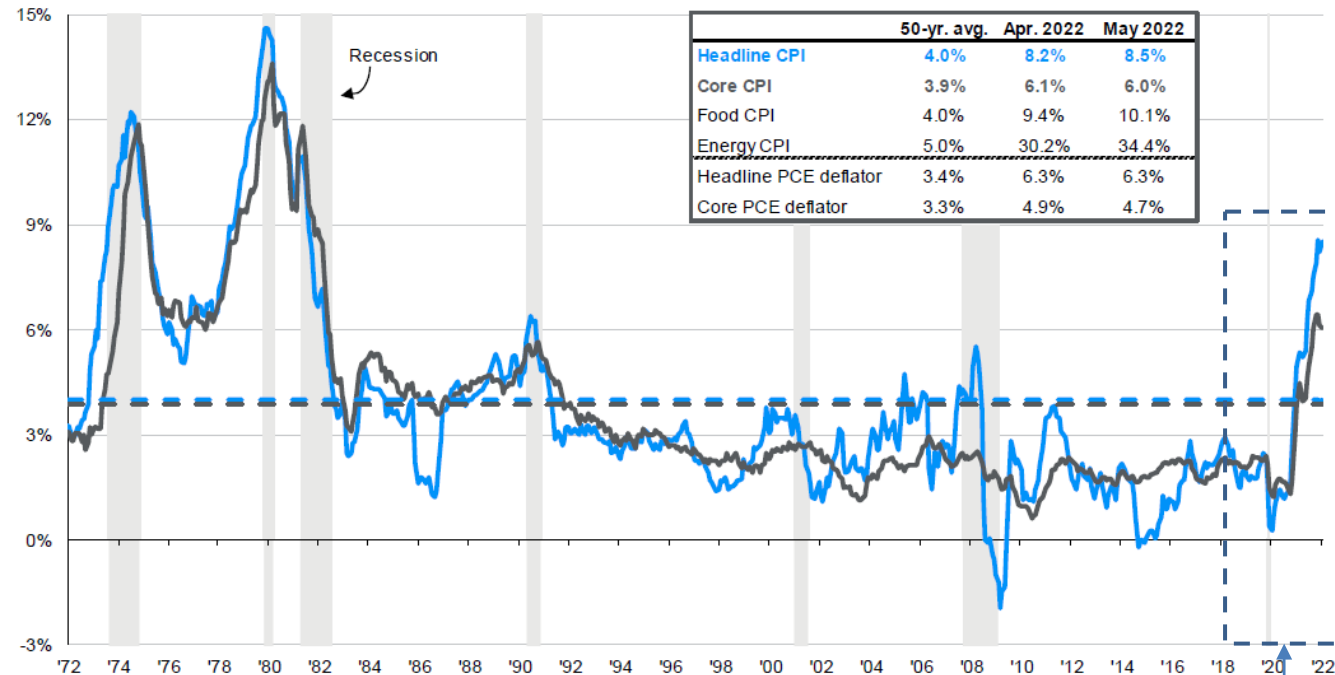
Historical inflation surges occurred during periods of significant social and economic events, such as global wars, depressions, and pandemics. Higher inflation has historically weighed on market returns and real economic growth.



# Inflation Spikes Most in Decades

## CPI and core CPI

% change vs. prior year, seasonally adjusted



Source: J.P. Morgan

## Recent CPI

April: 8.3%

May: 8.6%

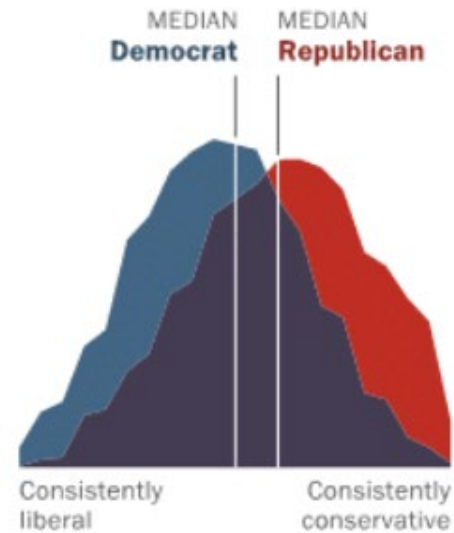
June: 9.1%

We have not seen this level of inflation since the 1980's. The Federal Reserve has the dual mandate of employment and price stability. Thus, as a result of near full employment and strong inflation, **the Fed will need to engage in monetary tightening.**

