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The GOP unveiled its version of the next COVID relief bill. The Democrats hate it. Is that a problem?

You bet it is. These two warring factions, each catering to the extreme forces within their party, will have a hard time agreeing on anything, and that is not good for the economy, and potentially, markets. Without new legislation, much of the fiscal stimulus designed to reduce the economic impact of COVID will expire.

Although there is a lot covered in each version, the main battleground appears to be the 'extra' $600 in unemployment checks, which ends July 31. The Democrats want to extend those payments until January 2021, the Republicans want to reduce it and then replace it with a payment equal to 70% of the lost wages. (See table below.) The primary disagreement is based on the fact that many workers were receiving unemployment benefits in excess of what they were earning when they were working. The GOP premise is that extending this payment is a disincentive to go back to work, although most economists are generally not as concerned. The bigger issue is that 30+ million people out of work creates an 'income gap' Without incomes, the economy cannot function so any method that allows the government to temporarily fill that gap (fiscal stimulus) will keep the economy on a more reasonable trajectory.

Source: Zerohedge

We believe another important feature that is getting much less attention is the liability protection contained in the GOP proposal. It will be very difficult for any schools to re-open if there is an open-ended liability for COVID related damages.

We believe that Congress will reach a deal, but as of Friday evening, no agreement has been reached, so as of this moment, the fiscal stimulus has been reduced. A fairly quick compromise will cause little disruption, but if the stalemate drags on, it will have negative implications for economic growth and presumably for markets as well. – Stay Tuned!

Below, is a summary of each proposal (From CNET.com) and how they compare with the original CARES Act, signed into law on March 27 of this year.

CARES VS HEROES VS HEALS ACTS: WHAT'S THE DIFFERENCE?

	CARES Act	Heroes Act	HEALS Act
Total cost of stimulus package	$2.2 trillion	$3 trillion	$1 trillion
Stimulus check maximum payment amount	$1,200 to single filers earning under $75k per year, $2,400 for joint filers under $125k. Reduced $5 per $100 of income above limits.	Same as CARES.	Same as CARES.
How much stimulus money you get for dependents	$500 for all dependents 16 and under. College students 24 and under are not eligible.	$1,200 for dependents, maximum of three.	$500 for all dependents, no age limit.
Enhanced unemployment benefit	$600 per week in addition to state benefits.	Same as CARES.	Initially $200 per week. Then up to $500 per week to match 70% of lost wages when added to state benefits.
How long enhanced unemployment lasts	Expires July 31.	January 2021 for most workers, through March 2021 for gig workers, independent contractors, part-time workers and self-employed.	$200 per week bonus through September. Then 70% matching of lost wages. Extends expiration of federal benefits until Dec. 31.
Paycheck Protection Program	Allocated $659 billion total in forgivable loans for small businesses, who must use 75% on payroll to be eligible for forgiveness. $130 billion remains, but expires Aug. 8.	Expands eligibility, eliminates 75% payroll requirement and extends application period to Dec. 31.	Injects another $190 billion into the PPP fund, expands eligibility and allows businesses to request a second loan. Eliminates 75% payroll requirement and expands approved uses of funds for loan forgiveness.
Employee tax credit	Tax credit on 50% of up to $10,000 in wages.	Increases tax credit to 80% of up to $15,000 in wages.	Increases tax credit to 65% of up to $30,000.
Bonus for employees who start new jobs or are rehired	Does not address.	Does not address.	There could be a return-to-work bonus of up to $450 per week for unemployed workers who secure a new job or are rehired.
Eviction protections and moratorium	Bans late fees until July 25 and evictions until Aug. 24 on properties backed by federal mortgage programs (Fannie Mae, etc.) or that receive federal funds (HUD, etc.)	Expands to cover nearly all rental properties in the US, extends eviction moratorium an additional 12 months, allocates $200 billion for housing programs and another $100 billion for rental assistance.	Does not address.
School reopening	Does not address.	$58 billion for grades K-12, $42 billion for higher education.	$70 billion to K-12 that open for in-person classes, $29 billion for higher education, $1 billion to Bureau of Indian Education, $5 billion state discretion.
Liability protection from coronavirus illness	Does not address.	Does not address.	5 year liability shield to prevent schools, businesses, hospitals, from being sued over coronavirus related issues.
Coronavirus Testing	Does not address.	Does not address.	$16 billion.

