thoughts

HANSON+DOREMUS
INVESTMENTS AND PLANNING

FROM HANSON+DOREMUS AUGUST 2024

Döner diplomacy...

Every country has culinary specialties influenced by other places as food cultures eventually meld together. Rarely does it become political.

In the U.S., we've got hamburgers (who knows where they came from). In the U.K., it's curries and chicken tikka masala. In the Netherlands, they have rijsttafel (inspired by the Indonesian "rice table"). In Germany, it's the döner kebab.

For the uninitiated, döner is a sandwich made from shaved meat, cooked as it turns on a vertical stake. It is very popular, more so than any kind of bratwurst, and kebab shops have become a pervasive feature of German cities and towns. That makes it very, German, right?

The origins of the sandwich in Germany have been traced back to 1970s Berlin, created by members of the large Turkish community that settled there. But döner kebab clearly has Turkish origins. "Döner" comes from the Turkish verb "to turn" and "kebab" is the word for "roasted meat." Germans say the fare is theirs, while the Turks correct their pronunciation.

Turkey recently took it a step further and applied to register "döner" under the EU's "traditional specialty guaranteed" (TSG) designation (think: Italy's mozzarella tradizionale or Spain's serrano ham). Turkey's application claimed döner dates to the 1800s and the cooking method to 1546. TSG would be a big deal as it carries with it costly bureaucratic requirements and exclusive use of the döner name only for products that conform to official specifications.

Germany has since appealed. Now the sandwich is a political hot potato. "The döner belongs in Germany. There is no need for any guidelines from Ankara," said German Agriculture Minister Cem Ozemir, whose parents, by the way, immigrated from Turkey.

And while Germany has been happy to claim the food, it has been less eager to take on political affiliations with Turkey. Turkey has had perhaps the longest accession process to the EU (and its predecessor unions), which began in 1959 with application to the European Economic Community. Since then, negotiations have stalled and restarted. Official membership talks with the EU began in 2005. Since 2016, they have been frozen after EU officials voiced concerns over President Erdogan's response to a coup. In 2019, talks were officially suspended as the EU felt Turkey had been moving further away from Europe, "backsliding on the rule of law and on fundamental rights."

Throughout the decades of accession history, Germany has often been an outspoken (and sometimes furtive) fly in the ointment. Fueled by their döner kebabs at lunch, officials return to their chambers to oppose Turkish accession. Now that the lunchtime favorite has become the political story, who knows how this döner diplomacy will play out? One thing is clear: our palates often agree where our politics do not. - Mark Andrews

GERMAN KEBAB CONSUMPTION THROUGH THE YEARS

Source: picture from GPT; stylized chart for humor

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802.658.2668
hansondoremus.com
431 Pine Street, Suite 302
Burlington, Vermont 05401

A LOOK BACK

By Julie Won

How good were our Covid-era predictions?...

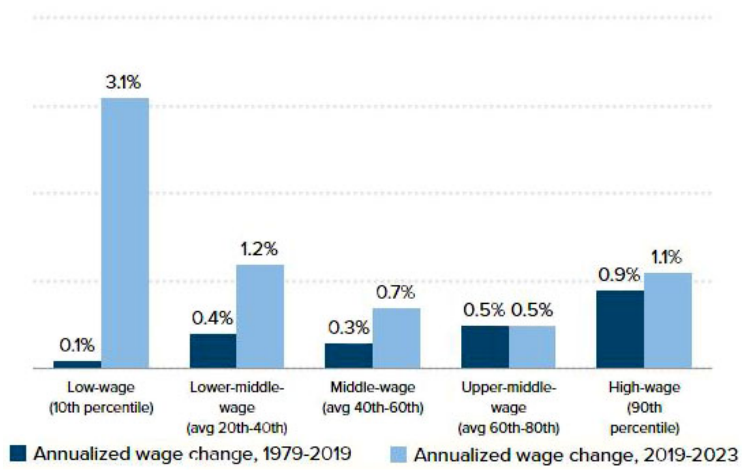
It's been more than four years since the World Health Organization declared Covid-19 a global pandemic on March 11, 2020. Covid is still very much with us -- in fact, there's a surge in infections now, as there has been every summer since 2020. But we've come a long way from the dark pre-vaccine days when Covid was more life-threatening. Covid still can be a serious illness, and sometimes fatal; but for many today, Covid has been reduced to the nuisance of feeling unwell for a short period.