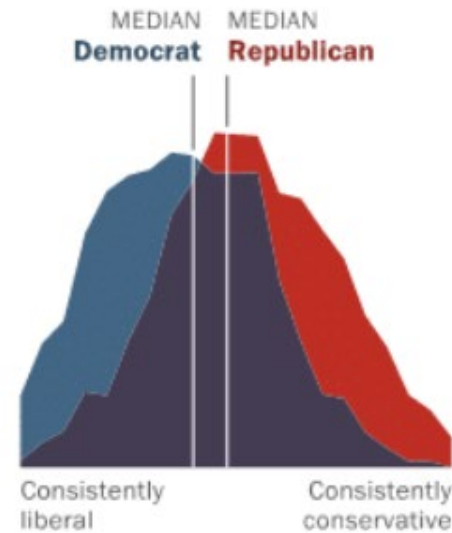
## Democrats and Republicans more ideologically divided than in the past

*Distribution of Democrats and Republicans on a 10-item scale of political values*

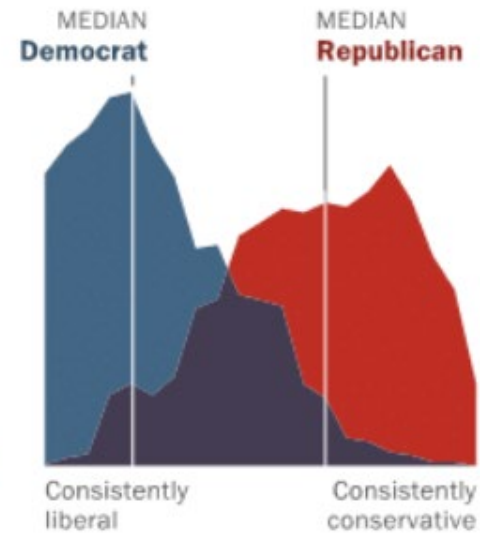
**1994**



**2004**



**2017**



Notes: Ideological consistency based on a scale of 10 political values questions (see methodology). The blue area in this chart represents the ideological distribution of Democrats and Democratic-leaning independents; the red area of Republicans and Republican-leaning independents. The overlap of these two distributions is shaded purple.

Source: Survey conducted June 8-18, 2017.

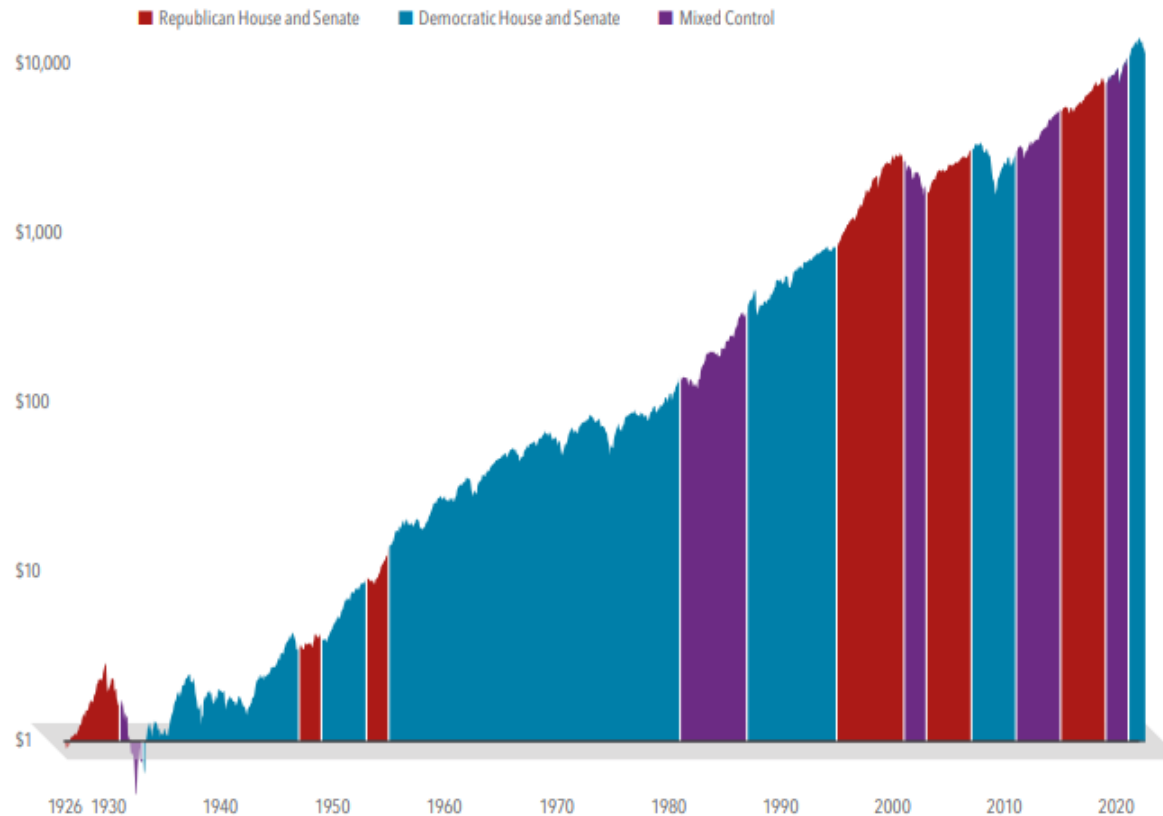
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# Market Performance and US Congress

