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Economic and Market Commentary

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

So, you have a spare goat, and it's a fine goat indeed. Milk giving, healthy and only three years old. To you, it's a surplus goat because you actually have three more at home just like it. What you don't have is a cattle dog. You spend half your day trying to herd your cow and goats into their pens every single day. If you don't, how are you ever going to harvest your milk or make your yogurt or cheese?

Now I on the other hand, have a most wonderful pack of dogs. Self-sufficient, smart and with innate abilities to herd animals into a pen in a tenth of the time it takes you. What I don't have, unfortunately, is a female goat that I can breed my Billy with in order to grow the herd.

What do you see here? What you should see is a match made in heaven. I trade you my extra cattle dog, you trade me your female goat, and we just concluded a deal. Donald Trump would be proud. We each wound up with something we needed by exchanging something we didn't need, and now we're both better off for the transaction. Economists would call this barter. Pretty cool, pretty efficient, but it has its drawbacks.

Coincidence

If one were to look up the etymology of the word coincidence, they would find the word is derived from the Latin "cum" (with or together) and "incidere," a compound verb from "in" and "cadere," "to happen." In other words, to "come together."

So going back to our fortuitous neighbors of 12,000 years ago, wasn't it a wonderful coincidence that one neighbor had a surplus goat and happened to need a surplus cattle dog to keep them all together, which his next-door neighbor happened to have. What if it wasn't so easy? What if that neighbor with the extra dog had a great mouse-catching cat instead? Now if the guy with the goat had a mouse problem in his barn, no problem. But what if he already had his own mouse-catching cat but still needed the dog, which he intended to pay for with the goat? Now we have a real problem.

What's The Fix?

Now the guy with the excess mouse-catching cat has to find a third person who needs a mouse-catching cat and happens to have an extra cattle-herding dog he's willing to trade for the mouse-catching cat so that he can complete the trade with his neighbor with the extra goat. It doesn't take long for things to start getting complicated.

Here's a new wrinkle. What if the guy who had the extra goat also needed a fence to keep them all in? Now if the guy who happened to have the cat which he couldn't trade for the cattle dog happened to know how to build a fence, bingo, he trades the guy with the extra goat for, not a cat, not a dog, but a fence. A fence that he builds with his own two hands, advancing the concept of barter from only trading a good for another good to the concept of trading a good for a service. Believe it or not, commerce has just moved light years ahead. If you think about it, a similar revolution is going on today through companies like Uber and Airbnb where underused assets are electronically traded on a constant basis.

So What Next?

Barter certainly had its merits, and without a doubt, moved commerce along, but as cool as it was, it still had its limitations. There was no standard of measure. If your dog was missing an eye, did that mean he was only worth a three-legged goat? It was very hard to quantify, and even more challenging was the fact that you had to at least know each other to consummate a deal. As societies and surpluses grew, and people had more than they needed, an opportunity arose even before money was invented.

It Was Called "Gift Economy"

Basically speaking, a "gift economy" flourishes because a constantly recurring giving of services and goods is taking place between the citizenry with no specific payback date required. Consider it an early form of social insurance, one that was particularly valuable in a hunter gatherer society. Think about it. I return that evening after stalking prey for 15 hours, I'm empty-handed, and my family is waiting hungry and expectant. The concept of a gift economy comes in pretty handy. I bet you didn't realize the concept of insurance, sharing the risk, dates back 12,000 years.

The Concept Of Money

More than 15,000 years ago, obsidian was the most prized possession known to man. This vulcan rock can hold an edge that surgeons today still use. Cataracts were removed in the Middle East using obsidian scalpels over 1000 years ago. When the concept of the gift economy first disappeared, it was replaced by the emergence of money, and obsidian was the coin of the realm. This commodity ruled for more than 5000 years until it was eventually replaced in the third millennium by copper and silver. As early as the code of Hammurabi, the concept of money was developed with the codification of fines, taxes and interest, payable in money, literally set in stone.

And so it went, for thousands of years, until King Xerxes in ancient Lydia finally standardized the form of coinage made from electrum, a naturally forming alloy of silver and gold that revolutionized commerce forever.

Over time, the concept of coinage became more standardized. Gold and silver started being made into coin by highly regulated government mints, carefully ensuring their weight and metallic content.

Soon more common metals like copper, bronze and nickel were used. What all the coinage had in common, as was the case with barter goods, was that the commodity had a value. The cow could be turned into beef, the bronze into a spearhead, etc. They were in essence a reliable store of wealth with a known equivalent of value. A known equivalent value eliminated the guesswork in commerce: was the one-eyed dog really worth a three-legged goat, or would it take two bronze "staters" to buy the goat? This standardization of value was a huge milestone, but at the same time, it brought with it tremendous challenges. Do you have any idea just how much copper coinage it would take to buy a cow in ancient China? Try roughly 50 pounds worth. What if you wanted to buy a hundred cows, not just one, now you have a real logistical problem.

