

The Horsch *Business Report*



Helping you grow your career and your company



LARRY HORSCH

INTRODUCTION

We're pleased with the number of subscribers to date and the general response to the first Horsch Business Report.

We are launching a hybrid blog on our website as you receive this report. This free blog will involve a question, observation or quote and you'll be asked to react to it. We will review the responses and announce a winner and their response along with a modest prize. We'll have a new subject periodically.

Again, we invite you to refer your friends to our website listed below to get our free business report and to be involved in our free blog if they choose.

As always, we hope that these ideas will assist you grow your career and company.

Your responses are welcomed and appreciated.

THE ECONOMY:

The US economy continues to slow as indicated in our May/June business report with a continuous overhang of the China – US trade issues. While negotiators are still at work, positions have hardened making a near-term resolution unlikely. The current biggest sticking point is Huawei Technologies, the massive telecommunications company that China insists on protecting from restrictions, and the US insists on restrictions because of spying implications.

When reading the economic news, it's important to distinguish between leading, coincident and lagging economic indicators. Leading indicators like the stock market, manufacturing activity, new business formation and consumer sentiment tell us where we may be headed. Lagging indicators tell us about what we've already experienced, and the coincident indicators tell us what's going on today. If you're making decisions about the future obviously the leading indicators are key.

The Conference Board economic indicators at the moment show us the economic trend in the US over the last few months is relatively flat. To see the full array of all their indicators you can reach them at www.commerce.gov.

Activities in Europe and China are also slowing and the English Brexit, with possibly no agreement by this fall, isn't helping matters.

Fortunately, the threatened tariffs on Mexican imports will fade as Mexico begins to do the proper thing in guarding its own borders and slowing the immigration at the US borders.

Some would say these observations are too bearish and we would say that they represent the views of a political independent and economic realist with no hidden agenda. (No Wall Street happy talk.)

THE WASHINGTON SCENE:

The political scene is shifting in the Democratic arena toward the far left as the polls see Joe Biden slipping and Pamela Harris and Elizabeth Warren gaining ground. At the same time the polls show that Joe Biden has the best real chance of beating President Trump in 2020. It is still very early in the 2020 race and at this point the Democratic candidates must cater to the more liberal delegates in the convention and once they are nominated, they tend to move toward the middle to get elected. (The same process goes on in the Republican Party only the initial shift is to the far right.)

Today most serious observers see the money in politics and gerrymandering as the biggest corrosive items in the political system.

- US elections continue to be burdened with enormous fundraising efforts. While the McCain-Feingold Law was passed some years ago aimed at limiting spending, it was overturned by the Supreme Court based on the right of free speech. It is puzzling to see that no Washington D.C. think tank or foundation has studied this with the assistance of constitutional scholars and members of both parties to see what could be done to limit expenditures and still be approved by the Supreme Court. Apparently too many in Congress are comfortable with this as they personally have the outside funding needed to perpetuate their stay in Congress.

- Recently the gerrymandering issue in the United States was reviewed by the Supreme Court that essentially decided not to get involved in the matter, indicating that they felt it was a state issue. I believe the minority opinion got it right. It's hard to imagine that distorting the voting process in the United States is not a constitutional issue that should be addressed by the Supreme Court.

MANAGEMENT:

It's very helpful in business that all employees participate in incentive compensation. Done right, there can be less need for middle managers as employees are incentivized on their own and there is less need for excessive reports. In all cases, when you have incentive compensation for it to be effective it can't involve token amounts. It must be a material amount. (A 5% bonus doesn't really move the needle.)

Today, if we look at the full range of general compensation items and rate these for incentive impact, we'd list them as follows:

1. **Salary** – expected and not much incentive, but can be disincentive if too low
2. **Bonuses** – highly motivational in nature and prefer it to be measurable to eliminate misunderstandings
3. **Profit-Sharing** – good motivational impact and builds teamwork among various functional areas
4. **Stock Options** – generally motivational with vesting when the stock price is above the exercise price
5. **Stock Rights & Stock Ownership** – highly motivational and you are aligned with shareholders
6. **401(k) Programs with Matching Funds** – replaced pension plans and rewards savers which has little to do with incentives and often advances the interests of older workers who have more discretionary funds
7. **Pensions** – once vested have almost no motivational value

As we review the above, the simplest combination for most companies is to have a salary slightly below market with a large opportunity for bonuses and some form of profit sharing and/or 401(k) Matching Programs (equity grants or ownership may or may not be involved, depending on whether the company is publicly held or privately held.).

It should be noted that options are really a one-way street. Either they work and they cost the employee nothing or don't work and they cost the employee nothing.¹ At the executive level they should have cash invested in the company, not just options. Suddenly they are shareholders and will act like shareholders.

One of the most powerful incentive programs that exists is employee stock owner programs. (ESOP) It spreads the ownership wider in the company so that most employees are likely to act as shareholders. To encourage these plans, Congress has established significant incentives for banks to finance them, for companies to develop them, and for the seller of the stock to have added benefits. Today in the US about 6,500 companies are using ESOP's to motivate employees. While there some expenses to launch and administer these plans, the benefits far outweigh the expenses in most instances.

Unfortunately, most government jobs have no incentive compensation, but have generous medical plans and pensions. Sad, because it's a formula for underperformance.

INVESTING:

Sometimes it's confusing to have an economic report or a company report that seems positive, but the market reaction is not going in that direction. Much of this relates to the fact that there are at least three different audiences. First, there are short-term traders (a few minutes to several months). Second, there's intermediate investors (several months to three years). Third, there's long-term investors (beyond three years).

