thoughts

FROM HANSON+DOREMUS

MAY 2022

The tale of the tape...The world in numbers...

The stork is not working overtime:

__10.6 million__ – the number of babies born in China in 2021, the lowest since 1949. The one child policy put in place in 1980 was highly effective. Now China needs more babies, but urban couples are balking. Like everywhere, raising more children is increasingly expensive. (*Barron's*)

__7.3 million__ – the number of births in the U.S. over the two-year period 2020-2021 (@3.5 million per year), the fewest births in back-to-back years in 40 years. Like China, the U.S. birth rate is slowing, and unless it picks up or is counterbalanced by immigration, our GDP growth rate long term will fall. (National Vital Statistics)

In praise of the IRS (I know it sounds crazy but occasionally praise for the IRS is in order):

__24 million__ – the backlog of tax returns which will be cleaned up by the end of 2022.

__13 hours__ – the amount of time Americans spend doing their taxes today versus 18 hours in 2010. (This one I am not sure about. People spending less time on their tax returns? The form 1040 plus instructions now totals 230 pages. All praise to the productivity of TurboTax I guess).

__20 percent__ – the amount the IRS budget has been cut since 2010 even as the number of returns has grown by 20%. (IRS stats - *The Economist*)

As if American Higher Education did not have enough to worry about:

__Shrinking__ – the number of 18–24-year-olds will decline starting by the mid-2020s.

__1 million__ – U.S. college enrollments are down by this amount since 2019.

__Foreign student enrollment__ - also down. Especially from China, which had been the big supplier of high pay enrollees. (Just getting from China to the U.S. today, or vice versa, is well-nigh impossible). (Education stats – *The Kiplinger Letter*)

China is de-emphasizing English in their core curriculum both at the primary and secondary levels.

(*The Economist*)

I guess they expect the world to learn Chinese. That won't happen! The list of "Category V – super-hard languages" includes Arabic, Chinese (Mandarin and Cantonese), Japanese, and Korean. These are only for the masochists including sadly, yours truly (Mandarin).

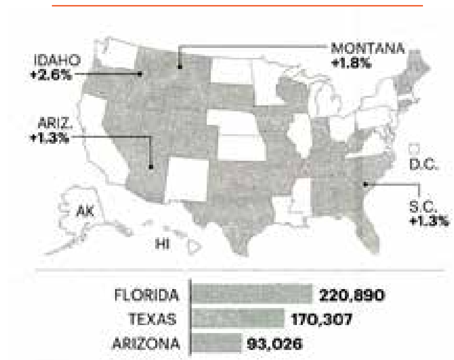
Finally, where are Americans moving these days (*see chart below*)?

- Eric Hanson

ON THE MOVE

The U.S. population was 331,893,745 as of last July, up 0.1% from 12 months before - a historically low growth rate. But as the real estate market accelerated, millions of Americans packed up and moved to new states.

STATES GAINING RESIDENTS*



* Domestic migration only, July 1, 2020, to July 1, 2021; does not include births, deaths or international migration.

Source: AARP Bulletin; U.S. Census Bureau

Hanson+Doremus Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients.
The firm also consults with individuals on financial planning, and works with self-directed retirement plans on investment options.

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GLOBALIZATION

By Eric Hanson

Globalization in retreat? 1914 redux?...

From the end of the Civil War to 1914, globalization, or the increase in trade between nations, grew dramatically. This was due in part to leaps in transportation technology like steamships, the building of the Suez/Panama Canals, and transatlantic cables which allowed for more direct telegraph links. Then came World War I, and globalization came to a screeching halt. The war involved the most important economies in Europe, slashed economic activity, and encouraged beggar-thy-neighbor trade policies.

Today many wonder whether the current era of globalization, which began in the late 1980s, will also end abruptly. If it does it will not be due to the Russia-Ukraine conflict. Russia is a small part of the world economy, much smaller than Germany/France/England were prior to 1914, and although Russia is important in energy and some commodities, it is not a major factor in global supply chains.