HYPOTHETICAL GROWTH OF \$1 INVESTED IN S&P 500 INDEX  
January 1, 1926–June 30, 2022



Source: Dimensional Funds

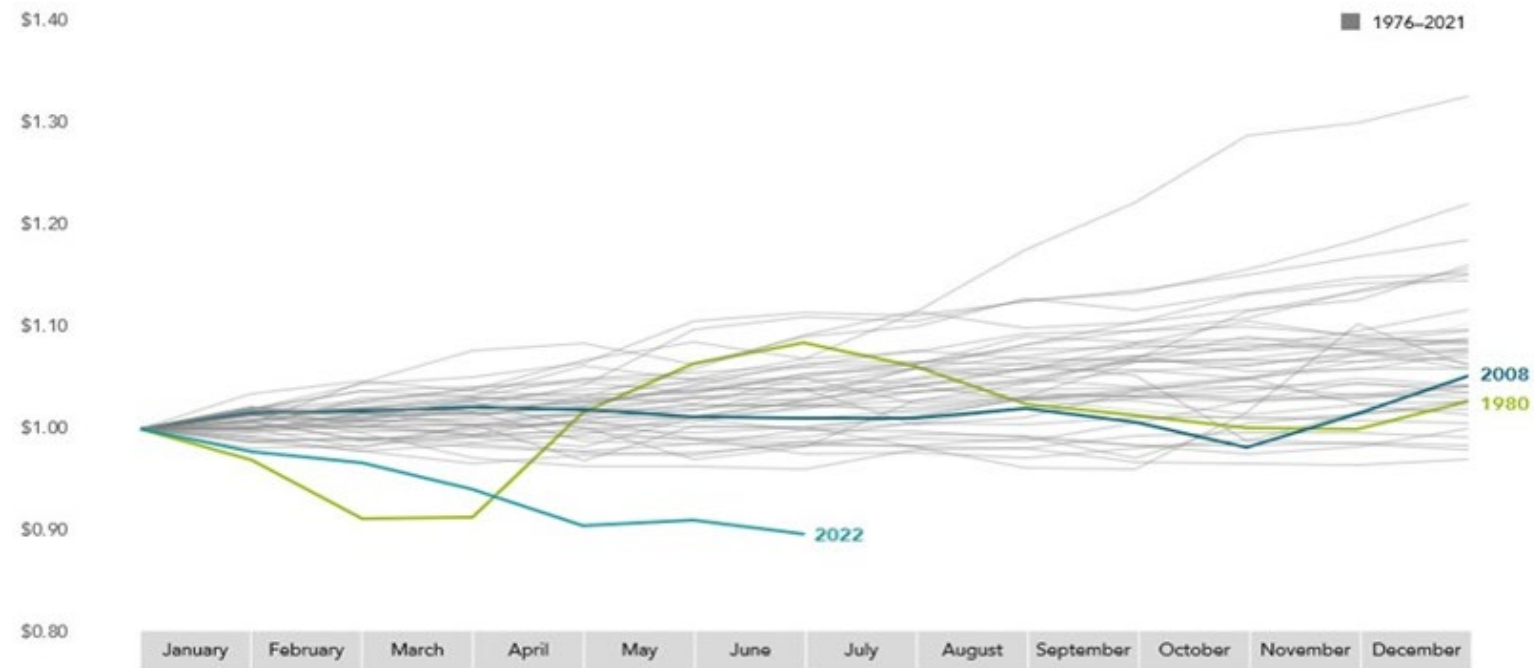
- A century of stock data shows that stocks have trended higher regardless of who was in power.
- Shareholders invest in companies, not political parties, that focus on growing their profits and serving customers.
- Actions by Congress of course do impact stocks, but the forecasted effect can often be ambiguous.



