

Third Quarter 2020

Economic and Market Commentary

By Ray L. Lent, Founder, The Putney Financial Group; Chairman, Portsmouth Financial Services

The year started off fortuitously enough with two guys working out of their garage and deciding to found a company. Their names were Hewlett and Packard. Culbert Olson was sworn in the next day, January 2, as California's new governor. Meanwhile, in Washington, John Nance Garner was serving as the country's Vice President, and a 58-year-old Franklin Roosevelt was gearing up for a run at an unheard of third term as President. The year was 1939.

Finally Rounding the Corner

After enduring a staggering 10-year Depression that saw 20% and 30% unemployment year in and year out, the country finally felt that it was emerging from a long dark tunnel. It was finally getting its mojo back. Signs of an American Renaissance could be found everywhere. Just start with Broadway. Lillian Hellman's *Little Foxes* opened in May. Down the street, Philip Barry's *The Philadelphia Story* was playing to packed houses. Soon to open would be Maxwell Anderson's *Key Largo*, the basis for Humphrey Bogart's immortal portrayal of Frank McCloud, an army veteran in the 1948 film adaptation.

Stick with me now, there's more. On the West Coast, Hollywood Films were producing movies that came to define the "Golden Age of Cinema," with releases like, *Gone With the Wind*, *Mr. Smith Goes to Washington*, *Gunga Din*, *The Hunchback of Notre Dame* and *Goodbye Mr. Chips*. So what about literature you ask? Just as impressive. John Steinbeck's *The Grapes of Wrath* was number one on the New York Times best seller list for 26 weeks. Not bad, when you consider Raymond Chandler introduced Detective Philip Marlowe to the world in *The Big Sleep*, and Eugene O'Neill's *The Iceman Cometh* was published to outstanding reviews the same year.

It wasn't a year just about culture, innovation and science; pop culture exploded as well. Both Superman and Batman were introduced to the world along with nylon stockings, Pan American Airways began its first transatlantic service with its Boeing 314s, fondly known as the "Yankee Clippers."

By mid-summer, a former Swiss patent clerk wrote to President Roosevelt, alerting him to the potential power of the atom bomb, a letter that arrived on August 2 which quickly led to the establishment of the "Manhattan Project." The clerk's name? Albert Einstein.

How Quickly the Tide Can Turn

It was less than two weeks later that MGM opened their latest blockbuster at Grauman's Chinese Theatre on August 15. The star of the movie? A 17-year-old sensation named Judy Garland. The Movie, *The Wizard of Oz*. For sure, the country was back on "*The Yellow Brick Road*," waiting

to see just what's "*Over the Rainbow*" with an optimism that had not been shared for the previous decade.

Holding true to the old adage that things can change on a dime, there was no more keeping one's head in the sand when Nazi Germany invaded Poland on September 1. Two days later, both Britain and France declared war on Germany. World War II had officially begun.

Balancing the Books

Just before the stock market crash of 1929, the U.S. federal budget was operating at a billion dollar a year surplus. In other words, the federal government was bringing in tax revenue one billion dollars more than they were spending on running the country. Then the bottom fell out. October 29, or Black Tuesday, saw the opening salvo of the Great Depression. At the time, the country's GDP was just around 100 billion dollars, and the government was operating in the black. It took more than 10 years to get the country back to anything close to that level of production, and when they did, fiscal year 1939 was running at a three billion dollar deficit (spending more than they took in) representing 3½ % of GDP. Obviously, this then gets added to the cumulative national debt the country had already run up.

Buying Time

To get to the point where the country was rounding the corner and could see the light at the end of the tunnel, federal spending had kicked in to create jobs and infrastructure projects like never before. Obviously, all of this had come at a cost. Not only was the government operating at significant deficit spending levels, but other parts of the government, like the military, were being starved. When Britain and France declared war on Germany, our standing army here in the U.S. stood at approximately 185,000 soldiers, roughly the size of Portugal's, ranking it at approximately 18th in world size.

France had already surrendered by the following spring, leaving Britain to battle alone against the Axis powers. The problem now was that the U.S. needed time to put American industry into overdrive, building jeeps, tanks, warships, fighters and bombers to support the war effort. America needed time to retool, and that was going to take money, lots and lots of money. The reality was there was no choice. Without America being the industrial engine for the war effort, all would have been lost. Britain could only have held out for so long had they been forced to sign some form of Armistice, the world would have been a very different and scarier place.

