

The Horsch *Business Report*



Helping you grow your career and your company

INTRODUCTION

Having spent over 50 years in business and professional investment management, I have become concerned that a lot of business and investment reporting is too near-term focused, often too shallow in content and sometimes not very objective. Since we are living in turbulent times, getting the facts right matters more than ever.

This newsletter is an attempt to focus out a bit, go deeper in observations and to remain as objective as possible. We will focus on the areas of economics, government policy, investing and business management. While I prefer to avoid government policy because of the politics involved, it is simply too important in the overall impact on business activities.

The newsletter will be available free of charge, published bi-monthly, initially in printed form and later by email.

E M & F Communications has been formed as a division of Eagle Management & Financial Corp., my consulting firm that was established in 1988. We have created a website, www.horschreport.com, featuring our bi-monthly reports, my bio and some original quotes. Later we will have some podcasts, a hybrid blog and at least one book.

You are welcome to invite your friends to receive this free newsletter by having them visit our website.

We're hopeful that these ideas will be helpful in developing your career and your company.

Your observations are welcome and appreciated.



LARRY HORSCH

THE ECONOMY OVERVIEW:

It's likely that we, in the United States, are headed for an economic slowdown in 2019 along with that already under way in Europe and China. The stock market has begun to discount this with heavy volatility and the Federal Reserve has backed away from raising interest rates further. An ongoing trade war with China is now aggravating the situation. It is President Trump's attempt to stop the Chinese from stealing technology and subsidizing their large government owned corporations in violation of the World Trade Organization rules.

FREE TRADE

When we examine the concept of free trade, we find it only in a modified form in the real world, different from the pure form that envisions nations doing what they do best and buying other goods and services from other nations who are doing what they do best. In the process, prices are lowered and the standard of living rises for all. Today we deal with the modified form using the WTO as a referee on the rules.

If a growing number of nations move toward nationalism and start violating WTO rules and trade agreements in hopes of helping themselves, the system can begin to unravel and the economic adjustment to follow can be severe. In the 1930s, the nationalistic theme around the world was "beggar your neighbor" and this resulted in everyone becoming a beggar as economies collapsed. The Great Depression lasted from 1930 until World War II in 1941.

While the WTO needs to improve its operations, particularly in the enforcement of violations, it still represents a reasonable trading system to facilitate world trade.

On a personal note, our venture capital fund incurred its largest loss in its 17-year history when an Israeli company got its national export bank to subsidize loans making it possible to allow a

customer to use \$1 million of equipment for six months with no charge. It absolutely killed our business. The lights went out and the employees scattered before any complaint could ever be filed with the WTO.

GOVERNMENT POLICY:

We have now arrived at a point in Washington politics where President Trump has to deal with a hostile House of Representatives who will be challenging him at almost every turn. In addition, the Mueller investigation indicates that there could be many instances where impeachment might be appropriate. The drums are beating by the Democrats for impeachment.

President Trump did an amazing job of getting disgruntled former factory workers in the Rust Belt states to vote for him on the theory that he would bring manufacturing jobs back to their area. With labor costs of \$10 - \$15 per hour higher in the US versus underdeveloped countries, this is unlikely to happen on any big scale and when this becomes apparent, his support in that area will melt down.¹

President Trump's other strong support has been the Evangelical Christians who share his support of the right to life issue. While he has continued to support that cause, it is a bit surprising as a religious group that they ignore his relatively low moral standards. This support could fade a bit when they grasp this more fully but they may be one issue voters.

If these types of support begin to fade away, Republicans in Congress will begin to abandon him and all this could take place before the 2020 election. The key is the Republicans in the Senate whose vote is needed to actually complete an impeachment process.

¹ A large BMW plant was recently opened in Mexico where the average labor rate in the plant is three dollars per hour. Their equipment is no different than that offered in the United States, so the productivity is approximately the same for the workers.

President Trump's big issue is that his skills in running a family business and his emotional state that allowed him to develop a real estate empire are not well suited for the biggest job in the world. If he becomes frustrated with Congress and his businesses continue to slide, he could simply throw his hands in the air, quit and go back to New York. His frustrations at the moment appear to be putting him in a bunker mentality and his administration is still experiencing a revolving door of talent.