# Visualizing Annual Fixed Income Returns

## The Worst Start to a Year for Fixed Income on Record

Bloomberg US Aggregate Bond Index: Growth of Wealth



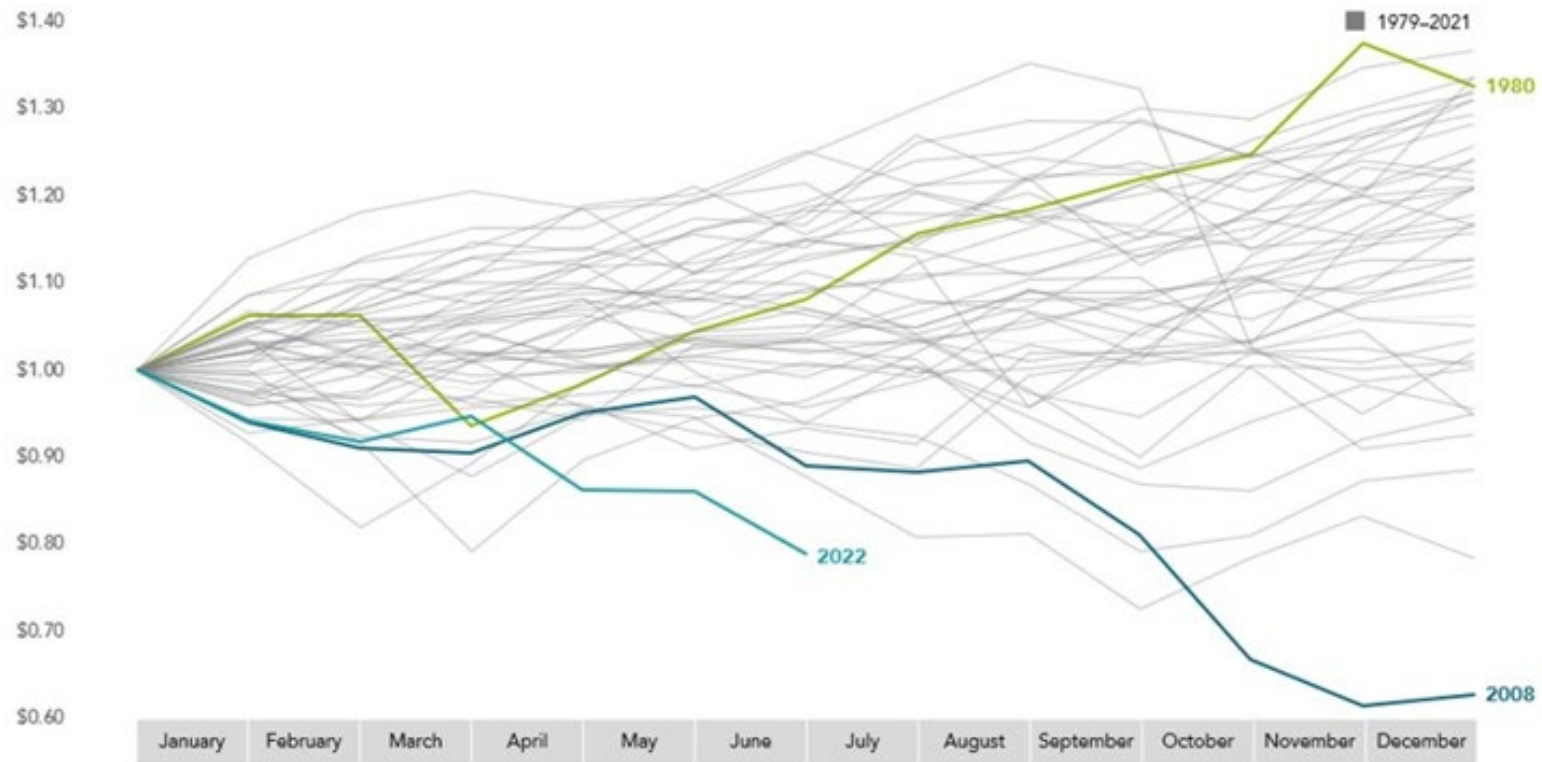
Source: Dimensional Funds



# Visualizing Annual Equity Returns

## Poor Performance to Start the Year in Equities

Russell 3000 Index: Growth of Wealth

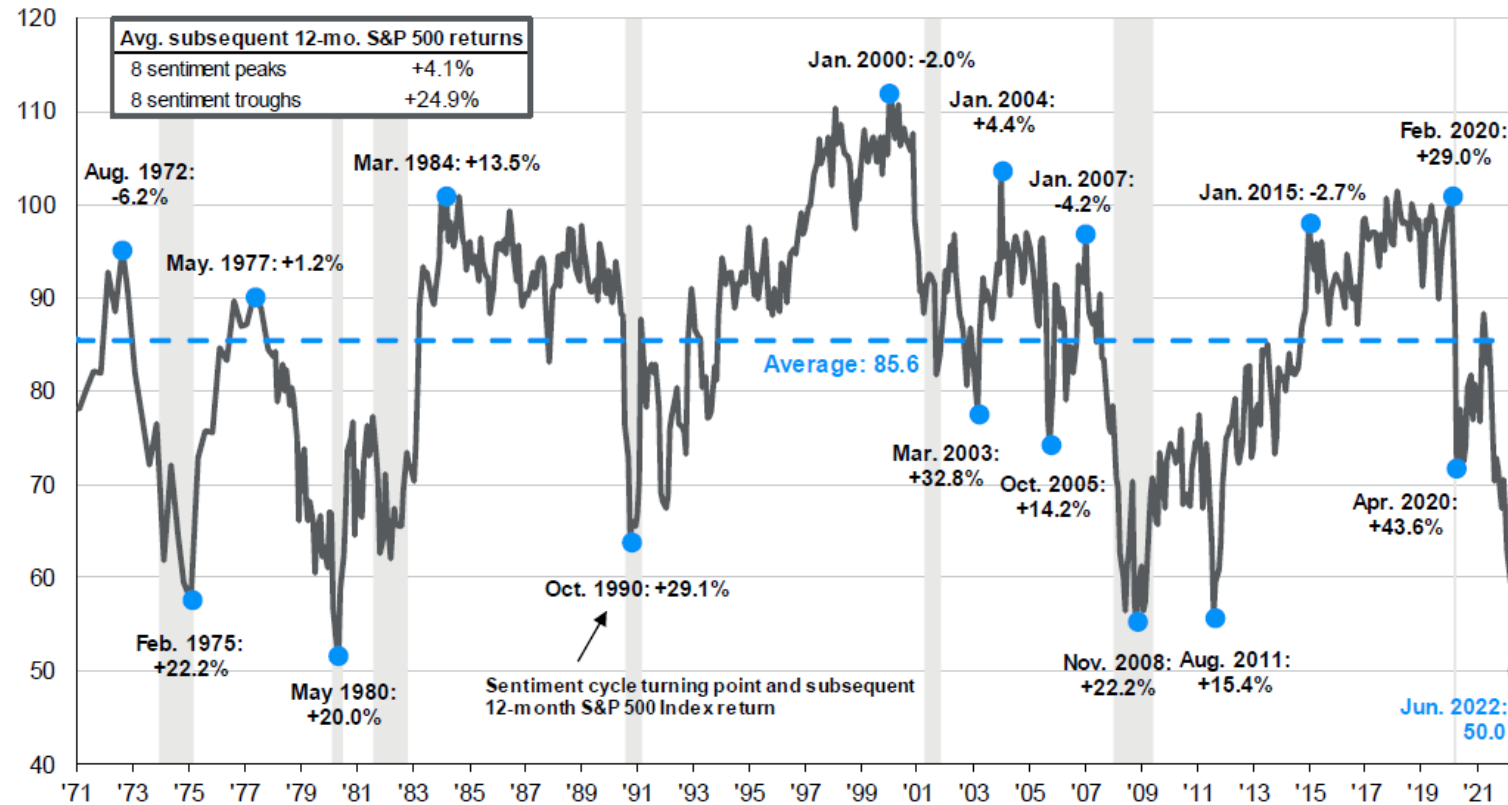


Source: Dimensional Funds



# Consumer Sentiment at Multi-Decade Lows

Consumer Sentiment Index and subsequent 12-month S&P 500 returns



Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.  
Peak is defined as the highest index value before a series of lower lows, while a trough is defined as the lowest index value before a series of higher highs. Subsequent 12-month S&P 500 returns are price returns only, which excludes dividends. Past performance is not a reliable indicator of current and future results.  
Guide to the Markets - U.S. Data are as of June 30, 2022.

Extreme bearishness can make a case for bullish returns as bad news gets priced in.

