

ECONOMY

A broken moral compass

THINK STRATEGICALLY: Serving in Gov't Is all About Character

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com



Integrity, Character and Strong Values

As we begin our discussion, we must review what a moral compass is.

A moral compass is the set of values taught since childhood that allows an individual to make prudent decisions that impact our lives, actions and the very definition of us as a person.

Since I was a little boy, my mom taught us how each person should judge what is right or wrong, which is the very essence of a moral compass.

Since Puerto Rico began electing its own governor in 1948, we have had a newspaper publisher, bohemians, lawyers, engineers and career politicians in office. These men and women were elected to serve all Puerto Ricans, except for one.

As we analyze the recent arrest and accusations of former unelected Gov. Wanda Vázquez and several alleged co-conspirators, including two who pleaded guilty, we note how frail her moral compass was as she sought to stay in power.

In Antoine de Saint-Exupéry's "The Little Prince," there is a brief discussion about the importance of love and friendship. Simultaneously, the fox asks that the prince domesticate him; the prince explains what friendship entails

as well as missing someone and needing a person. The confused fox is told, "What is essential is invisible to our eyes," describing friendship's true feelings. To no small degree, the governor's power, words and influence may be invisible to our eyes; however, the effects of both comments or impacts, whether right or wrong, can bring Puerto Rico to its knees.

The other disturbing impact has been attempting to use the Financial Institutions Commissioner's Office (OCIF by its Spanish acronym) for political gain. The oversight of financial services is a significant piece of the economy of any nation, and because of these developments, its integrity has come into question.

OCIF and its employees are an agency that distinguishes itself with professionalism and integrity. In contrast, balancing their role as both a regulator and a promoter of the industry is never easy; for these reasons, we need experienced commissioners with ample industry knowledge and deeply rooted values.

Since 1987, because of my involvement in the banking and financial sector, I have known most of our commissioners. Several have been my coworkers, and other lifelong friends, the key traits

in the ones I know well has been integrity, character, prudence, with total respect for the office.

Suppose we harnessed OCIF's power with a single phrase; it would have to be the "potency of language." There is no better example than those stated by former Commissioner Alfredo Padilla, who said: "The OCIF, as a regulatory body, similar to federal regulators, is a critical element in the framework of a democratic system; for this reason, it is critical that the independence of this office is maintained."

Serving in government is all about character, honesty, integrity, clarity and respect for the office. We can conclude that these qualities are essential but in many ways invisible to our eyes.

Week in Markets: Jobs Grow 111% Above Estimates; Markets Seek Direction

The U.S. stock market has staged one of the best rallies since 2020, from its lows in June this year.

This market change has been driven by stronger-than-expected corporate earnings, lower gas prices, a strong jobs market, and the expectation that inflation will come down.

Nonfarm payroll employment rose by 528,000, significantly more than the estimated 250,000, or 111 percent more than forecast and higher than the last four-month average of 388,000.

The sectors that experienced the greatest jobs growth were:

- Hospitality: 96,000
- Professional & Business Services: 89,000
- Health Care: 70,000

The expectation is that job growth will slow as the Federal Reserve continues to increase interest rates in its fight to

reduce out-of-control inflation. However, there are still 10.7 million job openings and only 5.5 million job seekers, a 48.42 percent deficit, meaning that job markets have strong demand.

Also, the unemployment rate fell to 3.5 percent and is now at the same level as before the pandemic. The critical question is will the Fed respond aggressively or be skeptical during its next Federal Open Market Committee meeting.

We see a Fed that must stay keenly focused on its fight to control inflation, and we see it raising rates further to see at least a 1.5 to 2 percent decrease in the Fed's preferred inflation metrics, the consumer price index (CPI) or personal consumption expenditures price index.

The markets could react with solid volatility in the months ahead. However, from our vantage point, we think the worst market downturns may be behind us.

There are four potential directions for the U.S. economy and the markets:

1. GDPNow puts recession behind us: the GDPNow model estimate for real GDP growth reported on Aug. 4 that for the third quarter (3Q), GDP growth is projected at 1.4 percent. If this materializes, the worst is behind us.

2. Fed raises rates too much and takes the economy down: If history is to repeat itself, the Fed does not have a good track record of achieving so-called soft landings and has tended to push the U.S. economy into contractions; however, the lowering of most commodities, especially gas, will provide substantial relief.

3. A growing U.S. Job market is not what the Fed is expecting: Some 528,000 new jobs and unemployment falling to 3.5 percent, reaching pre-pandemic levels and the lowest percentage since 1969, along with a decrease in the labor-force participation rate, with more job openings than job seekers, is not what the Fed was planning.

4. The U.S. recorded two consecutive quarters of GDP contraction; technically, the economy is in a recession. Why the ongoing debate? The current rule is that two negative GDP quarters indicate a recession. However, the the National Bureau of Economic Research's Business Cycle Dating Committee uses

several criteria to declare recessions, including payroll employment, personal income, consumer spending and industrial production trends. Last week's 111 percent job growth above estimates seems to restate the recession question. An economy adding 528,000 jobs with a low unemployment rate is inconsistent with a recession.

Even with today's advanced modeling and computer models, there is never certainty about which direction the economy and markets will take. However, evaluating the probability of a diverse set of outcomes can help investors prepare their portfolios for opportunistic investments at sensible prices.

The Final Word: Inflation Reduction Act Passes Senate; Transformations are Marathons, not 100-Meter Races

Lastly, after a long journey with much drama and twists, the Senate passed President Jose Biden's signature economic package after a marathon voting session overnight that handed the president a much-needed political victory a couple of months before the midterm elections. The former Build Back Better Act, now known as the Inflation Reduction Act, was passed with voting split along party lines and Vice President Kamala Harris casting the deciding vote in an evenly divided Senate. The bill goes to the House of Representatives for passage before being sent to Biden for enactment.

Although much smaller in size and scope than the Build Back Better, this bill is still significant, addressing health care, taxes, IRS enforcement, clean energy and the climate. According to estimates, the bill could represent \$433 billion in expenditures, but raise \$739 billion in revenue, reducing the budget deficit by roughly \$300 billion over a decade.

This is another example that transformations are marathons, not 100-meter races, especially in Washington politics.

Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.

Weekly Market Close Comparison	7/29/22	7/22/22	Return	YTD
Dow Jones Industrial Average	32,845.13	31,889.29	3.00%	-12.22%
Standard & Poor's 500	4,130.29	3,961.63	4.26%	-16.89%
Nasdaq Composite	12,390.69	11,834.11	4.70%	-24.36%
Birling Puerto Rico Stock Index	2,807.61	2,751.40	2.04%	-4.44%
U.S. Treasury 10-Year Note	2.67%	2.77%	-3.61%	1.10%
U.S. Treasury 2-Year Note	2.89%	2.98%	-3.02%	1.20%