Doucet Asset Management, LLC Quarterly Newsletter

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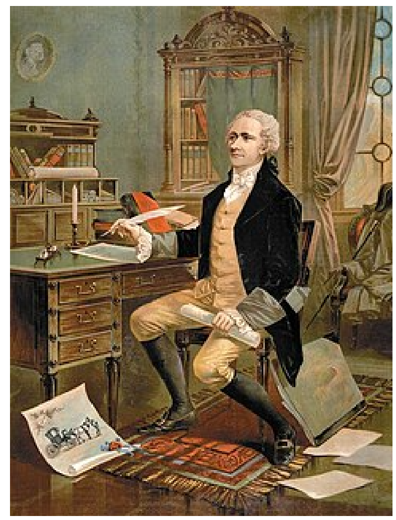
The Clock is Ticking

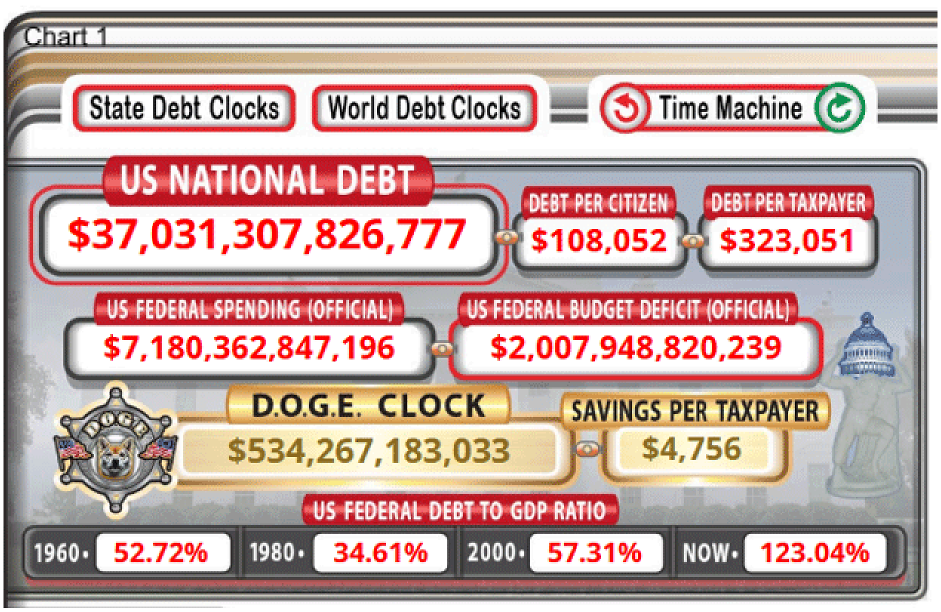
"A national debt, if it is not excessive, will be to us a national blessing."

-Alexander Hamilton

When U.S. government debt was quickly approaching $1 trillion during waning days of 1980, former New York City real estate mogul Seymour Durst decided to do something about it. (Yes, that Durst family. Seymour is probably best known as the inspiration for the overbearing father in the movie "All Good Things," which was based on the real life story of his son Robert.) He sent every Congressman a holiday card that year with a simple note: "Happy New Year! Your share of the federal debt is $5,000."



