Basis Points – February 12, 2019

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Above the Fold

- BB&T announced last week that it will buy SunTrust Banks for $28 billion in an all-stock deal, creating the sixth-largest U.S. bank. The deal is the biggest bank deal since the 2007-2009 financial crisis. The combined banks' footprint will cover the East Coast, with a new corporate headquarters in Charlotte. A major reason for the merger involves the huge cost of technology needed to survive in the banking business today. Banks are spending billions to keep up with the ever-evolving banking technology and to upgrade older, legacy systems. The firms without billions of dollars to pour into that technology effort are forced to get creative or merge with other companies. The combined bank will be in a better position to invest in cyber defense and compete on mobile and automated banking systems. Changing customer demands set the stage for the "tremendous increase in the need for technological investment," according to BB&T's CEO. "Our clients now demand what I call real-time satisfaction — they want what they want, when they want it. We are all facing an increasing set of complex economic realities where we have to invest more and more in technology."
- U.S. Representative Alexandria Ocasio-Cortez, Democrat of New York, and U.S. Senator Ed Markey, Democrat of Massachusetts, spoke at a press conference last week to announce their new Green New Deal legislation that promotes a more environmentally sound country with economic benefits for everyone, even those who don't want to work. An overview circulated by proponents of the bill states that the plan seeks a "massive transformation of our society" that could rid the country of fossil fuels by 2030, and "create millions of family supporting-wage union jobs." But for those citizens who would rather not work, there's something in the plan as well. The overview notes that the Green New Deal aims to provide "economic security for all who are unable or unwilling to work." While the legislation patterns itself after FDR's New Deal, which was aimed at rescuing the country from the Great Depression, the FDR plan did not include a benefit for those willingly idle. The main tenet of the Green New Deal seeks to shift the U.S. to all renewable energy in 10 years, which would force a radical change to the country's transportation, industrial and electricity generation systems.

A Lesson Learned the Hard Way

In the 2008 Batman movie *The Dark Knight*, one of Wayne Enterprises' accountants traced company money and figured out that Bruce Wayne must be Batman, and confronts Batman's right-hand man Lucius Fox (Morgan Freeman) with a demand for cash or he will go public with the information.

Accountant: "I want $10 million a year, for the rest of my life."

Lucius Fox: "Let me get this straight. You think that your boss, one of the wealthiest, most powerful men in the world, is secretly a vigilante who spends his nights beating criminals to a pulp with his bare hands. And your plan is to blackmail this person? [Smiles] Well… good luck!"

The accountant quickly realizes that he has miscalculated and quietly slinks out of the office. A similar realization must have come across the mind of the esteemed journalists at The National Enquirer last week. Senior figures at the tabloid emailed demands to Jeff Bezos, the world's richest man, and implied that if he did not comply, they would release embarrassing and lewd pictures of him to the public.

Bezos chose to release the blackmail plot details and emails to the media himself, and federal officials are now investigating the incident as attempted blackmail. The old saying goes that if you are going to shoot at the king, you had better not miss. Whether the demands are deemed to have amounted to a crime or not, the Enquirer clearly missed.

Two Things

- Since the recent market low on Dec. 24, the Industrial sector has been the best performing S&P 500 sector with a gain of 22 percent. More than 90 percent of Industrial stocks recently traded to a 20-day high, the strongest reading in roughly 30 years. The Industrials sector has the highest historical correlation to the S&P 500 index, at 0.86, so Industrial strength is a very positive sign for overall S&P 500 performance. Energy is the second-best performing group since the recent correction low, up about 20 percent.
- Frank Robinson was a fiery, intimidating baseball player. He leaned over the plate while waiting for the pitch, just daring the pitcher to throw inside. The pitcher frequently did, and Robinson got plunked with 198 pitches during his long and storied career. He was born on Aug. 31, 1935, in Beaumont, Texas, and died last week at age 83. Robinson grew up in Oakland, the youngest of 10 children, and was a high school basketball teammate of Bill Russell. Robinson remains on the short list of the best players in baseball history, as he is the only man ever to earn MVP honors in both leagues and also won the triple crown in 1966. He retired with 586 home runs, which at the time trailed only Hank Aaron, Babe Ruth and Willie Mays. But Robinson's legacy would extend far beyond the batter's box. On April 8, 1975, Robinson officially became baseball's first black manager. A player for the team as well as the manager, Robinson put himself in the No. 2 spot in the batting order that day. In the first inning, he hit a home run off Doc Medich of the New York Yankees. Robinson continued to manage in the big leagues for 16 seasons, and in 2005 President George W. Bush honored Robinson with the Presidential Medal of Freedom, the country's highest civilian award. Baseball will miss his long shadow.

Did You Know

The U.S. economy is far less volatile than it used to be. The ebbs and flows of our economic cycle usually cause many investors to anticipate and worry about the next economic slowdown. Although it may seem like there is risk and volatility in today's economic cycles, a little historical perspective could make us much more comfortable with the current state of economic affairs, especially when compared to the previous 200 hundred years of economic expansion and decline. The economy in the past was far more volatile than it is now.

During the period of 1870 to 1910, the U.S. economy was in a state of recession 50 percent of the time, and the average length of economic expansions was short, at 25 months. The depths of the resulting recessions were also deep, at an average decline in GDP of 3.7 percent. Boom and bust cycles were common. With no government financial backstop or monetary authority or plan, there was the need for private lenders such as J.P. Morgan himself to step in and loan the government funds to head off full-scale panics.

With the adoption of the Federal Reserve in 1913 and its assumption of control of U.S. monetary policy, our economy became more stable and less prone to shocks. However, from the period of 1910 to 1980, the economy was still in a state of recession 26 percent of the time, with short average economic growth periods of just 44 months, and average recession GDP declines of 4.3 percent.

Only in the more recent era of economic policy in the U.S., from 1980 to 2018, have we seen recession periods that are much shorter than in the past, at only 8 percent of the time, with longer economic expansions averaging 101 months and lower GDP declines during recessions of 2.1 percent.

With the creation of the Federal Reserve (the Fed), this powerful government body became the “lender of last resort” in economic crises, and its influence helped to curtail risks of large-scale financial panics before they began. A major factor for the smoothing of the economic growth cycles over time has been the Fed’s responsibility for a “dual mandate” of price stability and full employment. The transparent economic policies of the Fed, and the focus on a stable inflation rate over the past 40 years, has allowed economic expansions to last longer, and the succeeding recession periods to be much less severe.

In addition to the influence of the Fed, a shift in what our economy produces has also smoothed economic cycles for the better. During the 1800s, our economy was much more focused on the production and sale of hard goods, with boom and busts in the railroad, agriculture and industrial segments very common. Over time, our economy has rapidly moved away from a goods economy to a services economy. Services are by nature less volatile and do not depend on raw materials pricing and availability, transportation of products or inventory management. This shift from goods to services has greatly moderated our economic volatility.

While we may fear the ups and downs in our economy with the resulting harmful effects on GDP growth and unemployment, our economy and its growth and decline cycles are far healthier and more stable than any time in the last 200 years.

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