But America did rise to the challenge. They bought time by entering into the "Lend Lease" program with Britain, giving them desperately needed war supplies and armaments, yet still walking a tight rope of neutrality. They extended the longitude of the "protective seas" by almost 2000 miles, putting the Axis powers on notice not to interfere with Allied convoys crossing the Atlantic within 2000 miles of the American coastline.

By the end of the War, more than 407,000 Americans had lost their lives in defense of freedom. As previously noted, there was no choice, but now America was in debt. Deep, deep debt like

never before. With the wartime economy expanding the GDP to roughly 225 billion dollars per year, 1945's budget deficit was 48 billion, more than 20% of GDP, an unheard of amount. The new year came, and 1946 brought on a recession. As millions of GIs were mustered out of the service, the economy could not immediately employ them. It was going to take a bit of time for the country to retool to a peace time economy. But soon the pieces started to fall into place, and the post-war recovery began to boom. Once the expansion had started, it lasted all the way up to the 1973 Recession. More than 25 years of economic prosperity.

Okay, Smart Guy, So What's the Connection?

Elementary, dear Watson, elementary. All right, I'll admit it, I've adored Sherlock Holmes since early boyhood and have read everything written by his creator, Sir Arthur Conan Doyle. Please don't get me wrong; by no means am I trying to be glib. I believe we are living in historic times with historic implications, my point being that we now find ourselves in what in today's parlance would be known as a "no brainer" situation. Once again we and the rest of the world are fighting for our lives. This time it's not against Fascism but rather Mother Nature.

Covid-19 is currently producing a 9/11 catastrophe every 3½ days measured in the loss of American lives. Let me put it in another way. The most popular airline in use pre-pandemic was the Boeing 737 which had a maximum capacity of 215 passengers if booked to the gills. At the current pace of the virus's mortality rate, this is equal to terrorists blowing up a fully booked 737, with all souls lost every six hours. That's day in, day out just here in America. Who in their right mind would want to fly? Obviously, it would crush travel and everything else.

The reality is we will get through the pandemic. Will it be the concept of herd immunity that pulls us through? I doubt it. That would require more than 200 million Americans getting infected, with conservative death estimate tolls north of two million Americans dying. It just doesn't work. You need not look any further than Sweden for proof. They tried it, and it has been a disaster. More than 7% of Stockholm's nursing population has passed away since the start of the pandemic. No, it seems our road to recovery and gaining our lives back will come through effective therapeutics, vaccines, social distancing, rapid testing, contact tracing, mask wearing and a shared sense of civic commitment. Personally, I'll take Dr. Fauci's advice over Dr. Atlas any day. Fortunately, at the time of editing this piece, Pfizer has announced the advancement of a vaccine with a 90% effective rate. That's great news, but now is not the time to let our guard down. It will take months and months for the vaccine to be nationally available to all people. In the meantime, the epidemic continues to rage on.

"History Doesn't Repeat Itself, But It Often Rhymes"

Mark Twain

Our economy cannot heal without deploying medical science and our common sense. Failure to act will only continue to extract an alarming price that can be measured in both lives lost and economic decay. Going forward, just as we did during World War II and the Great Recession of

2008 and 2009, federal money will need to be printed and spent to prevent tens of millions of people from suffering tremendous pain and displacement.

Since this election may or may not have been decided by the time you receive this commentary, it's important to remember whoever is in the White House will have to face the reality of staggering federal debt as a result of Covid-19. In this situation, I agree with the President: "It is what it is." Between relief packages both past and future, along with reduced GDP, high unemployment and even higher underemployment, we have a real challenge ahead. Remember, this is on top of our already significant national debt and a looming avalanche of credit defaults coupled with an already aging infrastructure. The question begging to be asked is: What do we do about it?

Step Back For A Minute

Rebuilding economic prosperity and eliminating unsustainable debt spending can only be accomplished by growing our GDP. It cannot be done by cost cutting or tax increases alone. Let me say it again, rebuilding our economic prosperity can only be accomplished by growing GDP. Tax increases and budget cuts should only be considered as just a couple of tools, not all of them, that are in the tool box. We have to think smarter than that. Just like we did after World War II and the Great Recession of 2008 and 2009.

So here's some perspective that will help us understand the country's current economic state and how we have dug ourselves out of similar situations in the past. Not just dug ourselves out but prospered and grew. Let's start in late 1945. The country's production had more than doubled over the course of the War. Now the country was facing around a 50 billion dollar annual deficit, more than 20% of GDP. That's six times the annual debt spending as compared to 1939's 3½ % of GDP. It's estimated that America's cost to fight World War II was approximately six trillion dollars in today's money. We'll go into how we got out of the hole in just a minute. Bear with me, here comes the perspective. Pay attention.

