THE LOOMING DISASTER WITH PEOPLES CAPITALISM

This is apt to be a very controversial paper and I doubt that many of you will agree with me. While I've been working in this Market arena all of my life, I am somewhat of an outlier. As I began writing, however, my pen took on a life of its own!

I believe that we are well into the era of a People's Capitalism, and with such, the demise of the stock markets as we have known them during our lifetime. There is little doubt that the Super Rich will be getting "Richer", and the People getting Poorer! The simple math of compounding $10,000 of savings or income at five percent for 10 years goes to $16,300. Most people can save little if anything. But the rich have high incomes, some excess of which is invested and along with investment income, which is invariably reinvested, grow exponentially. Bruce Boghosian, a math professor at Tufts University, has claimed that without redistribution of wealth, our market economy would not be stable, as wealth always tends to concentrate, going up, not trickling down. Bear in mind that technology eliminates jobs, whether in farming, mining, or manufacturing. That's what appears to me to lie on the horizon. And I doubt that it can be forestalled or altered.

The only open question is time, that is how long before this demise is broadly recognized and the various courses it takes. Whether “good “ or “bad”, domestic tranquility or revolution, confined to the United States or eventually world-wide, are all secondary questions!

The history and evolution of this position is fairly easy to track; in fact it is probably 400 years of cultural, economic, and global history with which we are all familiar, but not at all well recognized . These are pieces of a puzzle assembled over four centuries, today accelerating more swiftly through the development and compounding of technological progress in communications and global correspondence. Again, the evolution of knowledge and people using that knowledge which only becomes apparent and consequential after the fact. Which consequence is more rapid today as the result of the afore mentioned technological progress.

Today, for the average investor, the big word is “Wealth Management”! Yesterday it was savings, and before that is was the family farm, before that it was but master and serf, or the crown, the nobility, the shopkeeper, merchant, and craftsman.

The social and economic order 1000 years ago was most ordinarily defined by birth, the church or religion, and education. Peace, prosperity, trade, and invention on one side, and war, poverty, isolation, and lack of education on the other.

We all know this history; we studied it from grade school through college and generally enjoyed the wonderful legends, truths, and myths. So just how did we get here, to The Markets of 2017? And with that, we all tend to believe that mankind today is better, more well developed, smarter, and more prosperous than ever before. Such of course have some truths, Darwinian evolution for instance, along with falsehoods, like the world is flat. Our history of all, tends to be "Western", emanating out of Europe from Rome to England, 200 BC through 1300 AD, then England, France, Spain, and the Low Counties, with wars, trade, and into exploration, with gold, silver, and new lands, and the New Worlds of Asia, North and South America, the American Revolution, and the formationUnited States. Say 1400 through 1800.

Excuse my grade school lessons, I will get to the point!

While commerce of one sort or another did exist many centuries before 1400, it was ill defined relative to that which began with the commerce created out of "the explorers." Perhaps the development of large ocean going ships was the starting point of big trading and with that the emergence of England, Holland, Spain, and France, as powerful and wealthy nation states; it is no coincidence that these countries were on the coast of the Atlantic Ocean. Land and riches to be seized in far away places and ships to carry them to market.

It was at this point in time that three very significant items took place, they became the rule: first, the laws of supply and demand, second, the limited liability company, and third something resembling a stock market. Adam

Smith is widely credited with developing the economic theories codifying the laws of supply and demand, the free market economy, and the division of labor, along with so many other postulates. More demand creates greater supply or higher prices, thus bringing in more supply as new players enter the markets on either or both sides. Commerce then takes the step of finding the supply wherever it is, and bring it to meet the demand, wherever that may be. Think spices, silk, tobacco, and of course gold. India, China, South America, North America, and Africa had many such products, Europe at that time had the demand or the markets. And of course, there was Adam Smith's "Invisible Hand."

