

J. Michael Locke

Musings

#258: Musing April 14, 2024

Haven't written in a couple weeks. Simply didn't have much to share.

So much for rate cuts. I am joining the group thinking the Fed won't cut rates at all this year (Larry Summers thinks the next move will actually be a rate hike). Hope you bought gold at beginning of the year. Put simply, the economy is showing good strength even with the higher rates and the deceleration of inflation has stalled out over 3%. More specifically, we recently had a good jobs report with these highlights from CNBC:

1. Nonfarm payrolls increased 303,000 for the month, well above the Dow Jones estimate for a rise of 200,000.
2. The unemployment rate edged lower to 3.8%, as expected, even though the labor force participation rate moved higher to 62.7%.
3. Wages rose 0.3% for the month and 4.1% from a year ago, both in line with Wall Street estimates.

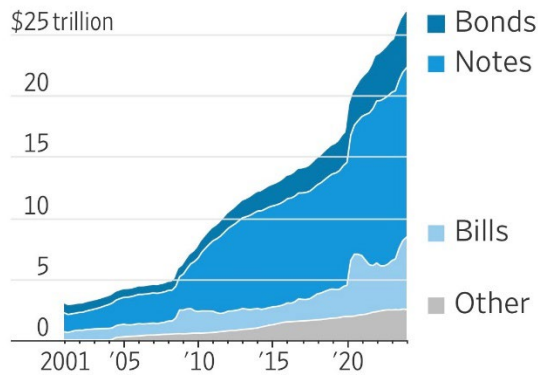
Then we had a higher than expected inflation report with CPI up 3.5% which was an acceleration from recent months. Good to see wage growth rising faster than prices so real wages are up.

Back to Larry Summers, he and colleagues wrote an interesting paper published by the National Bureau of Economic Research by Larry Summers et al. which helps explain the consumers negative perception despite strong economic fundamentals (<https://www.nber.org/papers/w32163>). The issue is our metrics measure the costs of things but not the cost of financing them. *"Unemployment is low and inflation is falling, but consumer sentiment remains depressed. This has confounded economists, who historically rely on these two variables to gauge how consumers feel about the economy. We propose that borrowing costs, which have grown at rates they had not reached in decades, do much to explain this gap. The cost of money is not currently included in traditional price indexes, indicating a disconnect between the measures favored by economists and the effective costs borne by consumers. We show that the lows in US consumer sentiment that cannot be explained by unemployment and official inflation are strongly correlated with borrowing costs and consumer credit supply. Concerns over borrowing costs, which have historically tracked the cost of money, are at their highest levels since the Volcker-era. We then develop alternative measures of inflation that include borrowing costs and can account for almost three quarters of the gap in US consumer sentiment in 2023. Global evidence shows that consumer sentiment gaps across countries are also strongly correlated with changes in interest rates."*

Interestingly, there is an underlying shift toward part-time jobs which is not covered by mainstream press. From zerohedge.com, *"since March 2023, the number of full-time workers has collapsed by 1.347 million while the number of part-time workers exploded by 1.888 million"* (thanks Steve Peake). I think this is part of a broader shift in how people look at work and how companies manage their labor needs. The increase in labor supply is mostly coming from immigration (which is good!).

The long end of the yield curve will also stay high because the federal government has to borrow so much. The amount of borrowing by our federal government is crazy. We need Erskine Bowles and Alan Simpson back. Look at this chart:

U.S. Treasury debt outstanding



Note: Marketable debt only
Source: Treasury Department

The budget office announced that for the first six months of Fiscal 2024, interest costs on all of this debt increased 43% and we are now spending more on interest payments than the department of defense according to the WSJ.

Here is an interesting excerpt from Jamie Dimon, the great CEO of JP Morgan Chase: *“In spite of the unsettling landscape, including last year’s regional bank turmoil, the U.S. economy continues to be resilient, with consumers still spending, and the markets currently expect a soft landing. It is important to note that the economy is being fueled by large amounts of government deficit spending and past stimulus. There is also a growing need for increased spending as we continue transitioning to a greener economy, restructuring global supply chains, boosting military expenditure and battling rising healthcare costs. This may lead to stickier inflation and higher rates than markets expect. Furthermore, there are downside risks to watch. Quantitative tightening is draining more than \$900 billion in liquidity from the system annually — and we have never truly experienced the full effect of quantitative tightening on this scale.”*

I try to invest around major trends I see playing out in society. While I don’t keep formal lists, I thought I would share some of my thinking on places to invest. Pretty simple, and not particularly insightful, but thought I would share.

