Palmetto Wealth Management

The Power of Perception:

Why Negativity Persists in a Positive Economy

John M. Gustafson – 30 June 2023

"Sometimes things fall apart so that better things can fall together." - Marilyn Monroe

The second quarter of 2023 witnessed significant developments in the global financial markets, driven by various factors such as continuing economic growth, positive geopolitical events, and monetary policy evolution All despite the constant drumbeat of negativity in the media.

However, challenges such as the moderated, but continued inflation and nagging labor shortages hindered the rebound slightly. Especially in the U.S. where unemployment remains historically (as in, since before I was born) low.

Strangely enough, despite the nice rebound in the investment markets YTD, slowing inflation and the ability to get a job if you want one, everyone remains unhappy. I think this is a side-effect of the continuing damage we all realize inherent in social media but can't seem to avoid. The algorithms have all learned that negative stimulus keeps everyone engaged far longer than positive reinforcent. Especially when politics continues to divide our populace into opposing teams.

"Keep your face always toward the sunshine—and shadows will fall behind you." - Walt Whitman

An interesting example of this phenomena that I read (in the WSJ, I think) was a survey amongst American investors. 72% were happy with "their" accounts and performance currently, but only 29% thought that the overall economy was on the "right track." That, my friends, is what we call, cognitive dissonance.

I strive to keep these notes from being pollyannish – I am in the risk mitigation business after all - but the constant negativity about everything is tiresome and it ignores reality. As mentioned in several of these essays, we like to deal with reality on reality's terms. And right now, things are going pretty well, economically speaking.

"Remember, the stock market has a tendency to climb the wall of worry. Those who stay invested, despite the fears and doubts, are the ones who reap the rewards of long-term growth and prosperity." - Benjamin Graham

This is not meant to say that it's OK to put on blinders and ignore all risk. There is still plenty out there, but to ignore the opportunities isn't the correct way to proceed either. Thankfully, the crazies were defeated, and America didn't default on our debt obligations and the expected bounce occurred.

As is normally the case, there is always short term risk – much of it difficult to see – and almost always long term opportunity. The political environment makes it more murky simply because we are continually whipsawed between opposing policies and there is little consistency as to which will be passed and which will ultimately fail.

On the positive side of the ledger, the bipartisan infrastructure bill (actually titled "The Infrastructure and Jobs Act" because D.C. likes to make everything sound great) that was passed at the end of 2021 is continuing to push non-COVID-related funds out into the economy for heavy, industrial work that should continue for the next several years.

This is the sort of economic stimulant, unlike the COVID giveaways, that promote stability rather than raw inflation because of the longer-term nature of the cash flowing into the economy and it is across multiple beneficiaries giving the funds a larger multiplier in the economy. The only limitation on these projects will be our ongoing labor shortage.

It will also be nice to not worry which bridge may fall next or if the road will ruin your expensive wheels and tires on your car. Stay tuned...

"The future of energy is green, and those who invest in it today will reap both environmental and financial rewards tomorrow." - Elon Musk

This is an area I've looked at for years for our portfolios, but until recently, there have been few companies so focused in the publicly traded arena. Finally things have shifted to the point that there are some smaller businesses homed in on "green" technology, mostly component suppliers or very niche players. However, several large corporations are tackling the need for energy derived from somewhere other than dino-juice.

Several years ago (around 2014) I made the comment in one of these notes that I believed China would be a significant leader in going green. Not because they give two you-know-whats about the environment – simply because they do not have enough fossil fuels of their own to satisfy their immense and growing needs and desire the security of energy independence.

So far that supposition appears to be gaining accuracy. According to "Scientific American" in 2022, China invested $546 Billion in solar and wind energy, EV's and batteries. Literally more than the U.S. ($141B) and the EU ($180B) combined. They are out to quite a lead.

The good news which will hopefully get our country back on track and ramp up competition is that some of the latest legislation from D.C. (the mis-named "Inflation Reduction Act") had specific tax credits to incentivize EV's and other alternative energy purchases, but ONLY if the majority of the goods are assembled in America.

