Insights and Observations: Fourth Quarter 2019

Consider the following observations about China from John Lee, senior fellow at the Hudson Institute and the U.S. Studies Centre in Sydney. (WSJ 12/15/19)

- In every negotiation, pressure is relative, and the U.S. has more political and economic leverage than China.
- Consider why China engages in predatory, illegal economic behavior. It needs to grow rapidly to maintain fiscal stability, manage its debt and advance its strategic and military ambitions.
- The only reliable way Beijing has of maintaining adequate growth is to support its companies with cheap credit. China showers state businesses with subsidies and stolen intellectual property, and shields them from foreign competition.
- The rise of Chinese corporate debt since the 2008-09 financial crisis has been one of the largest and most rapid – in relative and absolute terms – for any 10-year period in peacetime economic history.
- The Chinese domestic economy is slowing because of chronic overinvestment.
- The current Chinese model is self-defeating. Less-deserving companies continue to receive the bulk of finance and opportunity. The staggering misallocation of capital is worsening, which makes the mushrooming debt even harder to manage.
- As Chairman of everything, Xi Jinping faces acute pressure. His success depends on preventing the emergence of a genuinely independent middle class, which is what led to democratic transitions in Japan, South Korea, and Taiwan.
- The U.S. has a far more adaptive and diverse economy than China.

There is plenty of research supporting the premise that stock market forecasts have no value. Forecasters know they are on shaky ground … that's why most do not offer predictions with specific timeframes.

> **We have long felt that the only value of stock forecasters is to make fortune-tellers look good.**
>
> **Warren Buffet**

Biases and corruption play a role in expert recommendations.

> **The simple fact is that most informal experts can spew out conclusions without much fear of being intercepted by wiser or more careful parties. Who's filtering the recommendations of investment gurus? In the short run, most informal experts can get away with quite a bit, and do all the time.**
>
> **David Freedman, Author – Advisor Perspectives 1/6/20**

Most of us want certainty. With investing, in particular, it doesn't exist.

> **The lesson the research provides is that, as much as we would like to believe there are those who can predict the future, prognosticating equity markets is the occupation of charlatans.**
>
> **Larry Swedroe, The BAM Alliance – Advisor Perspectives 1/6/20**

Consider the following observations from Haim Israel, a "future" strategist at Bank of America. (Barron's 12/27/19)

- Forget about the short term. Even the long term is not that long term anymore. It's happening way faster.

- It took 64 years for 50 million people to use airplanes. For cars, 62 years. For Pokemon Go, 19 days.
- A lot of the projected megatrends, like aging and climate change, are such massive challenges that governments are being forced to take charge.
- In the 2020s, we'll have more grandparents than grandchildren, more people over 65 than people under 5.
- Japan isn't the oldest country on the planet. It's China, because of its one-child policy, which has since been abolished.
- In this decade, close to 800 million people will join the silver, or over 65, economy. It will pressure pension systems worldwide.
- Especially in the U.S., the silver economy still holds more than 50% of the spending dollars. However, this group only does 10% of the spending.
- This year, Gen Z is turning 18 and 19 and integrating into the real economy, getting real jobs and moving out of their homes. They're into sustainability and services rather than goods. There will be a 50% drop in drivers' licenses in the U.S. They're the force behind what we call peak cars.
- There will be 500 billion connectable smart devices by the end of the decade. By 2025, we'll connect with an online device every 18 seconds, or 4,800 times a day.

By many measures, we may have just lived through the greatest decade of all time.

According the United Nations Development Report, the gap in living standards is narrowing, with an unprecedented number of people in the world escaping poverty, hunger, and disease. The World Bank reports that extreme poverty in the world fell from over 18% to just below 9%, between 2008 and 2018. According to the World Data Lab, more than half the world's population can now be considered "middle class". People have better access to water, sanitation, healthcare, and vaccines. In Africa, the incidence of malaria declined by almost 60% from 2007 to 2017, and antiretroviral therapy reduced HIV/AIDS deaths more than half.

Global life expectancy increased, the global mortality rate for children declined, death rates from air pollution declined, and deaths from climate-related disasters declined. Consumption of 66 out of 72 resources tracked by the U.S. Geological Survey is now declining.

Yet we've lived through a period of populist revolts and geopolitical tensions, and wherever societies have been open and markets free, scientists, innovators and businesses persisted and made greater progress than ever. That's the case for optimism. Tin-pot strongmen, looting politicians and punctilious bureaucrats make mischief with societies and economies. But mankind creates faster than they can squander, and repairs more than they can destroy.

