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Baron Point Research Accomplishing the Means to the Ends Chosen October 17, 2022

Baron Point issue research describing current intermediate term trends and topics we find interesting. This research is intended to complement the regular Monthly Fact Sheets which include our monthly return updates.

A summary table of contents is shown below. **If you have any comments please feel free to email us at info@baronpoint.com or call +1 (212) 248-2733 x701.**

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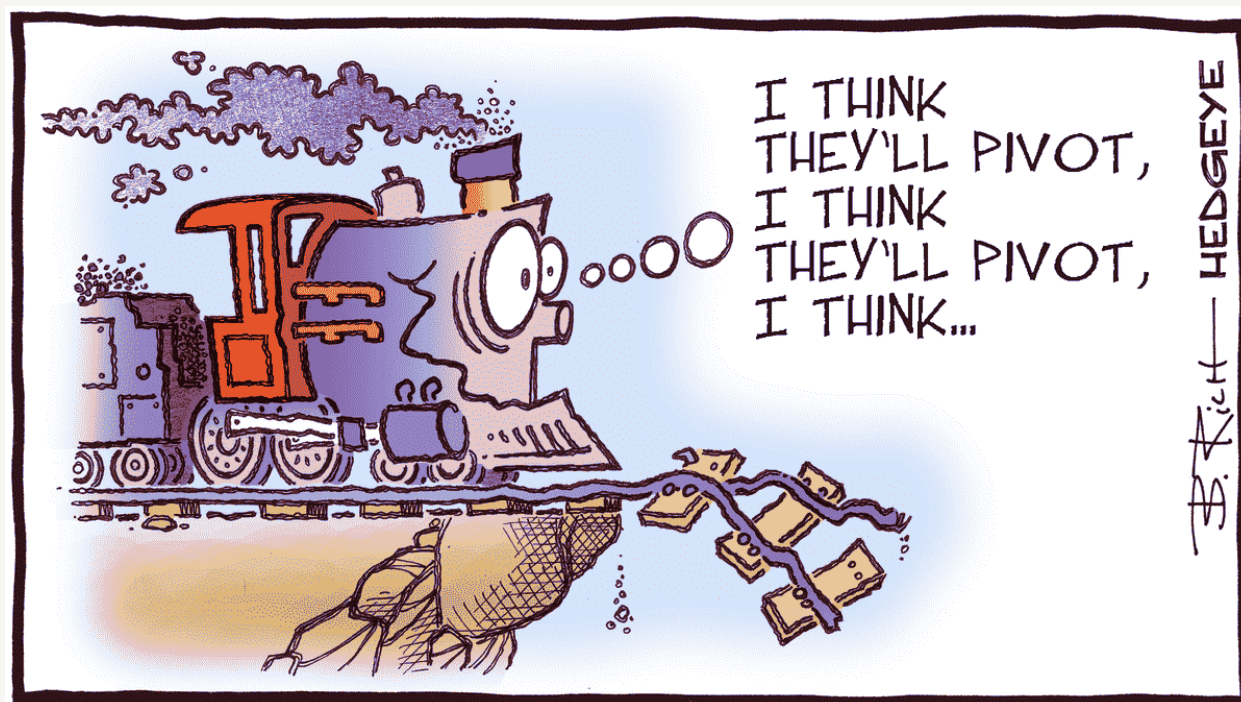
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Accomplishing the Means to the Ends Chosen

By Victor Sperandeo





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Personal Note from Trader Vic

In the 1970's I owned a specialist options business (Hugo Securities) trading on all option exchanges with 39 traders. I financed my options positions (inventory) with a "demand loan" from Chemical Bank. If the bank wanted the loan back they would simply "demand" payment within 24 hours. So, you could use the loan, but not spend it (or you might lose it)! Then it happened to me in 1981. The bank called in the loan, and I had 24 hours to wire back the borrowed money. To do so, I had to liquidate 75% of my positions. This happened all across the nation and credit/money was not available at any price. The economy came to an abrupt halt. So did money supply growth and therefore inflation stopped.

