Basis Points – November 15, 2018

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Above the Fold

- Shares in electric and gas utility companies are normally very safe and stable investments that are purchased for their high dividend yields and low volatility. This is not the case for California utilities over the past year. PG&E (formerly Pacific Gas & Electric) operates gas and electric grids for central and northern California, which have been ground zero for the devastating wildfires seen both this fall and last. PG&E stock has fallen 43 percent over the past year, and the dividend has been discontinued. On Wednesday, PG&E shares fell as much as 25 percent, crushed by the possibility that its equipment sparked the catastrophic wildfires ravaging the state. PG&E has a total of $3.5 billion in cash and an additional $1.5 billion in wildfire insurance coverage on hand but may face $15 billion in damages from this year's Camp Fire, the deadliest fire in state history. The company admitted that it could be subject to significant liability in excess of insurance coverage. Bankruptcy protection is a likely path for the utility, although, given its high importance to the very large population of California, it will most likely receive aid from the state to work through its problems.
- Macy's has initiated a radical experiment aimed at turning the retail chain's fortunes around. The 160-year-old retailer plans to cut the size of its stores and reduce the amount of merchandise and the number of employees at its slower-performing stores, even by walling off entire sections at some locations and leaving the space empty. Sales per square foot at large department stores are very low these days, so management is attempting to make their spaces more financially efficient. The smaller-store footprint, an experiment now under way at four locations, is intended to save money on staffing and inventory while improving the chain's lackluster shopping experience. "If we were building stores today, we'd build them smaller," said the CEO.

Three Things

- Is gold a good hedge against global upheaval or inflation? Not really. From the founding of the United States in 1776 until 1945, the real price of gold was flat, and the investing world did not have much use for the metal as an investment during this long period. Only after World War II did the idea of buying gold catch on with the investing public, for use as a hedge against nuclear war, currency crises and economic turmoil. However, reviewing the performance of gold shows that it is in fact not a good hedge against inflation, and the price performance of the metal has a lower return and higher volatility than both stocks and bonds. Over the last 50 years, a portfolio of 50 percent stocks and 50 percent U.S. Treasury bonds generated average annualized performance of 9.62 percent vs. gold at 7.40 percent. The standard deviation of the 50/50 portfolio is also much lower than gold, at 10.5 percent a year vs. 28.1 percent for gold. A lower return over time while taking on much higher risk is not a formula for a good investment or inflation hedge. During times of crisis, as in 2008, it is not gold that performs best but U.S. Treasury bonds. In 2008, the price of gold rose just 6 percent, while the 10-year T-bond rose 21 percent.

- Wage growth continues to pick up steam, although not at a pace that would generate a detrimental amount of inflation. One interesting note is that wage growth for job stayers is rising as quickly as wage growth for job switchers, at 3.6 percent. A “job stayer” is someone who is in the same occupation and industry as they were 12 months ago. This shows that firms are paying up to retain existing talent rather than lose them to the competition in a very strong job market.
- After a 25 percent decline in the price of crude oil over the past six weeks, the major question many have posed is whether the decline was due to increasing supplies of crude on the market, or from declining demand from large energy-gobbling countries like China. RenMac Research has run the data, and they see only about one-third of the decline arising from lower demand, and two-thirds of the decline due to much larger than expected supplies of oil. Their model suggests that oil should only be down $5 a barrel due to demand factors, while higher supplies have caused the remaining $10 decrease in the price.

Did You Know

During a contentious post-election press conference at the White House last week, President Trump and CNN’s White House correspondent Jim Acosta sparred during a heated argument regarding Acosta’s line of questioning and the president’s view of its appropriateness. After the press conference concluded, the president revoked Acosta’s White House press pass, which allows a reporter to work in and around the White House unescorted. CNN filed a lawsuit in Federal District Court on Tuesday, seeking the court’s relief to have Acosta’s White House access returned. While the court will most likely rule on the side of CNN and reporters in general and the issue will be off the front pages quickly, it is interesting to note what the actual laws in this case are and when they were decided.

The president does not have any constitutional obligation to open the White House to the press and the president is allowed to choose which reporters he would meet with privately. The president can also play favorites with news networks, agreeing to sit for interviews on those networks that he prefers and can similarly discriminate against networks that he does not care for.

However, once the White House opens itself up to all accredited reporters with press passes, such as for a press conference, the government has created what is called a “forum for free speech in interaction with the president.” This “forum” idea is established law, and in such a “limited-purpose public forum,” the administration is not allowed to discriminate based on the viewpoint, network affiliation or perceived character of a reporter.

There is a judicial precedent on this issue, in a 1977 case, Sherrill vs. Knight. In that case, the U.S. Court of Appeals for the D.C. Circuit ruled that the First Amendment applies to reporters seeking press passes. And the ruling specifically stated that the White House could not deny a press pass to a reporter arbitrarily or for less than compelling reasons. This case did not go to the Supreme Court, as D.C. Circuit precedent is law in the District of Columbia.

Therefore, Acosta's press access will most likely be returned in the coming days. The president, however, made his point by pushing the envelope, as he is usually keen on doing.