No, if globalization comes to a halt, it will be due to politics. Here in the U.S., Democrats (the supporters of labor unions) have blown hot and cold on globalization, liking the increase in trade but assailing the loss of jobs to lower wage countries. The Republican party has historically been the party of free trade and low tariffs, but this took an abrupt U-turn under President Trump. The Republican agenda now includes resistance to globalization, limiting immigration, and securing the southern border.

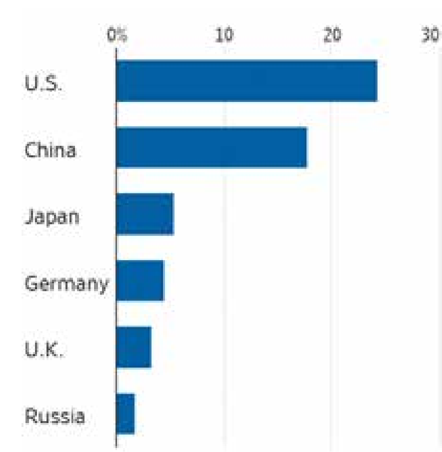
So, we may be in for a period where both political parties are critical of globalization and more supportive of tariffs, quotas, and other trade barriers. The political winds are shifting. J.D. Vance, author of *Hillbilly Elegy*, is running for the Senate in Ohio as a Republican. Originally opposed to Trump, he is now an ardent supporter speaking out about excessive federal subsidies to the poor which he says lessen the incentive to work, and about the loss of jobs to globalization.

So, will this era of globalization end soon? We are doubtful. The world is too interconnected today, and too many businesses depend on foreign sales and production. What is more likely is that reliance on one country will be replaced by multi-country sourcing. Some production in China may be shifted, say to Vietnam or Indonesia, and production in Vietnam or Indonesia might be shifted to Mexico, and so on.

Some production will be "re-shored," shifted back to the U.S., but the process will be slow and uneven. Intel and others are making a concerted effort to ramp up semiconductor production here and move away from South Korea (Samsung) and Taiwan (Taiwan Semiconductor). A recent *WSJ* article highlighted how Salomon SAS is trying to bring the manufacture of hiking boots back from Asia to France. The re-shoring is going slowly as the supply chain in Europe must be rebuilt from scratch. Adidas of Germany tried setting up highly automated shoe production lines in Germany and Atlanta in 2016. Both plants were shut down in 2020 as uneconomic. New Balance still manufactures some of its shoes here in the U.S. but can only source 70% of necessary parts locally.

Re-shoring sounds like the answer to many prayers but re-shoring does not generally involve big employment gains. Salomon's highly automated boot factory will employ just 15 workers versus five times this number in Asia.

COUNTRIES' ESTIMATED SHARE OF GLOBAL GROSS DOMESTIC PRODUCT IN 2021



Source: The Wall Street Journal; International Monetary Fund
Note: In U.S. dollar terms

HAS GLOBALIZATION PASSED ITS PEAK?

Global trade volume as a percentage of GDP since 1970*

*Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product.

Source: Statista

FIXED INCOME

By Liz Ford

Are bonds still worth it?...

Dropping bond prices have recently caused anguish for many investors, especially since bonds are usually held out as the less risky part of a balanced portfolio. With the U.S. bond market losing more than 9% so far in 2022, it's natural to wonder if bonds are still holding up their end of the bargain.

Over the last 40 years, interest rates have fallen dramatically (*see graph to the right*) and we've grown accustomed to bond prices going up, not down. When you buy a bond, you lock in set interest payments. These cash flows get more attractive as new lower interest bonds are issued. While it may be nice to see the value of your bond go up, the interest you earn ends up being a larger component of your total return. With lower yields we've been forced into accepting less compensation for tying up our money.

