Insights and Observations: Third Quarter 2023

The U.S. national debt now stands at $33 trillion, or 120% of gross domestic product (GDP). The federal budget deficit for the fiscal year that just ended is projected to be $1.7 trillion, or about $13,500 for every U.S. household.

The *rate of population growth plus inflation* in the U.S. increased by 21.6% over the ten years ended 2022. Total annual federal spending increased 69.4% over that same period … or more than three times faster.

If federal spending had been limited to *the rate of population growth plus inflation* during that decade, the federal government would have spent $1.6 trillion less than it did in 2022, which would have resulted in a budget surplus of $200 billion.

> **If the federal government had limited spending to "the rate of population growth plus inflation" over the past two decades, the national debt would have increased by less than $500 billion instead of $19 trillion.**
>
> **Norquist/Ginn – WSJ 10/3/23**

With interest rates on the rise, interest payments on federal debt are up 30% from last year alone. Net interest payments this coming fiscal year are projected to be $745 billion, according to Congressional Budget Office projections. It's hard to imagine, but debt payments are now roughly the equivalent of the entire U.S. national defense budget.

Morningstar just released its annual "Mind the Gap" study. The study found that investors lost out on about one-fifth of fund performance as a result of the timing of purchases and sales.

The average fund returned about 7.7% annually over the 10 calendar years ended 2022. The average investor, however, earned only 6% over the same period. The difference of 1.7% suggests that timing costs are a persistent drag on performance.

One of the clearer takeaways from the study is that investors are more likely to mistime their investments in highly volatile funds than they are in less-volatile funds.

The use of allocation funds also helps mitigate mistakes that investors are prone to, such as buying more of a high-performing stand-alone strategy and selling a lagging one when they should be doing the opposite.

Jeffrey Ptak, Morningstar Research – Financial Advisor 9/23

According to the Department of Housing and Urban Development, older adults are the fastest-growing segment of the homeless population. Federal data shows that people 55 and older made up 16.3% of the sheltered homeless population in 2018 and 19.8% in 2021.

In some way the statistics make sense, because the supersize baby boomer generation is now old. But other factors are making the elderly increasingly vulnerable to homelessness:

- High housing costs are especially hard for seniors living only on Social Security.
- Low-cost living centers do not have the capacity to handle the larger baby-boom generation.
- Society's dispersal of families equates to less support for older parents and grandparents.
- The second half of the baby boom generation came of age during back-to-back economic downturns, and many worked jobs that stopped offering pensions.

The fact that we are seeing elderly homelessness is something that we have not seen since the Great Depression.

Dennis Culhane, University of Pennsylvania – WSJ 9/12/23

Troubles in the commercial real-estate market are being fueled by a combination of rising interest rates and high vacancy rates. From 2015 to 2022, banks doubled their direct lending to commercial real-estate projects. Total *direct* bank exposure is estimated at around $2.2 trillion, with small and medium-size banks originating most of the loans.

> **With the commercial real-estate market now in meltdown, those trillions of dollars in loans and investments are a looming threat for the banking industry. The banks are in danger of setting off a doom-loop scenario where losses on the loans trigger banks to cut lending, which leads to further drops in property prices and yet more losses.**
>
> **Shifflett/Putzier – WSJ 9/6/23**

Banks have also lent money to financial companies that make loans to some of those same projects. According to a Wall Street Journal analysis, that brings total bank exposure to $3.6 trillion … the equivalent of about 20% of their deposits.

The volume of commercial property sales was down 74% in July from a year earlier. Sales of downtown office buildings hit the lowest level in two decades, according to data provider MSCI Real Assets.

When deals begin again, they will be at far lower prices, which will shock banks. It's going to be really nasty.

Michael Comparato, Benefit Street Partners – WSJ 9/6/23

According to the Census Bureau, median household income adjusted for inflation declined last year by $1,750 to $74,580, and it is off $3,650 from 2019. For households in the fourth income quintile (incomes from $94,000 to $153,000), they saw their purchasing power decline by $4,600 in 2022 and $6,700 since 2019.

