

Fourth Quarter 2021

Economic and Market Commentary

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For almost 8,000 years, a Mesolithic people occupied the land centered by the confluence of the rivers Ouse and Foss. Today, people would define the area as, “The Northern Moors of England, south of the Scottish border.”

Their names evolved into the Brigantes. Like most paleolithic people of their time, the Brigantes started out as hunter gatherers and evolved into an agrarian society whose settlements changed from temporary to permanent. And there they lived, slowly morphing into the society the Romans encountered around 50 A.D.

At first, things were copacetic. The Brigantes initially became a “client state” of Rome, actively trading and interacting with the Ninth Roman Legion until their leaders demonstrated too much autonomy. Then things got hostile.

In 71 A.D., the Brigantes were defeated by 6,000 Legionnaires of the Ninth Legion. With the fighting over, the Legionnaires built a permanent fort occupying approximately 50 acres. In recent years, archeologists have found the ruins of this fort under what is today York, England. For centuries to follow, Roman emperors such as Hadrian, Septimius and Constantine I all held court in York during their various campaigns.

Like today, Mother Nature had a say in man’s intentions, and the rivers Ouse and Foss began to flood regularly, so that by the time of the Roman decline, the settlements declined dramatically and were eventually taken over by Angles by the late fifth century A.D.

For the next 300 years or so, the settlement eventually grew into a city, with cathedrals and centers of learning such as “The Cathedral School of York,” founded in 627 A.D. Parenthetically, the school is still in existence today as the “St. Peters School.” Alas, all good things must come to an end, and in 866 A.D., the Vikings raided York and captured the city.

For almost 100 years, the city prospered under Viking rule. It became known as “Jorvik” and grew to a population of more than 10,000 people, second only to London in size in all of England. There commerce prospered with the founding of a mint metal works. In addition, glassworks abounded, and the beginnings of a thriving textile industry took hold, one that flourishes still in York more than 1000 years later.

Yet, once again, all good things came to pass, and this time it was Good King Edward who completed the unification of England by driving the Vikings out in 954 A.D. But just when things seemed to be settling in, the Norman Conquest of England took place in 1066. The people of York rebelled against the Conquest and were brutally subjugated when William the Conqueror

destroyed everything from York to Durham to suppress the uprisings once and for all. This period became known as “The Harrying of the North.

Another 100 years passed before York once again began to prosper, but not without blood on its hands. In 1190, York Castle became the site of a massacre of hundreds of Jews who lived in the city. Putting the insane bloodshed behind them, York finally grew into a European trading center.

From York, grain and woolen goods were exported throughout Europe, and items like wax, cloth and wine were imported from the Continent. When King Edward I made war with Scotland, he made York his command headquarters. In spite of a peasant revolt in 1381, York’s prominence and privileges continued to grow in England. For the next 300 years, once again, York found itself at the center of English history. First, the city suffered decline during Tudor times. When Henry VIII took the throne, he closed or destroyed the many Catholic churches, abbeys and schools. Shortly thereafter, one of York’s most famous citizens, Guy Fawkes, masterminded his blowing up of Parliament to aid the Roman Catholic Restorationists.

By the mid-17th century, the English civil war was in full bloom, and once again York was a scene of bloodshed and mayhem until parliamentary forces eventually defeated Prince Rupert in July of 1644 at the Battle of Marston Moor.

With the monarchy restored in 1660, the merchants and gentry took center stage, making York the cultural capital of the north of England. Fine townhouses and estates were built, many of which are still standing to this day. It was the introduction of modern railways in the first half of the 19th century that ultimately led to York becoming an engineering center and transportation hub by the late 19th century.

Doc George and His Wife Constance

Doc George was York’s first psychologist, and his wife Constance was a devout missionary. Both of their fathers were Anglican ministers. Together they had three sons. The oldest, George, became a farmer. The middle boy, John, became a geologist. The youngest, Wystan, well, he’s the one we’re really interested in.

Coming from such a devout Anglican family, Wystan attributed his love of music to his days as a choir boy. By age 8, he and his inquisitive mind were sent off to boarding school. At 13, he was attending the prestigious Gresham School in Norfolk. And by age 18, he was attending Oxford. He first came to Oxford on a scholarship in biology and soon was introduced to Old English poetry through the lectures of J. R. R. Tolkien. His path was set; he knew now that his life’s calling was that of a poet.

