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Economic and Market Commentary

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"Block the box." That's what transportation engineers refer to as an all-too-frequent condition we've all found ourselves in at one time or another. You're driving along and traffic is heavy. The bonehead driving ahead of you enters into an intersection in front of you on a green light but doesn't have enough room to go all the way through because of backed up traffic. So what happens naturally is the bonehead gets stuck in the intersection. Obviously, this is going to cause the cars that now have a green light to get stuck with no place to go. Regrettably boneheads usually come in multiples, so there's an excellent chance the car with the green light will also enter into the intersection with no place to go, and to make matters worse, they'll all start leaning on their horns. Nice touch. Now if this little cluster maze should occur at multiple intersections, you simultaneously get what is commonly now referred to by the rest of us as "gridlock."

What's In A Name

Since childhood, I've always been fascinated by the science of etymology, the origins of words. I have to admit I wasn't all that surprised when I researched the etymology of the word gridlock only to find out that it originated back in my home town of New York City. It appears that the powers that be in the New York City Department of Transportation had the brilliant idea to close Broadway to car traffic back in the 1970s. A young traffic engineer named Sam Schwartz remembered that the senior engineers had all protested by saying, "You can't do that. It will lock up the grid." Years later, when Schwartz had risen to Chief Traffic Engineer for New York, he titled a report he was writing, "Gridlock Prevention Plan."

Now the phenomena is not unique to New York or San Francisco or the U.S. for that matter. In fact, according to *Time Magazine,* the worst traffic jam in history occurred in Sao Paulo, Brazil, in 2014. According to *Time*, if the cars had been measured end to end, you would have had more than 214 miles of autos going nowhere.

Modern Game Theory

Common sense tells us that if all drivers practiced common courtesy, most gridlock would be avoided. We wouldn't squeeze into the intersection only to go nowhere and screw it up for everyone else, ourselves included. So why do we do it? Human nature. There are always those who look to maximize their own benefit. In this case trying to quicken their own travel time.

Unfortunately, mutual cooperation can often be a rare commodity. These days in Washington, it's a particularly rare commodity whose shortage has resulted in its own form of gridlock where no one gets home faster. In fact, it's the entire country that suffers. Social scientists and game

theorists have studied this type of irrational behavior which is exemplified by rational individuals choosing not to cooperate fully, when knowing that if they did, it would be in their mutual best interest. In this case, we're talking about the country's best interest.

The Prisoners' Dilemma

Back in the late 1940s, a think tank at the Rand Corporation was studying cooperative behavior and applying it to real world situations such as shortages, congestion, mutual annihilation and the like. Two scientists named Merrill Flood and Melvin Dresher originally formulated a concept, and a third scientist and game theorist named Albert Tucker created a game using prison sentences as rewards to illustrate the theory. The game's name became, "The Prisoners Dilemma." Allow me to explain the mechanics of the game the same way it was explained to me.

Two suspects of a street gang are arrested. They are separated and held apart, neither one able to communicate with each other. The prosecutors realize they have enough evidence to convict them both on a minor charge but not enough to convict them on the more serious charge they know they are guilty of without a confession. The prosecutors figure the only way they'll get a confession is if one of the suspects squeals on his colleague. In this game, there are four outcomes that can occur. For our purposes, we'll call our perps Saul and Enrique.

The following are the four possible outcomes all dependent on whether one guy turns on the other or not:

A. Saul and Enrique each turn on the other resulting in each getting convicted of the more serious crime and sentenced to two years each in prison.

B. Saul squeals on Enrique, and Enrique keeps his mouth shut. Saul goes free, and Enrique gets a three-year sentence.

C. Enrique squeals on Saul, and Saul keeps his mouth shut. Enrique goes free, and Saul gets a three-year sentence.

D. Saul and Enrique each keep their mouth shut. The prosecutors can't pursue the more serious charge, and Saul and Enrique each get one year.