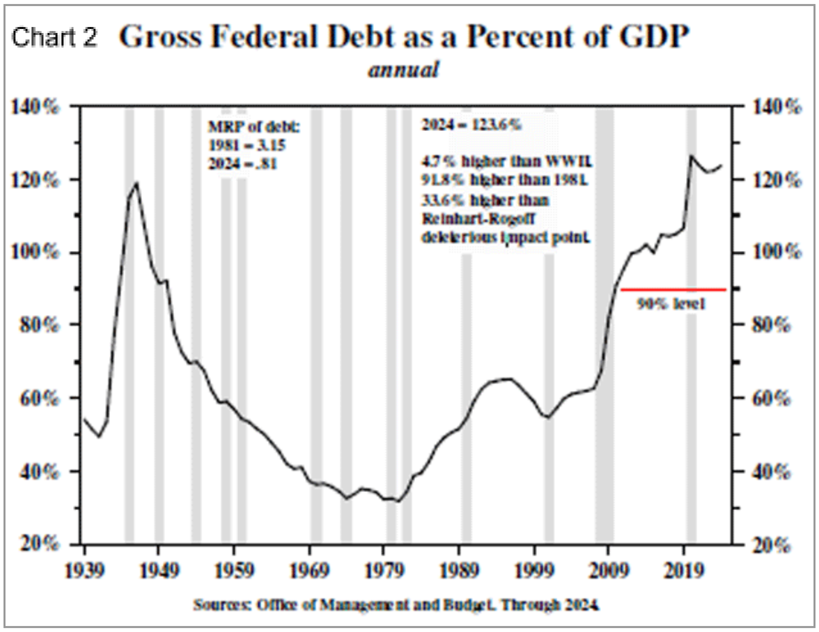
Nine years later, the US government debt nearly tripled to $2.8 trillion, and had risen from 34% to about 57% of GDP. Again Durst felt compelled to act. But this time, he decided to do something more public. He constructed an 11 x 26 foot clock at a cost of $100,000, strategically placed one block north of Times Square in Manhattan. The clock would show the U.S. gross national debt and each American family's share of the debt. He named the clock the National Debt Clock.



Today, Durst's Clock paints a much more dire picture than it did in 1989. The national debt now stands at more than seventeen times the first Debt Clock total at $37 trillion, or about 123% of GDP, and your share is about $108,000! Interest expense now exceeds defense spending, and the only line item higher on the government income statement is Social Security. But there is one silver lining. The yield on the 10-year Treasury has literally been cut in half, falling from about 9% at the start of 1989 to below 4.5% today.

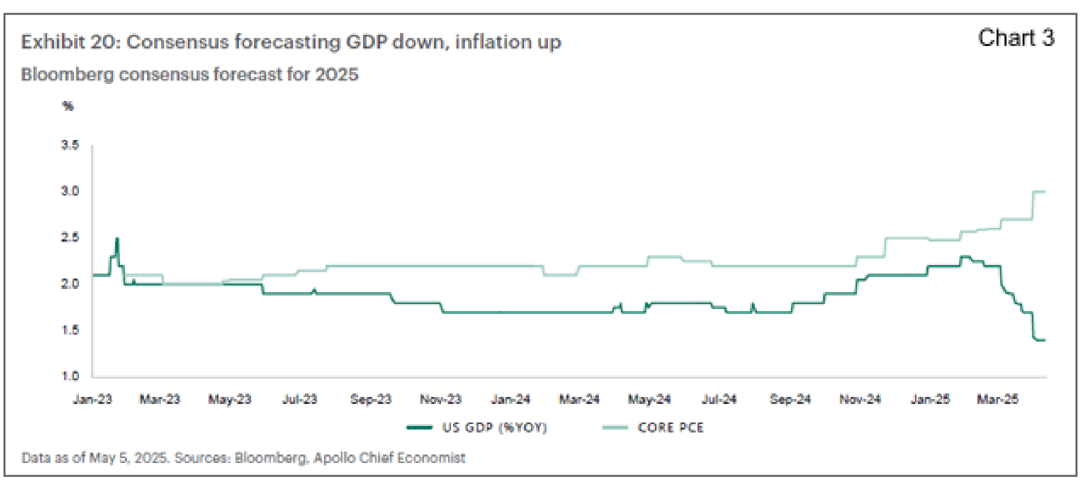
Good Times, Bad Times

Is Federal debt bad? Hamilton would say a reasonable amount of government debt can be a "blessing." It can help facilitate growth, provide funds necessary to purchase silver bullets in a time of military crisis and finance government spending. When debt poses a significant risk to the economy through higher interest rates, reduced national security and anemic economic growth, it is no longer a blessing.



What is a healthy level of debt and when does it become untenable? Authors Reinhardt and Rogoff attempt to answer this question in their book entitled "This Time Is Different." They suggest that 90% debt to GDP is that unofficial deleterious impact point for countries where the debt begins to cause more harm than good.