When the federal government initially passed the annual budget for 2020 (that's the fiscal year that just ended on September 30), they planned on a 1.1 trillion dollar deficit of roughly 4.8% of anticipated GDP. Unto itself, it was pretty high by historic standards. But, on the other hand, the economy was in pretty good shape at least for some if not the many. So what happens next? The pandemic hits, GDP shrinks. People are scared, wondering, and now there are tens of millions of newly-unemployed, many of whom were already struggling to begin with.

This is not a medical or public policy editorial, but economic commentary. I will just report that the government stepped forward and spent money, lots and lots of money. It extended and enhanced unemployment benefits, granted payroll protection loans (PPPs), and this is on top of the expenses actually incurred trying to fight a war. That is to say, a war on the Corona virus itself. By fiscal year's end, the deficit exceeded three trillion dollars or 18% of GDP, almost four times the original estimates.

Want me to really make it clear? Think of your household budget. Imagine if every month, for every dollar you spent on running your household, you had to borrow 48 cents of it to make ends

meet. That's exactly how last year went. And you know what? This coming year will be more of the same regardless of who ends up in the White House. Yes, our numbers are eerily similar to what they were at the end of World War II, but the difference is that we haven't won the virus war yet and we still have a long way to go.

Let Me Bring It Home

They called them "The Greatest Generation." Whether they were or not is not the issue. What they were was tough, creative and resilient. Not just in defending democracy during a war, but in creating a modern economy that would become the envy of the world. I believe it will be more than useful to give you a quick rundown of how America worked off its debt after World War II and built the most robust economy the world had ever seen. Although this is no perfect road map for us to follow, there were certainly some valuable trends and strategies deployed that any savvy investor today would be wise to take note of

When the Troops Came Home

- **Lesson One:** Educate your work force. It started with a firm government commitment to morph our men and women in uniform into a well educated work force. The mechanism, "The GI Bill," perhaps the best money ever spent. By the end of its first few years, it swelled the American middle class. As old industries change, as they always do, workers need the skill sets to be valued and add to productivity.
- **Lesson Two:** American manufacturing recognized what people wanted, and automobile manufacturing and all the jobs associated with it quadrupled between 1946-1956.
- **Lesson Three:** Gains in productivity through science and innovation helped farming and manufacturing workers transition into higher-paying jobs in the service sectors.

Advances in agriculture led to mass consolidation and mechanization. More food produced by fewer people. A mixed bag, but a definite growth driver. Bad for the small family farm in some ways because many farmers left the land and moved to the burgeoning suburbs and cities. This exodus catapulted yet another growth industry—housing.
- **Lesson Four:** Armed with low interest rates, easy to get government-backed mortgages in the form of VA loans, America's Greatest Generation decided to nest. New communities were growing up left and right. Easy parking, convenient to shopping, room to breathe. What's not to like? Millions and millions of people worked directly in the housing industry so these homes would exist.
- **Lesson Five:** Getting from here to there required good roads. Remember, I reported that American car sales quadrupled in the first 10 years after the War?

Well, they did. And American roads at the time were antiquated. Soon the most impressive road-building projects since the Roman Empire commenced. When it was over, America had 65,000 miles of new highways. Talk about creating jobs.

Look at the pattern that emerges here. It's not random, it's synchronicity. It's thoughtful planning.

Now we find our vets driving down their new freeways, coming home to the suburbs in their fin-tailed Buicks after a day in the new service economies. What do they do at home? Simple. They procreate, producing the baby boom generation. Think about this progeny, vast in number, better educated than any previous generation with a drive to create, innovate and consume. Oh yes, we're talking big time consumers here, and their appetites needed to be satisfied. That means more manufacturing, more jobs and a growing GDP.

The advances in shipping with the invention of containers, jet travel, telecommunications, computers and the like created an American economy that was the envy of the world. By 1965, our country achieved two milestones: 1. For the first time, the American economy represented more than 35% of the world's goods and services and 2. America created Medicare to provide health insurance for those 65 and over.

At the time, more than 56% of Americans in that age group had no health insurance of any kind. Did it have an impact on everyday lives in America? You bet it did. Between 1965 and today, the average life expectancy in America has grown by more than 11 years. That's how you restore an economy.