Let Me Bring It Home

If Saul and Enrique were to cooperate with each other and keep their mouths shut, collectively they would serve the least amount of time. If one cooperated by keeping his mouth shut and the other put his self-interest first by betraying the other, 50% more prison time is spent. Now if neither cooperates, and they both put their own self-interest first, they collectively spend twice the time in prison compared to if they had each cooperated.

This field of study has been further developed over the past 75 years and has revealed that humans have systemic bias towards cooperative behavior. This bias toward putting self-interest first, is now blatantly on display in Washington, where cooperation would so obviously enhance

the public good.

Think about it: Right now we have a bi-partisan infrastructure bill overwhelmingly approved by the Senate (cooperation). Unfortunately, as of this writing, it's going nowhere because Congress refuses to pass it unless the stimulus package is voted on simultaneously (gridlock and self-interest).

The Country Needs Both Pieces Of Legislation and Here's Why

Since this is part of a continuing series on the "state of play"* in America, you'll recall my repeated reference to the fact that the country and the world have been in a state of war for almost two years now with the mightiest foe of all being "Mother Nature" due to the Covid-19 pandemic. You'll further recall the assertion that, when you are at war, you spend whatever it takes to win the war and figure out how to pay for it later. That's exactly what we did during World War II, and that's exactly what we need to do now. We didn't restore prosperity back in the 40s by cutting budgets, but instead ushered in 35+ years of prosperity by spending money. By spending money wisely, we grew the economy, created jobs and enhanced Americans' standard of living.

The Tigers Win the Series In Game Seven

It's October 1945, and the war had just come to an end. Baseball's World Series pitted the Cubs against the Tigers. The Tigers won in game seven, in large part due to MVP Hank Greenberg driving in seven runs during the Series. He had been discharged from the service just months before and joined the Tigers roster in the nick of time. Meanwhile the bean counters in Washington were adding up the cost of the war and figuring just how deep in debt the country was. It was a big number, a very big number.

By the beginning of 1946, American debt had reached the highest level it had ever seen– almost $242 billion, 113% of our GDP. But the war had proved that Americans could respond rapidly in times of crisis. At the beginning of World War II, the American army ranked 17th in size in the world. Just behind Romania. It was manned with many high school dropouts and required a recruit to read at a fourth grade level in order to join the service. It became clear to American leadership that things needed to change and change quickly.

New recruits and volunteers were trained to operate the sophisticated equipment that was being built out of necessity to win the war. Our factories were retooled and soon turning out tanks, ships and planes at an unheard of pace. By the end of the war, 11 million hardened veterans returned home. No longer needing to be soldiers, what would their lives look like? Would the country slip back into the strangling Depression that occupied much of the 1930s?

* Amazing what you can learn on the Internet. It turns out that "state of play" is a British term used to describe "the present situation."

Big Problems Often Require Bold Solutions

Even with the war still raging both in the Pacific as well as the European fronts, President Franklin Roosevelt tasked Congress to pass a bill that would give returning veterans an opportunity to prosper in life. He was bound and determined that this time we'd do better by our veterans than we did for the returning Doughboys of World War I.
For much of 1944, Congress debated, bartered and wrangled amongst themselves and eventually passed the "Servicemen's Readjustment Act of 1944." We know it as the G.I. Bill. The G.I. Bill made low-interest mortgages available for home purchases. It established veterans hospitals throughout the country. It granted stipends to cover tuition in trade schools and colleges. It paid unemployment benefits to veterans as they retooled themselves. The G. I. Bill made money available through low-cost loans to buy businesses and farms.

Between 1944-1949, more than nine million veterans received benefits under the bill. In 1947, 49% of all college admissions were veterans. The G.I. Bill expanded the middle class like nothing before it or since. Veterans started families, developed the suburbs and changed the socio-economic fabric of the country for decades to come. You need look no further than San Francisco's southern neighbor, Daly City, for a perfect example of how the G.I. Bill spurred on prosperity.

