Basis Points – October 23, 2018

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Above the Fold

- Dan Clifton, political strategist at Strategas Research, notes that in meeting with many clients during the past few weeks, his single biggest takeaway is that sentiment is very bearish. This is not a unique development for midterm election years in October, as he remembers being on the road in mid-October 2014 and every meeting was bearish as well. Economic worries were similar in 2014, and S&P 500 performance so far this month mirrors October 2014. Although it is difficult to look through to after the midterm election, presidents usually get more pro-growth after the midterms as they begin worrying about their own reelections. In 2010, very few investors believed President Obama would extend the Bush tax cuts, but three weeks after the midterm election a deal was in place not only to extend the Bush tax cuts, but also a payroll tax cut and 100 percent expensing were added to the mix. Stocks rallied accordingly post-election.

- Mid-term election voter turnout is typically much lower than presidential election years and usually only policy wonks and the fully committed turn up to vote. However, in 2018 it seems that voters from both political parties are fired up to go the polls two weeks from today. Voter interest in the midterm elections has surged to record levels within both parties. A new *WSJ* poll points to an energized electorate, spurred to the polls by a myriad of issues in this polarized political climate. Nearly two-thirds of registered voters showed a high level of interest in the elections, which is the highest ever recorded in a midterm election since the *Journal/NBC* poll began asking the question in 2006.

Three Things

- A measure on the ballot in Colorado this November could be very important for the health of U.S. domestic oil production. While Colorado is not usually thought of as an energy state, output last year was a respectable 350,000 barrels a day or about five times higher than a decade earlier. Production growth has increased sharply due to new fracking technology used for production in the Denver-Julesburg Basin. Proposition 112 is a proposal that would restrict new oil and gas wells to be at least 2,500 feet from “any structure intended for human occupancy.” Passage of the bill would greatly affect future energy production in the state, as 85 percent of non-federal land would be off-limits to drilling under the new guidelines. Existing wells would be grandfathered in, but future expansion plans in the state would be severely curtailed. Although opponents of the bill have raised 40 times more money for election advertising than proponents of the initiative, the odds are about even for passage of the bill at this time.
- ISI Research feels that the current strength in the U.S. economy is being underappreciated. JOLTS data (Job Openings and Labor Turnover Surveys) show that the economy is still very strong and accelerating. Leading Economic Indicators (LEIs) accelerated 7.0 percent year-over-year in September. ISI feels that the volatile downward moves in the S&P 500 over the past two weeks are detached from these strong economic numbers, and implies that investors are worried about trade tensions, Saudi Arabia and Fed tightening, not overall strength in the economy.
- The formula for calculating credit rating scores will see a change next year. Fair Isaac Corp., creator of the widely used FICO credit score, plans to roll out a new scoring system in early 2019 that factors in how consumers manage the cash in their checking, savings and money-market accounts. The new “UltraFICO” score isn’t meant to weed out applicants, but is designed to boost the number of approvals for credit cards, personal loans and other debt by considering a borrower’s history of cash transactions, which could indicate how likely they are to repay their debts. FICO asserts that borrowers with at least several hundred dollars in their accounts, who have had the accounts for a while, who transact frequently and don’t overdraw these accounts are likely to see their scores rise.

Did You Know

Jeff Bezos became the richest man on the planet in 2018 and is arguably the richest person in history. He is celebrated as a business genius and is seen as man with visions of the future that scan a horizon far greater than the average business expert. Bezos founded Amazon in 1995 and still holds a 20 percent stake in the business. It seems as if Amazon has always been a beloved and respected force in corporate America. This was not always the case, however.

I stumbled across a fascinating article from a May 1999 *Barron's* cover story titled, "Amazon.bomb." The story foretold the impending doom of the fledgling web retailer. Through the lens of the two decades hence, it is easy to second-guess the criticisms of the company that were laid out in the article. But the article's misreading of the market, potential competition and the underestimation of Bezos' long-term vision is truly breathtaking. *Barron's* at the time was implying that Amazon was but a year from failing and fading into the dustbin of history as one of the most-hyped business failures ever.

Some of the interesting points the article made:

"Increasingly, Amazon's strategy is looking like the dim-bulb businessman who loses money on every sale but tries to make it up by making more sales."

"Once Walmart decides to go after Amazon, there's no contest. Walmart has resources Amazon can't even dream about."

"Unfortunately for Bezos, Amazon is now entering a stage in which investors will be less willing to rely on his charisma and more demanding of answers to tough questions like, 'When will this company actually turn a profit?' and 'How will Amazon triumph over a slew of new competitors who have deep pockets and new technologies?'"

"AOL has amassed what's considered to be the biggest audience of users on the internet, 16 million subscribers in all. Amazon has only half that many clients, and most view the site as a retailer rather than as a source of information or entertainment. That's why they don't tend to hang out on the Amazon site for hours at a time the way they do at AOL."

"Despite all the hoopla surrounding Amazon, Bezos has not really revolutionized the book industry at all. He is a middleman, and he will likely be outflanked by companies that sell their wares directly to consumers. To begin with, publishing houses themselves could sell their books online. And new technologies promise to cut costs even further by allowing consumers to download books via the internet. Books can be printed out on traditional computer printers or put into a new notebook-sized computer device that displays books on its screen a page at a time."

"Here's another potential threat to Amazon: What's to stop famous authors from establishing their own websites to sell their books? If Madonna can have her own record label, the theory goes, why can't Stephen King or Danielle Steel have their own book imprint?"

“Against this backdrop, Amazon is looking more and more like a traditional retailer, complete with an expensive network of warehouses loaded down with inventory. Amazon is buying a lot of costly bricks and mortar, the very stuff that is supposedly bloating costs at traditional retailers.”

“Those traditional retailers, meanwhile, are moving onto Amazon’s turf. Even Borders, the bookstore chain that has been the farthest behind in the race to capture online eyeballs on the internet, just announced a cross-marketing agreement with internet upstart About.com.” [Note: Borders and About.com are no longer in business.]

“Soon Amazon will be encountering competition on the internet from even the nation’s mom-and-pop bookstores. By August, the American Booksellers Association will launch BookSense.com, a program that will let local stores launch individual websites with their own logos, designs and book reviews.” [BookSense.com is no longer in business.]

“Adding to the cutthroat competition are various websites with search engines that track down whatever book you want at the lowest price. On top of all that, there’s the site called Buybooks.com, which has a stated business plan of undercutting Amazon’s prices by at least 10 percent.” [Buybooks.com is no longer in business.]

“Adding to Amazon’s woes is its recent purchase of warehouse space. Traditional booksellers like Barnes & Noble and Borders already have warehouses around the country. Taken together, Ingram and Barnes & Noble have enough distribution sites to offer overnight delivery at no extra cost to about 80 percent of the U.S. The best Amazon can offer right now is delivery in three to seven business days, and that’s if it has the book in stock. [Amazon can now deliver every product within hours, if needed.]

“Eventually, shareholders and bond buyers will wise up.”

Dim-bulb businessman? Amazon 1, *Barron’s* 0