thoughts

FROM HANSON+DOREMUS

MARCH 2024

Companies survive, products often don't...

This is how *The Economist* put it in a recent article. Apple will most likely have a long and bright future, but most of its products will be more fleeting. They will come and go. Remember the Apple II computer and the original Mac? They are in the dustbin of history now or selling on eBay as fashionable home and office decorations.

But there are examples of products that have survived long after their debuts. How about Snickers, the best selling candy bar in the U.S.? Introduced in 1930, it has changed little over the past nearly 100 years. They did take out malted milk and coconut oil from the formula and substitute in skim milk and palm oil. The most visible and annoying change however is "shrinkflation." They cut the size of the bar over the years…. But as you might imagine, the price has just kept going up!

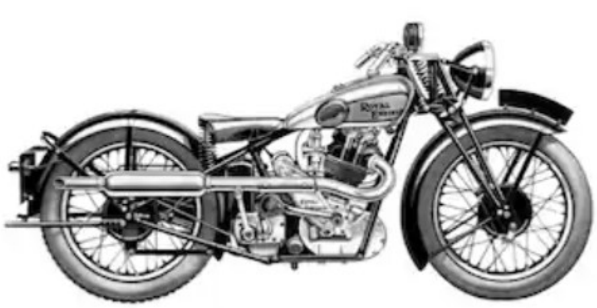
Another unchanged product is the Royal Enfield Bullet motorcycle, which *The Economist* notes is probably the most unchanged vehicle in continuous production today. First manufactured in England in 1932, the Bullet was transferred to Indian ownership in the 1950s. The Bullet has a simple 350cc engine. It is "tried and tested," easy to maintain, and rugged, with a very old school "thump" to the motor. It survived the onslaught of the Japanese bikes in the 1970s and still sells well globally, starting at around $2,500 in India.

2023 ROYAL ENFIELD BULLET

Source: www.royalenfield.com

There have been changes along the way, like the addition of fuel injection and an electric starter in place of the original kick starter (traditionalists complained about this one). The bike also comes in more colors now than it did originally, but it still looks today very much like it did back in the 1930s (*see pictures*).

1932 ROYAL ENFIELD BULLET



Source: www.indiatoday.in

This is not to argue that long lived products are good and short lived ones bad. It is more to note that it is harder and harder to find products that have stood the test of time in their markets. We live in a world of change and technology, where marketers push us to buy the latest products with gizmos we didn't even know we needed. Aluminum and plastic are now in, and steel and durability are out unless you can deliver the latter at a very low price point.

In our house we have a countertop machine that toasts, broils, bakes, air-fries, slow cooks, and dehydrates. All-in-one! I am sure it is chock full of semiconductor chips. If it breaks it is probably cheaper to throw it out than to try to find the rare repair person who can work on it. Sorry to be the curmudgeon here. Probably time for a Snickers.

- Eric Hanson

Hanson+Doremus Investment Management is a registered investment advisor offering integrated investment management and financial planning to individuals, businesses, and nonprofits. It was founded in 1995 and is regulated by the U.S. Securities Exchange Commission.

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SAVING FOR RETIREMENT

By Mark Andrews

Is the 401(k) going away?...

The 401(k) has become a retirement savings institution—over half of civilian workers have one. But the government might not want to keep paying for the advantaged tax treatment it currently allows.

For some quick context, 401(k)s are a "defined contribution" plan, where the employee contributes x% of salary in the current year and the employer often matches up to a certain amount. The plan comes with a tax advantage: contributions are made with pre-tax income, and taxes are deferred until funds are withdrawn in retirement, usually when individuals are in a lower tax bracket.

The favorable tax treatment of 401(k)s costs the government in a few ways: 1) tax collection is deferred from the present until retirement; 2) the government collects a smaller percentage of income since retirees are typically in lower tax brackets; 3) the government misses out on taxes that would have been paid on capital gains realized along the way. That all adds up. For 2021, the Treasury valued the revenue it would have earned if not for 401(k)s at $119 billion.

That is a lot of money, around 2% of fiscal spending in 2021, though the government is probably willing to pay for this if it accomplishes its goal of getting more people to save for retirement. But it is not clear that the tax treatment of 401(k)s does that. Boston College's Center for Retirement Research contends it is more the automatic payroll deductions that induce saving, not the tax advantage.

