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Musings

#241: Musing
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Is the Fed in charge or the bond traders? There have been no recent changes in Federal Reserve set rates but traders are selling US 10 year bonds which drives the yields up. The cost of capital for businesses and individuals is driven by these yields. So bond traders just raised the cost of a mortgage. Bill Clinton openly complained about this with his advisor James Carville saying *"I used to think that if there was reincarnation, I wanted to come back as the president or the pope or as a .400 baseball hitter. But now I would like to come back as the bond market. You can intimidate everybody."* The yield curve show rates at different durations. Traditionally, you got a higher rate to commit to a longer term bond so yields went up with time. Recently, the curve has been inverted with two year rates above 10 year rates. So to some extent, the recent move up for 10 yr is also part of the return to normalcy and the existence of a term premium. This higher cost of capital will slow economic growth so official fed hikes probably done.

Great piece in WSJ by former Fed board member on what this all means. The US has drastically increased its deficit spending which it finances by selling bonds and as the appetite to buy those bonds wanes (and is not artificially supported by Federal reserve buying them), the federal government interest rate expense is about the markedly increase. the-bond-markets-message-federal-reserve-inflation-monetary-policy. *"The U.S. is courting trouble. The federal government is 43% larger than it was four years ago, and its reach is expanding mightily. More than a third of the surge in investment spending can be traced to government subsidies, credits and handouts. The chosen corporate recipients of the government's largess ostensibly benefit, but the rest of the private economy will be burdened by significantly higher rates and rising costs of doing business. The coming supply of Treasury securities required to fund U.S. government deficits will likely be substantially larger than official estimates. And purchasers of Treasury debt will demand higher yields, at least until something breaks in the economy."*

In the meantime, you can get pretty nice rates practically risk free. Short term rates have gotten so good that famed investor Jeffrey Gundlach thinks bondholders should just "T-Bill and Chill."

One of the troublesome developments in the public equity markets has been the growing acceptance of companies losing money. According to Scott Galloway, "In 1980, 9 out of 10 tech IPOs were profitable. In 2021, it was 1 in 5." The founder of Broadview Associates once told me – "a company isn't worth anything until it proves it can make money." Technically, a company should be valued on its future cash flows discounted back to today. The question becomes the probability of those future cash flows. You have to separate broken business models (like WeWork) from good business models just investing for scale (like Amazon.) One way is to look at gross margin. If a company loses money at the gross margin level, the business model has not been proven. According to the WSJ, Rivian loses $33,000 on every car it sells – the cost to build the car is $33k more than the sales price! Not sure that company is worth anything.

Government money can be dangerous. During the pandemic, Washington passed all kinds of stimulus bills and pushed billions of dollars out to various industries. However, this money was only temporary so almost like a narcotic giving a temporary high. Smart operators tracked this one time money separately and made sure they didn't build up expenses against revenue that would go away. However, too many operators used this government money to keep existing cost structures and now are going to be in trouble. Many are reporting on the "child care cliff" as many child care centers operated this way and will now close. You will also see many higher education institutions close their doors. Government money can also change with policies. In Illinois, there has been a "school choice" program where taxpayers could get a tax credit by donating to an entity which awarded scholarships for children to leave underperforming public schools and go to private schools. The governor recently killed the program (Illinois is one of the few states going against school choice) and now many private primary/secondary schools are struggling to make their financials work as the students don't have the government money to pay their tuition. The Governor of South Carolina famously turned down federal money to expand Medicaid because it was temporary and he was concerned what would happen after the support was gone. I think you always need to have a business model that works without special government support.

The basic framework of employment and HR is changing (and not just because of remote work). Thoughts from Rishad Tobaccowala:

For decades the fundamental beliefs of most organizational design were built on five assumptions: 1. The organization gives structure and directs work; 2. Tenure and experience are critical to advancement; 3. Most of the work is done inside an organization; 4. Fairness requires a common set of rules and ways of working to be applied to all; and 5. Most employees are full time employees of the company.

These are now being supplemented and in some cases being replaced by the exact opposite realities and dawning realizations: 1. The organization enables talent to create structure and direct work. Talent does not work for the organization, but the organization works for talent; 2. Expertise in a changing world and constant learning rather than tenure/experience are key; 3. Most of the work is done outside an organization by suppliers and marketplaces to access talent when one needs it and to remain agile and cost-effective in a transforming world; 4. Fairness means customizing programs for each talent to which everyone has equal access; and 5. Most staff are either contract workers, free-lancers, or fractionalized employees.

We got a window on the value of your data for targeted advertising. Meta is proposing to charge users $14 a month for ad-free Instagram in Europe. The EU is pushing to require Meta to get user agreement for targeted ads and Meta is proposing that if users won't allow ads, they will have to pay $14 a month to use Instagram. I have always believed web activity and data should be personal property and users should get paid for it.

Interesting stat: of all the outstanding us mortgages, 61% have a rate below 4% according to UBS.

Crazy stat: Amazon gets 45% of the price from third-party sellers on its platform.

Fun quote from local Florida newspaper – "There are two barometers by which a seasoned Floridian judges that a hurricane might actually be a problem for them – if Jim Cantore shows up and/or the Waffle House closest to them closes."

Scott Wisniewski taught me the “kid sports vegetarian model”— don’t let your kid participate in meets — swimming, cheer, track etc. Only games and preferably those with a set timed length like soccer or water polo.

Should buying clothes at Costco be a source of pride or embarrassment?

Go to weddings and funerals. Life can get complicated with kids and other activities making it hard to travel to a wedding or a funeral but I encourage readers to make it happen. It is a unique opportunity to show your love and support for someone and your attendance matters. RIP my Aunt Jane.

jml