

The Horsch *Business Report*



Helping you grow your career and your company



LARRY HORSCH

INTRODUCTION

We continue to live in challenging times and hope you find some of our Report ideas helpful. We've expanded the Washington Scene section of this Report based on the important issues that need review.

Your feedback is valuable in our being able to serve you with useful information. You can register your ideas, agreements and disagreements on our website listed below.

As always, we welcome new readers of the Report, so pass along our website to others who may find the Report helpful.

ECONOMICS

General Overview

Consumer spending continues to support the U.S. economy going into the 11th year of expansion of the current business cycle. We have written before about the weakness in business spending and the negative effects of the U.S.-China trade war which is continuing. While the negotiators may arrive at a first phase settlement of the dispute shortly, it is unlikely to address the bigger issues of China stealing technology, subsidizing government owned businesses and not opening up their markets properly.

Beyond the trade war, there is really a clash of culture, economic systems and political systems that are poles apart, making issues more difficult to resolve.

There have been two notable bubbles that have appeared in the U.S. economy. The silly pricing of fake disruptive technology companies in Silicon Valley has already collapsed

(WeWork, Uber, etc.). The second bubble continues on its own way as car dealers make loans to customers with bad credit or excessive loans already on the books. Some have observed that the packaging of these loans for sale in Wall Street is in fact more profitable for the dealers than selling cars. There is a parallel to the bad mortgage situation in the Great Recession, albeit on a smaller scale.

World Trade Organization (WTO)

While we need an international organization to referee trade disputes, the WTO has fallen woefully behind.

- They recently resolved the Airbus illegal subsidy affecting Boeing that took 15 years to conclude, which borders on scandalous.
- Its rules require unanimous consent to change trade agreements, which is a crippling matter administratively in a large-member organization.
- China is still treated as a developing nation legally, which enables them to subsidize their government-owned companies.
- Its trade agreements don't cover cross-border data flow and many services.

Founded in 1995, the WTO badly needs upgrading and this view is held by leading Democrats and Republicans in Congress. Its outdated aspects are one of the reasons Pres. Trump skipped getting it involved in the U.S.-China trade war. It tells you something when the biggest trade war in recent history isn't even brought before the WTO.

Organizations need to be updated from time to time to be effective which reminds us of an old quote:

"If you don't like change, you're going to like irrelevance even less."¹

THE WASHINGTON SCENE

Income Inequality

In today's Democratic runoff for a candidate to oppose Pres. Trump in the 2020 election, the most liberal candidates have made a big point of wanting changes to taxes and other actions to reduce what they describe as scandalous inequality of incomes in the United States.

A recent study compared the U.S. Census Bureau figures for the top 20% of income earners in the U.S. versus the bottom 20% of income earners in the U.S. and found a 17–1 ratio, which is extreme. On further examination, the study found two flaws in the U.S. Census Bureau data. The top 20% of earners did not have their income adjusted for taxes, which is a significant adjustment. The bottom 20% of earners did not have their income adjusted for transfer payments (welfare payments), which is also a significant adjustment.

The result of these adjustments reduces the 17–1 income ratio to 3.8–1 income ratio, which is important but not extreme. In any society, the brightest and most disciplined citizens will always have higher incomes than those that are not so blessed. Based on the above, it doesn't seem very sensible to aggressively attack the current economic system and view it as radically unbalanced.

Federal Government Deficits

Some years ago, a reporter was interviewing a liberal U.S. Senator from the East Coast. The reporter was challenging the Senator and noting that the Senator was from a very wealthy family which would normally cause that person to be conservative and yet he was very liberal. The Senator's response was instructive. He said, *"I find it easier to teach liberals economics than to teach conservatives compassion."* In this brief quote we have the essence of the historical difference between the major political parties.

The Trump administration is obviously not interested in spending restraints and our federal budget deficit is now almost \$1 trillion annually. If no one cares about the deficit, it will continue upward like a banana republic. The Republican Party must become more of a watchdog on government spending or our long-term outlook will be diminished. We are not feeling the full effect of the budget deficit impact on interest expense squeezing out other budgeted spending to date because of low interest rates. However, as interest rates climb to normal levels the squeeze will become more apparent.

Admiral Mike Mullen, former Chairman of the Joint Chiefs of Staff, some years ago proclaimed the following when asked about the greatest security threat to U.S.:

“The most significant threat to our national security is our debt.”