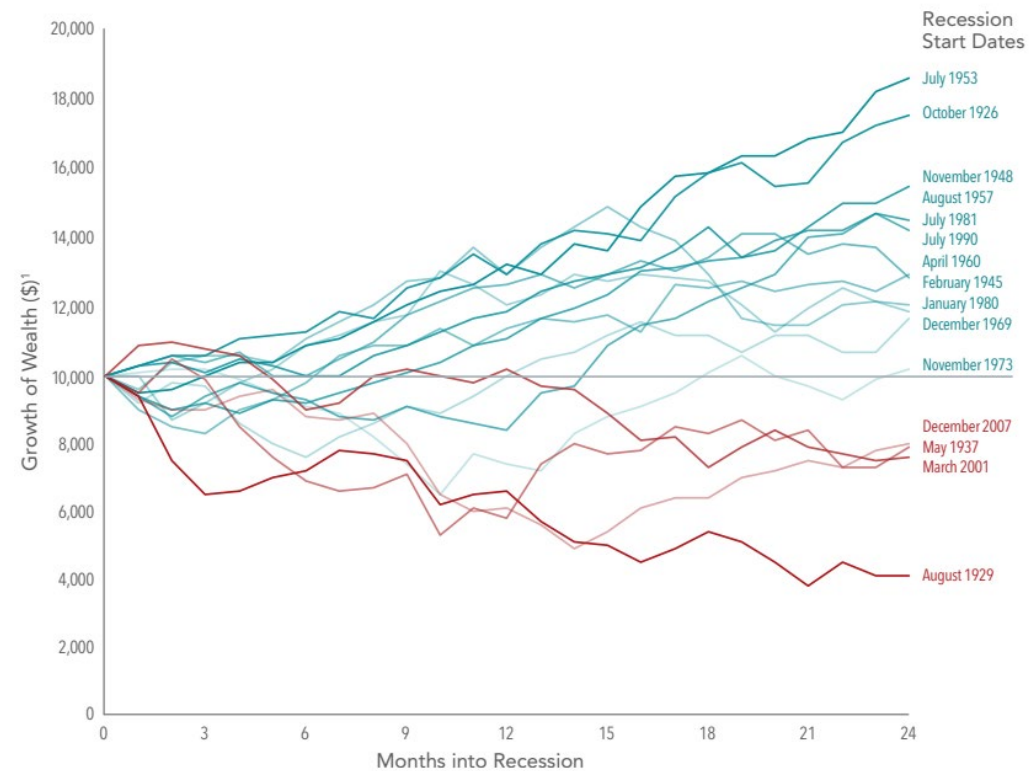




# Stock Markets Through A Century of Recessions

- Over the past century, there have been 15 recessions.
- In 11 of those 15 instances, stock returns were positive two years after the recession began.**
- Average annualized returns 2 years out? **7.8%**

PERFORMANCE OF A HYPOTHETICAL \$10,000  
INVESTED WHEN A US RECESSION BEGAN



Source: Dimensional Funds



# Stock Performance Around Recessions

## How Do Stocks Perform Around Recessions?

On average, stocks performed worse 1 year before a recession than during a recession. In the 2 years following a recession, price returns were positive 82% of the time.

Recession Start	Length (Years)	During Recession	6M Before	12M Before	6M After	12M After	2Y After
7/31/1953	0.83	18%	-6%	-3%	17%	30%	55%
8/31/1957	0.67	-4%	5%	-5%	18%	33%	25%
4/30/1960	0.83	17%	-5%	-6%	7%	10%	1%
12/31/1969	0.92	-5%	-6%	-11%	14%	8%	34%
11/30/1973	1.33	-13%	-9%	-18%	1%	23%	18%
1/31/1980	0.50	7%	10%	14%	6%	8%	-12%
7/31/1981	1.33	6%	1%	8%	-19%	20%	18%
7/31/1990	0.67	5%	8%	3%	3%	8%	20%
3/31/2001	0.67	-2%	-19%	-23%	-6%	-18%	-7%
12/31/2007	1.50	-37%	-2%	4%	21%	12%	44%
2/29/2020	0.17	-1%	1%	6%	12%	44%	?
Average Return		-1%	-2%	-3%	7%	16%	20%
% Positive Return Periods		45%	45%	45%	82%	91%	82%

Cumulative price return of the S&P 500 during past recessions. Past performance is not indicative of future returns.

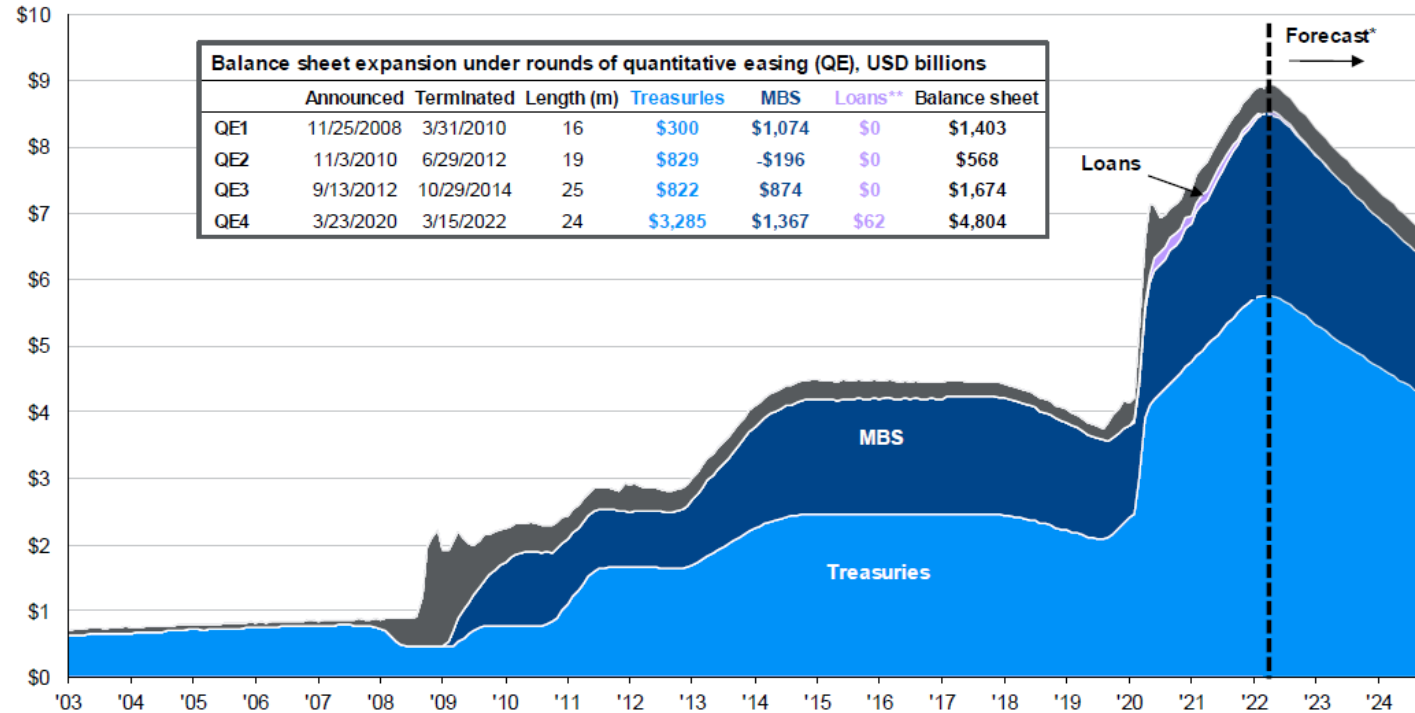
Table: Darrow Wealth Management • Source: YCharts; Nber • Created with Datawrapper