In 1602 the Dutch East India Company was established in law by the Dutch government as a "Chartered Company", given a monopoly on the Dutch spice trade, and allowed shares or interests to be issued and purchased in Guilders with no liability to the shareholder with loss or damage to assets of the "chartered company." And, equally important, these shares or interests could be transferred or sold from one person or shareholder to another without transferring liability or contingency. Thus, one can reason to this evolving into shares of stock, able to be bought and sold.

Think of the investor euphoria, "my ship came in!" and all that surrounds such; in addition to a payoff on the voyage and the cargo, the shares themselves became more valuable as commerce grew and they could be sold from one investor to another.

Many such limited liability companies were created in Holland, England, and other European countries. Of course the British East India Company was probably the most profitable venture ever, it virtually owned India for a century or two.

Stock markets probably first existed or were created in the Low Countries in the 15th and 16th centuries and the Dutch East india Company, afore mentioned, is widely accepted as the first "publicly traded such company." London followed with a wide variety of exchanges in the 18th century and then the New York Stock Exchange came into being in 1817. It was at first a group of traders meeting almost daily under the famous Buttonwood Tree outside on the street, but eventually moved indoors on Wall Street. It was a "members only" group of people, running their own businesses of buying and selling for themselves or others. The rest is history, evermore widely active and governed by both the members and eventually the United States government.

Once again, fellow Literarians, I will not dwell further on history and the stock markets, but from the foregoing I hope you see how these three items became a foundation for what exists today.

The second very big piece of the puzzle is what we know or think we know about "Capitalism". From an Economic point of view, Capitalism has existed for a long, long time. There are all kinds of words today, both political and economic which have become intertwined, pejorative, popular, and social which are often used in a conflicting manner. Private property, ownership and labor, capitalist ownership of the means of production, wages to labor, profit to the owner, rentiers return, free markets, and so many others.

And then there was State Capitalism and Karl Marx, the Russian Revolution, and the ever widening of economic theory from the 18th century through today.

Technically, capital means money. Putting the "capital to work" means buying or investing in something, an apartment building, a truck, a bond, or shares of stock. This tends to be "passive", that is it is just owning something, upon which the owner, the capitalist, expects a return on his or her money and does no actual work other than owning that something. To the average owner of the money, the stock markets now appear to be the place, mode, or opportunity in which to invest that capital. The primary goal is to make money, not to pay taxes or create jobs, but to make money. In fact, as we have so often heard, machines, assembly lines, or computers are better, they don't get sick or want a raise and can always be replaced with a newer, faster model. Capital thus becomes superior to labor in many instances.

From 1900 through the present stock markets have evolved and grown from a group of members in New York, London, or Amsterdam, buying and selling shares for themselves and others, to the pillar of global finance. They are the place to raise capital, to acquire entire companies, merger and acquisition, to speculate on new company futures, to receive returns in dividend payouts, and to participate in the growth and that "corporation's" development and being a shareholder with no personal liability of the company while enjoying the price appreciation of success. Of course, however, there is a risk of losing capital and your investment amid non-success or failure.

From 1900 through about 1950, most of the large shareholders of publicly traded companies were the founders of those companies, other large investors with lots of capital to invest, and institutions such as banks, insurance companies, foundations, and institutions in quest of returns on their capital.

That period of time, 1900 through 1950, was periodically punctuated by great growth, particularly in the United States, two world wars, a depression in 1930, and substantial legislation or regulation of the stock market industry. But the New York Stock Exchange remained “member controlled”, and having a”seat” on the Exchange as a “member” was to be in an exclusive club and the dominant place to seek or provide money for investment as the key driver of capitalism in Europe, the United Sates, and elsewhere, and to these shareholders it became a financial religion.

Gradually, at first, coming out of the Depression and World War II, all of that began to change in the 1960’s and greatly accelerated through the “ups and downs”, from 1970 through today. Some good markets, and some very bad ones, but the pace of market uses, changes, products, and participation changed substantially which change continues today at an even faster pace. Most of those “brokerage firms” are now large corporations, no longer owned by “members or partners”, and no longer that exclusive club.

