

## J. Michael Locke

### Musings

---

#### #233: Musing July 29, 2023

The Fed is getting close to the elusive soft landing. Various measures of inflation are coming down while the economy grew 2.4% last quarter and unemployment remains low.

One reason the Federal Reserve's hike in interest rates has not more significantly damaged the economy is that only 11% of household debt is variable according to WSJ. Everybody locked in their low cost mortgage or auto loan so rising rates don't change their debt service (it just kills home sale volumes because no one can sell the house with the 3% fixed mortgage to buy a new one with 7%+).

This has led the stock market continued rally even with another 25bps (.25%) increase in rates by Fed to highest level in over twenty years. Deal activity starting to pick up. I like how investment bank Healthcare Growth Partners (HGP) framed things: *"In 2023, AI dominates investments, while human psychology dominates investment behavior. After a decade of remarkably low interest rates, investors have experienced the shock of runaway inflation and the most aggressive Fed hike cycle of this generation. The market's reaction mirrors the five stages of grief – denial, anger, bargaining, depression, and, around the corner, the final stage: acceptance. Grief is the natural emotional response to loss. In this context, "loss" is the end of the 10+ year easy money market cycle that sparked ever rising valuations and a flurry of investment and transaction activity which skyrocketed to a peak with COVID stimulus. Acceptance is the stage where one comes to terms with the reality of a situation and moves on. From a market perspective, it means investors will accept a future that may not look like the past and express a desire to get back into the game."* Financial markets are getting back to normal.

Do money managers allocate funds to private equity and other private investments simply for their lack of correlation to other asset classes based on timing delays? I have personally found that alternative / private investments provide superior returns to public markets if you can handle the lack of liquidity. Still, I thought this perspective from BusinessWeek was interesting. *"One very simple, very dumb model of private investments is that they are like public investments except that their price is updated less often. This has two attractive features:*

1. *Private investments have lower volatility: The stock market goes up some days and down other days; private investments are marked to market every quarter or whatever, which just smooths out a lot of variance. If you want lower volatility, just being told the price less often is ... I mean ... kind of that. We have discussed this feature before, and it is plausible that some investors pay extra for private-market investments precisely to avoid seeing prices change too often.*
2. *Private investments are lagged. When the stock market drops, your private equity investments don't. The stock market is a leading indicator: Stocks go down because the market expects cash flows to be lower in the future. Private valuations are more lagging: Private investments tend to be marked down when cash flows are actually lower. If the stock market is wrong and cash flows turn out to be fine, stocks will go back up and private investments will never lose value. (This is Point 1, about*

*volatility.) If the stock market is right and cash flows go down, stocks will stay down and private investments will lose value, but later. This is good. It is a hedge. Your stocks go down one year and you are sad, but the losses are offset by your private investments whose valuations are still fine. Next year, your private investments finally go down and you are sad, but the losses are offset by the stock market, which, always forward-looking, is up again. Your overall portfolio has less volatility, because it consists of uncorrelated assets: forward-looking public stocks and backward-looking private investments.”*

I don't believe in the “super app” vision proposed by Musk and others. The concept is that users should be able to do more in a single app instead of having to open up a different one. Apparently, this is what happens in China with WeChat amongst others. Behind the name change of Twitter to X, is Musk's vision to make Twitter a super app (or everything app) where you can shop, make payments and maybe even order a ride (rather than going to Amazon, Paypal and Uber). Here is the “X” (formerly a tweet) from X CEO Linda Yaccarino “*X is the future state of unlimited interactivity – centered in audio, video, messaging, payments/banking – creating a global marketplace for ideas, goods, services, and opportunities. Powered by AI, X will connect us all in ways we're just beginning to imagine.*” I think these markets are too developed and users are very comfortable with existing offerings. Apparently, Musk is also talking about eliminating “regretted user minutes” where people doomscroll.

So much for work ethic. Trending hashtag topic on TikTok is “lazy girl job” according to WSJ. “*Bilodeau and scores of other women online are bragging about their work setup using the hashtag #lazygirljob. To fans, the ideal lazy-girl job is one that can be done from home, comes with a chill boss, ends at 5 p.m. sharp and earns between \$60,000 and \$80,000 a year—enough to afford the basic comforts of young-adult life, yet not enough to feel compelled to work overtime. Veterans of such jobs say roles such as “digital marketing associate,” “customer-success manager” and “office administrator” are good bets for achieving the lazy-girl lifestyle.....Six in 10 workers say they're putting in less than maximum effort, according to Gallup's Global Workplace report this year. In the Gallup survey of more than 120,000 working adults, the biggest complaint from those workers was their workplace's culture.*” [the-career-goal-of-the-moment-is-a-lazy-girl-job](#). Not sure why the sexist moniker as this applies to both men and women.

I believe it is really important to understand the person and not just the skill set when you are hiring. Good piece by private equity firm LLR on hiring talent:

### *5 fundamentals of talent evaluation*

*Talent evaluation covers five areas: motivation, experience, skills, culture fit and what I call “upside in the company”*

- 1. Motivation. This is the number one category I address when interviewing talent, asking questions like: Why are you interested in the position? and What motivates you to go to work every day? The candidate's answers reveal vital details about what drives them as a person. That, in turn, will help to provide you with a solid foundation of the overall performance you can expect from them.*
- 2. Experience. There's no getting around it: Experience matters. Any good hiring manager can get a good sense of a candidate's background from their resume or LinkedIn, so I see this as an opportunity to add texture and depth to their story. What was your most significant contribution in your last position? or What would you have done differently? These questions can give you a sense of what they were hired to do, whether or not they achieved it, or what they actually accomplished —*

