WASATCH CAPITAL MANAGEMENT OF RAYMOND JAMES®

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INSIDE THIS NEWSLETTER

To a Man with A Hammer, Everything Looks Like a Nail

- Article by Mark Lazar

When my information changes, I alter my conclusions. What do you do, sir? **John Maynard Keynes**

September was whirlwind of headlines; Israel held snap elections, Saudi oil facilities were attacked, the Federal Reserve reduced its target rate (Federal Funds) by .25%, Ukraine became a political lightening rod, and the Patriots, Chiefs, and 49ers are undefeated.

In spite of impeachment rumblings and the threat of oil supply shock (Saudi output represents 5% of global oil supply), the US stock market is up nearly 20% Since January. While it's easy to get caught up in political theater, some of the reasons for Mr. Market's enthusiasm include real wage growth of over

5% year-over-year, new home sales are experiencing the best YTD growth since 2007, and retail sales are up over 4%. Admittedly, there are a number of global concerns; however, the US economy, at least today, doesn't appear to be one of them.

Item	Data point
S&P 500 Return YTD	19.94%
Bond Index Return YTD	8.47%
Foreign Index Return YTD	13.18%
Emerging Market Index YTD	3.70%
U.S Forecast GDP 2019	2.50%
Unemployment Rate	3.70%

**All hyperlinked data as of 9/29/2019*

As the presidential debates heat up, the candidates have largely avoided addressing economic policy other than broad generalities. This is a good time to discuss two opposing schools of thought; supply side versus demand side economics. John Maynard Keynes is more or less the father of demand side theory. Keynes believed that while a free market system is generally efficient, it's prone to periodic dislocations or collapse in aggregate demand. He postulated that during these times the government should goose the economy via monetary stimulus (i.e. low interest rates, expanded money supply, etc.), and/or fiscal stimulus (government spending programs). Examples include the Bush tax rebate checks and Cash for Clunkers, both of which ultimately failed to move the economic needle yet cost the taxpayers $101 billion and $3 billion, respectively. Washington bureaucrats did high fives while the taxpayer wrote the check.

By contrast, supply side economics takes money from the government's hand and returns it to the consumer, who instead of buying a new car, might choose to remodel a bathroom, take the family to Disney World, buy a new eBike, or some combination of spending and saving. Supply side economics focuses on cutting tax rates, reducing regulatory hurdles, and shrinking government, which ultimately competes with the private sector for resources, such as labor and capital. In other words, government spending crowds out the private sector, redirecting resources towards less efficient endeavors.

Proponents of Keynesian policies often cite the multiplier effect, which supposes that every dollar injected into the economy—presumably from government coffers—ultimately increases output by a factor of about 2.2 times. This is wrong for two reasons; first, the US, or any other developed country, for that matter, doesn't have a surplus treasury. Rather, they have debt, and a lot of it. In order to spend that additional dollar, they must borrow, tax, or print it. Deficit spending today results in a drag on the economy tomorrow. In other words; there ain't no free lunch.

The second reason the multiplier effect is an obvious fallacy is that, if true, no country would ever experience a recession, since they could simply spend their way out of it. A glaring example being the Great Depression, which started in 1929 but lasted until 1941. Despite (then) record deficit spending via FDR's New Deal programs, the economy suffered an unprecedented twelve year contraction.

While every country must maintain basic infrastructure, politicians on both sides of the aisle love to sell big infrastructure spending programs. Inevitably, these programs overspend and under-deliver. Roads, bridges, public buildings, water systems, and such should be maintained in similar fashion to a home; one year you paint the exterior, remodel the bathrooms the following year, the next year the roof is replaced, etc. But it would be foolish to replace a roof that still has a decade or more of useful life simply for the sake of keeping the roofer busy. This is what is known as the broken window theory.

One final illustration: since 2007, the European Union has relied almost entirely upon Keynesian policies to boost their economy. The US initially did the same, then turned to supply side policies favoring lower taxes and reduced regulatory drag. By comparison, the EU has grown an average of .93% per year, whereas the US has grown at nearly three times the rate, or 2.61%. The reason being that (economic) growth is driven by innovation, entrepreneurship, risk-taking, and efficient allocation of capital. Disruptive technologies like smart phones, 3D printing, cloud computing, and robotics come from the private sector, not the government. Big government doesn't create; it merely redistributes.

The political equivalent to, "This time is different," is, "We must do *something*." Bureaucrats would be wise to put down the hammer and recognize the economy should neither be managed nor controlled. To do otherwise simply shackles the free market preventing it from doing what it does best; innovate, create abundance, destroy costs, and increase living standards.

Wasatch Team Updates

First of all, Morgan Irvin has left Wasatch Capital Management to pursue other opportunities. We wish her the best of luck! In other activities….

Mark

Mark & Savina on a hike in Ithaca, NY this fall.

John

John & Shawn hiking around Canyonlands National Park this month.

Beth

Beth touring the Botanical Gardens in Montreal.

Melissa

On a fall hike in Cottonwood Canyon with friends from California.

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