For almost 5,000 years, the area that became Daly City has been populated. In modern times, it remained a small and under serviced community until Henry Doelger started developing the West Lake District in the late 1940s. Homes and businesses were built to house the returning veterans who were starting families because they could see a bright future. Think of all the jobs that were created to build the homes, schools and shops. Today Daly City is the largest city in San Mateo County. Now think of Daly City's story multiplied a hundred times and you get a sense of how the G.I. Bill helped shepherd in a period of great American prosperity.

It's Been Called the Best Half Trillion America Has Ever Spent

Long before he became America's 34th president, as a young Lieutenant Colonel, Dwight Eisenhower went on an adventure. The Federal Aid Road Highway Act had just been completed. The government had spent $500,000 and paved 13 miles of road. Now the army wanted to see the condition of the rest of America's roadways. So they assembled a convoy of trucks to drive from Washington D.C. to San Francisco. Eisenhower was part of the convoy.

Little did the convoy realize it would take them two months to make the journey. They averaged 60 miles a day. Nine of the trucks in the convoy never made it because the condition of America's roads was deplorable, and Eisenhower never forgot it.

By the end of the Roaring Twenties, Americans were in love with cars and there were plenty of them, yet there were still few paved roads. Once out of the cities, roads were either made of dirt, or if you were lucky, gravel. When Eisenhower took office, there was less than one quarter of

America's roads thought suitable to handle the automotive traffic anticipated over the next 20 years.

With the Korean War having wound down and with Eisenhower's encouragement, Congress ultimately passed, with bi-partisan support (cooperation), the "Federal Aid Road Highway Act." The plan was to pay for it with federal bonds, and then pay the bonds off with federal gas taxes. The goal was to connect every American city with a population of 50,000 or more with paved highways. Then Secretary of Commerce, Sinclair Weeks, called it "The greatest public works program in the history of the world."

Lo and behold, the plan worked. By 1960, there was more than 10,000 miles of new paved roads accommodating the more than 74 million registered vehicles. When the program was eventually completed, almost 50,000 miles of roads had been built at a cost of approximately $500 billion. A lot of money one might say, but money well spent.

It's estimated that every dollar spent on construction through the program produced $6 in economic benefit. In one way or another, the expansion of American business, jobs creation and the tremendous reduction of debt relative to GDP was all interconnected to the building of America's highways. Think about all the jobs created around construction, steel manufacturing, car manufacturing, paint, oil products and car parts. You know that back in 1960, not one of America's 100 largest companies was a retailer. Certainly, times have changed. Today, more than half of America lives in the suburbs, with Amazon, Fed Ex and UPS trucks driving up and down the highways Eisenhower had the foresight to support.

Money Well Spent

By the time the G.I. Bill had done its work and the American highway system had been put in place, America's debt to GDP had dropped from an all-time high then of 113% to an all-time low of 24%. Today, our debt to GDP is more than 130%, and we need to break the gridlock.

There are two major pieces of legislation on the blocks right now—the Infrastructure Bill and the Climate and Social Spending Bill, both of which can serve as the 21st century's version of the G.I. Bill and the Federal Aid Road Highway Act. Cooperation and meaningful, well intended debate will set the appropriate price tag, not chest pounding, obfuscation or filibustering. Less self-interest and more mutual cooperation is what's called for to avoid gridlock and decline. Leaders from the "Greatest Generation" have already given us a blueprint for how money well spent can expand the economy, bring down debt and extend the American Dream to the greater number.

So What's In the Bills, Anyway?

We hear so much talk about price tags, filibusters, divergent party wings and reconciliation but so little about what's actually in the bills. Let's spend just a minute or two and look under the hood (I must have highways on the brain) of the Infrastructure Bill because that has already passed the Senate with overwhelming bi-partisan support (cooperation) and is scheduled to be voted on before election day. As valuable as the bill is to American prosperity, there is no

guarantee it will pass through the House because the progressive wing of the Democratic Party is threatening not to vote for it. (Now, as this commentary goes to press, it is on the President's desk for signature.)