The Simple Mulberry Tree

Morus Alba, commonly known as the white mulberry tree, is an important source of food for the silkworm whose cocoon, as we know, is the source of silk. Although fast growing when young, these trees soon become slow-growing and rarely exceed 40 or 50 feet in height. They thrive in warm regions—Asia and Africa principally. When in full bloom, their beauty is astonishing. While voluntarily confined at Saint Paul de Mausole Asylum in Saint Remi, France, Vincent Van Gogh painted his famous, "The Mulberry Tree," whose beauty pleased him so greatly that he wrote to both his brother Theo and his sister Wilhelmina espousing its "magnificent bushy yellow foliage."

Now for the purposes of our narrative, it is not the beauty of the mulberry tree's bloom that we're most interested in. But it's the tree's use in early paper production that draws our attention. Almost as soon as people invented writing, they started looking for something easier and cheaper to manufacture than the clay, papyrus, and parchment which they had been using for 3000 years.

During the early Han Dynasty in China, Emperor Ts'ai Lun had his scientist mix a combination of finely chopped mulberry bark and hemp rags with water. After mashing it flat, they then pressed out the water and allowed their product to dry in the sun. Before long, they had paper. The concept grew so quickly that by 400 A.D., paper was being used throughout Eurasia. Not only was it cheap to make, but it also absorbed ink so you couldn't erase it, making forgery much harder.

The Silk Road

Here's where today's commentary comes together. As cultures developed and communities looked past their immediate borders, it was the Silk Road, an ancient network of trade routes that enabled both economic and cultural trade between East and West. In essence, connecting the world from China to the Mediterranean Sea. During this time, metal-based coins presented countless advantages, including containing their value in the coins themselves. But on the other hand they were targets of manipulation, "clipping," "shaving," and "debasing," just to name a few. Not to mention the sheer bulk and weight that sometimes needed to be carted around in inhospitable environments just to complete a purchase. Something had to be done.

By the early seventh century Tang Dynasty, merchants and wholesalers (think of them as precursors to Goldman Sachs) started using their new mulberry paper to issue "demand deposits." Basically, they deposited a specific amount of metal coin, and they were then issued a piece of paper that said at some point in the future whoever held that paper could receive the stated amount of coins in return for the paper by simply presenting it to the insurer. What a boom, no longer having to brave the deserts and mountains lugging strong boxes of coins, but "demand deposit" instead.

Here's Where the Government Gets Involved

It didn't take long for the leaders of the Song Dynasty in China, somewhere during the 11th century, to start printing paper money. The Emperor handed out a small number of monopolies to government-run deposit shops. People would deposit their copper coins, incidentally called "cash coins," and in return receive money printed by the shop. For their efforts, the shops received a small payment. The concept became so popular that, by the early 12th century, the amount of bank notes issued in a single year amounted to an annual rate of 26 million strings of cash coins. Now things really started getting out of hand when the amount of paper currency being issued far exceeded the coins on deposit. In other words, if everyone showed up at once to redeem their paper money, there would not be enough coins to pay them all off. So what happened is that people started discounting the paper money more and more. Now, instead of redeeming a paper note that was supposed to buy the equivalent of something worth a hundred copper coins, it might only buy them something worth 20 copper coins. Sound familiar? Today we call it inflation, too much worthless money chasing too few goods.

Parenthetically, when Marco Polo returned from his travels in the East, he wrote his autobiography, *The Travels of Marco Polo*, and perhaps one of the most unbelievable chapters in his entire book was one entitled "How the great Kaan causeth the bark of trees made into something like paper to pass for money all over his country."

You Would've Thought Greece Would Have Been All Over This Concept

But in reality, Europeans waited hundreds more years before they started issuing paper money of their own. In fact, Investopedia tells us that the first paper currency issued by European governments was actually issued by colonial governments in North America because shipments between Europe and the colonies took so long, and the colonists would often run out of cash as operations expanded. Instead of going back to a barter system, the colonial governments used IOUs that traded as currency. The first instance was in Canada, then a French colony. In 1685, soldiers were issued playing cards denominated and signed by the governor to use as cash instead of coins from France. Talk about funny money.

