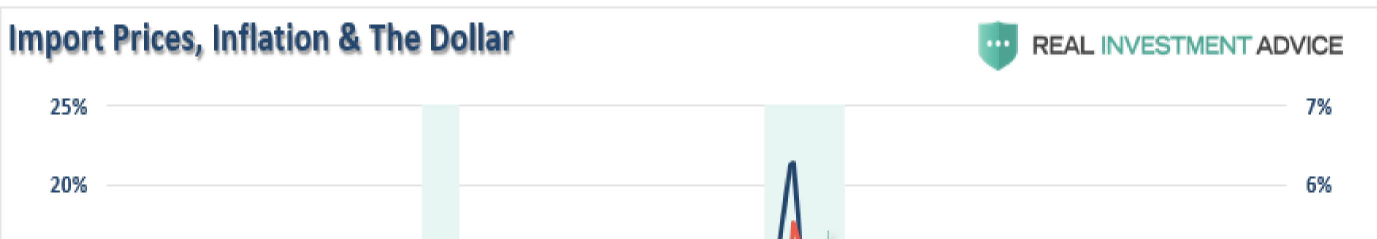
One of the worst possible outcomes for the U.S. economy, and ultimately for investors, is stagflation. Of course, if you weren't around in the 60-70's, there is a reasonably high probability you are not even sure what *"stagflation"* is. Here is the technical definition:

> *"**stagflation** - persistent high inflation combined with high unemployment and stagnant demand in a country's economy."*

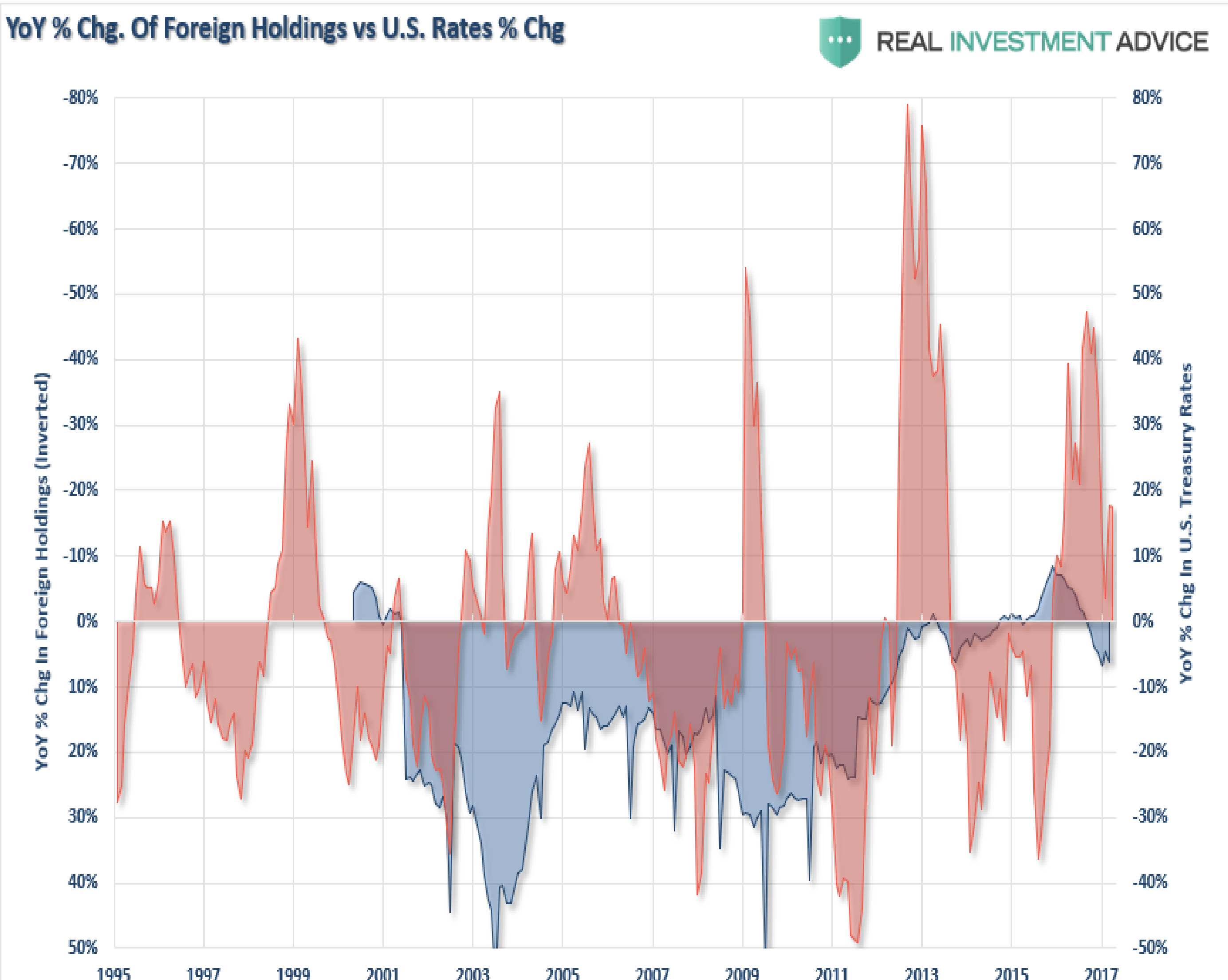
How can that happen?•Exactly in the way you are witnessing now. While the current Administration is keen on equalizing trade through tariffs, trade deals, and trade deficit reduction, they have also embarked on a deficit expanding spending spree which has deleterious long-term effects on economic growth. At the same time, the administration is attacking our major trading partners, particularly China, leading to a push to shift away from the U.S. dollar as a reserve currency.