A second bill, the Climate and Social Spending Bill, now will not be brought to the Senate simultaneously, but at least Congress has guaranteed that it will be brought forward shortly. The problem here is some Democratic Senators are questioning the true price tag of the bill, and for the bill to pass, all Democrats need to be on board for the process of "reconciliation" to work. Not to think negatively, but if the bill doesn't pass or even come up for a vote, I will lay out the nuances and history of filibusters, reconciliation and cloture. But let's not get ahead of ourselves. Let's hope the Infrastructure Bill does come up for a vote and passes because it would be great for the country, great for Americans and great for the markets. And so it did just a couple of days ago.

So here's just some of what's in the bill:

- Even though Ike did America a great service by developing our roads and bridges, things don't last forever. There's more than 173,000 miles of roads and 45,000 bridges in America in need of great repair and $110 billion is proposed for that purpose in the legislation.

- As America stretched out into the suburbs, many communities were divided by highways. Redesign, demolition and reconstruction are key components in righting this wrong and strengthening our communities. Several billion dollars are earmarked for the purpose of "reconnecting communities" that had highways cut right through them.

- Amtrak is a nightmare. Its backlog of maintenance and repair is staggering. $66 billion is earmarked for working through the backlog, modernizing our passenger and freight rail and connecting our cities by rail. (Just like we did with highways back in the 50s, the price tag equals somewhere around $40-50 billion.)

- The bill calls for a large investment in public transportation. Get some of the cars off the road some of the time by providing safe, clean (read that electric) buses, trams, trolleys and trains, and most importantly, make stations accessible to all users. Price tag: $40-50 billion.

- America's Broadband infrastructure needs to be dramatically upgraded. Access to information and data needs to be fast and reliable for America to maintain its competitiveness. Many low-income households are without Internet access. That needs to change if we ever want to continue to grow our middle class. Think grow the number of tax payers by doing so. Price tag: about $65 billion.

- School buses today: Fume-belching gas guzzlers. Tomorrow: All electric. Cost: somewhere around $10 billion.

- Modernization of ports and airports. We're just now getting a taste of supply chain backup (gridlock). Cost: Somewhere around $10 billion.

- Lead pipe water service. Think of Flint, Michigan (let's stop poisoning ourselves). The infrastructure package calls for a $65 billion investment in our power grid. Think fewer blackouts and replacing lead service lines and pipes for our water delivery and think of fewer deaths from cancer.

- The bill also calls for capping old orphaned gas wells, cleaning up abandoned land mines as well as beefing up our cyber security and investing in infrastructure to ease the fallout from droughts and floods.

Conclusion

Although I've only provided a partial list of what's included in the bill, nonetheless it gives you a pretty good perspective on where the money will be spent if it's passed by both Houses. That's why it passed through the Senate with such overwhelming bi-partisan support. (To me, it's clearly being spent for the civil good.) Politicians can argue how it's going to be paid for and what its effects on taxes and inflation might be. That's just what happened in the late 40s and 50s, when the G.I. and Federal Highway Aid bills were passed. Remember, in the long run, back then the country's GDP grew by $6 for every $1 spent.

Going forward into the new year, we at Putney are not anticipating wholesale changes in the market environment. That's not to say things will be static. We are expecting continued choppiness in market valuations, with smart companies continuing to take actions that will increase their growth potential. These companies will look for acquisition opportunities, opportunities to divest themselves of underperforming divisions and continue to innovate and evolve as they shake off the negative pandemic effects and resource/product shortages.

Although most economists believe interest rates will rise as tapering occurs, the overall impact should not be overly dramatic, and interest rates should remain relatively benign. A natural and healthy growth transition should accompany the post-Covid demand for resources, products and services. With that said, one still needs to be vigilant about their health and using safety measures and not getting cavalier thinking the pandemic is behind us..

With the very best of wishes for all during the upcoming Thanksgiving holidays. As always, with...

Best Regards,

Ray Lent
RLL/dot
Enclosures