Many have opted to spend their money instead, contributing to our current inflationary woes. The Federal Reserve's recent rate hikes are intended as a counter measure. More raises are expected this year, and it's tough to predict how high rates will go. Since the 1980s we've tended to overestimate how much rates will rise, but this time may be different. Recent lower prices likely reflect at least some of this uncertainty.

Our long-term strategy has been to see bonds as a diversifier to stocks, a source of liquidity, and an income generator for portfolios. Favoring stability, we try not to get "too cute." We avoid speculative credits and high-turnover trading, opting to buy high quality corporates, municipals, and treasuries and hold them to maturity (whether in individual bond ladders or buy-and-hold bond funds). With this approach, bonds are continually maturing and can be reinvested at new rates. Rates have risen dramatically this year (*see graph below*), and higher interest payments should help normalize bond returns over time.

We're also encouraged by recent research at Vanguard supporting the continued value of bonds as a diversifier to stocks. Over the last 30 years, the correlation between stocks and high-quality bonds has been low (bonds moved in the same direction as stocks, but less dramatically) and often negative (bonds moved in the opposite direction of stocks). This has persisted in both high and low-rate environments and the goal is to mute portfolio losses if equities fall.

While we do track market fluctuations, our focus remains on analyzing credit quality: the ability of issuers to make interest and principal payments and avoid default. We look for solid issuers trading at reasonable prices relative to the market. Lower quality issuers can feel the negative effects of rising rates more acutely, and historically investors have tended to seek shelter in high-quality bonds during times of market stress. We also prioritize parts of the yield curve where we think investors are being properly compensated for increasing time to maturity.

Bonds still make sense to us but finding suitable yield for clients has been an ongoing challenge, especially as inflation has increased. Falling bond prices may sting now but earning a more rational rate of interest for our time and money should prove to be a welcome change in the long run.

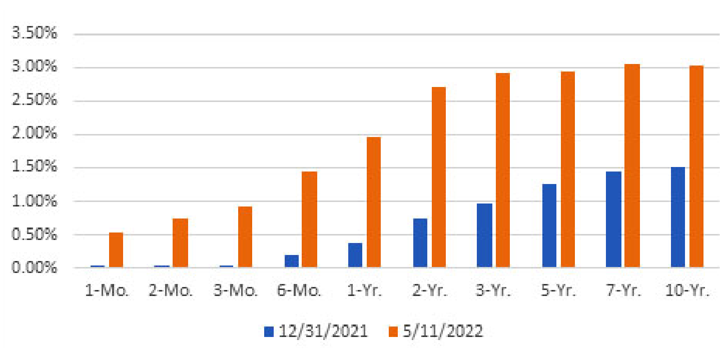
MOVEMENT OF THE 10-YR. U.S. TREASURY YIELD

(Last 40 Years)

Source: *Liz Ford with data from Bloomberg*

RISING U.S. TREASURY YIELDS

(Various Maturities - Year to Date)



Source: *Liz Ford with data from Bloomberg*

INVESTMENT TRENDS

By Anne W. Doremus

Keeping an eye on your cash...

For most of the past decade, we didn't spend a lot of time thinking about how to invest our clients' cash. With short-term interest rates pegged near zero, it didn't really matter whether your "ready" funds were in a bank deposit account, money market fund, CD, or short-term Treasury bill. Income on cash-like instruments of any sort was simply not to be had.

The Fed's efforts to fight inflation by raising rates has rocked the investment markets this year. As Liz points out on page 3, this sea change has been particularly painful for bond holders who had enjoyed decades of falling yields and rising prices. Stock investors too have felt the pain as interest rates weigh on corporate profits and valuations.

But there is another side to the rising rate story. While long ignored, cash and "near-cash" returns are beginning to perk up. True, the yields are still relatively low, but the dollar volumes are huge. *WSJ* columnist Jason Zweig recently reported that banks today hold \$18.5 trillion in deposits and another \$4.5 trillion in money market funds. Investors, concerned about the eroding effect of inflation, are moving their cash into higher yielding alternatives, and the institutions who manage these funds are bracing for more of this cash "sorting" in the coming months.