“Deja Vu All Over Again”

Yogi Berra

Just so there's no confusion, America's dramatic prosperity on the heels of massive debt from fighting World War II was no anomaly. By the late 1990s, the increase in public debt slowed to a trickle, and in fact, our federal budget operated for several years with a budget surplus. Americans are no strangers to spending money when we have to and digging ourselves out of debt. In fact, at the end of the American Revolution, our young Republic owed more than 70 million dollars to the French and Dutch, yet just 20 years later, we paid cash for the Louisiana Purchase.

The early 2000s started with the Dot.com bubble bursting followed shortly thereafter by the tragedy of 9/11. It wasn't long before America was back to war with invasions in Iraq and Afghanistan. These wars were not funded with tax increases but with debt. Technology advanced, our wartime economy prospered for a while, and then the bottom fell out. Fueled by lax lending standards, low interest rates and a derivative market gone mad, we soon faced the demise of the housing market and our banking industry being on the verge of collapse. Remember Lehman Brothers, Wachovia and Washington Mutual? From peak to trough, the stock market fumbled some 55% in a matter of a few months.

Our deficit spending again flew into action with quantitative easing, government bond buy backs and back stopping our banks with money and bailouts. Remember “Too Big to Fail?” Soon our annual deficit surpassed the trillion dollar mark. But once again, the money proved well spent. The housing market rebounded, no bank depositors were short changed, science and technology pushed the envelope forward, and equity markets recouped to ultimately hit new all-time highs. In large part, the recovery from the Great Recession of 2008-2009 was spurred on by product innovation, enhancements to productivity and the advent and maturation of fledgling industries. For example:

- Facebook connected in an unheard-of fashion. Today, more than two billion people around the world a day share laughs, ideas and frustrations. In its brief, 15-year history, Facebook launched the world of social media and employed hundreds of thousands of well paid workers along the way.
- By late 2009, Apple’s i-phones, revolutionary mobile phones and breakthrough internet communications devices, were now available in all major markets. Think about it: The i-phone has totally transformed the way we communicate, get information and stay connected. Granted at times it can be invasive and a distraction, but its contributions to commerce and productivity are staggering. E.G., you’re waiting for your car to be brought around and you remember you’re low on toilet paper. You whip out your phone, and in a few quick clicks, Amazon will have it on your doorstep tomorrow.
- How about Uber and the dawn of the “shared economy?” For many people who only need a car now and then, think Zip Car, where you literally rent by the hour. Don’t want to drive? Open up that cell phone and hail a ride with Lyft or Uber. Think how this shared economy concept has morphed into spaces like Airbnb or Vrbo. It’s also moving into planes, boats and heavy equipment. Why pay for something 365 days a year when you only use it for 10 days?
- How about Square? Back in 2009, Twitter founder Jack Dorsey and businessman Jim McKelvey started Square, an incredibly easy and inexpensive mobile payment system. I’m telling you, in 50 years, the idea of using paper money will be as arcane as wampum.
- One more, then I promise I’ll stop. Think collective bargaining power, just like unions used to enjoy. Now apply it to the world of group buying and negotiating a discount along the way. What do you get? “Groupon,” part group buying, part coupon clipping, hence the name. You are looking here at the birthplace of the modern subscription service. If you don’t think that’s big business, think of Netflix as an example.

Conclusion

It was my original intention to carry this narrative forward in a discussion of who I believe will be the innovators this coming decade and why I am so optimistic about America’s economic

future in a post-Covid-19 world. Obviously, prosperity doesn't come without hard work, but it's in the American DNA not to shirk a challenge and to put in the hard work. As I said, that was my original plan, but my senior editor, Denise O'Toole, prevailed in her position that I shouldn't outwear my welcome but should save the rest for the Fourth Quarter commentary. Wise counsel, thank you, Denise.

Those who know me well know that I've never been much of a joke teller, but I sure enjoy a good story. I heard one a few weeks back that I'll share with you in the hopes, once again, of providing a bit of perspective. Here goes.

Two good ol' boys in the Midwest were talking across the fences separating their two farms. One's an eternal optimist, the other a dyed-in-the-wool pessimist. It's a clear and warm day, and the optimist says, "Isn't this a bright and sunny day? Surely this will mean a fine crop this year." The pessimist rubs his stubbly chin and says, "It's too darn hot, too darn soon. These crops will burn, and this year will be a bust."

A couple of days go by and once again the farmers meet across their fences, only this time it's raining. The optimist says, "Isn't this glorious? This rain will nurture our crops, and I know this will be a bountiful harvest." Once again, the pessimist rubs his stubbly chin and says, "This rain will be the ruin of us. It's come too darn early and will rot the roots of our crop."