Introduction

No one would begrudge the Fed for being concerned about inflation. "Nothing works in an economy (in the long run) with high inflation," Fed Chairman Powell has said.

Now please consider this Ludwig Von Mises quote:

"Economics is the science of the means, to be applied, for the attainment of ends chosen."

The key point is there are several means to accomplish the ends chosen. In this memo, we attempt to explain why the Fed's means to the end is utterly incorrect and attempt to suggest a much better course of action.

U.S. Financial System and Federal Government

The financial system is complex. There is no way any person, in or out of Wall Street, can understand the subtleties that surround the variation of outcomes and unintended consequences that are possible. That is especially true with the Fed's unlimited power to print money and control the cost of credit as it has since its secretive origins and the 1913 Federal Reserve Act.

Sadly, the U.S. government today is *nothing* like the government that our "Founding Fathers" put in place via the Constitution. James Madison the Father of the Constitution wrote, "The powers delegated by the proposed Constitution to the federal government are *few* and *defined*. Those which are to remain in the state governments are *numerous* and *indefinite*."



Instead of liberty and very limited federal government we have given “The Leviathan” of total and unlimited government controlling virtually everything one does in their life in America.

Assessment of Fed’s Ultra-Hawkish Monetary Policy

Today we have “the Fed raising rates to lower inflation” come hell or high water. *Is this the correct means to accomplish the ends chosen?*

We believe that the current monetary policy is *more than incorrect*, as it has little to do with lowering the money supply in the long run. This is because the Fed is increasing the money supply (See Page 5 – 6, The Bond Bear Market Meets the Fact of Life Cast Reunion 2022, September 26, 2022) and this expansion episode is the primary cause of inflation in America.

Interest rates are the “cost of credit.” The higher the interest rate the lower the number of marginal borrowers and economic growth. Historically, raising interest rates without decreasing money supply growth does not lower inflation.

The FOMC hawkish rate rising rhetoric in advance of policy meetings was intended to talk markets down in order to create a reverse wealth effect (making investors poorer so they would spend less).

The FOMC has effectively become a tribe with a Chief! A tribe is led by a leader and there is no dissent, only compliance with the Chief, and like a tribe the current Fed seems under the control of its Chief with the other members following with little or no dissent.

What is missing from the current policy making at the FOMC seems to be objection from other members, or even genuine “deliberation”. There is very relevant data that we think should be discussed and debated. In the past Fed’s there were contradictory opinions voiced to the public, but today why are we not hearing any dissent?

Collaboration is a working practice whereby individuals work together for a common purpose to achieve what’s best for “the people.” Collaboration enables individuals to work together to achieve a defined and common business purpose for the economy within the law (the Constitution). Participants are expected to explore and debate the pros and cons based on facts - not on some soothsayer’s desire or prediction of what the future may or may not be, as nobody knows the future. Without genuine debate of the facts, we have an authoritarian/totalitarian effective collectivist dictate.



Fed Policy Today is a Colossal Wrecking Ball taken to the US Economy

After maintaining an ultra-easy monetary policy since the 2008-2009 Great Recession, over a decade, the Fed abruptly reversed course with the largest increase in short term interest rates in the shortest time in all of U.S. history. That caused a recession which is likely to deepen, and a sell-off in asset prices. If these jumbo rate rises continue, it will lead to one of the greatest recessions in American history, one that could rival the Great Depression.