As these market times and conditions were occurring in the United States, markets began to develop world wide, first England and most of Europe, then Japan and on into Asia and Latin America. Everywhere! These emerging markets have become very large on their own and investors world wide participate. In fact, there are large stock markets in Russia and China servicing the word-wide investor, and these are supposed to be “Communist Countries?”

Thus I have come to say , that “no one” really owns common stocks today, as “everyone” owns them in mutual funds, exchange traded funds, pension funds, 401-K’s, endowment funds, City and State retirement funds, and of course straight-up in their personal portfolios all of which have replaced personal savings accounts for future plans and personal financial goals. The once large and financially important savings and loan industry hardly exists any longer. Perhaps “owning stocks” is like owning a car, a TV set, or a cell phone at the beginning of those markets? Nothing special now, everybody owns them.

Stock brokers, formerly called “a customers man” under the Buttonwood tree, are now known as “Wealth Managers”, as I referred to earlier. They sell, market, plan for, or aid the individual saver or investor with “product formulas” to accomplish a particular goal: retirement, a first house, children’s education, a reserve for bad times, unemployment, or emergency. Sounds like a very good idea indeed. But, and there is always a but, amid all of this evolution just what are these investments and what are stocks today, much less what is the form of capitalism which has concurrently evolved?

Almost “Everybody,” I again point out, in one way or another, is the ownership of today! The very concept of “Capitalism” is or was someone “owning” the company, running it, and insisting on a return on that capital. Today, as the situation evolved, the Board of Directors, elected by the shareholders theoretically represents ownership, but do they in fact exercise that responsibility or do they more or less represent special interests, most often the government, a few institutions, the fund management , the labor unions, and management. It is hard to serve so many parties, each of whom may have a different goal. The small shareholder may just be along “for the ride!”

Such is what makes me believe that that we do indeed have some form or other of a “Peoples Capitalism” via ownership of shares either “straight-up,” or in one fund or another, with the anticipation of return based upon past data with some judgement or prediction of future occurrences and values. However, the broad advice and data upon which the “wealth management” is based, is on past performance, particularly in line with averages, that is the DJIA, S&P 500, Nasdaq, interest rate returns, etc. But if we know nothing about the past other than the five-year, the ten-year, or twenty-five year average rate of return, can we rely upon such to hold true in the future? It never has, why should this hold true tomorrow!? Once everyone or almost everyone owns or participates in these things called stocks and bonds, then you have a very different “risk-reward equation!” Who will guarantee your return of capital much less an income? S & L’s did have a guarantee of some amount through the FSLIC and most pensions today are protected by the PBGC, although not all, particularly State pensions, as most of these are self insured.

Just recently, in our adult lifetime, what happened to the small investor's savings or pension in 1972, 2001, or 2008, and what will happen in some market decline in the future? We worry about Social Security, longevity and funding, this might work well in a bull market; but , beware of the bear.

Perhaps the government should step in and insure or guarantee these stock market returns? A risk-less environment? This is certainly not capitalism or the reason to invest in stocks, guaranteed. What! And we all thought the government was today already pretty much involved !

Most of the contemporary market wisdom eschews variable asset allocation and certainly not market timing. Current wisdom says "Set your course, wisely dependent upon your goals and objectives, and stay with it through the long term (whatever that is.!)" Again, experience says that some pretty damaging storms can occur and that a wise investor should exercise sound and precautionary measures to avoid such calamity.

Another part of this current formula with which I take great exception is "The Averages".

