



Basis Points – October 25, 2018

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Above the Fold

Boeing shares popped 4 percent yesterday after reporting stellar earnings numbers that were above street expectations. Boeing, the world's largest aerospace company, said its business is booming thanks to strong demand for commercial jets and new defense projects. For the quarter, Boeing reported earnings per share of \$4.07, up 36 percent from \$2.99 in the same period last year. Boeing is racing to meet global demand for commercial aircraft, as global passenger traffic rose 6.8 percent annually through August. Boeing expects to bring in as much as \$100 billion in revenue in 2018, up \$1 billion from a previous forecast. Its backlog of orders has risen \$17 billion this year to \$491 billion, a list of 5,800 commercial aircraft orders that will be built and delivered in the future. Boeing stock has risen 25 percent in 2018.

Three Things

- The Mega Millions jackpot of \$1.6 billion was drawn on Tuesday night and one lucky person from South Carolina won the big prize. The size of lottery jackpots has grown sharply in recent years, as lottery administrators have tweaked the odds of big games like Mega Millions, making them more difficult to win. Americans spend a shocking amount of money on lottery tickets these days, as total lottery spending (in constant dollars) has more than doubled since 1995. Total spending on state-level lotteries has increased from \$29.8 billion in 1995 to \$72.7 billion in 2016. More states offer lotteries today, but per capita lotto spending has also doubled since 1995. Per capita lotto spending in 1995 worked out to about \$112 a year for every person in America. Today, per capita spending is up to \$225 a year. The highest spending states are on the East Coast. Massachusetts leads the nation with a huge \$767 in annual per capita lotto spending, followed by West Virginia (\$594), Rhode Island (\$513), Delaware (\$421) and New York (\$421). And sorry to burst your bubble, but if you buy a lottery ticket on Wednesday, you are statistically more likely to die before the Friday drawing than to win the big prize.
- Cumulative advantage is an interesting concept in the win/loss nature of our world. It means that a tiny 1 percent advantage can end up creating a huge gap in outcomes. Two plants take root side by side in a forest. Each day they will compete for sun and soil. If one plant can grow just 1 percent taller than the other, it can receive more sunlight and raindrops. This gives it slightly more energy to grow taller than the other plant. The bigger the plant gets, the more it can crowd out the smaller plant for the lion's share of resources. The taller plant then has a greater ability to spread its seeds and reproduce. The plants that are only slightly better than the others soon come to dominate the forest. What begins as a tiny advantage can grow much larger over time. This effect is seen in the Amazon rainforest where just 1.4 percent of all tree species account for 50 percent of the trees.
- The \$3.5 trillion U.S. retail industry may be seeing the hollowing out of the malls, but many retailers continue to thrive in this new retail era. The disruption and bankruptcies in the industry may have even seen a bottom in 2017. The pace of store closings has slowed from 5,700 at this point last year to 4,480 in 2018. Stores have refocused their services and offerings to create a more customer-focused experience, where a shopper can order online and drive up to a store and be handed the product, for instance. Barbara Kahn, esteemed marketing professor at the Wharton School at The University of Pennsylvania, writes in her new book, *The Shopping Revolution*, that retailers that are succeeding in this new retailing era have focused on four areas: brands, experiential, frictionless and low cost. Successful examples of these four focuses are Warby Parker, which has established a strong brand name in eyewear; Tiffany, which has upped its experiential game with its Blue Box Café in its New York City flagship store, which on some days has a waiting list of 1,000 people; Amazon, which is on the cutting-edge of frictionless buying with its "1-Click" buying option; and Dollar General in the low-cost sector, which plans to open 900 stores this year as it expands its reach into rural America with inexpensive food and clothing.

Did You Know

The global news cycle is tense over the Jamal Khashoggi murder on October 2, and many have called for a change in the relationship between the U.S. and Saudi Arabia, and even enacting economic sanctions on the Kingdom. The geopolitical relationship between the U.S. and Saudi Arabia is much more intricate than it seems, however, and Tyler Cowen of Bloomberg does a great job in distilling why.

Trade between the U.S. and Saudi Arabia is currently about \$24 billion per year. Yes, the U.S. is now energy-independent, but many U.S. allies, most notably Japan, rely on oil imports. Part of the larger U.S. foreign policy stance is promising those allies freedom from major supply disruptions. The Saudis typically have recycled their petrodollar surpluses, investing them in American enterprises. Turkey and Iran do not invest in the United States. Good or bad, the Saudis are America's economic ally in the region.

The connections between the U.S. and Saudi Arabia run much deeper than just trade numbers, however. One feature of the geography of Saudi Arabia is that its major oil fields stand apart and can be taken over without controlling the major Saudi cities. That is one reason why the Saudis were so wary of Saddam Hussein. That risk means the Saudis are especially dependent on American military protection. In turn, the U.S. knows it has a lot of leverage over the Saudis, and therefore making deals with the Saudis involves easier enforcement and lower transaction costs.

The Saudis in the past have been an oil swing producer, so can hurt Russia economically whenever they want. That power is attractive to the United States. And while the Saudis are dependent on the U.S., they also know America has few other potential regional partners for cooperation on such a large scale. The U.S. has also strongly encouraged a healthy Saudi tolerance of Israel, which they have complied with.

Whether for reasons of geography, military power or economics, Saudi Arabia will remain America's natural partner in the very volatile Middle East region.

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