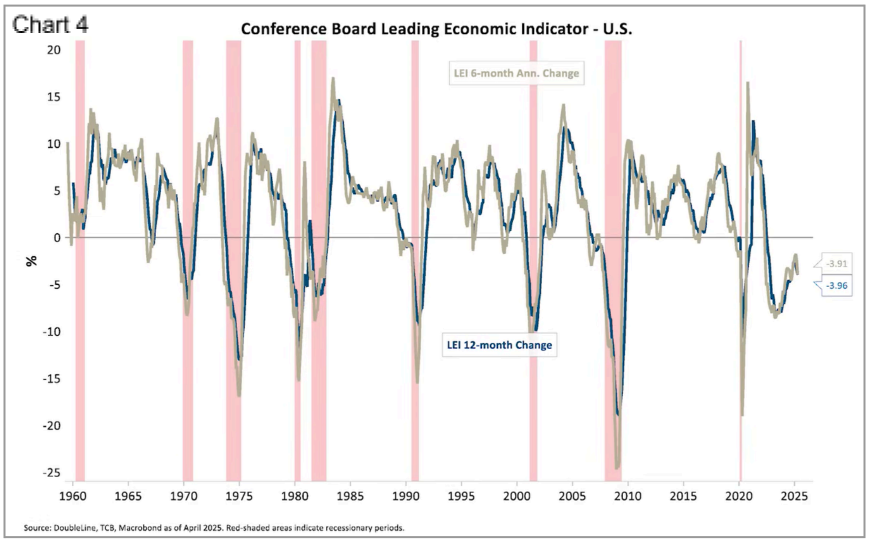
Most economists agree that government debt is ok as long as the growth in the underlying economy outpaces the rise in debt. Since 2008, Bloomberg shows that US GDP has basically doubled, from $14.77 trillion to $29.96 trillion today. The problem is US government debt has grown by 377% in the same time period. Famed economist Lacey Hunt believes the U.S. may have already reached a point where government debt has become a curse and no longer a blessing. His research shows that in 1981, $1 in debt added $3.15 to GDP; today, $1 equals $.81 in GDP. And all of this is occurring while the US economy is expanding. While these statistics illustrate elevated US government debt has already reached an unhealthy level, a real crisis could begin when the US economy enters its next recession.



This could help explain why the past several Administrations have been so eager to prime the economy with both fiscal and monetary stimulus. The current administration is no exception. Currently, the Bloomberg consensus forecast is for the rate of GDP growth to soften and inflation to rise over the next several months (see chart 3). The recent passage of the “Big Beautiful Bill” hopes to positively change these trajectories. However, it also expected to increase U.S. government debt substantially in the interim.

Time Change

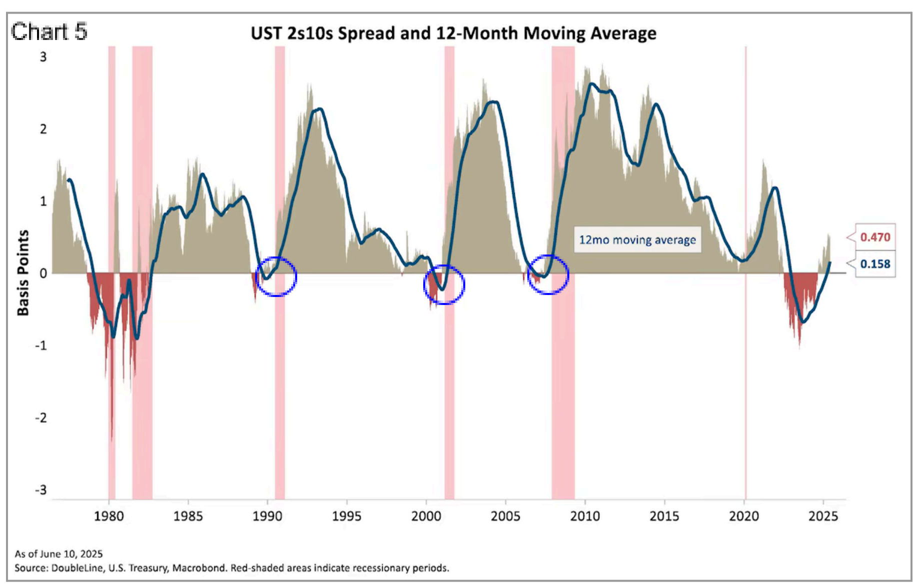
The US has never experienced these historically high levels of debt, deficit spending and easy monetary policy in peacetime and while the economy is expanding. These economic stimuli have made the dismal science of economic forecasting even less predictable than normal. Together, they have neutered the accuracy of formerly accurate predictive tools, resulting in a plethora of false positives when it comes to important events like predicting the next economic slowdown. Two of the most often sighted indicators are the Conference Board Leading Economic Indicators (LEI) and the inverted yield curve.