The economy in the US as well as that of other developed nations it quite reliant on foreign trade, buying from and selling on or in other global markets. US brokerage companies, banks, and investment companies have offices located all over the world. Today there are three major owners of shares of companies:

first, the founder and big shareholders, second, the public but in two categories, each somewhat different: small shareholdings and maybe in managed accounts, and ETF's and mutual funds, and then third, Wall Streeters, which I define as others with a wide variety of interests ranging from private equity to hedge funds. Each of these three have different positions, objectives, and measures of control in being shareholders and owning the company shares. Even though they may think they are "owners" or are told so, only a few of them are actually "capitalists" . The Investing public tend to be "savers" or use the "markets" as a place to store or protect their hard earned, inherited, or reserve money and anticipate a return on that money, sort of like the Capitalist but not exactly. The first group, the founders, are true capitalists, while the third group are the opportunists or sort of speculators, which they would never allow us to call them.

I'd like to talk a bit about these "averages," and the stock markets referred to above. Bear in mind that these are the figures against which all are measured. The Performance! The Dow Jones Averages were created in 1896, at first just the Industrial index, consisting of thirty companies, usually large companies representing all of the various industries in the United States, the thirty change, that is companies can be eliminate as no longer representative, and others added to adjust to the current economic or contemporary representation.

The "thirty" have changed 51 times since 1896; only one company, General Electric, has been in the average for 100 years. These removals and additions are the nature of a market through an ever changing and growing financial and corporate history. American Sugar Company, US Leather Company, and General Motors are no longer in the Dow, while Microsoft, Nike, and McDonalds, which were not were not even alive in 1900, have been added. Such additions and deletions are wise, good moves, but comparing one period, with these additions and deletions, to another presents a“tricky” comparison!

There are two other Dow averages. the Railroad and the Utility averages which came along later. As strange as it may be, these Dow averages are “price weighted”, not capital weighted; this means that a 5% move in price of a $100 per share stock has three times the impact in the DJ average than that of a 5% move in a 33 dollar per share price.

The other two very important and very prominent stock market averages which are also carefully watched and used as passive goals or bogies, the Standard & Poor 500 which is a very all encompassing and diversified group of companies of large cap US corporations is widely reviewed as the best gage of the market, and then Nasdaq, perhaps originally viewed as originally representing the Over the Counter market, but today more aggressive and growth issues. Both of these are “capital weighted,” that is size of the company dominates percentage or weighting in the average, rather than just the raw price, thus they are quite different from the Dow Jones averages which are price weighted, as noted previously.

Together, these three averages ARE widely considered as the United States Stock Markets, and used as the the boggy in the so called passive investment position. The averages you "have to match or beat," is often hard for "active" investors to do. None the less, all are the measures of the United States investment community which has consistently grown in size and stature over one hundred and fifty years of history and record keeping.

There is another very, very large investment in our country which is perhaps less well understood by the public investment community, The Bond Market, which is in fact and reality, much, much larger in overall value or size than is the stock market. This bond market ranges from Certificates of Deposit, CD's into bonds issued by most corporations, States, the United States Treasury, and similar world-wide institutions and countries. However, this "bond market" is considerably less well known and understood by the investing public. But huge institutions such as insurance companies, banks, pension funds of all sorts, rely more on bonds than stocks in their portfolios to meet their obligations and their financial security.

Bond prices are driven by three simple factors; interest rates, duration or length of time or the maturity date, and quality of the issuing entity. And remember, when interest rates go up, bond prices go down, if rates go down, price goes up. Enter the dedication to pronouncements from the FED, the IMF, some of the big banks, or Wall Street gurus. Anything having to do with interest rates is very, very important to all markets!

It is not my intention, gentlemen, to give a basic investment course to you tonight; many of you are more well investment educated than I! Looking back to my market primer, however, such is now fairly well available to all investors, savers, and the public in many forms; ETF's, Exchange Traded Funds, mutual funds, and wrapped together in passively managed portfolios, often times computer driven.

