

## Something to Think About



OAKWORTH  
CAPITAL BANK

# COMMON CENTS

We talk a lot about risk and return in our industry. The more risk you take, the more return you should expect. That doesn't mean you take foolish, uneducated risks. However, it does mean you have to expose your portfolio to some volatility if you want to make any real money.

Basically, you can't stick your money in a coffee can and complain about not making any money. On the flipside, you can't load up on small/micro cap stocks, and not expect to occasionally have some wild swings in market value. It is almost like going to an amusement park: if you want the adrenaline rush, go ahead and get on the roller coaster with the 100' foot drop. If not, stay on the carousel.

When it comes to investing, most people understand this, or at least say that they do. However, folks seem to forget all about the old risk and reward paradigm when it comes to macroeconomic and monetary policy. Everyone wants to "smooth out" the boom and bust cycles of the economy, and have nice, stable but impressive growth.

In fact, along with its supposed dual mandate of minimizing inflation while maximizing employment, the Federal Reserve attempts to do just this: smooth out the economy. Consider this quote straight from the Cleveland Fed's website:

"As the 1980s progressed, theoretical developments in the design of monetary policy (discussed more fully in the next section of this essay) reinforced the idea that stabilizing inflation expectations is crucial to keeping the economy on its maximum-employment trajectory.

Economic performance improved in the 1980s and 1990s, in terms of both inflation and unemployment. During this period, operating under the formal guidance of the dual mandate, inflation gradually declined and became low and stable. The Federal Reserve became more practiced in conducting countercyclical monetary policy, or put another way, smoothing out business cycle fluctuations while keeping inflation in check."

Then, of course, our various governments have enacted any number of rules and regulations on business for a variety of reasons. Many of these come from well-intentioned beliefs that they can keep bad things from happening in the future. The Dodd-Frank Wall Street Reform and Consumer Protection Act is an example which immediately comes to mind.

By the way, this isn't going to be a critique of that particular piece of legislation.

Some years into the most tepid economic recovery anyone can remember, people are wondering why the economy isn't growing any faster than it is. We have all heard any number of reasons why this is so, and many of them have merit. Yes, the population is aging, and people tend to spend less as they get older, at least that is thought process. Sure, we are starting from a much higher base than previous recoveries, and it is hard to grow at the same rate as you get bigger. After all, growing your business 10% is a lot easier in absolute terms when your revenue is \$1,000 as opposed to \$1 million.

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**The most terrifying words in the English language are: I'm from the government and I'm here to help.**

**Ronald Reagan (a politician)**

## Something to Think About Cont.

However, what if all those rules we have put in place to protect workers, individuals, and the economy from unpleasantness are having the desired result, even if we didn't know what that was?

Consider the table below, straight from the Swiss based World Economic Forum's Global Competitive Index for 2014. This group breaks down economies into various components, ranks each one, and assigns a composite ranking. The good news? The United States is still a competitive economy, ranking 3rd out of 144 countries. The bad news? The first pillar, or our institutions.

*Please read the table as follows: pillar name, raw score, and country ranking out of 144:*

