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"Meet the New Boss, Same as the Old Boss"
-The Who

The most overused quote in the investor playbook is "The four most dangerous words in the investment world are 'It's Different This Time.'" To be candid, I have a love/hate relationship with this quote. On one hand, it is always different this time, as markets evolve, innovations occur, and the opportunities for growth or potential for risk come from new sources in each cycle. No two economic cycles ever look the same nor do they end in the same manner.

On the other hand, every economic cycle has its moments where investors are prone to hype and hysteria. We will abstain from naming the guilty parties *cough* WeWork *cough* but the broken record of investors placing great trust in a 'visionary' founder, rather than trivial matters like positive cash flow, seems to occur in the latter stages of a cycle.

In essence, every period has its factors which have truly changed, and those that remain the same. Regarding the former, the financial crisis left lasting scars on the economy, and consumers have been slow to accumulate debt in the current expansion. In prior cycles, consumers quickly increased their spending and leverage.

However, during the current cycle, the consumer savings rate has remained high. The personal savings rate in the U.S. recently hit 8.3%, whereas before the end of the last cycle, in 2005, it was as low as 2.2%. Many cycles have ended simply because the consumer had gotten out over their skis, and taken on too much debt. That has not happened yet, which bodes well for future economic growth.

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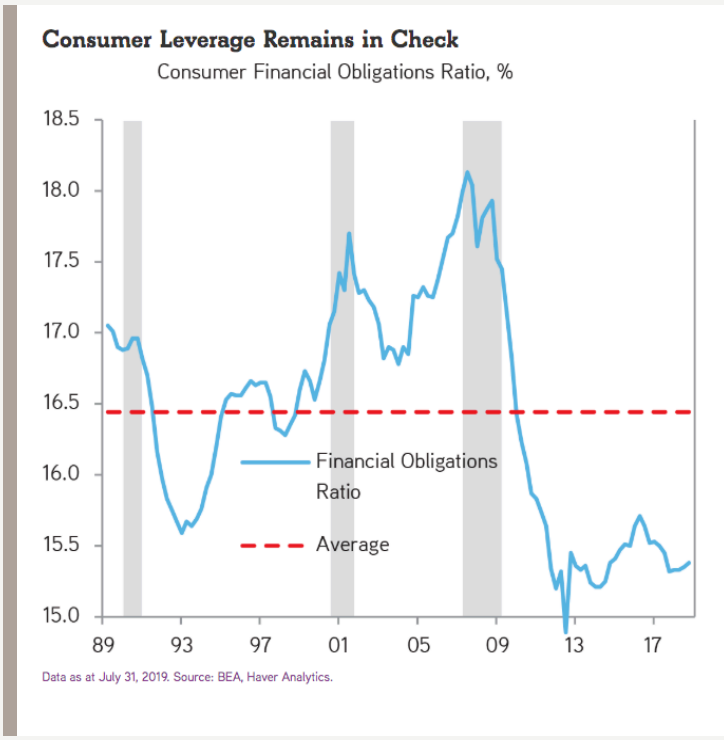

What remains the same is the massive role that interest costs play in the overall economy. You can see in this illustration to the right that financial obligations fell significantly during recessions, as high interest costs stifled spending. Then, as the Federal Reserved lowered interest rates in response to the growth slowdown, leverage picked back up. From 2013 to 2017, leverage in the U.S. increased, but has dropped over the last two years. This coincided with interest rates being at zero, and not truly starting to move higher until 2017 and 2018. As rates moved higher, consumers reduced the amount of debt they had taken on.

This brings us to present. The Federal Reserve has cut rates from 2.5% to 1.75% over the course of the last year. The move is small from a historical perspective (compared to the loan sharkish rates of 14% in '80's), but has significant implications for the future of the economy. Until inflation picks up meaningfully, which may be awhile due to the shale boom in the U.S. and limited catalysts for accelerating economic growth, the Federal Reserve is not likely to raise rates. If the Fed is not going to raise rates, debt costs will remain low. Corporations will continue to borrow money to buyback shares or fund mergers, and consumers can refinance their mortgages at incredibly low levels or take out 60 month auto loans for 0.0%. Lastly, it is important to note that stocks with growing dividend yields of 2.0% to 3.0% contine to look attractive relative to bond yields of 0.0% to 2.0%.

Political volatility in the U.S. (higher taxes, greater regulation) and globally (trade wars, Brexit, and tariffs) remain headwinds to further stock market appreciation. We continue to believe incorporating some more defensive measures into client portfolios should help protect against volatility. However, our dependence on credit remaining available and interest costs remaining low is the new boss, same as the old boss, and should continue to support growth in the U.S.

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All data via the Federal Reserve and KKR