Source: CNET.com

Gold is Up; The Dollar is Down; Are These Two Sides of the Same Coin?

The quick answer is 'Sometimes', but right now, this appears to be true.

The reason the answer is sometimes is that gold has various uses. Sometimes it is a commodity and sometimes it is money. If other currencies are stable, gold will tend to act independently like a commodity. However, when there is concern about the stability of currencies, especially the dollar, gold acts more like a currency, it becomes more 'money-like', and there are reasons why this could be the case today.

If gold is currently acting as money, it is important to understand the functions of money, which most of us rarely think about. The three core functions of money are:

1. **Money is a Unit of Account** - You can think of money as a yardstick - the device we use to measure value in economic transactions. It enables us to compare the value of bicycle versus a refrigerator, as an example.
2. **Money is a Medium of Exchange** – Money is widely accepted as a method of payment for goods or services.
3. **Money is a Store of Value** – If I earn $25 today, I can hold onto it and spend it next week, next month, or even next year with little, if any, degradation in value.

Paper money, dollars, are well suited to fulfill the first two functions. It is this last function that is being affected by the sudden economic collapse that has occurred in response to the COVID pandemic. Let's examine this further.

We recently listened to an interview with Bob Prince, the co-CIO of Bridgewater Associates, one of the largest hedge funds in the world. The interview was of note largely because he was able to condense this very complex situation into simpler terms. We thought it would be worthwhile to condense it a bit further to make it more understandable to a wider audience.

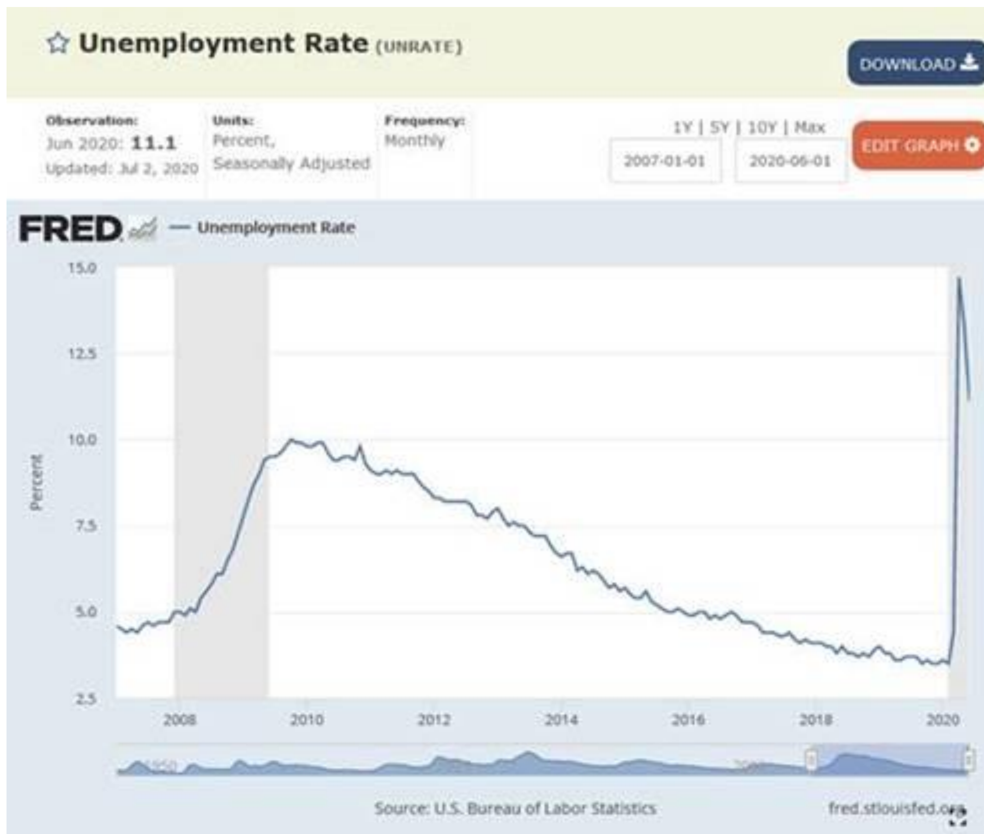
The 'typical' recession begins when economic growth and interest rates are high and unemployment is low. Interest rates can rise for several reasons, but the most common is that the rapid growth raises the risk of inflation, which in turn pushes the Federal Reserve (FED) to raise interest rates as a means to slow the growth rate and avoid an inflationary problem. These interest rates decisions are difficult because measuring economic growth is all done in the rear-view mirror. Looking at what happened over the last month or quarter is not necessarily an indication of what is happening in the economy at that moment. As a result, the FED may raise rates too far and/or too fast and this in turn causes growth to stop and we have a recession.