A few more days go by, and the good ol' boys once again find themselves talking across the fence. The optimist says, "You know, Saturday is the start of duck hunting season. You want to go out on the Lake? I'll bring Buck (the optimist's prize black lab)." The pessimist says, "Let's do it. I'll meet you down at the dock at 6:00am."

Saturday arrives, and the optimist and the pessimist head out with Buck. About an hour goes by, and a flock of mallards fly overhead. They both take aim and fire. Two birds fall from the sky. The optimist says to the pessimist, "Watch this." The optimist now turns to Buck who has been patiently sitting in the boat. Buck is given the command, "Now go get those birds." Without hesitation, Buck steps out of the boat and is just standing there on top of the water, barely getting his pads wet. Without further instruction, he walks on top of the water, picks up the two birds in his soft mouth and walks back to the boat.

Buck gets back into the boat, dry as a bone, and gently lays the two birds down at the feet of the pessimist and retakes his position in the boat. With that, the optimist turns to the pessimist and says, "Well, what do you think of that?" The pessimist thinks for a moment and then says, "Aaaah, I shudda known better. That damn dog of yours don't know how to swim!"

Let me end this commentary by sharing my cautious but most optimistic opinion that in our post-pandemic world, we will resume economic prosperity. To get from here to there is a three-phased process. We need to *respond*, act thoughtfully to the threats at hand and promote safety. We need to *recover*, meaning restore and emerge stronger. We need to take our flexibility and innovations so that we can enter the third phase. That's when we *thrive*, and build long-term enhancements to the public sector and establish a better foundation for the future.

Just as I said in my last commentary, “there’s no fooling mother nature.” We need to be responsive, alert and cautious. Now is not the time to be a statistic. We’ve all been mesmerized by the red and blue demarcation maps on the news this past week or two tracking electoral votes. Soon we’ll be viewing a mostly red map again that’s tracking surges in new cases of Covid-19 which have been exceeding 100,000 cases per day, every day this past week. No, this is not written to scare or unnerve, it’s written to remind.

There’s a most capable civil servant in San Francisco who on most days wouldn’t warrant a second glance. I’d like to shine a spotlight on him for just a moment for his wisdom and heartfelt advice. His name is Grant Colfax, and he’s the Director of the San Francisco Department of Public Health. Grant put it quite succinctly in a recent interview. When asked about the upcoming holidays he said, “Let’s be here next year, when hopefully this pandemic will be behind us, and we can get together with our loved ones in close contact, hugging, sharing food and giving toasts. But this year, we need to use caution.” I agree. This is the year to be a survivor, not a statistic.

Stay well and stay safe. As always, with...

Warmest Regards,

Ray Lent
RLL/dot
Enclosures

Post Script

Thank you kind reader for wading through the commentary. Just rest assured that it took me longer to write it than it took you to read it. In fact, it took so long, the election has now been declared, and in all likelihood, Joe Biden will be sworn in as our 46th President on January 20, 2021. No matter who won the race, all of the challenges relayed in this column remain. We as a nation must come together exactly as generations past have done and “seize the day.”

Now as promised, I wanted to share some fresh coping skills that have been passed on by our readers. I will continue to do so until we can retire our masks and come together once again.

- Golden Gate Park is celebrating its 150th anniversary. At the center of the music concourse is a 150-foot tall Ferris wheel called the “Sky Star.” This will be the first time there will have been a Ferris wheel in Golden Gate Park since 1892. It’s safe, has great Covid-19 protocols, and the views are exceptional. Don’t be a shut in, here’s a local adventure.
- Garden of d’Lights at the Ruth Bancroft Garden. Using thousands of lights and lasers, the Bancroft Garden in Walnut Creek will come alive every night between November 20 and December 20. Meander at your own pace, excellent distancing protocols. Don’t be a shut in, here’s a great local adventure. Phone 925-944-9352.

- All right, if you insist on staying home, here's a tip: Check your credit cards rewards program. Those airline miles are certainly not as attractive as they once were. Certain credit card companies get it and are offering services that we are actually using, e.g., free Uber eats deliveries membership for up to 12 months on top of a 5% discount on restaurants charges and groceries are being offered by American Express (some minimums apply). Am Ex is not alone. Some Bank of America cards are now allowing you to use your loyalty points toward dining, takeout and groceries. These are examples of just a couple of programs out there. Pull out your card, call the 800#, and check out the changes. If you find anything else, call Denise, and we'll share with everyone else. Stay well and stay safe.

Ray