Over 2020-2021, we and many others tried predicting how things would look once we emerged from the worst. It was simply too enthralling to imagine a wholly different world – and really, what else was there to do during lockdown?

Would the handshake come back? (It did.) Would leisure travel recover? (Yes, with a vengeance.) How would the office and the world of work change? (We're still figuring this out.) In this newsletter, we questioned if universities and senior living communities would ever get back to normal. We guessed that shopping at bricks-and-mortar stores would eventually recover but also thought telemedicine would develop more than it has. We worried about everyone's mental health, especially students in high school and college. And while we never went in this direction, others guessed we would go into a "Roaring Twenties" era of carefree pleasure-seeking, as after the 1918-1920 Spanish flu.

Many widely anticipated "big picture" socioeconomic trends did come to pass as expected. There were serious efforts to build supply chain resiliency, which meant more onshoring and reshoring. The age of small government gave way to big government spending. And we did see changes in one area we were extremely interested in: the balance of power between labor and corporations. In the late pre-pandemic years, there was much ado about wage stagnation while corporate profit margins continued soaring – a situation that just did not seem sustainable. The pandemic offered a chance for a major reset for workers, as we and many others expected.

ANNUALIZED REAL WAGE GROWTH ACROSS THE DISTRIBUTION, 1979 - 2019 VS 2019 - 2023

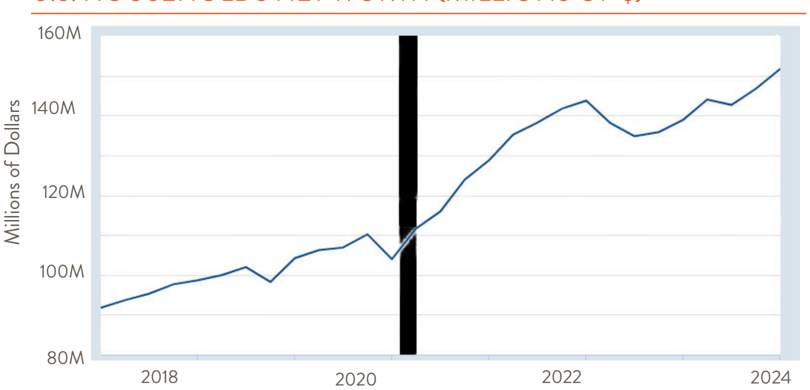


Source: Economic Policy Institute

While inflation reached unanticipated levels, real wages (meaning after inflation) rose more over the 2019 -2023 period than the previous four decades – especially for low-wage workers. Yet the state of the U.S. worker is ever evolving. In a short time, we've cycled through a "great resignation," worker shortages, high job vacancies, "quiet quitting," and just recently, the first inklings that the job market might be starting to weaken.

One of the biggest post-pandemic surprises for us has been how much U.S. household wealth has grown. This is not to discount persistent wealth inequality or the hardships that many have endured. But, according to the Fed, household wealth has grown across the board and markedly so for low-wealth groups. The San Francisco Fed found that post-pandemic wealth accumulation was greater than what would have been expected without the shock of the pandemic.

U.S. HOUSEHOLDS NET WORTH (MILLIONS OF $)



Source: Federal Reserve Bank of St. Louis

Shaded areas indicate U.S. recessions.

So, what happened? Sitting in the depths of economic collapse in 2020, we never would have imagined that so many Americans would end up experiencing so much prosperity. Yet somehow, through a combination of heavy saving during the lockdown, generous fiscal stimulus, zero interest rates, wage gains, debt repayment suspensions, and a booming stock and housing market, many Americans became wealthier than ever. Today, an all-time high of 30% of the U.S. population has a stock market portfolio worth at least $500,000. A record-high 37% of the population has a home worth more than $500,000. Wow. How little we knew when Covid first hit us. How little we still know today.

PERSONAL FINANCE

By Eric Hanson

Financial literacy comes of age... and it's getting younger...

In an earlier edition of the newsletter, we reported on a study done by the ARC Centre of Excellence in Population Ageing Research. They found that the age at which financial mistakes are minimized is on average age 53 or 54. This means we stumble through a lot of financial errors from high school to near retirement. Wouldn't it be much better if we learned the important financial lessons early on, so we didn't suffer so many painful financial losses later?

