FIRST CAPITAL FINANCIAL

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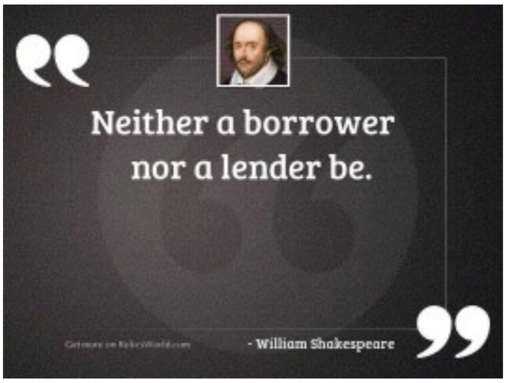
Sponsoring Mutual Fund Dealer

Notwithstanding its many failings, capitalism has been a formidable engine of wealth creation and economic development over the last three hundred years. Up until the mid-nineteenth century, most of the equity accumulated came from retained earnings -also known as *profits*. Businesses financed their operations using this capital, and were effectively self-financing. From that point on, debt in the form of bank loans or public bonds, have systematically helped finance businesses to the extent that the issue of credit instruments is the essential means now for the accumulation of capital.

I installed this underground pool so I could literally be swimming in debt.

Since President Nixon's decision to end the Breton Woods international monetary system in the early 1970s, financial deregulation and innovation has led to to the financialization of capitalism. Unsurprisingly this has resulted in the proliferation of debt, and where total debt measured 150% of US GDP in 1980, it has risen to 400% today. To put this is context, during the depths of the Great Depression, it was 300%.



Currently, debt plays a larger role than equity, where bond markets total $130 Trillion worldwide, up 30% in the past three years. By contrast, the total capitalization of equity securities is just three-quarters of this amount, and that is mostly due to record low interest rates which fuelled a rally in stock valuations. In 2019, the securities industry collected $21.5 Trillion globally, and virtually all of that was raised in the form of fixed income. Only 5% came from common or preferred shares.

Debt is so pervasive that the term capitalism has become a misnomer. <u>We now live in the age of leverage, which should more correctly be called debtism</u>. For all the inherent instability that leverage provokes, governments encourage private lenders to keep lending to avoid a recession. Lenders make money not from the interest charged on loans, but from arrangement, prepayment penalty, advisory fees and syndication fees derived from the distribution of the default risk across the financial system.

Although a permanent debt overhang adds chronic stress to the economy and may eventually require some for of financial catharsis, unless governments around the world collaborate to engineer the Great Deleveraging or Great Write-Off. Absent of that, the age of debt it would seem, is here to stay.

Be safe, be well!

Martin
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