Current Comments

Gary N. Clark, CFA
April 2023

Much has changed in the investing landscape since a year ago. Interest rates are higher. US Treasury bills were close to yielding zero a year ago and they are about 5.0% today. The phalanx of other interest rates is also higher, although the yield curve is inverted (short-term rates are greater than longer-term rates).

The increase in interest rates created an attractive alternative to many bank deposits and savings accounts. U.S. Treasury Bills of one year maturity briefly provided a yield of 5.3% last month. These forces contributed to the failure of Silicon Valley Bank and highlighted a weakness, likely temporary, in many other banks.

In February of 2022, a Fox News Entertainment commentator announced that "The Recession has begun", which was based on our inverted yield curve. Good for him. Since that time, the GDP has increased over 5.6%, and personal income increased about 4.9%. The unemployment rate last month (13 months later) is at 3.5%, near an all-time low. Fourteen months ago, there were almost two vacant jobs available for every unemployed person. So, we have been doing okay, and there is some inflation.

While it does not yet appear to have actually begun, there are several indications of an impending recession. One indicator is the inversion of the yield curve. A famous economist once wrote that the inversion of the yield curve had predicted nine of the last five recessions. The Leading Economic Indicators have generally declined over the past six months. Jamie Dimon, the IMF, and Bank of America have made cautionary statements about our economic future.

Also, there is the continuing war. A year ago, I thought it would probably be over in about 3 months, and that Putin would be deceased in 12 months. We were clearly wrong on both counts. This war will result in significant changes in our world, notably to its structure.

World War II and Today

Amazon Prime Video has a series titled "World War Two Diary – Day By Day". It is a brief recap of the news items for each day of WWII.

Each episode in the series covers a month of the war, beginning in September 1939 and ending around the later months of 1945. This series appears to have originally been compiled and produced by a Spanish physician in the 1950s, meaning it was created and produced by a foreigner.

The series consists mainly of news clips from each consecutive day of WWII. The creator or producer would have lived through the Spanish Civil War and WWII and would have observed the relationship between the two. The first time I watched this, the verbal narrative was an imperfect translation into English, often with incorrect accents and pronunciations. Sometimes it was hard to understand.

What I got out of it and what interested me was that the daily recap of events was not always consistent with what I had read in my high school or college history books or old 1944 Time magazines or even watching Victory at Sea as a youth in 1954. There were also clips about Finland, Russia, Greece, and Uruguay that I was not familiar with.

The second and third times I watched this series, the verbal translation had improved and perhaps there were subtle changes in content. As I watched the series for the fourth time, I am noticing more improvements in the verbal narrative and the narrator now has an accent that is more clearly American English. I think I also note that the content has also perhaps slightly changed, with the inclusion of more clips or insertions that seem to favor the British. Is history changing?

I also gained an appreciation of how WWII seemed to expand from perhaps having origins in a smaller special military operation in Czechoslovakia in 1937, to a brief minor special military operation in Poland in 1939, then evolving into a conflict that took place all over the world. After the official start in Poland, the war seemed to limp along until it appeared finished for some. Hitler announced that the war was over in June of 1940 and that Germany had won, but it appeared to flare up again and continue on.

Borders and economic relationships changed after the war, which has been discussed further elsewhere. The same might be true for the current Ukraine war. Russia, Poland, Germany, and Ukraine have a complicated history. We'll write more on this later.

Demographic Changes and Commercial Property

Big changes have taken place in the market for commercial property. The commercial valuations have recently been affected by several factors.

a) During Donald Trump's presidential term, one of the tax code changes was to limit the deductibility of state and local taxes on federal tax returns. This increased the after-tax cost of living in a higher-tax state for higher income people. Higher-tax states such as such New York and California tend to vote more Democratic than lower-tax states, such as Alabama and North Dakota.
b) The pandemic influenced many to work remotely and after a while those in New York wondered why they needed to pay the lease for a Manhattan apartment when they could live in Montana and pay a fraction of New York City apartment rental rates. The same went for electrical engineers in San Jose who found they could work remotely from Boise, and periodically commute into the office via Southwest Airlines or Alaska Airlines.
c) Due to the migration out of New York and Los Angeles, many did not go to the urban restaurants, but rather to the ones in Billings or Boise. The result is a significant increase in commercial vacancy rates in certain major urban areas. Parts of New York City have a commercial vacancy rate of over 22%, with smaller pockets of 40%. Downtown Los Angeles has a commercial vacancy rate of over 25%. Our personal survey of downtown Los Angeles finds areas with about 40% vacancy rates. Economics teaches that there is a market clearing price. Vacancies, of course, will lead to an adjustment of market prices, as well as a modification of the product to fit market needs and wants. As lease rates adjust, valuations adjust.
d) Another set of factors looming in the background is the decline in the U.S. fertility rate and the prospects for future population growth, and internal migration trends. Texas is growing.

We do not structure portfolios based on our view of the future. The returns on various asset classes will vary. And, we are currently generally optimistic about the year ahead, realizing that some factors may cause concern.

Thank you for your continued confidence.

Gary N. Clark, CFA