What A Legacy

It would be cruel to leave you in suspense. If you haven’t figured it out by now, our third and poetic son was W. H. Auden. Considered by many to be, along with T.S. Eliot and William Butler Yeats, one of the greatest poets of the 20th century.

As is often the case for many writers, Auden supported himself in his early years after Oxford by writing reviews, librettos, essays, and scripts for documentaries all the while working on his poetry that would evolve greatly in form and substance throughout his lifetime. Never one to stagnate his style, he incorporated both symbols and reality which many feel gave birth to literary modernism. It's felt that the "beat generation" of poetry owes a great debt to the writings of Auden in demonstrating the elegance of technical forms married to the textured use of language.

Auden was prolific as well as brilliant, entertaining and thought-provoking. I'll spare you an essay on some of my favorite pieces like, "The More Loving One," "Hearing of Harvests," "Dover," and "As He Is," and instead we'll turn our focus on perhaps his most respected piece, and the one that translates most acutely to where we find ourselves today.

The Age of Anxiety

Auden left England in 1939 and moved to New York. When war broke out, he contacted the British Embassy so that he could come home and serve. He was told that at age 32, unless he had specific needed skills, he was not wanted. I guess being a poet didn't count. When trying to enlist in the U.S. Army, he met a similar outcome. So, he taught at the University of Michigan, Swarthmore, and The New School, all the while continuing to write his poetry.

In 1944, he began his magnum opus, *The Age of Anxiety*, which he completed in 1946. Upon its completion, it was met with mixed reviews. T.S. Eliot hailed it as "his best work to date," while the *Times Literary Supplement* deemed it "his one dull book, his one failure." So much for the *Times* opinion considering it went on to win the Pulitzer Prize for poetry and Leonard Bernstein and Jerome Robbins were so inspired by it that the former wrote a symphony based on it, the latter a ballet.

The poem is book length and takes place in a Manhattan bar where four solitary drinkers express their innermost thoughts. They share their commonality of inescapable plight brought on by a world in the midst of war.

Let Me Bring It Home

Perhaps the most memorable line in *The Age of Anxiety* is, "The world needs a wash and a week's rest." Truly, is that not the way most Americans feel right now? At the time of this writing, we've just entered into the third year of fighting COVID-19 in America. Earlier this month, we recognized the first anniversary of the capitol storming on January 6. In addition, December inflation numbers are at the highest they've been in 40 years.

Now if that isn't enough, add the worry of supply chain disruption, pay inequality, and erosion of democratic norms along with a backdrop of partisan politics not seen since Reconstruction to the mix. As much as we are ashamed by it, racial inequities and gender bias are pervasive. Not to beat a dead horse, but we can't forget Mother Nature. One needs to look no further than the global fires and flooding of recent years to be reminded of the effects of global warming.

Allow me to be clear about whether global warming is or is not a result of human interaction with our environment. It is real, and it is happening. (It's happening the same way the earth was affected by the last Ice Age, some 14,000 years ago, when our planet was populated by less than

2 million people, about the same number of people in Los Angeles who have now contracted COVID-19.)

So, does this represent the beginning of a long-term downward trend or a rational recognition that substantial challenges exist to the strongest major economy in the world and should not be ignored?

A Glass Half Empty or A Glass Half Filled

Having gone to a science and math high school that has produced four Nobel prize winners (how I ever got through the curriculum is still a question I ask myself all these years later), I've long believed that it is science and innovation that push the envelope of human advancement and prosperity forward. With that said, you can firmly count me in the camp of the glass half-full. In fact, I believe it to be well past half-full, but nonetheless, it's time we take an inventory on both sides of the ledger.

Chicken Little's Perspective

By no means do I take these challenges lightly or are their negative consequences lost on me. The following is an annotated inventory of the dangers, both real and perceived, that I feel threaten both our financial as well as physical security. Since no reader of mine lives in a cave, I will keep the commentary short and succinct since I'm sure by now you've been bombarded with input from every news source available on the same topics. With that in mind, I will limit my topics to five. The way I see it is as follows (topics not listed in a particular hierarchy):

□ China. When the world's second largest economy slows, so does global GDP. China is currently suffering through a real estate downturn. Too much leverage along with inflated prices. Defaults or restructuring of debt will occur. Is this a Lehman Brothers 2.0 moment? Most analysts think not. Although the government will most likely not directly bail out indebted developers, they will most likely use monetary tools to ease a potential credit crunch as well as encourage banks to help healthy developers acquire distressed developer projects.