I would like to, or rather need to, return to the beginning. But still a bit more history, a short one with just a few meaningful words:

Merchants, Mercantilism, The East India Company, Adam Smith, Joseph Schumpeter, David Ricardo, Karl Marx, John Maynard Keynes, Milton Friedman, John D. Rockefeller. Andrew Carnegie, Henry Ford, William McChesney Martin, Paul Volker, Marcus Goldman and Samuel Sachs, the Salomon Brothers, Edward Johnson, John Bogle, and David Rubenstein.

These twenty names more or less represent a 3 or 400 year history of the evolution of the economic system which we believe to be capitalism; the stock and bond markets, and with ten wealthy Dutch men investing in a voyage from Amsterdam in 1600 to thousands or even millions of Americans buying a mutual funds today, each risking capital to get a return. Added to this, of course, are some relatively new and exotic words such as "hedge funds," "private equity," synthetics and derivatives, and structured products.

Where do we go tomorrow? How will all of this evolve during the twenty-first century!

First of all, the of the major sources of capital have moved from wealthy individuals dominating ownership, to pools of money, whether pension funds, institutions, mutual funds, and even state owned or government owned investment entities as the major owners of most publicly owned common stocks and government or corporate bonds.

Do any of us have a decision making role in how the money in which we ostensibly share an ownership is invested? However, there are individuals who do have control, not necessarily direct ownership. but de-facto control; these are often our elected officials and the bureaucratic appointees there of.

Being a high-level bureaucratic employee or appoint-or is apt to be a very profitable job in the future.

And then there is the prize of all investment prizes, Social Security. I believe that it is only a matter of time before individuals will be able to invest their social security contributions and/or accumulated Social Security fund in mutual funds, just a select few and a limited amount in the beginning, but many more as time goes along. At present all of the Social Security funds must be invested in US Government guaranteed issues, say US Treasury Bonds or the like, This is beneficial to the government, of course, but with a 2.5% current yield, not so good for the investor.

Somewhere in this future financial scenario will be the “hedge funds” and the “private equity funds.” Each of these investment vehicles have grown quite substantially over the past decade and have replaced so called venture capital funds along with many business brokers and the investing banking departments in brokerage firms. Institutions and the large money pools are the main investors in these and most all of them do OK to very good except the managers, creators, and senior partners, who do very, very well; in addition these entities have even been able secure a preferential tax rate with a clause called “carried interest.”

The ‘Federal Reserve Board is perhaps the most respected entity in our financial system but it appears to me that it is becoming ever more politicized and drifting from it’s role of implementing monetary policy, interest rates and money supply. I take great exception with the FED targeting of inflation at 3%, which I consider to be too high as a long range target. On the other hand, the FED’s action in 2008 amid the emerging market crisis and melt down on Wall Street was brilliant. On this issue, however, I fear that they are behind the curve today and forcing interest rates to remain too low too long . Is there a political motive in this easy money policy?

One last item, one philosophically and politically complex. Money, making more, a million, a billion, is more often the primary goal of many if not most in the country today. Having investments go up, a pay off, is the primary objective. Young men and women coming out of college today want to be a CEO, as they make a lot of money! But few know what a CEO is! OH what a complex issue! Bear in mind two other very important and very simple pieces of this puzzle:

First, these Markets and wealth building are a big part of our history, the financial part, and that is forever changing, evolving, and something from which we all learn.

And Second, “when we go to bed at night, someone owns all of those stocks and bonds!”

In summary my friends, all of this is being loaded into the stock markets, in the United States today and also in markets world wide. Capitalism as we knew it in the nineteenth century, capital and labor, and markets as we knew them in the twentieth century with owners, capital formations, owners operating businesses, are things of the past and now we are totally focused on everyone, in every way possible, investing in the markets to get rich or maybe even save money for the future.

Trying to come to a come to a conclusion, my pen “continued that life of its own!” It says that “The new Peoples Capitalism is the supposed Road to Utopia “ and “The customers man of 1920 is now the Wealth Manager“ of tomorrow. I have a hard time seeing either of these working out in the future. It just doesn’t happen that way!

END

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