

## 2021 End of Year Report

I hope this letter finds you well. It has been slightly more than a year since I sent you my 2021 Beginning of Year Report. I will, in this report, as I have done in my past eight reports, reference one or more of those very same reports. On our website, [www.eglsederwealth.com](http://www.eglsederwealth.com), we have posted all previous reports under the Resources Tab. Once you click on the Resources Tab, then click on the drop-down entitled “Semi-Annual Reports” for easy reference to all past issues. Thank you in advance for taking the time to read this report.

*“Things work out best for those who make the best of how things work out”*

*John Wooden*

### **Tough Times**

Once again, as the good people of the United States have always done, we have risen to the challenges presented to us by the Covid-19 virus. It wasn't easy, it wasn't seamless and it surely wasn't without rancor – but we have risen and continue to rise to the challenges that this terrible virus has placed on us.

American businessmen and women, with great ingenuity, have adapted and continue to adapt to the obstacles placed before them. The Congress, in late March of 2020, when it mattered the most, in a mere two or three weeks, set aside partisan divisions and passed significant spending legislation so that everyday people and small businesses could pay their bills, preventing further damage to the economy and the further suffering of many of its citizens. From March of 2020 through July of 2020, a record 57.4 million people in our country filed for unemployment. The previous record was 9 million jobs lost over 18 months when the housing bubble burst in 2008.

Additionally, brilliant scientists from both here and abroad worked around the clock to create, in record time, highly effective vaccines – the funding for which was provided by the U.S. taxpayer - to prevent and lessen the number of people who would suffer serious illness and death.

Finally, the United States Federal Reserve – the “Fed” – with lessons learned from the housing bubble, financial crisis and Great Recession of 13 years ago, injected a record amount of money into the banking and financial system to make sure that the financial markets remained liquid and continued to run smoothly, successfully lessening the potential for damage to the economy, as well as to the banking and financial system.

### Comparing Then to Now

To everyone’s great financial benefit, on the economic front things have unfolded as I suggested they might in my 2021 Beginning of Year Report. To understand what has happened (and what has not) over the past two years, I believe it is important to compare and contrast what we went through 13 years ago as a result of the housing bubble and the lessons that we learned. There are many similarities and at least one significant difference.

In a complex world, it is seldom the case when you can pinpoint and lay blame on one precise thing which is the ultimate cause of something bad which has taken place. The ultimate cause of the housing bubble, financial crisis and the Great Recession was this: It was first the creation of and then the repackaging and selling of bad mortgages.

When my parents were coming up, there was no such thing as Rocket Mortgage or Quicken Loans. Back then, if you wanted to buy a house, you went to the local bank or savings and loan or credit union to get a mortgage.

It was typical for them to require a 20% down payment, it was typical that your monthly mortgage payment could be no more than 25% of your take-home pay and more often than not, the term of the mortgage would not be more than 20 years. They would keep your mortgage in-house, they would not be selling it. Your lender did not want to be in the foreclosure business, they wanted to be in the check-collecting business.

Prior to 9-15-2008 when Lehman Brothers collapsed, modern mortgage companies point of view was something like this: “What do I care if I lend Bob and Sue an amount of money that is equal to 125% of the value of the house that they want to buy which has gone up 100% in value over the past 3 Years? We’re not going to keep the mortgage anyway, we’re going to sell it to someone else.”

The primary difference between the “hot” real estate market then and the one that we have been experiencing for the past two years is this: The mortgages that are being created today are good mortgages. The pendulum has done a complete 180 degree shift. If you know anyone who has applied for a mortgage in the past ten years or so, the amount of documentation and verification that takes place now is mind-boggling. I will come back to this point in just a bit. Let me first go over the similarities between then and now.

In the summer of 2003, over three or four months, for various reasons, 30 year mortgage rates dropped from about 6% to about 4%. How this translated in the real world was that all of a

sudden people buying a home could borrow 33% more money *for the same* monthly payment. It's not that they wanted to borrow 33% more money, but everyone bidding on the home that they wanted to buy – real estate is sold at an auction – could do the same thing, and so they did. So, all of a sudden, people had 33% more money to spend on one item - real estate. Depending on where you lived, in about a year, most people's homes, whether they were selling or not, increased in value by 35 to 50%!

This is when something that the media has recently labeled, with respect to the current housing market, began to kick in back in 2003. They call it F.O.M.O. – the fear of missing out.