□ Russia and the Ukraine. Since the end of the Cold War, NATO membership has doubled. Countries like the Czech Republic, Hungary, Poland, Bulgaria, just to name a few, have all joined the alliance. Russia perceives this as a broken promise that the West would not admit former Soviet allies into NATO. NATO says that promise was never made. When NATO stated several years ago that they would admit Georgia and the Ukraine into the alliance at an unspecified point in time, this promise made Russia see red. (All right, pun intended, hence the current saber rattling.)

It's important to keep in mind this is one time when economic diplomacy should prevail. Russia's economy is roughly one tenth the size of the United States'. Other than fossil fuels, principally natural gas, they are a poverty-stricken country. Russia sells what they have of natural gas to Europe. If Europe were to buy their natural gas from the U.S.— we have a plentiful amount and have promised to supply— instead of from Russia, that would be a real setback to the Russians. I would expect a diplomatic solution to this one.

While on the topic of Russia, I would like to use it as a segue to topics three and four, market irrationality and Federal Reserve policy.

A few days ago, I was watching a live broadcast of a news briefing on CNBC. The briefing featured the Chairman of the Joint Chiefs of Staff, General Mark Milley, and the Secretary of Defense, Lloyd Austin. They were talking about the Russian troop buildup on the Ukraine and Belarus borders now surpassing 100,000 troops. While listening to this in-depth briefing, I'm watching the Dow Jones ticker at the bottom of the screen out of the corner of my eye, and within minutes, the Dow had gone up over 200 points. Seems mind-boggling, doesn't it? But that's not the end of the story.

Several days later, I'm again watching CNBC, and they are playing recorded excerpts from Federal Reserve Chairman Jerome Powell's comments on the impending shift from quantitative easing (making credit more readily available through a number of possible monetary tools) to tapering and increasing interest rates (making access to credit harder, and the cost of borrowing more expensive). Again, out of the corner of my eye, I'm watching the Dow ticker and couldn't believe what I'm seeing.

It's important to remember that the Federal Reserve discount rate is currently 1/4 of 1%. The 40-year average is about 6 1/4 %. (The discount rate is the rate that commercial banks can borrow from the Federal Reserve Bank.) Powell's comments might lead analysts to believe that instead of three or four 1/4 % point hikes this new year, there could be as many as five in an effort to tamp down inflation. Let's just say there were five hikes this year, and there will be even five more next year. That would bring the discount rate up to 2 3/4 % , less than half of the 40-year average. Not earth shattering by any means, but the entire time of the broadcast, the Dow ticker just kept going down. I thought to myself, "How irrational." It reminded me of a line from a Rudyard Kipling poem, "If you can keep your head when all about you are losing theirs...."

Finally, on our glass half-empty side of the ledger are again two related issues: Inflation and supply chain disruptions. They are most definitely linked and will probably take the next year or so to resume a sense of normalcy.

So, what's causing the disruption in the supply chain? Record shortages—everything from household goods to electronics to automobiles. (Many of these products ordinarily come out of China, but they no longer are, due to their commitment of holding down COVID-19 cases.) The imbalance between supply and demand has diminished inventories, resulting in more and more dollars chasing fewer and fewer goods.

As inconvenient and expensive as this bottleneck has proved to be, it should serve as a wakeup call for modernizing our ports, automating our warehouses and paying our truck drivers a wage that will make them want to drive.

Allow Me to Digress; "Trees Don't Grow to the Sky"

Fresh out of college and working in San Francisco until my first semester at law school started in the fall, I took a job as a "risk management trainee," my first job in the financial services field. There I encountered every manner of humanity from the avaricious to the noble, wise and honorable. (You might call it a microcosm of life.)

The stock market crash of 1929 was something I knew a bit about from school and the recounting of it from older family members who lived through it. But now, now I had firsthand

access to professionals who were actually brokers back then and lived through it. Well into their 70s and 80s at the time, they would recount the excesses that had occurred in the marketplace and the outrageous and imprudent use of margin. They would share with me people's perception back then that, "There's nothing to prevent the market from going up. If you're not in it, you're crazy."

Well, it didn't take long for those grizzled old veterans of the wars of finance to indelibly impress on me that, in their own words, "Trees Don't Grow to the Sky." In other words, no matter how rosy the market may look, there will become a time of recalibration. Gravity will serve its natural function and the market will come back to earth. How hard it lands becomes a function of how high it flew. This past January was a reminder of that old axiom, and the first few days of February have shown how quickly tides can turn.