Source: DoubleLine, TCB, Macrobond as of April 2025. Red-shaded areas indicate recessionary periods.

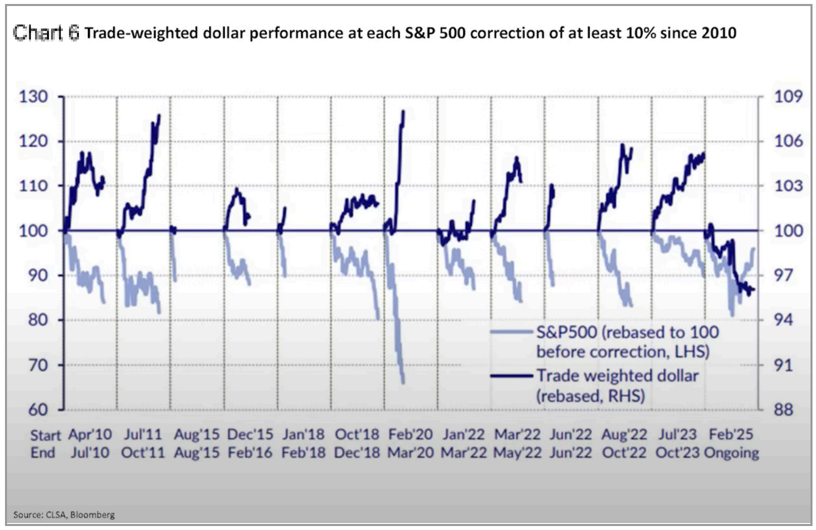
The LEI is a compilation of ten indicators that help telegraph where the economy is going in the future. The US is currently experiencing its second longest period of time that the LEI has been negative without a recession as shown in Chart 4. The current 23 consecutive month streak has only been surpassed by the period preceding the Great Financial Crisis. Justyna La Monica, Senior Manager at The Conference Board, suggests “the stock price rally was the main support of the LEI” over the last several months and kept recession signals muted despite “weak new orders in manufacturing” and “rising claims for unemployment insurance.”

Another historically reliable tool used to forecast a coming economic recession is the inverted yield curve. A yield curve inverts when short duration bonds yield more than longer maturity bonds. Typically, investors are paid more interest on their bonds the further out they venture on the maturity scale. Once a yield curve inverts, a recession alarm bell rings usually 6 to 18 months later. However, the most recent inverted yield curve lasted for a record 783 days or over 2 years, according to Bloomberg, and normalized on December 13, 2024. As evidenced by chart 5, the recession begins when the yield curve re-inverts. But so far, the US economy continues to advance.