What are investors' options for all these uninvested funds? As always, having a clear goal is the first step to any successful investment plan. If absolute safety and liquidity (i.e., being able to write checks, for example) is paramount, then traditional checking or savings accounts are still your best choice. Most products here still offer little, if any, interest with the national average annualized rate around 0.10%. Shopping on sites like Bankrate.com can reveal rates as high as 0.70% although these products typically come with restrictions.

For those who still want safety but are willing to have less liquidity, purchased money market funds may meet your needs. The annualized 7-day yield on the Crane Index of the 100 largest money market funds averaged 0.34% as of last week, up from a rock bottom low of 0.02% at the end of February. These funds' yields should be even higher given the 0.75% increase in the benchmark fed funds rate over the same period but for a little-known feature relating to fees. Traditionally, money fund managers charge anywhere from 0.25%-0.50% to manage short-term investments. However, as rates on cash fell below these levels over the last decade, most managers waived their fees to avoid offering clients *negative* yields. Now, rising rates are allowing managers to reinstate their fees (*see chart below*). Once fees are normalized, rates on money funds should move more in line with short-term rates.

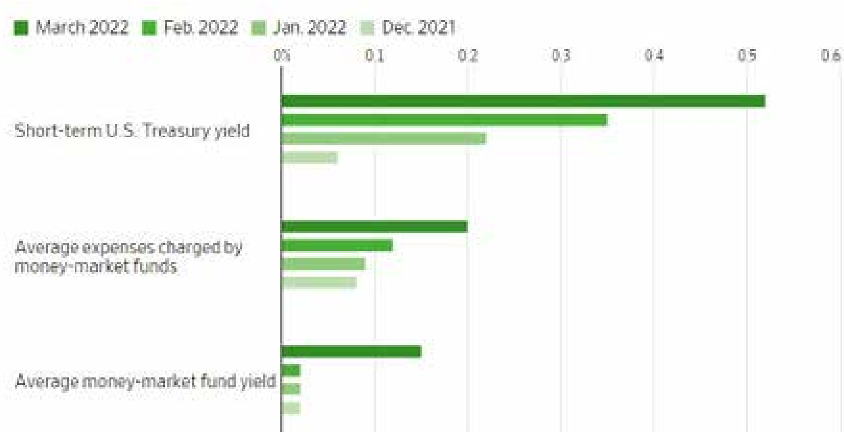
FDIC insured CDs and short-term Treasury bills (3-month) are a good option for investors still looking for absolute safety but willing to accept even less liquidity. Rates on both instruments are now up over 0.70% since the start of the year. Extending the maturity can provide additional yield with 1-year Treasury rates now at 1.97% and 1 year CDs exceeding 2.00%.

Finally, short-term bond and floating rate funds lie at the other end of the risk/reward spectrum for short-term investors. While there are lots of choices in these categories, investors are generally assuming more risk tied to interest rate changes. If the average term of the fund's holdings is very short, the risk of loss is limited -- but it is a risk, nonetheless. The short-term Treasury bond fund category, for example, has lost 4% since January 1st in the face of rising rates. As is always the case, investors can pick up yield by investing in funds that hold lower quality investments such as corporate debt or bank loans. These funds today can yield anywhere between 1.30% and 3.80%.

While short-term yields may not get anyone too excited today, getting *any* return on an investment that promises to hold its value is a new experience and one that may look increasingly attractive in today's volatile markets.

YOUR CASH IS STILL TRASH

Short-term interest rates have risen steeply since February, but expenses on money-market funds have risen higher than their yields. *



*Notes: U.S. Treasury is 90-day bills; Money-market fund averages are for Crane 100 Index of top 100 money funds; Yield is average 7-day yield.

Source: *The Wall Street Journal;* Crane Data; Federal Reserve