1.01 Property rights .....	5.3 .....	25
1.02 Intellectual property protection .....	5.4 .....	20
1.03 Diversion of public funds .....	4.6 .....	30
1.04 Public trust in politicians .....	3.4 .....	48
1.05 Irregular payments and bribes .....	5.0 .....	36
1.06 Judicial independence .....	5.1 .....	30
<b>1.07 Favoritism in decisions of government officials .....</b>	<b>3.5 .....</b>	<b>47</b>
<b>1.08 Wastefulness of government spending .....</b>	<b>3.1 .....</b>	<b>73</b>
<b>1.09 Burden of government regulation .....</b>	<b>3.4 .....</b>	<b>82</b>
1.10 Efficiency of legal framework in settling disputes ....	4.9 .....	23
1.11 Efficiency of legal framework in challenging regs. ...	4.4 .....	18
<b>1.12 Transparency of government policymaking .....</b>	<b>4.4 .....</b>	<b>44</b>
<b>1.13 Business costs of terrorism .....</b>	<b>4.2 .....</b>	<b>118</b>
<b>1.14 Business costs of crime and violence.....</b>	<b>4.2 .....</b>	<b>85</b>
<b>1.15 Organized crime .....</b>	<b>4.7 .....</b>	<b>73</b>
1.16 Reliability of police services .....	5.7 .....	22
1.17 Ethical behavior of firms .....	4.8 .....	33
1.18 Strength of auditing and reporting standards .....	5.5 .....	32
1.19 Efficacy of corporate boards .....	5.4 .....	16
1.20 Protection of minority shareholders' interests .....	5.0 .....	23
1.21 Strength of investor protection, 0–10 (best)* .....	8.3 .....	6

Obviously, I have highlighted certain segments which I find troubling. However, take a look at those two in red, and look at our country rank out of 144. Wastefulness of government spending = #73. Burden of government regulation = #82! In the later measure, we, the United States of America, ranks below 81 other countries, and immediately behind economies like: Ghana, Turkey, the Philippines, Cameroon, and the Dominican Republic. Yes, we are behind them, and, no, the countries ahead of us aren't all cowboy economies. Germany, Canada, Japan, the United Kingdom, the Netherlands, Ireland, Sweden, Norway, Chile, and Taiwan all are comfortably ahead of us.

For grins, the wastefulness of our government spending sandwiches us between France and Algeria, and well below all those countries in the last sentence of that last paragraph.

## Disclosure

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The opinions expressed within this report are those of John Norris as of the date listed on the first page of the document. They are subject to change without notice, and do not necessarily reflect the views of Oakworth Capital Bank, its directors, shareholders, and employees.

## *Something to Think About Cont.*

When you add the two together, you get a pretty wasteful and cumbersome regulatory environment for business, ostensibly to protect workers, individuals, the economy, and society from bad things happening to them. At least by comparison with the people with which we would want to compare. *I defy you to string 5 words beginning with W like that.*

This is what baffles me about folks who want even more rules and regulations. By international standards, it seems we already have more than we can say grace over. Further, since corporations are the big, bad guys, how can you explain how the ethical behavior of our firms ranks higher than government favoritism? How can we juxtapose the wastefulness of our government spending at #73 and government transparency at #44 with the efficacy of our corporate boards which ranks #16 and the strength of our auditing and reporting standards at #32?

We are in a weird situation where the least efficient and more opaque is dictating the rules of fairness to the more efficient and transparent. I didn't make this up; I just found verification of what I already knew from an independent, unbiased, foreign economic research/think tank.

*On a separate note, how is it our much maligned policy forces rank #22 and why is our judicial independence not a lot higher than #30? I thought we were supposed to have the best in the world.*

In the end, the United States is still a highly competitive economy. However, we spend, or should I say waste, a lot of money. A lot of it goes to protecting ourselves from, well, ourselves. This represents an enormous cost on business, which slows down economic activity, or at least diverts precious capital from its highest and best use.

But don't let me try to convince you. By all means, please follow this link: <http://reports.weforum.org/global-competitiveness-report-2014-2015/economies/#economy=USA>.

If and when you go there, you will undoubtedly find what I found: our private sector does things very well, and our public sector largely does this sort of middle of the pack, or at least lower than much of our primary economic competition. As a result, perhaps we should rethink letting the government dictate business, and perhaps we should explore the other way around.

Sure, some folks will get the short-end of the stick in that type of relationship; however, I would be willing to bet the rising tide of greater efficiency will lead to greater economic activity which will be a rising tide to lift the vast majority of boats. If that isn't politically possible, and I don't think it is, we should sit back, relax, and enjoy that for which we wished, again, whether we knew it or not.

I hope all have a safe and happy Memorial Day weekend.