# Shrinking the Balance Sheet

## The Federal Reserve balance sheet

USD trillions



In addition to raising interest rates, the **Federal Reserve will engage in quantitative tightening (QT)**, a contractionary monetary policy tool to decrease the amount of liquidity in the markets.

**What are the implications of monetary tightening?**



# Monetary Tightening: A Fundamental Headwind

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## Fundamental Headwinds

- Discount rates increase for fundamental equity valuation
- Bonds mathematically reprice as interest rates rise
- Speculative behavior decreases as liquidity tightens
- Borrowing costs increase, which can impact default rates, high-yield spreads, and asset values across the entire capital structure

## Economic and Market Outlook

- **Normalizing interest rate policy is likely healthy for the economy long-term!**
- **Expect more market volatility as interest rates increase and liquidity tightens.**

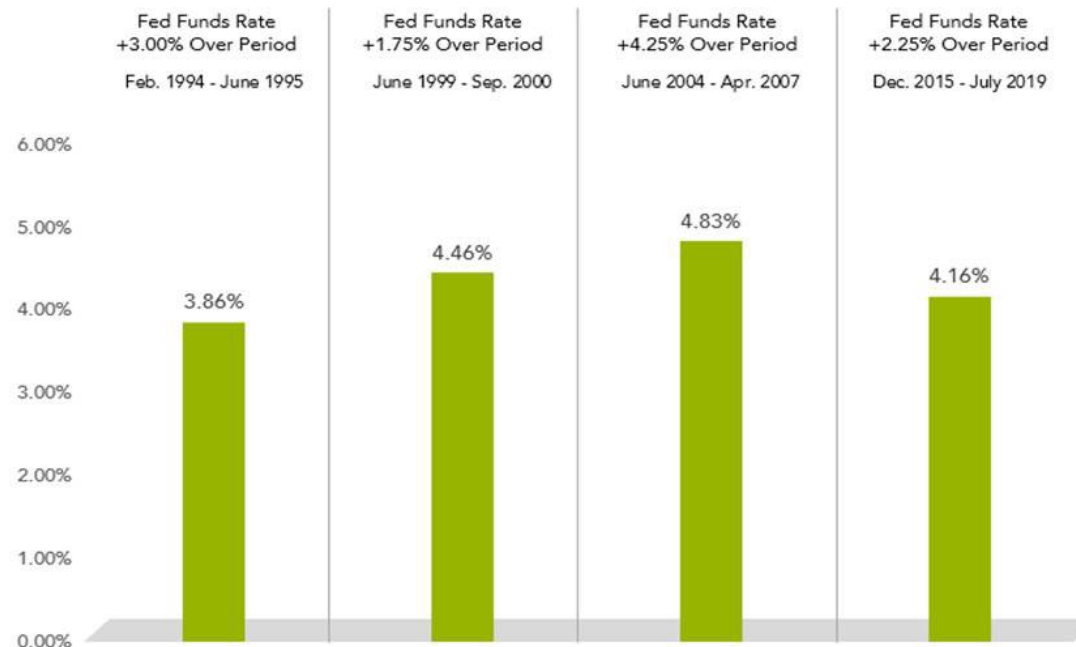


# Fed Rate Hikes Are Not a Bond Death Knell

Expectations in fixed income markets get priced in quickly. Over recent decades, we've **seen positive performance in periods of rising interest rates**. Bonds are the ballast of a portfolio, and with higher yields, they **remain the ballast of a portfolio with higher expected returns**.