Well, progress is being made. Eight years ago, Hanson & Doremus was asked by the Grossman School of Business at the University of Vermont to start a 'Personal Finance' course, open to business majors as well as students from across the campus. Art Wright and I have taught this course every semester since, with enrollments always at the maximum.

And momentum is building to introduce financial literacy to even younger students. This is important since college student debt has increased from $500 billion in 2007 to $1.6 trillion in 2024, and average credit card debt of 22-24 year olds, according to Experian, is $3,300 today, up nearly 50% from ten years ago. Finance is becoming a serious and expensive business for every young person now.

According to *The Economist*, 26 states (including California as of this summer) have now mandated a financial literacy course as a requirement for high school graduation. Within the next five years it is estimated that 70% of all high school students will live in a state requiring a financial literacy course.

Here in Vermont, John Pelletier runs the Center for Financial Literacy at Champlain College, which was established in 2010 to offer instruction to teachers of K-12 financial literacy and to monitor national progress in financial literacy programs. I asked John what he thought were the three most important financial lessons young people need to learn.

First, he said, they need to understand what makes up a credit score and how to ensure their score is as high as possible. Most young people have no idea what a credit score is and don't realize that their score is a key factor in determining how much they pay for a mortgage, car insurance, borrowing for a consumer purchase, and whether they will qualify for a credit card.

A second important lesson is to understand compound interest, the idea that you earn interest on your initial investment and also on the interest previously earned. Warren Buffett says compound interest is like a snowball rolling down a hill. It picks up more and more snow until it becomes very large at the bottom. We used the Vanguard *chart shown below* in our January 1997 newsletter. It is as valid today as it was then. The person who invests early (Pat) actually ends up with more money at retirement than the person (Chris) who invests two and a half times more but starts saving 10 years later. The early bird here does indeed get the worm.

And the final lesson is understanding budgeting, learning how to spend less than you earn. John suggests two books for young people on how to budget and accumulate wealth. The first is David Bach's, *The Automatic Millionaire.* Most people will not sit down and write out a monthly budget, listing all their income and then all their expenses. It's too tedious, and most of us don't have the discipline to stick to a budget anyway. The better approach, according to Bach, is to "pay yourself first," set aside what you want to save, and then shoehorn your spending into what is left. It's still painful and difficult but it's an approach more likely to succeed.

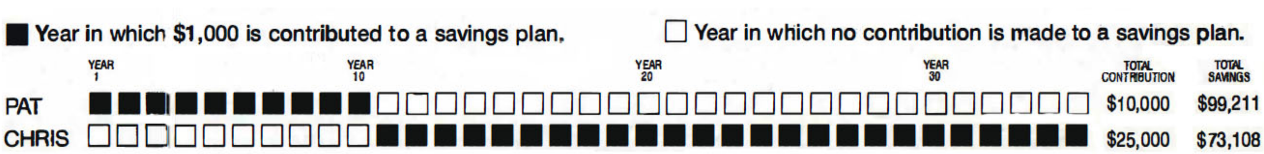
John also recommends Chris Hogan's book, *Everyday Millionaires*, which studied over 10,000 millionaires to find the secrets to their financial success. According to Hogan, it boils down to strong habits, a determined mindset, and strategy. The common denominator is millionaires save consistently, they avoid debt, and they invest the maximum in their retirement plans to take advantage of compound interest. Paraphrasing Warren Buffett again, investing (and wealth accumulation) is simple, but it is not easy.

EARLY-BIRD ECONOMICS

Here is a model that Vanguard Group, the mutual fund company, has developed to show how to put away less money and still end up with more at retirement. The secret: start saving early.

Pat starts contributing at age 25, invests $1,000 a year, and earns an 8% annual rate of return. He continues this program for 10 years and then stops making contributions. But the savings continue to compound at 8% a year until Pat retires at age 60.

Chris also invests $1,000 a year at 8% but he does so for 25 years. However, he does not begin his contributions until age 35 — and that delay leaves him with much less money than Pat has at age 60.



