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Economic and Market Commentary

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Born in Kiel, the northernmost port city of Germany, young Peter looked like he was born with a silver spoon in his mouth. He was the only child of a duke, and his grandfather was Peter the Great. But as it turned out, his early years were not easy. Shortly after his birth, his mother Ana passed away, and by age 11, so did his father, Charles.

Peter's mother had a younger sister named Elizabeth who would soon become the Empress of Russia. By the time of her coronation, she had moved young Peter from Germany to Russia, and by his 16th birthday, she had named him her heir apparent. It all seemed proper since, after all, he was Peter the Great's grandson except for the fact that he hardly spoke a word of Russian.

To keep the ball rolling, Empress Elizabeth chose a bride for young Peter the following year, an aristocratic young lady named Sophia. Sophia was well known to the family since she was Peter's second cousin. Before the marriage, Sophia converted to Russian Orthodoxy and changed her name to Catherine.

Over the next 16 years, Peter and Catherine shared a loveless marriage. In her diary, Catherine described Peter as a "drunkard, an idiot and good for nothing." They had two children, one of whom, a daughter, passed away as a toddler. Empress Elizabeth eventually passed away, and in January of 1762, Peter succeeded her on the throne as Emperor Peter III. Although his reign was brief, it was not without significance. Almost immediately, he withdrew Russia from the European Seven Years War. He signed a peace treaty with Prussia, established the first state bank of Russia and pronounced religious freedom for all Russians. Not bad for a leader who could hardly speak his country's language.

Like I said, it was not a happy marriage. Barely six months into Peter's reign, Catherine planned and executed a coup d'etat. Peter was awakened from his sleep one night, arrested, and forced to abdicate his throne the following day. Within several weeks of his arrest, he died under controversial circumstances. Today most historians believe Peter was assassinated.

"Girls Just Want To Have Fun"

Cyndi Lauper

Weeks after her husband's passing, Catherine II became the newly coronated Empress of Russia, soon to be known as "Catherine the Great." Reigning over Russia from 1762-1796, she became the country's last Empress and longest reigning ruler. She was known to have changed the face of her country by establishing the Smolny Institute of Noble Maidens, the country's first institution for women's higher education, and by making Crimea part of Russia through the Russo-Turkish War.

Catherine strove to present herself and Russia as an enlightened participant in the Western World. Russia acted as mediator in the "War of Bavarian Succession." She established the "League of Armed Neutrality," designed to defend neutral shipping. She helped steward the first Russian paper money. She also sought the modernization of government through the establishment of Provinces and Districts.

During the late decades of the 18th century, Russian enlightenment flourished. Both opera and the arts were supported, relations with Japan and China were opened, and schools were established. Catherine believed that through education, the Russian people could stand toe-to-toe with any Western Culture. Amongst all of Catherine's accomplishments, perhaps her most overlooked contribution was that she was the "mother of the modern roller coaster."

Amerikanskie Gorki

The latter half of the 17th century found many Russian aristocrats building hills of ice on their palatial estates during the winter months. Known as "Amerikanskie Gorki," which translates into, "American Mountains," these "sliding mountains" would sometimes stand 80 feet tall and be built over a wood structure covered in ice. With curves, dips and engineered ascents, these hills became a rage amongst the nobility. Catherine the Great loved these amusements so much that in 1784, she commissioned her royal engineers to construct one for her summer enjoyment, and so they did. Using wheeled carts instead of sleds and grooved tracks instead of icy slopes, the first modern roller coaster came to be. By the time of Napoleon's defeat at Waterloo, Russian soldiers had introduced the concept throughout much of Western Europe.

Originally the amusement of the rich, by mid-19th century, amusement parks for the enjoyment of the middle class sprung up throughout Europe. No attraction at any park was ever more popular than the roller coaster. Or more dangerous for that matter. Pretty soon amusement parks for everybody could be found throughout Europe. Copenhagen had its Tivoli, Britain had its Brighton, and Paris boasted no fewer than seven roller coasters, including "Les Montagnes Russes a Belleville," "Promenades Aeriennes," and the first looping variation of the roller coaster, the "Centripetal Force Railway."

Meanwhile, Across the Pond

You might ask, "Why is Lent always optimistic?" One big reason is I believe in American practicality and innovation. Here in America, we had yet to find time to create amusement parks. That's not to say Americans didn't like to have fun; they just needed to maximize what was already on hand. In the 1850s, large deposits of coal were being mined in an area of Pennsylvania known as Summit Hill.

