Cake With The Neighbors

Pine Haven Investment Counsel, Inc. – Commentary –2nd Quarter 2018
By Kori Allen, CFP® and Paige Johnson Roth, CFA®

Reflecting on our spring activities, we are humbled and reminded that we are not alone. We are all human with our unique and universal fears, aspirations and weaknesses. When our team was together last fall, we had the fortune of listening to Joshua Cooper Ramo speak about his newest book, *The Seventh Sense: Power, Fortune and Survival in the Age of Networks*. Broadly, he is talking about the digital or information age; however, at one point he specifies that anything can be a network; a group or system of interconnected people or things.

When we log onto our networks or type into our phones for research, we have faith and expectation that we will find our answers. Hours can be lost down rabbit holes tracing one thought or theory after another. Have you ever considered, while sitting in an audience at graduation, your interconnectedness to the 439th person walking across the stage? Prior to the information age, it might have taken days of sleuthing and talking. Today, you may be able to plug the person's name into Facebook, LinkedIn or Google and find the connections almost instantaneously. The digital age illustrates to us more quickly, albeit abstractly, that we are all connected.

When we look at societal, economic or market trends, this idea of networks becomes increasingly more portentous. As investors, we prefer to invest for the long-term, yet how is long-term defined? Fueled by the ease of information, developments, discoveries and transformations are happening at an ever increasing speed. The magnitude, volume and velocity of this connectedness is forcing rapid changes for businesses, governments and people around the world, to reconcile and adapt not only to interconnectedness but interdependence.

Our interconnectedness and apparent disconnectedness in the US is pronounced when considering financial inequality. During the Great Recession, Adbusters and the Occupy Wall Street movement coined the term "the 1%". Now it's used as shorthand to quickly convey inequality and illustrate that large swaths of population are not participating in America's fortunes.

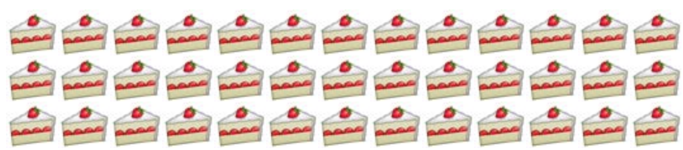
The following chart is from University of California, Berkeley economist Emmanuel Saez in collaboration with Thomas Piketty, "Striking it Richer: The Evolution of Top Incomes in the United States" (Updated with 2015 preliminary estimates), June 30, 2016. Numbers are compiled from Internal Revenue Service data and include capital gains reported on tax returns. There have been plenty of objections to the methodology and interpretations of the numbers, yet we are simply sharing the data to help illustrate a broader theme. This disparity has not been seen in the US since the 1920's.

Threshold Percentile	Income Threshold	Number of Families	Average Income of Families
	Full Population	167,314,000	$61,920
	Bottom 90%	150,582,600	$34,074

Threshold Percentile	Income Threshold	Number of Families	Average Income of Families
Top .01%	$11,267,000	16,731	$31,616,431
Top .1%	$2,045,000	150,583	$3,984,218
Top .5%	$682,080	669,256	$1,054,965
Top 1%	$442,900	836,570	$534,495
Top 5%	$180,500	6,692,560	$255,622
Top 10%	$124,810	8,365,700	$147,779

Net worth, a households assets less their liabilities, also shows similar disparities. December 6, 2017, The Washington Post ran a story, “The richest 1 percent now owns more of the country’s wealth than at any time in the past 50 years” by Christopher Ingraham.

The article cites work from an economist, Edward N. Wolff and describes the differences in slices of pie. Since it was the 4th of July, we’ll use slices of a sheet cake and we have 100 slices to share:

Percentile	Slices of cake		Average Net Worth
The 1%	40		$26,400,000
Top 20% (includes the 1%)	90		$3,000,000
Next 20%	8		$273,000
Middle 20%	2		$81,700
Fourth 20%	0		$8,900
Bottom 20%	-1		-$8,900

While we like to believe we are the land of opportunity, the greater the disparity, the more difficult it becomes to move up into more comfortable incomes or net worth. Our *networks*, families, communities and tax laws dictate our station. We rub elbows with like-minded, like-income and net-worth folks. Our children go to the same schools, the same clubs, and the same teams because we talk and we open doors for those who remind us of ourselves.

Often a goal for investing is to grow the nest egg at the pace of inflation, plus an amount to support a specific term of income. We want to see growing earnings, which over the long-term dictate the stock(s) price. Currently the greatest growth prospects are found within emerging economies. There are several reasons for this, but primarily the reason for optimism is a growing middle class. As a country becomes more affluent, more goods and services are purchased creating a virtuous cycle of growth. A growing stable middle class also tends to stabilize political and financial systems.

Much like diversifying a portfolio of investments, multinational companies also endeavor to capitalize on opportunities for growth, safety, or stability by investing into different countries or markets. If labor is cheaper in one part of the world, or their resources for manufacturing are far flung, they often grow in those regions. The companies manage their businesses both for production but also to be closer to their consumers. As a consumer base grows and diversifies, many nimble businesses reflect this dynamic in order to remain relevant and continue to increase their earnings.

Emerging economies also tend to have younger workers and are creating families at greater rates than the US and many other older, developed economies. When looking more deeply at population growth in the US, in 2015 non-native born accounted for 13% of the population yet accounted for 25% of all births.

We also need workers to continue to produce products and services here in the United States and there is a minimum of workers needed to continue at the current pace of growth. The US June 2018 unemployment rate was reported at 4%. There are fewer and fewer workers to sustain growth at this level. (Keep in mind, we have 10,000 baby boomers retiring each day in the US). Currently our population growth is contributing to a third of what is needed to continue growth. The remaining two thirds needed to foster growth would or could come from immigration. Technology, automation and artificial intelligence will slowly and increasingly fill in the gaps, but also displace workers.

Consider that the bottom 90% *averages* $34,000 income a year. A family of 4 qualifies for Medicaid at $33,948 and below as of 2017. To continue to support Medicaid, Medicare, Social Security and public and private retirement plans, a growing economy here and abroad is a necessity. With 90% of our population one emergency expense away from the poverty line, trade tariffs – increasing cost of goods - could readily trip them over. If emerging economies suffer from our trade tariffs, growth prospects there and around the world will diminish. The assets of the top 10% will shrink and the bottom 90% most likely will increase reliance on public services – and funds.

Much like the pomp and circumstance of graduation or wedding ceremonies, everyone has a role to play. There is not one silver bullet, no one tax code revision, trade agreement, nor campaign slogan that will address all the challenges in the United States let alone the world's. We are all interdependent and our survival depends upon looking at our neighbors as ourselves.

"It's a beautiful day in the neighborhood…." Fred Rogers