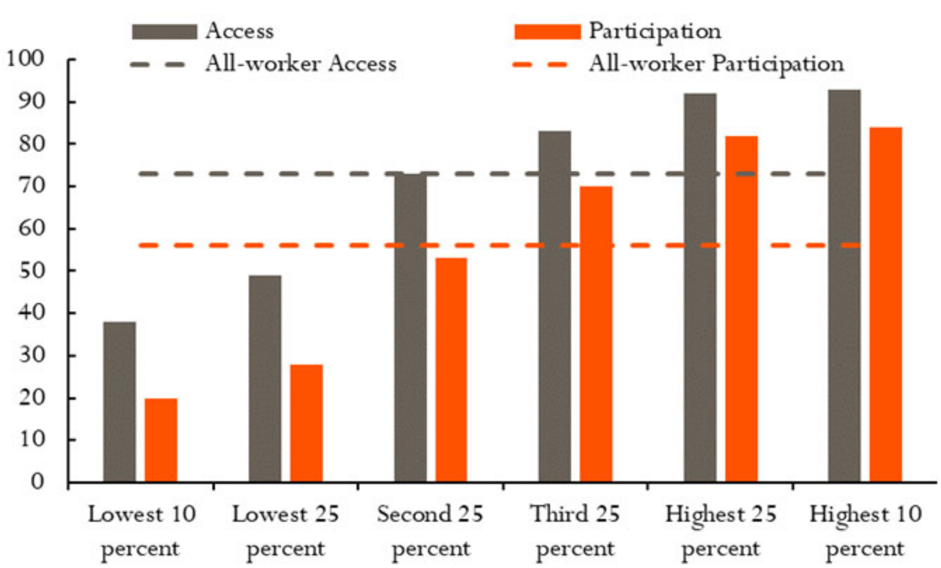
It also probably matters to the government who receives the benefit. *The chart below* shows retirement plan access and participation both increase with income—only half of the bottom quartile of earners even have access to plans. In other words, the tax expenditure ends up disproportionately benefiting the highest earners. With Social Security's Trust Fund set to run out by 2033, supporting wealthier workers' retirement might be an easy target.

The 401(k) is also under fire from some large corporations. In the fall of 2023, IBM announced it would discontinue the 401(k) option and instead reopen its pension. In contrast to the 401(k)'s "defined contribution," a pension is a "defined benefit" plan, where the employer agrees to pay x% of salary in the future. With pensions, the employer is on the hook to meet that commitment and invests in assets that can achieve the growth it needs. This strategy ran into some trouble in the 2000s from a combination of major declines in the stock market (tech bubble bursting and Global Financial Crisis), and regulatory changes to standards for pension accounting. The result was most pensions were underfunded—the obligation they had built up to their employees was greater than the plan's assets. Rather than continue to commit to future payouts, many corporations stopped offering them.

With the stellar returns of the past decade, more pensions are out of the hole and are now overfunded. Such is the case with IBM, and it wants to get at that money. By reopening the pension, IBM can lean on the assets it has already built up to fund the benefit to employees, instead of contributing cash to 401(k)s today. This option is not available to all corporations—they need to have an old pension plan that has grown to overfunded status as well as a desire to change the benefit they offer employees.

Like 401(k)s, many pensions are also tax-advantaged, and the government may not be so keen on them either. So what should we do if tax-advantaged retirement savings becomes a thing of the past? Keep saving. Employers would probably still provide some form of contribution towards retirement, and we should take advantage of any "match" offered. Ideally, "pay yourself first" by setting up the contributions to move automatically from paycheck to account. An added nudge toward retirement savings with 401(k)s is the penalty for early withdrawal (before reaching retirement age). If that goes, the discipline will fall to us to make sure we do not tap into those assets. The bigger picture is that regardless of the investment vehicle we should still make sure we are setting aside money for retirement.

ACCESS TO AND PARTICIPATION IN RETIREMENT BENEFITS BY EMPLOYEE WAGE GROUP



Source: Bureau of Labor Statistics, data as of March 2023

FINANCIAL MARKET REVIEW

By Neil Macker

Lessons from markets in 2023...

Morningstar.com recently published an article, "12 Lessons the Market Taught Investors in 2023," that explores some of the big picture teachings from an interesting year. Here are a couple themes we want to highlight.

The first is that it's really hard to predict what is going to happen and how those events will impact financial markets—especially when our political biases predispose us to a certain view.

Short-term market forecasts often rely on a singular narrative to explain overall stock market performance. But markets are complex. Multiple variables will drive the market over a 12-month period, many of which would be hard to imagine, like the pandemic in 2020. As shown in the chart below, investors should be wary about making investment decisions based on the flood of market estimates made at the start of every year.