A gravity railroad was constructed to take the coal down the mountain some 8.7 miles and deliver it to the town of Mauch Chunk where a train yard existed. Here the coal could be

transported by rail all throughout the New England states. By the early 1870s, the enterprising owners of the gravity railroad started selling tickets to thrill seekers who would stand in the wheeled carts on days the mine was closed and take the ride of their lives as they screamed downhill to the town of Mauch Chunk. The ride became so popular that the passenger railways started similar experiences for the adventurous when business was slow.
It wasn't long before a one-time colonial town named Gravesend, which had been a barrier island leading into New York Harbor, was transformed into America's first great amusement park, Coney Island.

A Sunday school teacher and part-time inventor named LaMarcus Adna Thompson started building "Gravity Pleasure Roads" that were constructed of wood with iron rails. Passengers could climb stairs to the top of a platform, sometimes 600 feet tall, to sit on benches inside open carts and go screeching downhill with such velocity that it would carry them up to the top of another 600-foot tower that would send them down a series of switchbacks that would eventually flatten out and end the ride. By the late 1880s, the concept of a "closed loop circuit" ride was perfected, and roller coasters could be found everywhere.

Columbus, Ohio, had the "Loop the Loop," Altoona, Pennsylvania, had "Leap the Dips," and Santa Cruz, California boasted "The Giant Dipper." But without a doubt the most famous roller coaster of them all was Coney Island's "Cyclone." First opened in 1927, it is one of America's oldest wooden roller coasters still in operation. Originally built at a cost of $175,000, it contains more than half a mile of track, and riders reach a speed of 60 miles an hour. Today, the "Cyclone" is listed on the National Register of Historic Places. Why? Because the Cyclone has it all.

Anatomy of a Roller Coaster

When the train leaves the station, and yes, roller coaster operators do refer to their cars as trains, it leaves the station heading for its "Lift Hill," typically the highest point of the ride. Older coasters would get you to the top using a long chain that would hook onto the train and release at the top of the hill, allowing the train to then "coast" through the ride's entire circuit.

From the "Lift Hill," the train typically goes into a pre-drop, which is a small hill or series of small hills often called "Camel Backs," before starting the main descent. When the main descent starts, the roller coaster can create a sense of weightlessness as it goes through its banked turns, double dips, cutbacks, loops and corkscrews. But for many, the scariest element of the ride is when the coaster comes to the "Head Chopper."

Let Me Bring It Home

On a roller coaster ride, the head chopper is the part of the ride where the train goes tumbling downward at breakneck speed under the support structure of the lift hill, giving the riders the illusion that their heads will be chopped off as they pass under. Obviously, this is only an illusion, and even the tallest of riders, with their arms stretched high over their heads, will pass safely—even if their hearts might be racing faster than usual. The key to safety is simply, stay in your seat. Don't try to get off the coaster until the ride is over and you are safely back at the station.

If you think about it, this is exactly the kind of roller coaster ride we've had since late last fall. Last fall saw the NASDAQ hit an all-time high. Government money had flooded the economy since the beginning of the pandemic and even before.

The harsh remembrance of the Great Recession of 2008-2009 reminded the government of the need to lessen the hardship that a recession can cause the average person. When the world shut down back in March of 2020, the government jumped into action with PPP loans, extended unemployment insurance benefits and eviction moratoriums, along with historically low interest rates. A $1.9 trillion infrastructure package designed to jump start the economy when Covid was in the rear-view mirror was passed. When the initial shock of the shelter in place order mandate hit, equity markets crashed. But only for a short time. Soon markets not only recovered but began breaking new highs. In spite of everything, it turned out that the economy was still intact, with many companies producing far better than expected earnings.

Miraculously, vaccines were invented in breakneck speed as a result of cutting-edge technologies. Many people used this disruptive time to reassess their lives and priorities, and terms like telecommuting and telemedicine became part of our everyday lexicon.

Lo and behold we saw the economy grow fueled by a rising stock market, ultra-low interest rates, ultra-low unemployment rates, rising property prices and modest inflation. Regrettably the Goldilocks economy was fueled by a complacent Federal Reserve Board that continued their policy of quantitative easing and keeping interest rates artificially low. This occurred during a time when they could have gradually eased off buying back Treasuries and steadily but modestly started raising interest rates toward historically normal levels.