Let Me Bring It Home

A fair question to ask might be, why are we talking about this now? The equity markets have been on a roller coaster for more than two years. Any doubt that Europe's in a recession has now been thrown out the window, and Japan is issuing government treasury notes with negative rates of return. Commodities have been a bust and oil has tanked. We could go on with a discussion of

Brazil's near bankruptcy, China's needed readjustment to a first world economy, not to mention the constant threat of geopolitical tragedy throughout the world. But please stick with me a moment longer because some things are most certainly in our control and can lead to positive life-changing results for generations to come.

Before you receive the next quarterly commentary from me, the Democratic National Convention will take place in Philadelphia, and the Republicans will have met in Cleveland. To say it's been a strange presidential cycle to date would certainly be an understatement, but it has never been my intention to engage in political discourse using this long-produced medium committed to political neutrality.

What I do most want to remind you of is that which I've written about these past six months: the country is currently $19 trillion in debt, with the balance going up by the minute. Is this sustainable? Absolutely not.

As a kid in high school, I remember having to read Hemingway's, *The Sun Also Rises*, a masterpiece of the "lost generation "written shortly after World War I. Over drinks, Bill asks Mike, "How did you go bankrupt?" Mike responded, "Two ways—gradually, then suddenly." Right now we're still in the gradual stage. Why? Because people are still willing to lend us money at reasonable rates.

Think about it, a country that can't finance its operations through borrowing money has few options. It can cut expenses, which could very possibly hurt the country and damage the economy. It can raise taxes, never pleasing people and again possibly compromising the economy. Or it can just print more money, causing huge inflation and again possibly ruining the economy. Just ask Zimbabwe or the Weimer Republic to see how well it worked out for them.

Today's reality is this: growth is slowing, baby boomers are aging, thus spending is less. Capitalism has historically been based on an ever-expanding number of people. People equal consumers. A decreasing number of consumers results in no easy solutions.

Conclusion

In just about six months, it will be time for us to head to the ballot box. Not just to pick our next president, but also to pick those that lead our school districts, city councils, state legislatures on up. If you're running for office, there is no doubt you've got rhetoric. What's not so certain is do you have ideas that can address stunted job growth, rising debt and an unsustainable path?

Things worth doing always require hard work and there's no doubt pain will be involved. Almost five years ago, a brilliant bipartisan group of Democrats and Republicans called the Simpson Bowles Commission was formed consisting of first-class minds taking on America's tougher problems while putting political allegiances on hold. One might say, almost unheard of. Eventually they presented their findings and put forth their recommendations. They were thanked for their job, thanked for their efforts, and summarily ignored.

For me, the glass is always half filled. I'm looking for ways of changing the "new normal" of lowered expectations, and as I get deeper into this political season, here are a few of the things my ears are tuned to:

One

Responsible immigration reform. Things I'm listening for will relate to strategic initiatives that bring educated foreigners and investors here looking to make financial investments in the United States that create jobs and enhance our leadership in innovation and entrepreneurship.

Two

Unemployment. It's tough to lose a job and sometimes even tougher to find a new one, but that doesn't mean we can't be contributing to the public good even while we're looking for work. By having unemployed workers required to volunteer at a nonprofit at least part time, all sides benefit. The workers gain skills, contacts and references, and we gain the use of their talents (why aren't more people talking about this?).

Three

Cut healthcare cost. No, I'm not talking about scrapping the Affordable Healthcare Act, but why can't we buy prescription drugs from reputable pharmacies overseas at a fraction of the cost? I'm looking to hear responsible discourse on getting proper value for what we pay for. Some of the advances in modern medicine are incredible, but if only a handful can afford to pay for them, so what?

Four

Remove unnecessary and unclear laws. I want to hear specifics about some of the needless redundancies in testing that are utterly wasting government resources. Current Department of Energy (DOE) rule making, for example, is totally wasting taxpayer money with redundant test procedures. No, I'm not talking, as some politicians are, about eliminating the Department of Energy or the Department of Education. I'm talking about eliminating the bullying culture of stupidity going on at places like the Federal Trade Commission (FTC) and the Federal Work Study Program (FWS), to name a few.

Five

Finally, and perhaps most importantly, we are a nation of innovators and entrepreneurs. I believe it's crucial that we pursue policies that both promote innovation and risk-taking to benefit all of us as Americans and citizens of the world.

Between now and November, you can be sure that we at Putney will continue to maintain our strategy of diversified portfolios, taking maximum advantage of asset classes enjoying low correlation to each other. We will stay constant in our focus of positive rates of return with the least amount of risk possible while continuing to pay keen attention to delivering highly dependable income streams with our insured products. As always, with...

Very Best Wishes,

Ray Lent

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Enclosures