1) *Healthy eating.* Many people (especially women) have historically focused on health as it relates to what they eat. I think that is quickly becoming the majority of people including men. People are avoiding sugar. Men are drinking non-alcoholic beer (the fastest growing beer is NA from Athletic Brewery) and high noons. Demand in groceries stores is moving from the center isle of processed foods and boxes to the outside with fruits and other fresh foods. Protein is taking over carbs (Greek yogurt and chicken) so short the endless breadsticks. The future looks good for Chipotle, Freshii and Cava but not so hot for Pizza Hut.

2) *Death of degrees.* Universities have priced themselves out of relevance as they mismanaged their cost structures subsidized by the federal government's student loan programs. *"According to the College Board, average annual private school tuition is about \$56,190; it's \$24,030 at four-year public colleges for in-state students. What's more, the average coupon in the form of a tuition discount that families get at a private college is now around 56% off"* (Jeff Selingo). The shortage of labor means that degrees are no longer necessary to get a good job. People are moving to skills-based hiring. Degrees used to signal to the labor market an assumed set of competencies that made the graduate a better worker. Now, it signals proficiency in beer pong and funnels for many. Google is the largest educator in the world through their free certificates. Vocational focus is coming back (plumbers are crushing it) and high schools are going to start offering more STEM for people to go straight to work without getting a degree. It is about certificates and competencies. The "Carnegie unit of credit" is silly and dying (by the way it was created as a measure of labor hours not learning). The number of students earning a degree is falling by 2.8% according to National Student Clearinghouse.

3) *Cloud / Data / AI.* The growing sophistication and ease of access to technology through SAAS models means it is becoming ubiquitous. Large on prem infrastructure has given way to a dynamic capacity cloud model. Technology is everywhere creating volumes of data to be analyzed to improve business processes and customer value propositions. Every business model must now have virtual delivery. "In place" businesses must adapt whether it is shopping malls or commercial office space. Short real estate. The AI boom is just beginning allowing a total reset of labor models. You can control your car through an app and customize your food delivered to your door. See commentary from Jamie Dimon on what JP Morgan is doing with AI after my initials below. Here is what Amazon CEO Andy Jassy wrote in his annual letter: *"Generative AI may be the largest technology transformation since the cloud (which itself, is still in the early stages), and perhaps since the Internet. Unlike the mass modernization of on-premises infrastructure to the cloud, where there's work required to migrate, this GenAI revolution will be built from the start on top of the cloud. The amount of societal and business benefit from the solutions that will be possible will astound us all."*

Interesting quote: "Data is the new oil" (Morning Brew). The big LLM models need data to continue learning and are running out.

4) *The rise of HR.* Success is all about talent acquisition and retention. Increasingly that involves different work models like part-time employees or offshoring. Economic leverage is moving to the worker due to labor shortages. Companies need better employment marketing and recruiting. HR is moving from a "staff function" under the CFO to an executive level and strategic position reporting directly to the CEO. Look for an increase in CEOs coming from HR. Women will outexecute men based on their better emotional intelligence (huge generalization but you get my point).

Another contributor to the growing strategic value of HR is company culture. While hard to define, it is really important. For example, clearly the culture of Boeing got "off track" with a focus on financial metrics over quality and safety. Culture gets set by the actions of the CEO and other executives – not what they say but what they do. It is culmination of a ton of small things. Reserved parking spaces, limited accessibility and use of "I" would point to a centralized control, authoritarian culture. Employee empowerment, expressions of gratitude and management engaging at the retail level points to a servant leadership culture. I am a big fan of an entrepreneurial culture with the following attributes:

1. Individual accountability with all efforts having a single individual responsible
2. Smart risk-taking

3. Fast / urgent / intense
4. Engaged 24x7 with emails and calls outside of 9-5 and on weekends
5. Focus on what creates value and deemphasizing activities which keep people busy but aren't critical
6. Conflict not avoided but taken straight on
7. Market – focused with constant looking at competition and consumer/client behavior
8. Use of data to make informed decisions
9. An “ownership” mentality where employees acts as they would if they owned the business

Capitalism is the best system in the world. Unfortunately, human's leaning into greed and consumerism can lead to a proliferation of purchasing. Like many who are blessed, we have too much stuff. There is something beautiful in just saying “enough” and simplifying. It wasn't always this way. From Rishad Tobaccowala, *“According to the Organizer Chicks Blog: “In 1960, the average family had 2.4 children, and the average home was around 1,100 square feet. By 2010, the average American family had only 0.9 children and 2,300 square feet. So, as a country, we have fewer people living in more square feet than ever before.”....and ...According to the National Association of Productivity and Organizing, 75% of American households can't park even 1 car in their two-car garage.”* This all reminds me of the old George Carlin skit on stuff.... <https://youtu.be/MvgN5gCuLac>