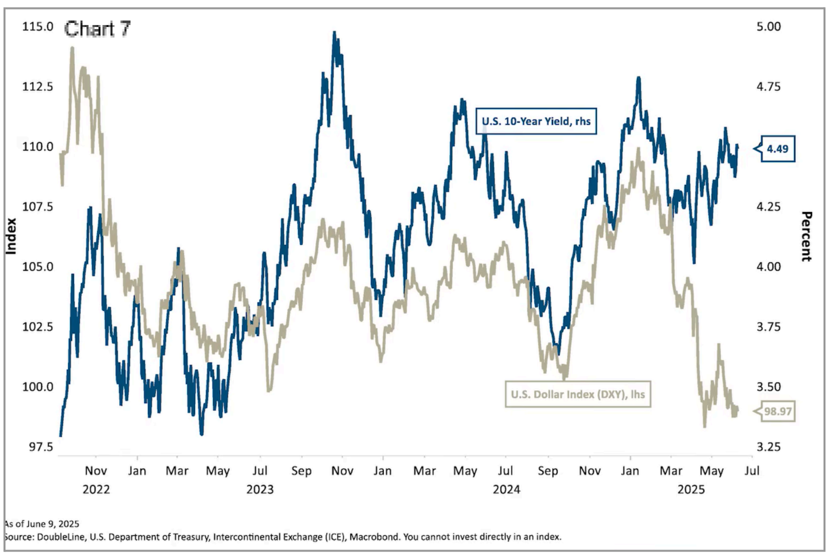


As of June 10, 2025
Source: DoubleLine, U.S. Treasury, Macrobond. Red-shaded areas indicate recessionary periods.

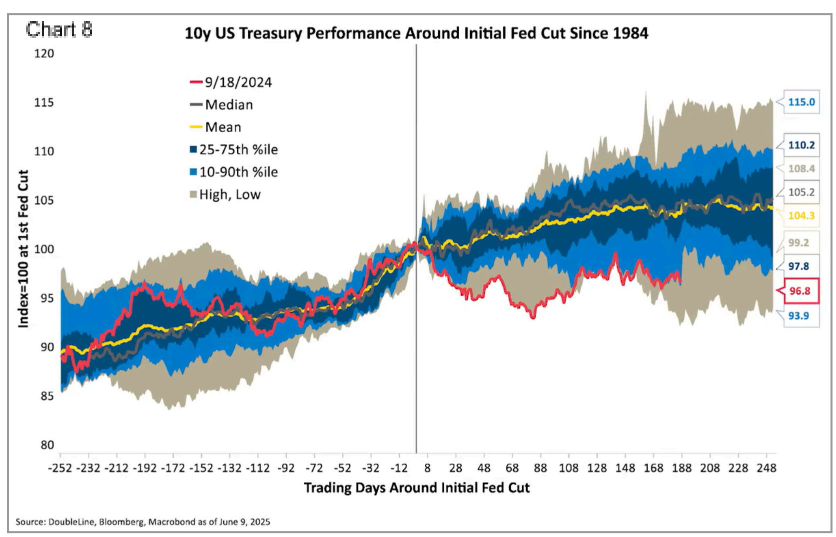
Getting Real in Real Time



While excess stimulus may be helping to promote false positives for many formerly historically reliable economic indicators, there are reaction functions that are occurring in real time that suggest the debt situation in the U.S. may have changed. In times of economic and market turmoil, US Treasuries and the US dollar have proven to be "safe havens" for world markets and economies. Since 2010, every time the S&P enters a bear market (when stocks are down 10% from their recent high), there is a "flight to quality" that occurs and the US Dollar rallies ... except for the most recent correction. Chart 6 illustrates that for the first time in the past 13 market corrections the US dollar failed to rise in value versus other major currencies. Is the long-standing trend of dollar strength in times of market or economic turmoil broken?



This reaction function does not appear to be an isolated event. Typically when the yield on the 10-year Treasury rises (prices fall), the U.S. dollar strengthens against other major currencies ... until recently. According to Jeffrey Gundlach of Doubleline Funds, the yield on the 10-year US Treasury has risen almost one half of 1% or about 50 basis points since "Liberation Day" in April. This would normally result in a corresponding rise in the value of the US dollar. However, as seen in Chart 7, the US dollar actually *fell* about 5% during the same timeframe.