A Perfect Storm

So, just when the country started feeling a bit more secure and better about the future at a time when many people were feeling Covid fatigue, the Omicron variant reared its head, and the winter surge of infections started kicking into full gear. Now, all of a sudden, it started to feel like Groundhog Day. Covid cases started to rise in China after which they tried to install a zero Covid tolerance policy that frequently shut down entire cities and provisions and left people stranded in their homes, unable to work, unable to produce parts needed in the manufacturing of goods made around the world.

We started hearing the term supply side disruption. In other words, the parts needed to fix or repair products were not coming in. Think about the home builder who can't close escrow because he can't get the appliances, windows and doors so clients can move in. Why do you think used car values went up so much?

Against this backdrop of easy money chasing too few goods, prices went up, and inflation started to kick in. As more and more inflation reports started making the headlines, the Federal Reserve realized they had been slow in changing their policy thereby spooking the equity markets with talk of significant rate hikes well into the future. This gave some the fear that the Feds would overreact and send the country into a recession.

By the end of the first quarter 2022, the country and the world were in for another tragic game changer when Russia invaded the Ukraine, starting the largest land war in Europe since World War II. This led to further disruptions in the supply chain, since 35% of the world's corn and wheat comes from Russia and the Ukraine. Additionally, a large portion of Europe's oil and natural gas comes from Russia. The effect on Americans other than shock and outrage? We need look no further than prices at the gas pump or supermarket shelves for the answer.

It's a Tightrope

Years ago, I wrote a monograph on Jean Francois Gravelet, a Frenchman known as "The Great Blondin." Blondin was a tightrope walker who in 1859 walked across an 1100-foot cable strung across Niagara Falls. When he safely made it across, he was hoisted onto the shoulders of some 5000 cheering fans. Quite a remarkable feat by anyone's standards.

Now it's the Federal Reserve Board's turn, and Jerome Powell, Federal Reserve Chairman, plays the part of The Great Blondin. His is a very different type of tightrope but no less treacherous. Neither he nor his fellow governors or fellow Americans want to see 9.1 % annualized inflation like we just saw for June. No, we all want to see inflation come down. So how do you do that? The answer to that part of the problem is simple: Spend less. People spend less when money is tighter. When it costs more to borrow, when lending standards are tougher and businesses have to tighten their belts, what's the result? We know the result: Higher interest rates and higher unemployment. That's a given.

The hard part in solving the problem is not how to lower spending but how to do it without choking the economy by raising rates too fast or too high and sending the economy into a recession. Point of clarification here: there are deep recessions like the one we saw in 2008-2009, and there are shallow recessions,* or those that meet the technical definition, and the economy starts growing again after a few quarters.

"A Spoonful of Sugar Makes the Medicine Go Down"

"Mary Poppins," 1964

Just like Julie Andrews sang the above song to us in "Mary Poppins," we have to accept that stopping inflation will be a bitter pill but one that needs to be taken to restore a healthy economy. It's my firm belief that the economy can be cooled down without diving into a deep recession.

*Remember, the technical definition of a recession, accepted by most economists, is when a country's gross domestic product declines in two consecutive quarters.

Keep in mind that the Federal Reserve can't help or control inflation caused by increased costs such as those costs in food and energy caused by the war in the Ukraine. But they can most certainly help deal with inflation caused by increasing demand such as what we've seen in the housing market.

Since interest rates started rising, a traditional 30-year fixed interest mortgage rate is running about 5.6%, roughly double what it was just a year ago. Has that affected the housing market? You bet it has. Multiple offers are dwindling, bids way over asking are disappearing, house prices have modestly declined and professional realtors are saying the housing market is starting to resemble a "normalized" market compared to a frenzied seller's market. To me, that's a great green bud indicator of a healthy economy beginning to show.

If you think about it, we've never had a recession start before with almost full employment; for sure it's a narrow tightrope. (The Great Blondin's tightrope happened to be two inches in diameter.)

I don't envy the Fed, but I do believe if the rope is navigated thoughtfully, there will be a lot to cheer about when the chasm has been safely crossed. There is no doubt that equity markets hate uncertainty. Transparency goes a long way in dealing with uncertainty, and if there is one thing this Federal Reserve Board has been is that it has been more transparent than any other Board in the last 50 years.