Once a company indicates that it's going to spend a great deal of money to improve its long-term position in the marketplace, short-term traders are usually sellers, the intermediate investors may trim their positions a bit, and the long-term investors hold what they have if they believe the long-term results will be good. So, the news item is judged differently by each of these groups.

Obviously, there is an advantage tax-wise to hold stocks over one year to get long-term capital gains treatment which is taxed at about half the tax rate of ordinary income. There is also an advantage of holders

over a very long period to give nothing to the government along the way. If you invest \$100,000 and it grows in equities at 7% a year over 10 years with no trades, you have \$197,000. If you trade the portfolio totally every two years paying long-term capital gains you have \$174,599 which is 11.4% less. If the equities grew at 10% a year and with no trades, you will have \$259,374 dollars. If you trade the portfolios every two years you will have \$217,375 dollars which is 16.2 % less.

To be a successful long-term investor you not only have to have confidence you have the right investments, but you need a cast-iron stomach to hold them through major market downturns. Over the last 60 years, Warren Buffett at Berkshire Hathaway has followed that approach and has probably been the best investor in the world over that period. Recently John Neff died who used a similar approach over 33 years at the Windsor Vanguard Fund and achieved a result almost 3x's more than the S&P 500 from 1964-1995. Most of the value-oriented investors have been beaten by index-type funds during the bull market over the last 10 years. However, much of this will probably be reexamined after a significant market correction. (You don't really worry about an airplane flown without a pilot until you hit serious turbulence.)

A PARTING SHOT:

As the Trump administration has dropped the US from many international agreements, insulted our allies and has taken a stance on global warming that is better suited to a 1980's grasp of the subject, he is increasingly causing chaos.

In contrast to this approach to leadership and teamwork, Sully Sullenberger, the hero of the Hudson River commercial jet plane landing some years ago has spoken on the topic in October 2018.²

We saved 155 lives on the Hudson. Now let's vote for leaders who'll protect us all.

By Chesley B. 'Sully' Sullenberger III
October 29, 2018

Nearly 10 years ago, I led 154 people to safety as the captain of US Airways Flight 1549, which suffered bird strikes, lost thrust in the engines and was forced to make an emergency landing on the Hudson River. Some called it "the Miracle on the Hudson." But it was not a miracle. It was, in microcosm, an example

¹ Most successful options today are cashed out with the owner never investing any cash

of what is needed in emergencies — including the current national crisis — and what is possible when we serve a cause greater than ourselves.

On our famous flight, I witnessed the best in people who rose to the occasion. Passengers and crew worked together to help evacuate an elderly passenger and a mother with a 9-month-old child. New York Waterway took the initiative to radio their vessels to head toward us when they saw us approaching. This successful landing, in short, was the result of good judgment, experience, skill — and the efforts of many.

But as captain, I ultimately was responsible for everything that happened. Had even one person not survived, I would have considered it a tragic failure that I would have felt deeply for the rest of my life. To navigate complex challenges, all leaders must take responsibility and have a moral compass grounded in competence, integrity and concern for the greater good.

I am often told how calm I sounded speaking to passengers, crew and air traffic control during the emergency. In every situation, but especially challenging ones, a leader sets the tone and must create an environment in which all can do their best. You get what you project. Whether it is calm and confidence — or fear, anger and hatred — people will respond in kind. Courage can be contagious.

Today, tragically, too many people in power are projecting the worst. Many are cowardly, complicit enablers, acting against the interests of the United States, our allies and democracy; encouraging extremists at home and emboldening our adversaries abroad; and threatening the livability of our planet. Many do not respect the offices they hold; they lack — or disregard — a basic knowledge of history, science and leadership; and they act impulsively, worsening a toxic political environment.

As a result, we are in a struggle for who and what we are as a people. We have lost what in the military we call unit cohesion. The fabric of our nation is under attack, while shame — a timeless beacon of right and wrong — seems dead.

This is not the America I know and love. We're better than this. Our ideals, shared facts and common humanity are what bind us together as a nation and a people. Not one of these values is a political issue, but the lack of them is.

This current absence of civic virtues is not normal, and we must not allow it to become normal. We must rededicate ourselves to the ideals, values and norms that unite us and upon which our democracy depends. We must be engaged and informed voters, and we must get our information from credible, reputable sources.


For the first 85 percent of my adult life, I was a registered Republican. But I have always voted as an American. And this critical Election Day, I will do so by voting for leaders committed to rebuilding our common values and not pandering to our basest impulses.

When I volunteered for military service during wartime, I took an oath that is similar to the one our elected officials take: "I do solemnly swear that I will support and defend the Constitution of the United States against all enemies, foreign and domestic." I vowed to uphold this oath at the cost of my life, if necessary. We must expect no less from our elected officials. And we must hold accountable those who fail to defend our nation and all our people.

After Flight 1549, I realized that because of the sudden worldwide fame, I had been given a greater voice. I knew I could not walk away but had an obligation to use this bully pulpit for good and as an advocate for the safety of the traveling public. I feel that I now have yet another mission, as a defender of our democracy.

We cannot wait for someone to save us. We must do it ourselves. This Election Day is a crucial opportunity to again demonstrate the best in each of us by doing our duty and voting for leaders who are committed to the values that will unite and protect us. Years from now, when our grandchildren learn about this critical time in our nation's history, they may ask if we got involved, if we made our voices heard. I know what my answer will be. I hope yours will be "yes."

Respectfully Submitted,



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² Original Source: Washington Post – October 29th, 2018
<https://wapo.st/2YerXLn>