*job titles can be misleading. I also like to ask candidates about the attributes they seek in a manager. At this point, I normally already know who their manager will be. This helps to ensure they will be a good fit for one another.*

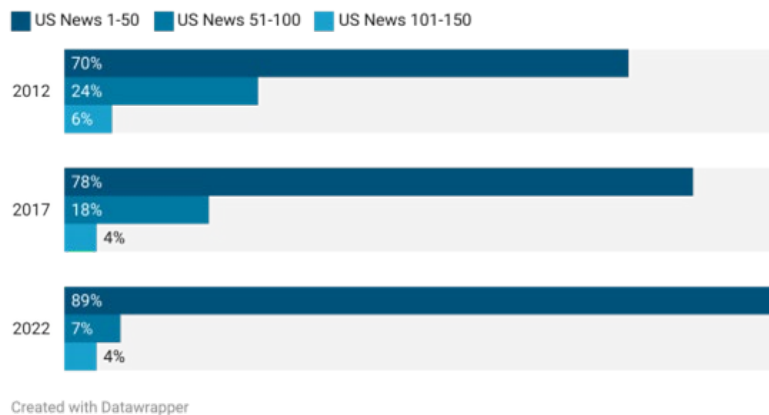
- 3. Skills. I start by asking candidates how their skills align with the position. Then I add: Are there any skills you don't possess that are in the job description? The goal here is to make sure people have taken the time to read the job description and understand what the role entails. Another valuable question is: What steps would you take to stay current on a required skill? This provides perspective on the candidate's interest as well as their learning agility.*
- 4. Culture Fit. Particularly for small companies, cultural fit can be the most important aspect of the hiring process. I ask candidates: What did you like or dislike about your last company culture? or simply: Describe your ideal culture. Based on their answers, I usually know right away whether they will be a good match. Another option is to ask: How would you create an environment that employees find motivating? I'm frequently surprised by how it's not just about pay and benefits. Often candidates value the opportunity for remote work or a company's philanthropic efforts. Taking notice of what's important to a person is a good indication of how they should align with your company culture.*
- 5. Upside. The final piece of the puzzle is upside in the company. Ideally, you're looking to fill a position, not just for tomorrow, but also for several years down the road. Asking questions like: How do you define success in your career? and What do you want to accomplish in the next five years? will shed light on how the candidate thinks about the position in the context of their larger career path, and whether or not your company can provide opportunities that will keep them around in the long term.*

Had to go to the DMV this week. Have you ever met a motivated, competent, customer-friendly government employee? Not sure I have. Hard to motivate if you get the same raise regardless of performance and can't get fired.

We need more transparency on the FICO scoring system. The opaque metric assigned to all individuals determines your access to credit and thus can significantly impact your life. Yet, it remains a mostly "behind the scenes" business process of the three credit bureaus. According to Equifax, here is what goes into a Fico score. *"The main categories considered are a person's payment history (35%), amounts owed (30%), length of credit history (15%), new credit accounts (10%), and types of credit used (10%). FICO scores are available from each of the three major credit bureaus, based on information contained in consumers' credit reports."*

The "middle" private universities in the US are in real trouble. As enrollments decline, the top branded schools are doing fine but the middle is struggling. In private higher education, there is cross-subsidization where a group of "full pay" students (no "institutional scholarship" which is really just a price discount) pay rack rate so another group of students can get big discounts. The challenge is there are fewer full pay students and those that exist really focus on the top/fancy schools leaving fewer for the lower schools to pay the bills. Interesting graph from Jeff Selingo:

## Liberal Arts Colleges: % of Population Who Are Full-Pay



The model of a doctor practicing with a couple colleagues in a private practice they own is dying. The American Medical Association (AMA) did a survey to understand the “employment status” of doctors with some interesting results. *“Between 2012 and 2022 the percentage of physicians who work in private practices (i.e., practices owned by the providers) dropped by 1,300 basis points—from 60.1% in 2012 to only 46.7% in 2022. Regarding employment status, 44.0% of physicians were reported as practice owners in 2022, 49.7% were employees, and 6.4% were independent contractors. This was down markedly from 2012, when 53.2% were practice owners. Moreover, this represents a continued decline in overall practice ownership, which was in the 76% range in the 1980s and 61% range as recently as the mid-2000s.”* (William Blair). Physicians are mismatched dealing with the large insurance companies around reimbursement etc. by themselves and need to be part of a larger entity.

I am not a big fan of the Greek system rush dynamic in higher education, especially among sororities. While Greek life can offer a lot of positives (I was in a fraternity), the evaluation and rejection it imposes on 18 year olds embarking on the next chapter of their life is problematic. I like the Greek systems where residency is minimized and there is a spot for everyone going through rush. Some Southern schools take a different approach and it can create a suboptimal environment. There is even a developing industry of “consultants” to help mom’s and daughter’s maximize their chances during rush. [sorority-consultants-rush-colleges-parents-prepare](#)

Let’s hope for a cool down soon. The 100 degree plus temperature of the Atlantic ocean right now is killing the coral reefs (they bleach out and then die). The reefs are part of the whole ecosystem of marine life and we can’t have them die.

Crazy stats on the failed system of Chicago public K-12 education. From Forbes: *“Chicago Public Schools spent nearly \$30,000 per student -up more than 70% since 2008. It’s the highest spending of any state in the Midwest with the highest teacher salaries in the region and the largest median pension benefit in the country of \$2.9 million.”* Yet, student learning continues to fall short and is not getting better. I am a big believer of school choice and unfortunately the Illinois governor ended a program that provided funding to allow more families (not just rich families) to choose their school. [how-illinois-is-failing-our-students](#) Proud of the Bennett Day call out on this article.

Jml