What does all that mean? Here is the problem with the current trajectory.

- *A weaker dollar leads to higher commodity prices creating cost-push inflation.*
- *As fears of inflation infiltrate the markets, interest rates increase which raises borrowing costs.*
- *As the dollar weakens, commodity prices rise increasing input cost to manufactures.*
- *Higher input costs, borrowing costs, and weaker profits ultimately force corporations to suppress wage growth to protect profits.*
- *As wage growth is suppressed, particularly with a heavily indebted consumer, demand falls as higher costs, both product and borrowing costs, cannot be compensated for.*
- *As demand falls, companies react by reducing the highest costs to their bottom lines: wages and employment.*
- *As profits come under pressure, stock prices fall which negatively impacts the "wealth effect"•further curtailing consumptive demand.*
- *As the economy slumps into recession, unemployment rise sharply, demand falls, and interest rates decline sharply.•*

As I discussed just recently, the bottom 80% of U.S. households are heavily indebted with no wage growth to offset the rising costs in *"non-discretionary"* spending requirements of***rent, utilities, food and healthcare and debt payments.*** However, **as the dollar weakens, the input costs to manufacturers rise** leading to concerns of inflationary pressures which pushes interest rates higher. The biggest risk to the markets, and investors, is both the current Administrations trade policies, particularly as it relates to China, and the reduction of the Federal Reserve's balance sheet. Combined, these two represent the largest buyers of U.S. Treasuries which is most inopportune at a time where the fiscal deficit is set to swell creating a surge in U.S. debt issuance. *(The chart below is the annual rate of change of foreign holdings of U.S. Treasuries versus the annual change in interest rates.)*



Furthermore, this is all occurring at a time when global liquidity is being withdrawn.