Source: Vanguard Group

INVESTMENT TRENDS

By Anne Doremus

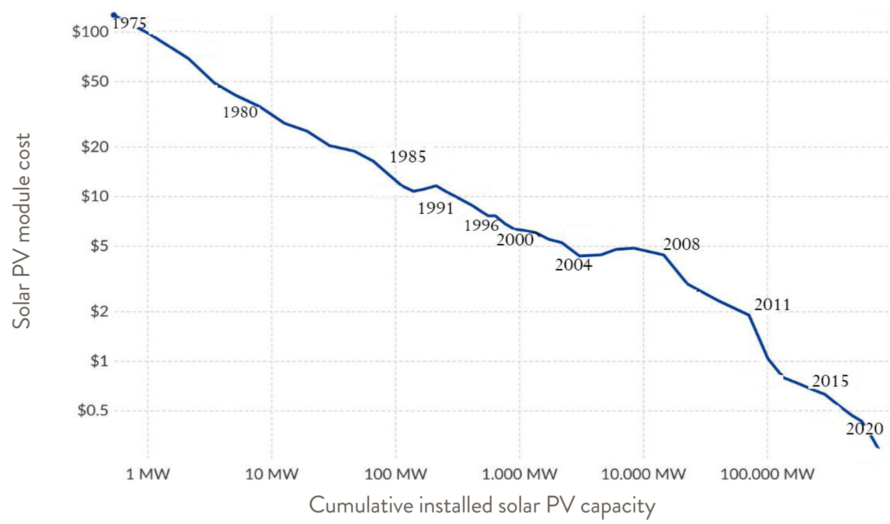
The sun is shining on solar...

In a recent issue, *The Economist* predicted that by the mid-2030s, solar cells will represent the single greatest source of energy for electrical generation globally. To get a sense of just how big a claim this is, consider that today coal, at 36%, is the largest source and solar stands at just 6%. While the shift away from coal toward solar has been going on for years, the rate of change has accelerated and been consistently underestimated. What is driving this growth?

To improve energy security and reduce carbon emissions, governments around the globe have implemented policies to foster solar production and adoption. Most notably, China has poured billions into its domestic industry through a broad range of subsidies and tax incentives. The result of this investment has been impressive. Wood Mackenzie, an industry consulting firm, reports that last year China's solar module production capacity reached 1,000 GW, almost five times that of the rest of the world. As is true with a range of other manufacturing industries (think cell phones or EV batteries), competitors will have a hard time displacing the now entrenched Chinese firms. China's well-established solar manufacturing ecosystem provides an edge on things like quality control while its sheer scale of production translates into lower unit costs. The above factors have created something of a "flywheel" effect too where falling costs spur additional demand which leads to increased production which lowers costs further (*see chart above*).

SOLAR PANEL COSTS HAVE FALLEN BY AROUND 20% FOR EVERY DOUBLING OF GLOBAL CUMULATIVE CAPACITY

Costs are measured in U.S. dollars per Watt, adjusted for inflation — 1975 -- 2022



Source: ourworldindata.com; IRENA (2023); Nemet (2009); Farmer and Lafond (2016)

The solar industry has had a range of attributes that most investors would consider attractive; a growing, global demand profile, supportive government policies and falling unit costs. But despite this, the industry has been a terrible place to put your money over much of its history. Consider that Invesco's Solar ETF (TAN), a fund composed of leading global solar firms, has produced a -9.0% average annual return since its inception back in 2008. In the early years of solar's adoption, ever changing consumer subsidies created something of a boom-and-bust cycle both in the U.S. and Europe. More recently, China's massive investment in expanding its solar supply capacity, estimated at over $50 billion since 2011 alone, has driven many European and U.S. competitors out of business. While this investment has driven solar unit costs down, it has also left the global market oversupplied. Most western manufacturers that remain in business depend on government incentives to survive, a condition that is not likely to change anytime soon.

According to recent IEA data, installed solar capacity is now doubling every three years. What, if anything, might slow this ascent? In much of the world, there is insufficient distribution capacity to connect solar producers to consumers, and expanding "the grid" has proven expensive and time-consuming. The intermittent nature of solar power also creates limitations although better battery technology and improved distribution would solve much of this problem. Finally, with growing supply and falling prices, there is a concern that falling returns will crimp investment in the industry. While these are genuine issues, they are not new and their combined impact to date has done little to slow solar's rapid growth.

Escalating tariffs are one new wrinkle to keep an eye on. Much of the developed world already imposes tariffs on Chinese solar module imports but their level is likely to increase in the years ahead. So far, declining solar unit costs have helped offset much of the tariff-related price hikes but whether this can continue remains to be seen. My bet is that the current excess production capacity is likely to keep global prices low for years. This is a good thing given the rising global demand for clean power in the years ahead.