A Glass Half Full and Then A Little Bit More

It's only natural and appropriate that the market should take note of the challenges around us. Does that mean the market is poised for doom? Absolutely not. What it does mean is we need to recognize and deal with the risks and capitalize on the incredible advances that science and technology have given us. Staying true to my policy of parity, I will limit my discussion to five items.

□ Inventory Rebuild. Think about it. The cupboards are bare. Ordinarily, there are three million new cars in the automotive inventory. Today, there is less than one million. Is it any wonder why used car prices have never been higher? Rebuilding this type of inventory reduces the cost of goods, keeps people employed and expands our GDP.

□ Telemedicine. Talk about efficiencies in the delivery system. Pre-COVID telemedicine was a rarely used term. Now it's part of our everyday lives. Obviously, it can't be a solution for a knee or hip replacement. But think of the ease, efficiency and cost containment to one of the fastest inflating sectors of the economy. The three major areas of growth in telemedicine to watch are:

- Remote patient monitoring. These techniques are frequently used in the treatment of chronic illnesses such as asthma, cardiovascular disease and diabetes.
- Store and forward. Here we're talking about the transmission of images which can make things like second and third opinions available in a flash. One can live in rural America and have a world class radiologist interpret your X-Ray as though you were in the room with her.
- Real-time audio/video communication. In this case, you could be at home talking to your GP in real time. Or you can be at your GP's talking to a far-away specialist in real time.
- Think about it: In a world with not enough health care providers, telemedicine technologies allow geographic reach for practitioners resulting in greater practice efficiency and lower health care cost, and improved health outcomes because of increased compliance and closer monitoring of chronic conditions.

These are just a few of the myriad of advancements and innovative opportunities brought by the acceptance of telemedicine.

Autonomous Driving. Once a far-off notion, now a technology that is here already. A recent study by Morgan Stanley research indicated that the ultimate implementation of autonomous vehicles can grow the American GDP by somewhere north of 7%. How? Improved fuel consumption (no heavy braking and accelerating), fewer accidents, fewer repairs, fewer medical bills.

Case in point: The modern diesel freight train can be up to one mile long and require no more than two railroad workers to operate it. Think of what autonomous vehicles can do to the trucking industry. You'll recall how a shortage of drivers has contributed mightily to the supply chain disruption we are currently dealing with?

Precision Agriculture. Think of applying a modern array of tools such as GPS guidance, robotics, drones and autonomous vehicles to make things more controlled and accurate when it comes to growing crops and livestock. We're talking about production maximization using less land, less pesticides, less fertilizers and less water yet producing a greater abundance of whatever it is you are growing.

Artificial Intelligence. Although around for more than 50 years (think of Big Blue finally beating a chess Grand Master), with advances in computing power, the availability of enormous quantities of data and new algorithms, AI is now recognized as being central to the digital transformation of society.

Just a few practical everyday uses of AI are machine translations (no more fumbling with that Berlitz dictionary); smart homes regulating thermostats saving energy and discomfort; and smart traffic sensors regulating the flow of traffic as roads get more and more congested.

AI systems can help to recognize cyber attacks and threats, protecting data and security both private and sovereign. Finally, just in the past couple of years, we've seen AI used in thermal imaging at airports to protect against the transmission of COVID-19.

There are great American companies working in each of these areas, often in multiple areas at the same time. Opportunities abound, and it's our job to try and recognize them.

Sometimes we're reminded of important lessons in unexpected ways. Just prior to the writing of this commentary, I completed a road trip up the entire Oregon Coast, traveling with my wife Echo and my dog Benny. We eventually ended our trip at the national monument of Fort Chapsop, the final wintering place of the Lewis and Clark expedition. Between 1804-1806, the two men led an expedition that traversed the unknown North American Continent and traveled from St. Louis, Missouri to the Pacific Ocean before being picked up by a whaling schooner that returned them to the East.

A remarkable feat of courage, scientific observation, diplomacy and ingenuity, the same traits present, if not sometimes obscured, in Americans today. It's the reengagement of these qualities that will ensure that the 21st century will indeed be an American century emblematic of hope and opportunity for all Americans as well as the rest of the world.

It's with great anticipation that I look forward to the day we can trade in our fist bumps and elbow taps for a handshake and a hug. Until that day comes, stay safe and stay vigilant.

With Very Best Regards,

Ray Lent
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Enclosures