RIP Daniel Kahneman. A nobel winning economist, Kahneman refuted the assumption that individuals all behave rationally according to economic principles. *“Dr. Kahneman presented his ideas to a general audience in “Thinking, Fast and Slow,” which distinguished between two modes of thought: System 1, in which the mind, acting quickly, relies on intuition, immediate impressions and emotional reactions; and System 2, in which the mind, slowing down, functions more rationally and analytically and is able to correct errors made by System 1. Much of the time, Dr. Kahneman argued, the mind works in System 1 and draws conclusions using System 1's toolbox: rules of thumb, cognitive biases and anything else that speeds up the judgment process.”* <https://amp.cnn.com/cnn/2024/03/28/world/daniel-kahneman-nobel-winner-death-intl->

Some return of humanity to our world recently. I found the eclipse underwhelming but it was great to see folks of all types/background outside sharing in something. Similarly, the NCAA women's basketball tournament was a breath of fresh air (and definitely better than the men's). Congratulations to South Carolina. Will be interesting to see if the momentum carries over to other women's sports. These two experiences showed the power of shared human experiences which are so limited in today's tech-centric polarized world.

Rip my first professional mentor Bob Craft. A wonderful man and accomplished lawyer. Taught me to “always go to weddings and funerals” and to invest in younger talent. <https://www.legacy.com/us/obituaries/nytimes/name/robert-craft-obituary?id=54814875>

Jml

More from Jamie Dimon annual letter:

THE CRITICAL IMPACT OF ARTIFICIAL INTELLIGENCE

Since the firm first started using AI over a decade ago, and its first mention in my 2017 letter to shareholders, we have grown our AI organization materially. It now includes more than 2,000

AI/machine learning (ML) experts and data scientists. We continue to attract some of the best and brightest in this space and have an exceptional firmwide AI/ML and Research department with deep expertise.

We have been actively using predictive AI and ML for years — and now have over 400 use cases in production in areas such as marketing, fraud and risk — and they are increasingly driving real business value across our businesses and functions. We're also exploring the potential that generative AI (GenAI) can unlock across a range of domains, most notably in software engineering, customer service and operations, as well as in general employee productivity. In the future, we envision GenAI helping us reimagine entire business workflows. We will continue to experiment with these AI and ML capabilities and implement solutions in a safe, responsible way.

While we are investing more money in our AI capabilities, many of these projects pay for themselves. Over time, we anticipate that our use of AI has the potential to augment virtually every job, as well as impact our workforce composition. It may reduce certain job categories or roles, but it may create others as well. As we have in the past, we will aggressively retrain and redeploy our talent to make sure we are taking care of our employees if they are affected by this trend.

Finally, as a global leader across businesses and regions, we have large amounts of extraordinarily rich data that, together with AI, can fuel better insights and help us improve how we manage risk and serve our customers. In addition to making sure our data is high quality and easily accessible, we need to complete the migration of our analytical data estate to the public cloud. These new data platforms offer high-performance compute power, which will unlock our ability to use our data in ways that are hard to contemplate today.

Recognizing the importance of AI to our business, we created a new position called Chief Data & Analytics Officer that sits on our Operating Committee.

Elevating this new role to the Operating Committee level — reporting directly to Daniel Pinto and me — reflects how critical this function will be going forward and how seriously we expect AI to influence our business. This will embed data and analytics into our decision making at every level of the company. The primary focus is not just on the technical aspects of AI but also on how all management can — and should — use it. Each of our lines of business has corresponding data and analytics roles so we can share best practices, develop reusable solutions that solve multiple business problems, and continuously learn and improve as the future of AI unfolds.

Clearly, AI comes with many risks, which need to be rigorously managed.

We have a robust, well-established risk and control framework that helps us proactively stay in front of AI-related risks, particularly as the regulatory landscape evolves. And we will, of course, continue to work hard with our regulators, clients and subject matter experts to make sure we maintain the highest ethical standards and are transparent in how AI helps us make decisions; e.g., to counter bias among other things.

You may already be aware that there are bad actors using AI to try to infiltrate companies' systems to steal money and intellectual property or simply to cause disruption and damage. For our part, we incorporate AI into our toolset to counter these threats and proactively detect and mitigate their efforts.