All Asset Classes are Moving Down in Unison

The Fed's non-stop jumbo rate hikes this year have resulted in market sell-offs, across asset classes. Here are a few samples showing the damage done as of Friday, October 14, 2022:

- Long term Treasury bond ETF (TLT) YTD return of -33.48%.
- NASDAQ 100 (NDX 100 and QQQ ETF) return of -34.49% YTD.
- 2 out of 3 NASDAQ stocks (3,756 of them) this week traded >33% below their 52-week highs, almost 900 MSCI ACWI stocks had slumped >20% past 2 months, 42 stocks within S&P500 trading below their COVID 2020 lows.
- 2022 annualized return on "60/40" portfolio -34.9%, the worst in the past 100 years.
- The iShares U.S. Real Estate ETF (IYR), with \$3.2B in assets, is down -31% YTD.
- Gold mining shares are off -45% since their April 2022 highs.
- Bitcoin has returned -58.65% YTD.
- Commodities and foreign currencies are all down double digits since rate hikes started this March. British Pound, Japanese Yen and Euro have suffered huge declines.
- Systematic trend following managed futures ETFs and funds are now SHORT every commodity, currency (except the U.S. Dollar), financial future, gold/silver, etc. This behavior has never happened before!

The unprecedented destruction in every asset class has been breathtaking and has caused tremendous anxiety around the world. How will this calamity manifest? Only time will tell us this.



How to Lower Inflation? Decrease the Money Supply Growth.

So, as we said at the start of the memo, here is a suggestion for a much better course of action to lower inflation, because simply aggressively raising rates can have some knowable consequences as history has taught us. We will discuss historical precedents later in the memo, but for the moment, let us discuss a misnomer in the fabled legacy of Fed Chairman, Paul Volker, and his eradication of inflation during his tenor.

In the latter half the 1970's, and early 1980's the Fed Funds Rate approached 20%, yet it did not end inflation until then Fed Chairman Paul Volker curtailed money supply growth. Short term interest rates went from 3.5% to 20% over 12 years, but inflation didn't decrease until the money supply stopped growing in 1981.

Therefore, if the Fed wants to lower prices and inflation, then it should *lower Money Supply growth* over five years to an annual rate of +5% and let the markets determine interest rates.

Will Joe Biden and Jay Powell Be Remembered as Herbert Hoover and Roy Young?

The worst economic mistakes ever made by an American administration was under the Hoover Administration.

In the lead up to the Stock Market Crash of October 1929, a Fed led by Roy Young made a decision to raise interest rates aggressively in 1928 and 1929 in an attempt to limit speculation in the stock market. This was wrong, because Fed rate policy did not affect stock prices, until the aggressive stance had a predictable effect on economic activity, which began to contract in advance of the stock market crash of 1929 in key industries of the economy. Back then, by the second quarter of 1929 it was apparent that economic activity was slowing in America, however, the Fed kept raised rates in the lead up to the crash, and even after the market broke in December 1929.

After the Stock Market Crash in 1930, it was the Smoot Hawley Tariff Act, an act which raised US tariffs on over 20,000 imported goods, and then in 1932 a tax rate increases on America's highest earners from 25% to 63%, increased regulations were in vogue, and they let the money supply drop 33%.

History shows that there were stupid policy decisions made by the Hoover Administration.



Conclusion: Stupid is what stupid does!

Today's Fed Chairman tells us we need to unlearn knowledge of the Money Supply, and its relationship to economic growth and inflation, while they singularly focus their policy on breaking inflation by aggressively raising rates. At the same time, last month, the Fed Chairman conceded to the American people that the rapid rise of interest rates will cause some pain, including slower economic growth and possibly higher unemployment. However, the administration fails to point out that unemployment is a lagging indicator as we discussed in our prior memo.

So, if we trust the words of our Fed Chairman, may we ask how much pain is the Fed willing to cause the American people now that the economy has already contracted for two consecutive quarters? A deeper recession, a depression?

Sometimes a bit of common sense goes a long way, and this quote, attributed to John Wayne says it all:

"Life is tough, but it's tougher if you're stupid."

This quote is a great reminder that life can be difficult, but not necessarily as difficult as the Fed is making it.

Thanks for reading,



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