The Impeachment

Since Sen. McConnell obviously feels the House of Representatives ran an impeachment process based on their own biased concepts, he feels free to do the same. He has openly admitted he’s taking his cues from the White House when the rules require a measure of impartial justice. He is openly flaunting the process. The idea of a jury taking its cues from the defendant is deeply puzzling and some Republican Senators are objecting to his approach.

Bloomberg

He adds a new wrinkle to the Democratic runoff and he may inspire you for not being beholden to any money groups or you may be discouraged by the idea that he’s essentially trying to buy the presidency. In a world of money driving politics, the former is increasingly attractive until a new version of the McCain-Feingold law can be enacted and supported by the Supreme Court to control spending in the election of public officials.²

MANAGEMENT

The Best of Both Worlds

Executives of larger companies would do well to borrow some pages from the Entrepreneurial Handbook to improve their performance on the following issues:

- **Determination.** Often the entrepreneur has made a major financial bet on the business and will not give up without a mighty struggle. Many large company execs don’t have that financial commitment.
- **Opportunism.** Without a strong core competence, the entrepreneur can take advantage of new opportunities in related fields and is not hesitant to do so. The core competencies of many larger companies have become the Holy Grail of planning but often are found to be applying to unattractive industries.
- **Quick Decisions.** Without a large bureaucracy to review decisions, the entrepreneur can move more quickly on key matters.³

The entrepreneur would do well to borrow a few pages from the Executive Handbook to improve the performance on the following issues:

- **Strategic Planning.** Too often the entrepreneur does not plan well for the future and suffers the results in underfunding, causing ongoing problems.
- **Internal Controls.** In a very small business, the entrepreneur keeps a lot of accounting informal. As the business grows, budgets and financial controls have to be strengthened.

Related to these two areas of business management, we have two observations:

- As entrepreneurial founders retire and hand over controls of the family business to the third generation, the founder’s “fire in the belly” is often replaced by a feeling

of entitlement and the business begins to decline.

- In professional management there are 10 executives who can be an administrator in a business (a maintainer) for everyone that can actually build the business. Having an administrator as the leader often leads to slow growth and loss of market share against your competitors, which eventually can put the business on financial life support if the process continues.

INVESTING

Current Markets

The last decade of investing in the U.S. has been wrapped up with a 13% compounded return over the last 10 years for the Standard & Poor's 500 index. That's unlikely to be repeated over the next decade because of the current high valuations and the starting point 10 years ago being so very low after the Great Recession. Many clear thinkers believe that the compounded return in the next 10 years will be about one half that rate and in the shorter run the results could be even more marginal.

U.S. equity markets continue to trade at historic highs with a cautious eye on the U.S.-China trade war. A portion of this condition is tied to very low historic interest rates on credit instruments and a portion of it is related to the confusion in the world which causes many investors to prefer the U.S. markets.

The SEC continues to favor efforts to allow individual investors to buy non-liquid company securities which we believe is a mistake. Having spent the bulk of our lives in venture capital which is full of investments with no real liquidity, we believe this area is best left to professional investors. They understand the risks and often can help the companies in matters of planning, finance and corporate governance. Often this assistance as provided by experienced investors is as valuable as the money that is changing hands.

Long-term Investment Opportunities

Two areas that have long-term potential are companies involved in artificial intelligence and other innovations in gene therapy in the healthcare area. The latter is likely to revolutionize medicine over time and is referred to as "individual medicine" by the Mayo Clinic. Both categories of investment will have ethical questions surrounding them, but these matters can be resolved over time.

A PARTING SHOT

We are all very busy in our lives processing information especially in an era of abundant emails and other digital forms of communications.

Most of what we process relates to smaller matters that need our attention. However, we would do well to set aside a little time each week for a BIG IDEA. A BIG IDEA can move the needle in our business and nonbusiness lives but often gets ignored because of the large demands of smaller issues and ideas. Consider setting aside at least a half hour per week for a BIG IDEA that can have a large effect on your results.

As we enter the New Year, perhaps your New Year's resolution is a good place to start pursuing a BIG IDEA.

Happy New Year

Respectfully Submitted,



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¹ General Eric Shinseki, retired Chief of Staff, U. S. Army

² Congressmen today spend about one third of their time fundraising to help support their next election campaign.

³ When Brian Cornell took over as CEO of Target a few years ago, one of the first decisions he made was to fire 17 vice presidents to get rid of excess bureaucracy and make the company more dynamic.