## Annualized Returns During Rising Rate Periods

Bloomberg Global Aggregate Bond Index (hedged to USD)



Source: Dimensional Funds, Bloomberg

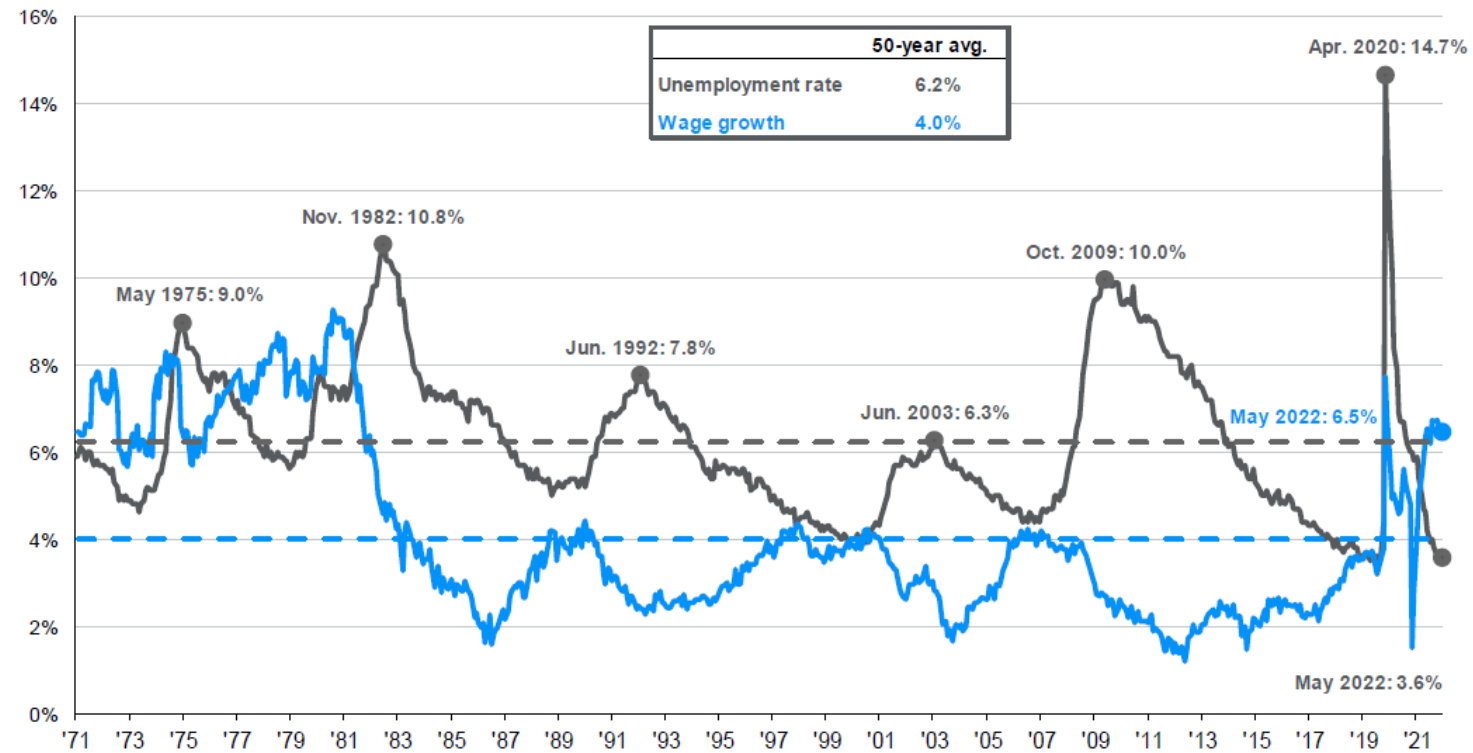


## Employment Remains Strong

The strength of the employment market and high inflation are driving tightening monetary and fiscal policy. In this inflationary environment, economic recovery and strong fundamentals can lead to market turbulence because they add inflationary pressure.

### Civilian unemployment rate and year-over-year wage growth

Private production and non-supervisory workers, seasonally adjusted, percent



Source: BLS, FactSet, J.P. Morgan Asset Management.  
Guide to the Markets – U.S. Data are as of June 30, 2022.





## What does the Future Hold?



Changing World Order?



China and Taiwan?



Crypto?



Central Bank?



Technology disruption?



Demographic/longevity risk?





## Thought exercises

1. What happens if Taiwan is invaded by China?
2. What shape will the next recession take?
3. What if Central banks ban crypto currencies?
4. What if Central banks enact crypto?
5. What happens when passive funds are more than 50% of all investments?
6. What alternate means are available for QT?
7. What is the prospect of longevity risk?
8. What major disruptive technology will be at the forefront in 5 years?
9. What happens in our profession in 5 years?



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