If President Trump begins to lose his base of voters, keep an eye on John Kasich, former governor of Ohio and a traditional, moderate Republican who is a proven performer in the political world.

To date, the Democratic candidates for the 2020 election are mostly very liberal candidates promising big ideas with little concept of how to fund them which leaves a lot of room for Joe Biden, or others, to go down the middle if they can receive the Democratic nomination.

MANAGEMENT:

One of the difficulties in managing a business in a fast-growing industry is that if you do it successfully you build a business rapidly without having setbacks and problems that occur in other slower growing industries. It's a little like students who have finished eighth grade and has been told to report to 12th grade in the fall. They would be missing a lot of normal intellectual growth and experience if it happened.

So today, we have some high-tech CEOs who had a great vision in founding their firm but are lacking the intellectual growth and experience to handle the job. In the internet area of customer privacy, they are very slow to understand the penalties for not paying attention to the government concerns, both here and in Europe. In some other industries they have only a faint idea of what the SEC rules are in handling

sensitive information properly and will pay the price for not being aware. In other sectors, they proceed to expand a service into new areas, violating local laws and asking forgiveness after the fact. In all cases the CEOs look like amateurs trying to manage a significant business.

In some larger successful traditional companies, the success was so powerful that the employees were almost operating in a dream world. In the 1970s and 1980s, IBM owned about 70% of the huge world market for mainframe computers based on their highly skillful sales and service operations. Many observers said at the time if an employee of IBM left to join a competitor, they weren't worth much until they had two years of experience in the real world outside of IBM because life in IBM was like a hot knife cutting through butter – very few real obstacles.

This leads me to an old story about experience and judgment. A younger, junior executive was asking a senior executive how he could be successful in business. The senior executive said, "You must have good judgment." The junior executive then asked, "How do you get good judgment?". The senior executive said, "You get it from experience.". The junior executive then asked, "What's the best way to get experience?". The senior executive said, "You get it from bad judgment."

The moral of the story is, we really learn a lot from our mistakes, and we remember them because of the pain involved at the time.

INVESTING:²

After a very extensive business cycle expansion in the US since the great recession, and the stimulating effects of a business tax reduction becoming history, the stock market is discounting trouble ahead. As we noted earlier, Europe and China have already slowed and the trade issues with China have not been resolved.

THE CHINESE DILEMMA

The easy solution for China is to balance off trade by buying more US goods and services. The more difficult matter for China is to stop stealing technologies and subsidizing huge government owned companies in violation of WTO rules. They can pass a law forbidding stealing technologies and other intellectual property items, but this activity is deeply embedded in the Chinese culture. (It should be noted that a significant part of Alibaba's revenue in China is from fake goods which supports 250,000 Chinese who work in their homes.)

If a solution isn't found and the US boosts tariffs from 10 to 25% on a growing amount of Chinese goods, many retailers will have to establish alternative suppliers in Southeast Asia which takes time and will cause inflation at retail. Hopefully the trade issues can be resolved since business decisions are often easier to make when there is some sense of stability.

Overall, it's a good time to be defensive in investing with the hope that there would be better days down the road.

A PARTING SHOT:

Once upon a time the mayor of the town near a swamp was asked to "drain the swamp". Rather than develop a detailed plan or consult with others, he charged ahead with many sticks of dynamite and blew up major portions of the swamp. In doing so he fouled up the waterway in and out of the swamp and great chaos occurred.

In the meantime, the City Council decided to get an investigator to look into the matter and to particularly try to remove blue tailed alligators. The investigator took about two years but found no blue tailed alligators. He did find several obnoxious varmints in the swamp and they were removed.

The mayor left the town and was never heard from again. He was replaced by a person with a greater grasp of swamps. As far as we know, everyone lived happily ever after.

Respectfully Submitted,



Larry Horsch
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² While the author is a Chartered Financial Analyst and has been a professional money manager most of his career, he will not engage in detailed investment advice since he is not a registered investment advisor.