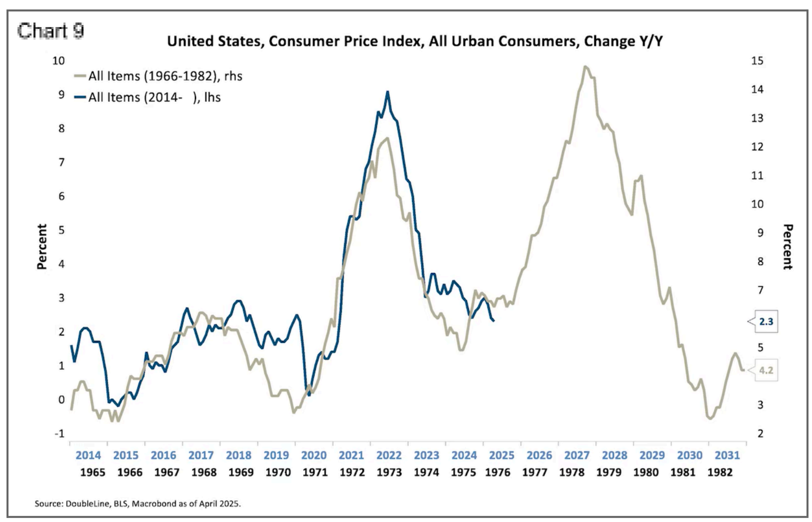
Perhaps the most troublesome marker is how longer bonds are now reacting to the machinations of the Fed. Chart 8 helps illustrate that since 1984, whenever the Federal Reserve lowers overnight interest rates or the Fed Funds Rate, the yield on the 10-year Treasury will also decline (and prices rise). Since the Fed began cutting short-term interest rates last Fall, the opposite has happened. The yield on the Fed

Funds Rate has declined from a range of 5.25% to 5.5% to the current range of 4.25% to 4.5% since last September. During the same time period, the yield on the 10-year Treasury has risen from 3.7% to about 4.4% today. While there may be Fed interest rate cuts later this year, longer term rates may not follow suit.

The current administration believes the Federal Reserve should reduce short term interest rates by another 300 basis points, or three percentage points; while the market is hinting the Fed should cut by only 50 basis points or ½%. The rate of inflation growth has slowed dramatically from its Covid high and unemployment has slowly begun to rise after its historic rebound. However, inflation is still closer to 3% than the Fed's goal of 2% and unemployment is still at a historically healthy 4.1%. Add future tariffs into the mix which will likely have upward pressure on consumer prices in the future and it is understandable why the Fed might be hesitant to increase rates in the near term.

All in the Timing

Perhaps the current Fed is most haunted by policy missteps of the late 1970s when a similar economic backdrop was developing. Highlights of the 1970s included high inflation caused by the Saudi Oil War and two separate 15% increases in the money supply after the US abandoned the gold standard. Towards the end of the decade, the Fed believed inflation was back under control. It seemed to delude itself. Three chairmen cycled through the Federal Reserve in less than 19 months at one point. Every time there was softness in the labor market, the Fed would cut interest rates to stimulate the economy, and inflation would come roaring back.



Today, the market and the current Administration seem to be repeating that same "mission accomplished" sentiment when it comes to fighting inflation. By comparison, the US increased the money supply by about 40% over the past few years followed by a significant dose of inflation, which has moderated in recent days. And while unemployment rose substantially during Covid, it is down from its peak, with only a modest rise from its lows. Despite current and pending tariffs threatening to adversely impact prices long term, the financial markets have mostly shrugged them off as nonevents...so far. However history warns that a declaration of victory may be premature. Chart 9 maps recent (2014 to present) CPI fluctuations over eerily similar movements from 1966 to 1982 and suggests cutting rates too soon could add fuel to the fire and cause more harm than good.

The US may have entered a paradigm shift where debt and deficits do matter and reactions to important economic data have likely changed. This new dimension adds an additional level of difficulty for the Fed. But hopefully, Congress will glance up, look at Durst's Debt Clock, and take real action soon before time runs out.

Sincerely,

Chris L. Doucet

Admin Notes

- Form ADV: Please contact our office at (205) 414-9788 if you would like to receive a current copy of our Form ADV II or the Schedule H Brochure.
- Proxy Solicitations: If you receive calls regarding proxy voting, we suggest that you inform the caller that you have delegated Doucet Asset Management full authority to vote the proxy on your behalf. Please note that we are not able to prevent these calls from being placed to you directly.

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