Johan Norberg, author/senior fellow Cato Institute – WSJ 12/16/19

The tech-heavy Nasdaq Composite Index recently crossed the 9000 mark for the first time ever. Nearly one-third of the index's weight comes from just five companies – Microsoft, Apple, Amazon, Facebook and Alphabet.

On March 9, 2000, at the top of the dot-com craze, the Nasdaq Composite crossed the 5000 level for the first time. At the time, I remember watching CNBC. Two "experts" were asked if the index would soon reach 5500. The first answered, "It will be a layup." The second, not to be outdone, answered, "It will be a slam dunk."

Needless to say, the index peaked a week later at 5049. Technology stocks soon tanked, and the Nasdaq Composite Index plummeted to 1200. It took 15 years for the index to get back to 5000. In 2017, the index finally crossed 6000 … 4,308 trading days since it first hit 5000.

Although the term capitalism has long worked as a shorthand signifier for a market economy, there is a sense in which to use it at all is to accept the socialist's premise that a market economy is a consciously created system, manipulated by its creators for their own material ends. But it isn't that. A socialist economy is, by definition, a system – it must be created, planned, vigilantly monitored and forcefully regulated in order to function. But a market economy has no plan.

Barton Swaim – WSJ 12/25/19

Americans work 22 fewer hours a week than they did in the late 19th century and spend 43 hours less on housework.

In providing so much for so many while requiring so much less work, capitalism's moral and economic justification is undeniable.

Steven Pinker, Harvard psychologist – WSJ 12/23/19

After the Great Recession of 2008-2009, economists assumed that interest rates would rise during the recovery, just like they did in previous recoveries, and plateau at over 4% by 2015. That never happened.

By the fall of 2010, rates hadn't budged. Like Charlie Brown taking another run at the football, economists gamely made the same forecast that year, and the year after that and the year after that. Rates remained stuck near zero until 2015, a stretch of free money unseen since the 1940s.

Greg Ip – WSJ 12/14/19

Economists also got unemployment wrong. They expected the unemployment rate to bottom out at 5% … today it stands at 3.5%, a 50-year low. So, how did economists get everything so wrong? One explanation is the fact that the global economy is awash in debt. This massive level of debt actually depressed growth, inflation and interest rates.

Another theory is that slow population growth has weighed down the global economy. With a slow-growing population there are fewer workers and customers, and aging households buy less "stuff".

Still another theory is that the economy spent most of the past decade operating below capacity.

> **We fell into a deep hole so we had a lot of spare capacity, and it took a long time to climb out.**
>
> **Jan Hatzius, Goldman Sachs – WSJ 12/14/19**

Apparently, it might take us another 10 years to fully understand what really happened this past decade.

The top 20 *elite* colleges represent less than 2% of all new college enrollments. According to *Educate To Career (ETC)*, a nonprofit specializing in college planning programs, the SAT scores at those institutions are almost perfectly correlated with the ordering of the college rankings. In fact, ETC asserts that elite colleges aren't necessarily creating winners … they are picking winners … essentially picking all-star teams.

Colleges started hiring luxury branding consultants to justify their 7% annual tuition increases. Stories about colleges offering climbing walls and campus sushi bars are now legendary for all of the wrong reasons. Over the course of 20+ years, families have been bamboozled into spending trillions on top-end colleges, while overlooking the fact that it's actually the academic major that is far more important – and that the nearby state college can provide a degree in that major, and they already paid a lot of that state college tuition through their tax dollars.

Hill/Havis, Educate To Career – Advisor Perspectives 12/10/19

Does keeping a few dollars under the mattress offer security and peace of mind? Evidently, for many of us it does. Banks are issuing more money than ever, but they don't know where all of it is going. The total value of U.S. dollars in circulation reached about $1.7 trillion last year. A Federal Reserve economist, Ruth Judson, estimates that about 60% of all U.S. currency has left the country.

Following the money trail can often mean encountering a motley cast of characters that wouldn't look out of place in a detective novel. Dollar bills are often vital grease for criminal gangs and tax cheats. They are also popular with collectors who worry about a future collapse of the financial system.

Winning/Glynn – WSJ 12/12/19

In Germany, a man stuffed more than 500,000 euros in a faulty boiler. It was incinerated when a friend made a fix on a cold day while he was on vacation.

> **People hide their money everywhere. It happens again and again that people keep money in an envelope and then they shred it by mistake.**
>
> **Sven Berelmann, Bundesbank – WSJ 12/12/19**