> ***"The removal of global policy stimulus has naturally come about as the world economy finally managed a couple of quarters of synchronised growth in 2017. But our view is that this growth is tenuous and very late-cycle, particularly in China and the US, as the credit cycle has already turned. And the next challenges for markets are just around the corner."***

While much of the mainstream media continues to promote expectations of a global resurgence in economic growth, there is currently scant evidence of such being the case. **Since economic growth is roughly 70% dependent on consumption, then population, wage, and consumer debt growth become key inputs into that equation.** Unfortunately, with real wage growth stagnant for the bottom 80%, demographics running in reverse, and consumers extremely leveraged, a sustained surge in economic growth to offset higher interest rates becomes unlikely. So, to summarize, we have a depreciating dollar policy from the White House, which is inflationary, with the Fed and foreign purchasers of our bonds not keeping pace with burgeoning deficits. With inflation, not generated by economic growth but by a weak dollar instead, pushes interest rates higher, the combination is a deadly one-two punch for the economy. This is an outcome to which the market is currently ill-prepared for. Just something to think about as you catch up on your weekend reading list.

Economy & Fed

- **This Is Not Your Father's Economy** by Caroline Baum via MarketWatch
- **Say Goodbye To The Old Tax Code** by Kevin Brady via USA Today
- **Trump Tax Cuts Still Unpopular** by Eric Levitz via New York Magazine
- **Analysis Of CBO's 2018 Budget Outlook** by Committee For A Responsible Federal Budget
- **Trump Inherited Trillion Dollar Deficits** by Stephen Moore via Washington Times
- **Both Parties Have A Plan For The Debt: Do Nothing** by Robert Samuelson via Washington Post
- **After Failed Tax Cutting, GOP Looks For New Deal** by Geoffrey Kabaservice vai NYT
- **The Tax Cut Is Just A Financial Engineering Game** by Macromon via Global Macro Monitor
- **Deficit: The GOP Has Been Playing Us For Suckers** by Stan Collender via Forbes

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Markets

- **IMF Sounds Alarm On Global Debt** by Tyler Durden via ZeroHedge
- **Uncharted Territory For Stock Valuations** by Bryce Coward via Knowledge Leaders
- **On Big Market Tops** by Sven Henrich via Northman Trader
- **Oil Prices Haven't Peaked Yet** by Simon Constable via US News
- **The Yield Curve Knows Best** by Kevin Muir via The Macro Tourist
- **Saxo Bank: The End Of A Cycle** by Mike Mish Shedlock via MishTalk
- **Bond Bears Still Bet On Higher Rates** by Sunny Oh via MarketWatch
- **How Long Will The Momentum Party Last** by James Picerno via Capital Spectator
- **When Failing To Prepare Is Preparing To Fail** by Tad Rivelle via Trust Co Of The West
- **S&P500 Faces Tougher Growth Comps In 2018** by Michael Cannivet via Forbes
- **The Bullish & Bearish Case For Oil** by Nick Cunningham via OilPrice.com

Most Read On RIA

- **Selling The 200-DMA** by Lance Roberts
- **Triffin Warned Us** by Michael Lebowitz
- **How Libor's Surge Will Help Pop The Global Bubble** by Jesse Colombo
- **The Risk To Markets - Global Growth** by Lance Roberts
- **Market Is Underpricing Risk...Again** by Doug Kass

Research•/ Interesting•Reads

- **Junk Bond Market Still In Denial•**by Wolf Richter via Wolf Street
- **US Pension Fund Collapse No Longer A Distant Prospect** by Aaron Brown via Bloomberg
- **Win The Game By Understanding Risk & Players•**by Johnny Kampis via American Spectator
- **Some Things I Am Pretty Sure About•**by Morgan Housel via Collaborative Fund
- **The Global Recovery Levels Off As Vulnerability Rises•**by Brookings Institute
- **In The Land Of Lost•**by Nick Maggiulli via Dollars and Data
- **Four Flash Points Of Volatility** by Nomi Prins via The Daily Reckoning
- **Stocks Are Spinning Their Wheels•**by Dana Lyons via The Lyons Share
- **Heading For Another Minsky Moment•**by•Jesse Felder via The Felder Report

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> ***?The trick of successful investors is to sell when they want to, not when they have to." -*** *Seth Klarman*

Questions, comments, suggestions ? please email me.