StraightTalk

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Thoughts from the Summer Conference

As I do every summer, I attended the Raymond James Summer Development Conference last month. This annual, four-day event brings together thought leaders from a wide variety of fields and is always additive to what I do for all of you. In addition to investment managers, a large group of us hear from technology developers, practice management experts, and keynote speakers from a variety of fields.

One of those keynote speakers was a Global Futurist named Chris Riddell. His highly entertaining talk encompassed many areas of life today, and how they will be shaped by a rapidly evolving future. He mentioned that the fastest growing industry in America is the gaming industry, which will only accelerate its growth as Artificial Intelligence is layered into the video gaming experience. Not surprisingly, the second fastest growing industry is healthcare, and the move within that industry to well care. He showed an image of the newest personal EKG machine, which is of great interest to the large part of our population with cardiovascular issues. At just $15,000, it costs a fraction of what a similar machine costs in hospitals, and it saves significant time and money versus countless visits to the doctor to get a readout. However, it almost already obsolete.

He mentioned that today, for just $95, you can purchase a watchband for the popular Apple watch that allows it to not only perform those EKG functions, but also can help predict a heart attack, by uploading your data to the cloud and analyzing it compared with tens of thousands of other patient's data. Wow.

While at the conference, I also read an article about the end of capitalism as we know it. This was not the back-and-forth capitalism vs. socialism debate of our political parties, but instead about the future of capitalism. This new version of capitalism will incorporate the value of information, and the changing nature of work in the future. The lines between work and free time will continue to blur, but the power of information will become critical, and the free exchange of it will alter markets everywhere.

The article pointed out a current example of this as being Wikipedia, the biggest information product in the world, which is created and updated by volunteers for free. Without any of the traditional support from advertisers, and because it is free – it subsequently destroyed the encyclopedia business we all grew up using to research everything.

In this future version of capitalism, we will need to put a dollar value on the information component of companies, which is not being done today. Intelligent machines like today's airplanes are an easy to understand example of this "information value." A computer mostly flies modern airplanes, which are firing back real-time information to the network during flight, while on board passengers use screens that are connected to the Internet. A plane is both an intelligent machine and part of a network, so it has both a physical value and the value of the information content from it. Today, we only value the plane on the cost to build (and ultimately replace) the aircraft. In the very near future, the quantity of information involved, the time saved, the productivity enhanced, and the creative content derived while using it will all be part of the "value." From the ground it looks like the same white metal bird as back in the golden age of air travel, but the truth is, it is radically different.

As we struggle to value what all of this "information" is worth, one thing is clear. The cost of it is going down, and the value is going up. Rather than waste time looking up something using a variety of research texts, we simply google it. All of the knowledge in recorded history is available at our fingertips – what is that actually worth? Perhaps more importantly, what can we collectively do with the time saved every day due to the cataloging and digitizing of this information? These time saving technologies are changing the nature of work in ways no one could have imagined just 15 years ago, and it is going to change our definition of capitalism.

The great technological advance of this century is not only about new objects, but also old ones made intelligent. The "knowledge content" of products is becoming more valuable, but will be a value measured on usefulness, not exchange value. Just as a society changed from merchant and slave capitalism in the 17th and 18th centuries to industrial capitalism in the 19th and 20th centuries, this article posits that we are headed towards a cognitive capitalism, one with hundreds of millions of networked people, devices, and appliances. And what exactly that means for the future is anyone's guess.

While that article discussing the far-off future of capitalism was interesting, another session at the conference addressed a much more immediate future – what the next year holds for our economy and markets. Phil Orlando, the always popular Chief Equity Strategist for Federated Investors, spoke in a standing room only session about international markets, earnings, the economy, tariffs, and the timing of the next recession.

He is not alone in drawing the contrast between the U.S. economy and the rest of the world, notably Western Europe and China –the popular phrase used by many economists today is that America is "the cleanest dirty shirt in the laundry." Specifically, Mr. Orlando mentioned the looming deadline for Brexit, Mario Draghi's term ending as the President of the European Central bank, and Japan considering raising taxes. The timing for all three of these events is in the last week of October, which could contribute to some increased volatility in international markets this fall.

Regarding corporate earnings here at home, his expectation is that, just as in the first quarter, the talking heads will be looking for weak corporate earnings, and will again be surprised with positive growth. Additionally, the "market" has priced in three Federal Reserve cuts this year, but his expectation is more like just one cut, and then a pause. Productivity is up 2.4% year over year (a 20 year high) and job openings continue to outpace the number of unemployed people to fill them, so, in his opinion, further rate cuts are not needed.

He also expressed expectation for economic growth of 2.7% for this year, with 2020 a bit slower at 2.4%. His target for the S&P 500 at the end of next year is 3,300, a ten percent increase from today. He illustrated many inputs for his calculation, but also showed the long term market averages for returns by Presidential year, which are far simpler to understand. Dating back to the mid 1950's, in the third year of Presidential terms our average market return has been 21.1%, while the average return for the fourth year has been 9.9%. He also said there has never been a recession in the third year of any Presidential term, and this year should be no different.

Speaking of recessions, as I point out in our conversations, no matter which party holds the White house – the business cycle has not been repealed, and recessions will still occur. The timing of them is quite difficult to specifically pinpoint, but there are several usually reliable indicators for a general time frame, and those currently point to late 2020 or early 2021.

The more immediate headline news question on the mind of most investors is tariffs, and what that means for our economy and markets over the next twelve months. His assertion is that President Trump is much more focused on the trade imbalance and what it means for our rate of growth, than he is with the actual tariff inequality. He is simply using the threat of tariffs to induce China and Europe to negotiate better trade terms, and in the case of China, some very specific trade goods. For example, we are the world's leader in the production of natural gas, and they are the largest energy consumer of any country on earth. The Chinese also eat more pork than the rest of the world combined. What do you feed pigs? Corn and soybeans. We also happen to be the world's leading producer of both corn and soybeans. It doesn't take a rocket scientist to see where this is going, even if it is predictably transactional.

Our economy runs a $55 billion trade deficit each month, meaning that we import roughly $660 billion more in goods each year than we export. That trade imbalance in an economy of our size subtracts about 3% from our annual rate of growth. So, if Trump can just get China to buy more soybeans and corn to help cut that trade deficit by one-third, our economy instantly grows 1% faster. The economy will clearly be an election issue, so Mr. Orlando is looking for a trade deal announcement by December, resulting in lower tariffs, more exports to China, and higher GDP growth in 2020 – the year Americans go to the polls.

As always, there were a variety of opinions on a wide range of topics, but the consistent message reminded me of the quote from Tom Pollack, the former Chairman of Universal Studios. He said "it's never as good as it looks, and it's never as bad as it seems."

With the economy and employment both good, and headlines on everything else bad – that's sage advice.