As a recession develops, the economy contracts and high interest rates are a road block to further investment and growth and companies rein in spending to adapt a contracting economy. This leads to higher

unemployment and a decline in the income generated by the economy (the income gap). The typical response is to then lower interest rates to spur investment, which eventually leads to a recovery of economic growth, declining unemployment, and growth of income.

This recession is different. When we started this episode, interest rates, unemployment, and economic growth were all low. The reaction to the pandemic caused a sudden, rather than gradual, increase in unemployment and therefore an equally sudden decline in income. The result was that we reversed the order of the typical recession. Instead of the income gap forming gradually as the recession develops, the income gap has formed almost instantly at the start of the recession. This is an economic problem unlike any we have faced in our lifetimes. The challenge for the government is to fill this income gap in order to keep the economy on its feet.

The problem today is that the massive spike in unemployment created a very large income gap and although we have had a meaningful recovery, unemployment is still 11%, which is still higher than the great recession of 2008-09 at its worst (see chart below). The difficulty today is that the primary tools to deal with recessions are easy monetary policy (i.e., lower interest rates) and aggressive fiscal policy (government spending), but monetary policy is already at extremes and has little additional benefit to add. **Fiscal policy has been aggressive, but that is temporary and requires additions or extensions if we are to fill the gap until the pandemic is over.**



The Federal Reserve has gone 'all-in' in terms of monetary policy with Chairman Powell promising low rates and FED support for 'as long as it takes'. The Cares Act has done its job over the last few months, but major provisions in the CARES Act expired on Friday and **Congress failed to act on revisions/extensions for the stimulus package due to partisan politics, which we detailed in the first section of this week's comments.**

As we've said previously, we fully expect Congress to act, but only when the delay gets painful enough for both sides. We hope it will not take too long, as it is our lives they are toying with.

Of course, all these actions taken by the FED or by Congress do one of two things: They increase the national debt or increase the money supply. Over the long term, that has repercussions. As we say time and again, the market anticipates the future and once again, the market appears to be seeing this problem in advance.

A rapidly increasing money supply is an invitation to inflation, which erodes the buying power of the dollar over time. Modest inflation has little impact over the near term; high inflation is a very real threat to the dollar as a store of value.

The massive increase to the national debt is a similar concern. At the beginning of the year, the public debt was almost $23 trillion (almost 110% of GDP). The initial COIVD

response several months back added about $3 trillion, and we are about to spend another $1 to $3 trillion on the next phase of stimulus. **The pure level of debt is one that would be very concerning for most any other country.** What has helped, is that interest rates are low, so the current cost is relatively small. However, **too much debt can only be reversed by a few things:**

1) **Rapid Growth**. There is not much opportunity for that right now.
2) **Debt Restructuring** – This is essentially a default and is not much of an option for the U.S.
3) **A Currency Devaluation**. In effect this means we inflate our way out of this debt. Inflation degrades the value of the dollar and we get to pay back that debt with less valuable dollars. We are potentially seeing the beginnings of this now.

The implication is that gold may not be rising in value as much as the dollar is declining in value (which makes the price of gold high in dollars terms). In other words, **gold is acting like a currency, not a commodity, because the market appears to be saying that the yellow metal is becoming a better store of value than the dollar.** I know we sound like a broken record because we already discussed this a few weeks back, but this is the essence of the reason why we own gold in our portfolios.

Gold is not a perfect store of value or perfect inflation hedge from year to year, but over the long term it has been very effective. To recall an example we used a few weeks ago, in 1930, a kilo of gold would have bought you a new Chevy. It will do the same today.

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