Even with perfect knowledge of the year's major events ahead of time, it's difficult to gauge the impact on the market. In 2020, we experienced a major pandemic and lockdown along with a contentious U.S. presidential election. With that knowledge, one might have predicted a substantial decline in stocks, and the S&P 500 index did see a one-month decline of 24%. But then the index closed 2020 up 16%! The 26% growth in 2023 would also have come as a surprise given knowledge of geopolitical events in Europe and the Middle East, U.S. bank failures, and the property market collapse in China.

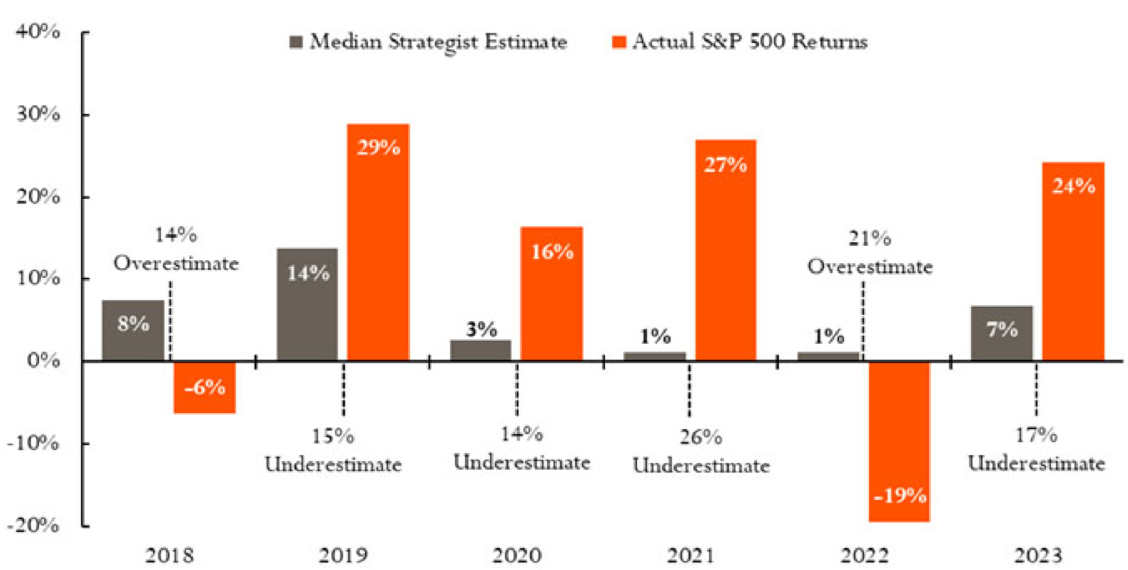
Perfect foresight on events does not necessarily mean prescient market forecasts. This also applies to the impact political outcomes might have on portfolio returns. Fears about the opposing party winning a presidential election can lead investors to sell or underinvest. This has happened on both sides of the aisle over the last 20 years, causing investors to miss out on years of strong performance because of their political views—certainly something to keep in mind for 2024.

The second big theme is that market timing is difficult, if not impossible. The inability to make accurate short-term market predictions also supports our belief that investors should remain invested in the market. Some of the most popular market valuation metrics (for example, price-to-earnings ratios) have been well above their long-term average over the last three years, leading observers to predict market downturns every year. While this advice worked in 2022, the market avoiders lost out on strong growth in 2021 and 2023.

Relatedly, it can be disastrous in the long run for investors to let bouts of poor performance drive them away from risky assets in favor of safe havens. Over the past century, the annualized return of the risky S&P 500 was 6% to 7% above risk-free Treasury bills. For $100 invested in 1928, the S&P would have returned $787,019 by 2023 versus $2,249 for T-bills. But performance is not distributed evenly within a decade or a year; it happens in spurts. Despite the long run dominance of the S&P 500, Treasury bills actually outperformed during three extended periods of more than a decade each (1929-43, 1966-82, and 2000-12). Indeed, in over 90% of months stocks effectively provided zero return on average. It was just 97 of the century's worth of months that drove all the return. Jumping ship when things look bad means you might not be invested during the one month or year that drives performance.

Our main takeaway from the article is that staying true to your investment plan is likely the best method for long-term capital appreciation for most investors. This includes remaining fully invested across asset classes and focusing on the long-term.