There’s a lot of discussion as to how battery technology will keep us beholden to China because of the rare-earth components where they hold a monopoly. However, just like anything else that is scarce, science is working on a solution for the future.

Look into “solid state battery technology” if you’re interested in viewing a potential game-changer in battery tech. Much faster charger, significantly higher energy density (i.e., smaller & lighter) with no rare-earth metals to be found. It looks to be the best answer currently – so much so, the leaders in developing those technologies with their partners are Toyota and Mercedes Benz.

Both produce a significant portion of their fleets in the U.S. currently. With the right incentives, as was delivered via the CHIPS Act, that should continue and grow as well.

"The stock market is a device for transferring money from the impatient to the patient." - Warren Buffett

All of this upside discussion makes me feel as though I should outline some of the risks that remain on our radar.

Inflation isn’t gone yet, although as discussed in the past few quarters, it is waning. And if you take a look at a chart of historical inflation, the reason things have felt so bad recently is mostly because we experienced over a decade with inflation far below the historical average thanks to the long recovery after the 2008 meltdown and recession.

To use numbers to illustrate what I’m saying... The average rate of inflation from 1950 through 2008 – after WWII until the Great Recession, was 3.85%. From 2008 until 2020 the average annual rate fell to 1.58%. Then, the spike from 2020 until now moves the inflation needle to 5.53% over that short period. What we've all seen and felt most recently.

What happens if you wrap that all together for the full period? (*drumroll*) The average annual rate of inflation in the U.S. from 1950 until 2023 is... 3.53% And the most recent month’s report shows a continued slide downward to the 4% level. A steady hand at the Fed has a “soft landing” within reach.

Remember, we’re in a world where everyone is unhappy, and perception is reality these days, but these are the figures. Definitely a different environment than most of the past decade, but also a more normalized one as well.

“A recession is when your neighbor loses their job. A depression is when you lose yours." - Ronald Reagan

This is, of course, the drum being beaten for the past 12 to 18 months by anyone with a public platform. “The Fed is going to go too far and cause a recession!” That could very well be – the yield curve (2 over 10) has been inverted for quite some time – but it’s not here now.

For the one-thousandth time I will reiterate - slowing growth is not “recession.” And in reality, growth hasn’t really slowed that much since all the COVID liquidity began sloshing around.

The one thing Chaiman Powell is doing that I think is brilliant, and reminds me of Alan Greenspan, is to continue to jawbone any enthusiasm to keep things from getting out of control. Is the Federal Reserve finished raising rates? Possibly... Not likely. Definitely not by the way he speaks. This puts just enough doubt in the minds of the traders and investors that a little extra caution continues to moderate their actions.

Irrational exuberance is the phrase Greenspan used as the 1990’s dot-com boom really began to get bubbly. We are a long way from that sort of environment and Powell is doing all he can with his tool box and his speaking engagements to keep things on track.

"In the midst of chaos, there is also opportunity." - Sun Tzu

So far, I’m happy with the heavier shift to the U.S. in our overall allocations. Tech has been the primary driver in 2023 – which makes sense as that suffered the most damage in the drawdown last year - and their financial metrics only continue to improve.

As outlined previously, the search for transitional green technologies will continue. We do continue to hold plenty of oil and gas affiliated companies in the meantime. Whatever the format going forward, energy is necessary to drive, build and ship goods across the globe.

The next minor adjustment to be made sometime soon will be to dial back our commodity exposure slightly. It has done well, but as inflation moderates, that outperformance will also. We are also finally in an environment where short-term fixed income is more than just a store of value in the portfolios, it can actually enhance returns.

Finally, thinking broadly about the economy in America it feels like we’re at another inflection point. Beginning in the 1980’s, much of our economic growth came in the form of service delivery and product development (intellectual capital) vs manufacturing.

I don’t think much of that will disappear, but it does look to me like manufacturing in America, because of the sophistication of the products being made (computer chips, “fly-by-wire" cars of all types, specialty chemicals, etc.) along with the need to revamp our country’s infrastructure, will lead to a new wave in our industrial and tech economy, more than simply services.

Thank you, as always, for your business and friendship and never hesitate to reach out if you have questions, comments or just want to catch up on the world.

Cheers!