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The Tipping Point

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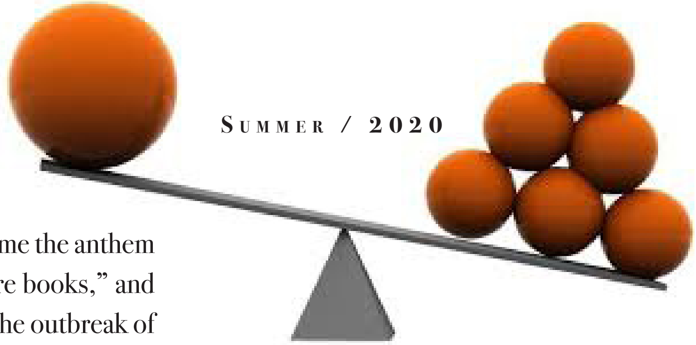

In the mid-1970's, the song "School's Out" by Alice Cooper quickly became the anthem to my third-grade fantasy. With the promise of "no more pencils, no more books," and school being "out forever" it is easy to understand the song's appeal. With the outbreak of the coronavirus pandemic earlier this year, what was once a forgotten childhood memory quickly turned into a parent's worst nightmare! If there is one lesson to be learned from the coronavirus pandemic, it is how quickly the world can change.

In his popular book, *The Tipping Point: How Little Things Can Make A Big Difference*, Malcolm Gladwell explores how quickly things can change. We tend to think that history is changed by a dramatic and unexpected singular event. Contrary to this opinion, Gladwell contends that these events are instead "tipping points" or "the moment of critical mass, the threshold, the boiling point." Gladwell colorfully recounts how a spark can either die out, or could ignite a revolution. The assassination of Archduke Franz Ferdinand could have been just a minor event, but instead, conditions were such that it became the tipping point that ushered in the start of World War I. With the outbreak of the coronavirus pandemic and the changes that quickly followed, one might wonder if the coronavirus pandemic is another tipping point.

Seldom has a historical event impacted so many people in so many ways. From the tragic to the trivial, the changes occurred so rapidly that they seemed simply unbelievable. With much of the nation forced to live in quarantine and many workers furloughed, the U.S. unemployment rate jumped from 4.4% in March to 14.7% in April. (June's unemployment rate was 11.1%.) With the sharp rise in unemployment, consumer spending fell 2.8% from the previous year. According to a report by the Federal Reserve, it will take at least two years to recover from the economic shock of the coronavirus pandemic and will require extensive stimulus to help the economy recover. Fortunately, the U.S. government is committed to providing continued stimulus in order to mute the effects of the pandemic and restore consumer confidence.

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Another change that occurred during this period was with consumer behavior. As Americans were in quarantine, they were forced to rely on technology and provisional suppliers for many of the items that they normally consumed via traditional brick and mortar businesses. From ordering meals and groceries online, to streaming movies, to remote learning and working from home, the void in traditional consumer spending that was created by the quarantine was filled by businesses that could harness technology to their advantage. Without question, technology-related companies have gained a greater foothold into many areas of business and will continue to expand in the decades to come. Whether these companies will cannibalize traditional businesses, or result in permanent changes in consumer behavior is yet to be seen. What is clear is that companies that invested in technology have not been as affected by the pandemic as those who didn't, and that companies that provided this technology (several of which are in our clients' portfolios) actually reaped benefits.

These changes to how businesses operate and how consumers purchase goods and services are called microeconomic decisions. Think of them as potential sparks that could start a fire. However, for a fire to catch, conditions need to be ideal. Theses conditions involve macroeconomic factors that deal with the big issues of economic growth, employment, etc., and are the conditions that cause a falling match to either be extinguished or become an inferno. There are three significant macroeconomic trends that were exacerbated by the pandemic: the continued lack of inflation with sluggish economic growth, the rising U.S. national debt, and the growing disparity of wealth.

First, low economic growth over the past decade has been a major issue for the country. Many economists are now starting to realize how international trade has contributed to this problem. As we predicted in a prior newsletter, many companies are realizing the need to diversify their manufacturing out of China. In addition, most Americans now see China as a significant threat to U.S. security and foreign relations. The global manufacturing consulting firm, Kearney, wrote that many suppliers have been rethinking their supply chain and relocating production out of China, due to the continued deterioration of relations with China and the mass shortages of supplies during the outbreak. According to Kearney, Southeast Asia and Mexico appear to be the beneficiaries of this change. The report also attributed this shift in production to Trump's tariffs on China.

By definition, increased tariffs on imported goods contribute to higher prices of goods imported and in turn, higher inflation. As the tariffs are mainly directed at China, it is not clear if the cost increase of moving manufacturing from China to other nations will have a sizable impact on inflation rates. With the U.S. unemployment rate currently at 11.1%, inflation will not be much of an issue in the near term. Likewise, interest rates should also remain low for the foreseeable future, as the Federal Reserve has indicated that it has no plans to raise interest rates this year, or in 2021. (With interest rates currently near zero percent and stock dividends averaging around 2%, it is apparent that stocks with growing dividends will be even more attractive to investors.)

The second macroeconomic challenge facing the United States is the growing national debt. During the coronavirus pandemic, the national debt has risen to over $26 trillion, or approximately $209,415 per taxpayer. As Federal Reserve Chairman Jerome Powell recently noted, the continued increase in national debt is not sustainable, and will result in future generations paying additional taxes to reduce this debt. Not only will taxpayer money be used to reduce the debt, but many state and local programs will see less funding due to budget constraints. A study published by the Mercatus Center has determined that swelling debt levels have already reduced U.S. economic growth rates by up to 1 percentage point annually.

The third macroeconomic trend has been the growing disparity of wealth in this country. Without question, the pandemic has put a spotlight on this growing problem. Data from the IRS indicates that from 2001 – 2017, the income of the top .001% of Americans has grown 102%, while the income of the top 50% have gained 32%. The lowest fifth of all Americans have seen little-to-no increase during this period. Over the past four decades, America's top earners (the top .001%) have seen their incomes swell to at least $63 million per year, as the U.S. has entered a period of wealth disparity not seen since the Gilded Age of the early 1900's.

Is the coronavirus pandemic a tipping point? It certainly has amplified the need to address the macroeconomic trends of low economic growth, rising national debt and disparity of wealth. It is apparent that the microeconomic changes (from working at home to ordering online) which were already occurring before the pandemic have been accelerated. While the changes that have occurred during this period are countless, it would be unrealistic to assume that *all* of them will be permanent. We are social animals and so far, technology cannot replace the company of friends and family. And while my children may never admit it, I am certain that the idea of school being "out forever" is no longer as appealing to them, as it once was to me.