Panic is Not a Strategy, Nor is Greed

There is no surefire play book for navigating a bear market. No investor can defy gravity nor can they successfully try to time the market. Case in point: Vanguard Mutual Funds, the inventor of the Index Fund, recently reported that over the past 20 years, the S&P 500 has averaged a compound 9½ % return, whereas their average S&P 500 fund investor averaged a measly 2½ % return over the same period of time. Why? Because, in the words of Jack Bogle, the mutual fund pioneer, "Your emotions will defeat you totally every time." When emotions come into play, investors find themselves on the wrong side of the fear and greed continuum.

This past month around mid-June the overall equity markets had officially hit bear market territory, down 20% or more from their previous highs. That became the 14^{th} time in the last 65 years that it has happened. If one were to look at the average return of the markets one year after hitting bear market territory, they would see that the average return for the market was up 15% in the previous 13 bear markets.

Take a slightly longer perspective from that bear market threshold and look at the three-year average return and you'd see the subsequent S&P 500 price return three years later was up an average 30%. Sure, there are no guarantees, but in the words of Mark Twain,"History never repeats itself, but it does often rhyme."

Conclusion

Back in the first century, historian Pliny the Elder described how some soothsayers used a crystal ball to foresee the future. Over the millennium, that effort came to be known as the art of "scrying." In early medieval times, practitioners of the art, if caught, were burned at the stake—perhaps a consequence that should come back for those who try to predict the future.

Between the end of June and the time of this writing, barely a dozen trading days have gone by and the NASDAQ is up more than 10%. Is that an indication of good things ahead or is it, in the parlance of roller coasters, just going over the first hump in the "Camel Back?" Sure, markets can retract again before they get a whole lot better, but we can't lose sight of the fact that the markets have advanced these past several weeks with the full understanding that the Federal Reserve will be raising the federal funds rates before the month is out. The reason they advanced is because of earnings. Many of the companies that have already reported came in with solid earnings for the past quarter and realistic guidance for the remainder of the year.

As we at Putney continue to do our best to navigate these turbulent financial waters just as we have done in 2008, 2001, 1997 and the infamous Black Monday of October 19, 1987, we remind ourselves that investors actually think in decades, not quarters.

It is our goal to continue to seek out companies that are not just growing sales but growing profits captained by sound and ethical leadership. As you know from previous writings and consultations, for the past several years we've been particularly interested in agricultural production from the standpoint of health, environment, sustainability, volume and price. We have become very conversant in plant based "meat" production, autonomous and vertical farming and heavy equipment.

Just like our dependence on sourcing of fuel going forward is critical to our wellbeing, our ability to produce more food without further degradation of our environment is critical. It's estimated that within the next 40 years, the world's population will grow by another two billion people. With billions of people going to sleep hungry across the world, as it stands, it will take science and ingenuity to bridge the gap (actually, two of the main ingredients that have brought us along as far as we've already come). With that in mind, I wanted to share with you a very quick story of a new food production growing technique I found fascinating.

Now many may find this technology Orwellian or something out of a Jurassic Park sequel, but it's really happening now and is close to FDA approval. It's known as "cultivated meat." It's a protein source that's not vegetable based, like the "Beyond Burger," but animal-based protein produced humanly without harm to the animal.

Since farm animals are a major source of Greenhouse gas, growing more meat with fewer animals has huge value. How does it work? Cells are removed from a live unharmed animal and placed in steel vessels called bioreactors. It's here in the bioreactors that hormones called growth factors are introduced. Now the cells can multiply, just the way they do in the animal's body.

This is a global movement. Singapore has already granted regulatory approval for cell-based meat. Before you turn your nose up at the idea, just remember that insulin has been produced in a similar fashion for decades. Not too long ago, the state of California wanted to look at granting an award to one of the 80-odd companies already operating in this space. Their team settled on a local company headquartered in Emeryville to evaluate. Although the logic is not completely clear to me, they decided to send a California State Assembly person Ash Karla to the lab for inspection along with three other politicos. When the tour was completed, they were seated for the tasting. On the menu was cell-based chicken. As it turned out, the lead delegate had gone vegan years before. With a mouth full of chicken, and not to be rude, he swallowed the bite and commented, "Just like I remember it—gamey."

It's my great hope that sooner rather than later, feeling safe and secure, we can see each other in person. Nothing beats a hug or a handshake. In the meantime, just call if you need anything and rest assured that we are always endeavoring to keep our eyes on the ball. As always,

With Warm Regards,

Ray Lent
RLL/dot
Enclosures