Middle-class Americans who think they're losing ground are right.

The Editorial Board – WSJ 9/13/23

Inequality actually declined last year, as higher earners saw a bigger drop in real incomes than Americans at lower income levels … a result generally attributed to the fact that Social Security checks are adjusted for inflation.

The International Monetary Fund expects capital spending and productivity growth will be the biggest drivers of India's future economic growth.

India, long known for deteriorating and inefficient infrastructure, is planning to spend more than 10 trillion rupees, or about $120 billion, for capital expenditures in the fiscal year ending March 2024, according to India's Finance Ministry. That amount is 37% higher than the previous year and double the amount spend just five years ago.

At the close of the last fiscal year, India had about 90,000 miles of national highways, according to the Ministry of Road Transport and Highways. That is almost double the more than 49,000 miles it had just a decade ago. Also, India now has more miles of electrified railway than the U.K. or France, according to the Organization for Economic Cooperation and Development.

Is India's infrastructure tangibly better? The answer is yes. Is it good enough for the kind of aspirations India has? Then the answer is no. It is still a work in progress.

Arup Raha, Oxford Economics – WSJ 9/11/23

As most countries develop, more women enter the workforce, which further fuels economic growth. For example, the U.S. saw the percentage of women (age 15 and up) who are working or actively looking for work, grow from 32% in 1948 to 59% by 2000.

India, which is now the fifth largest economy in the world, had its female labor-force participation rate peak at 31% in 2000 … last year it was just 24%. That rate is among the 12 lowest in the world, a list which includes Afghanistan and Saudi Arabia.

> **India's failure to bring more women into the labor force is complicating its ambition to capitalize on its youthful demographics as Western companies look for alternatives to China for manufacturing.**
>
> **Li/Agarwal – WSJ 8/18/23**

According to the Centre for Monitoring Indian Economy (a Mumbai think tank), only 38 million women were paid for employment in India last year, compared with 368 million men. Economists blame India's weak job creation, as well as a deeply conservative culture which believes a woman's place is in the home.

According to Costar Group, the average U.S. office lease size was 3,275 square feet in the second quarter, or 19% less than the average lease size between 2015 and 2019. The U.S. vacancy rate was 9.5% prepandemic. Now it is 13.2% and is expected to reach 17% in 2026.

Shrinking lease sizes are another blow to office owners during one of the industry's worst slumps since World War II. That slump is hurting cities, wiping out billions of dollars in property values and putting pressure on the shaky banking system.

Peter Grant – WSJ 8/22/23

Many businesses are reducing their space requirements because of hybrid workplace polices. The number of companies requiring workers to be in the office full time has declined to 39% from 49% at the beginning of the year. That trend is expected to continue, as newer companies tend to embrace flexible work practices.

As older companies age out, and newer companies come in and offer more flexibility, I think you're going to end up with only 15% of companies full time in the office.

Robert Sadow, Scoop Technologies – WSJ 8/22/23

China's economic struggles are similar to Japan's economic stagnation in the 1990s. But in some ways, China's problems are more troubling. For example, China's public debt levels are higher and its demographics are worse. In addition, geopolitical tensions between China and the U.S. are higher than previous trade frictions with Japan.

China today and Japan 30 years ago share many similarities, including high debt levels, and aging population and signs of deflation.

None of this means China is sure to repeat the years of economic stagnation that Japan is only now showing signs of exiting. Even so, economists say the parallels are a warning sign for Communist Party leaders in Beijing.

Stella Yifan Xie – WSJ 9/17/23

Japan was once considered an export powerhouse, but its real estate and stock market bubbles burst as the economy went off the rails and growth failed to rebound. China is currently in the middle of a real estate bust, and its stock market is on the decline.

China's total public debt reached 95% of GDP in 2022, compared to 62% of GDP for Japan in 1991, according to J.P. Morgan. China's per capita income was $12,850 in 2022, while Japan's was $29,080 in 1991. So, with China's population aging at a faster pace, weaker long-term growth will put the country at risk of *getting old before it gets rich*.

Daniel G. Corrigan, CPA/PFS, CFP®