CONSENSUS S&P 500 ESTIMATES VS. ACTUAL RETURNS (2018-2023)



Source: MorningStar.com

FROM OUR BOOKSHELF

By Anne Doremus

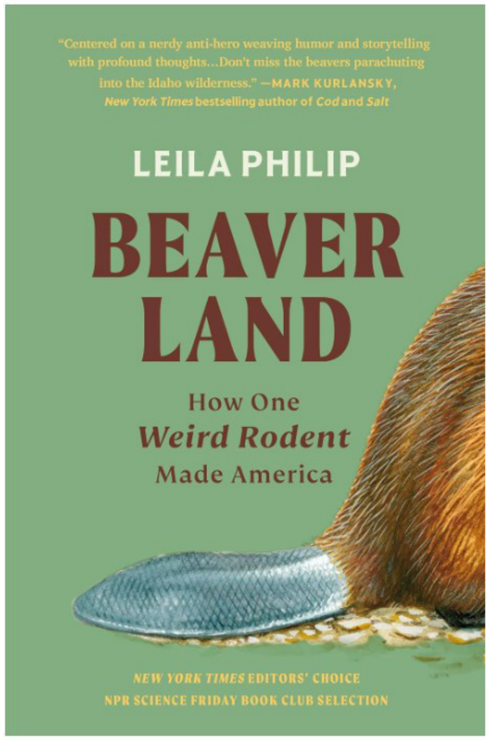
Worth a dam…

In the early pages of her most recent book, *Beaverland*, Leila Philip writes "The conversion of natural resources into power has always been the propelling force of empires." Knowing a little about early American history, I assumed the book's narrative would largely be an examination of the fur trade as a key driver to our nation's early economic success. While this theme is indeed central to Philip's book, the story she tells is far more interesting and complex.

To appreciate how beavers are intertwined with our nation's history, you first need to understand a bit more about them than what you may remember from middle school science class. On this front Philip does not disappoint. We learn, for example, that beaver teeth grow continuously, and that one inch of their fur contains more hair than you have on your entire head. Thanks to some incredibly special physiology, they can stay under water for up to 15 minutes at a time and the fat stored in their tails provides a source of food during long winters of semi-hibernation. And on the economic front, Beaver pelts, not gold, served as a form of currency for our nation's earliest communities. Philip too covers the beaver's historic significance to the continent's earliest indigenous populations and how fur trading permanently altered these communities.

The fur trade spanned roughly 300 years (1600-1900). By the 1860s, roughly half a million beavers were being "harvested" annually, largely for export to Europe where beaver fur was both fashionable and an important way to keep warm. A mere 40 years later, beavers were largely gone from the nation's landscape. Great fortunes were built around this trade, including those of some of our nation's earliest magnates like John Jacob Astor who had a near monopoly on the business in the late 1700s.

This somewhat grim history (for the beaver, anyway) is brought alive by the characters that Philip draws into her story. It turns out that beavers have been an object of fascination to many throughout history. Early beaver enthusiasts, like



Hachette Book Group, Inc.
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anthropologist Lewis Henry Morgan, viewed beavers in much the same way they did all natural resources – something to be managed largely for man's benefit. Others, like Dorothy Richards and Enos Abijah Mills, who at various times both lived with beavers, took a different perspective. To these early wildlife conservationists, beavers were a "keystone" species, integral to preserving the nation's wilderness, and more specifically, its water systems. Philip examines the ongoing tension between these two competing viewpoints which remains today. As one would expect, she includes the perspectives of a number of conservationists. But she takes a balanced approach in her research, also interviewing current day trappers and water management experts.

Admittedly, a treatise on beavers and their economic significance may not hold everyone's attention. But Philip's discussion of the role that beavers might play in the future is where the story gets interesting.

Perhaps to state the obvious, beavers should not be placed in the same category as our nation's other critical economic resources, like oil. They are living, breathing creatures that have a unique capacity to both shape and adapt to their ever-changing environment. This adaptability helped them survive both the widespread trapping of the early colonial period and the subsequent environmental destruction of their habitat. Encouragingly, this adaptability may also be what continues to ensure their survival. Philip devotes several chapters to examining how a broad coalition of researchers, environmentalists, and public policy advocates are now coming to understand the significant role that beavers can play in maintaining, and in many cases restoring, our nation's wetlands. Wetlands filter out pollutants like nitrogen from agricultural run-off and foster important biodiversity. But these bodies of water also serve as a kind of sponge, soaking up excess water during periods of flooding and retaining it during periods of drought. Beavers could well be an important part of adapting to a future that likely includes more of both.