When mortgage rates fell so quickly and prices went up so quickly, people began to think along the following lines: “Oh my gosh! Bob and Sue just built that house two years ago and they just sold it for \$300,000.00 more than what they paid for it! They made \$300,000.00 in just two years! I am missing out! I have to get into the real estate market!” Subsequently, it seemed like everyone became a real estate investor. This is when bad mortgages began to play their devastating role. The damage done to the economy and to the banking and financial system has only been eclipsed by what happened during the Great Depression.

Regarding the current “hot” housing market, when the shutdowns began in March of 2020, in addition to the record spending package that was signed into law by the President, The Federal Reserve, using former Federal Reserve Chairman Ben Bernanke's playbook from the Financial Crisis, very quickly injected money into the banking and financial system. Over the next several months, one of the results of the Fed's actions was that mortgage rates dropped from about 4% to about 3%.

All of a sudden, people buying homes could now borrow 25% more money *for the same* monthly payment. It's not that they wanted to borrow 25% more money, but everyone bidding on the home that they wanted to buy could do the same thing – and so they did. Sound familiar? Very quickly, real estate prices begin to rise in a significant fashion. Then the fear of missing out – F.O.M.O. - began to kick in – just like it did when we had the housing bubble in the 2000's.

The thing that precipitated all of this was Covid-19. Covid-19 not only caused the Fed to take steps which brought mortgage rates down, it caused government officials to initiate lockdowns, so many people were forced to work from home. This was particularly true in the metropolitan areas with very dense populations. Many of these people had always believed that they could work from home. For many, Covid-19 proved them right. So, many people from metropolitan areas – in our case, Baltimore and Washington, D.C and even Philadelphia, began to look for second homes in rural areas, such as the Eastern Shore. Most of the homes in our area that most people would consider to be “desirable”, aren't being purchased by people who live here, but rather from these metropolitan areas. I have met a lot of these folks and it is not uncommon for them to have combined annual incomes of \$500,000.00 to \$1,000,000.00 or more.

They don't want to sell their homes in the city, but their reasoning is pretty straightforward: "If I'm going to be working out of the house for the foreseeable future, while I love the view of the Capitol at night, I'd rather be overlooking the Miles River." Let's say that they decide to keep the purchase price for the house on the Shore at \$1,000,000.00 or less. With mortgage rates hovering around 3% for most of the past two years, after their 20% down payment, the monthly mortgage payment on the \$800,000.00 that they borrow is about \$3,400.00 per month. If you're in the middle class, that's a big monthly nut to crack. If you're making \$1,000,000.00 per year in income, it's nothing. To rent a nice apartment on Wisconsin or Connecticut Avenue in D.C., it would cost you more than \$3,400.00 a month. For the same monthly payment, you can have a house on the water.

The mortgages that are being created today to fund these purchases are good mortgages. As I mentioned previously, the amount of documentation and verification of assets and income that is required in today's world (because of what happened during the housing bubble) is mind boggling. Borrowers today are very well-qualified. In any real estate market, there are a finite number of buyers. It seems inevitable that at some point demand will soften and prices will go down. The difference will be, however, due to the quality of the mortgages being created, if real estate prices do drop, you will not see the foreclosures like we did last time.

### **The Banking System**

When Lehman Brothers collapsed on September 15, 2008, triggering the Financial Crisis and Great Recession, no living politician and no living banker had ever experienced anything like it. The last time something like that had happened was back in 1929, resulting in The Great Depression. At the same time, members of Congress and The Federal Reserve were charged with making very important decisions in a relatively short time frame, with no personal experience from which to draw. Thankfully, then Fed Chairman Ben Bernanke, while obtaining his PhD in Economics from M.I.T., had studied the events that led up to the Great Depression and the decisions that were made by the Federal Reserve which made things worse.

Whether it was things that the Congress did legislatively or things that the Fed did administratively, all courses of action taken were designed to accomplish one of three objectives: What can we do to prevent things from getting worse? What can we do to repair the damage that has been done? What can we do to make sure that something like this can never happen again?

I believe that the steps taken by Ben Bernanke and the Fed were the most important. One of the first steps taken by Mr. Bernanke, for which he received great criticism, was bailing out many of the very large commercial and investment banks. Prior to the crisis, the primary tool utilized by the Fed to modify economic activity was the raising and lowering of interest rates at the banks.

They had many other tools in their toolbox which had never been used here before, but their computer models suggested they would be highly effective.

When it came down to the large bailouts, Mr. Bernanke's point of view was pretty simple: The economy was grinding to a halt. The banking and financial system were grinding to a halt and on the verge of collapse. Monthly job losses were at record levels. If he didn't use the tools at his disposal, he could not predict how bad things might get. So he decided to use the tools at his disposal because he did believe that they would work – and they did.

Regarding his decision to do any number of large bailouts, he found himself and the Fed in the political crosshairs – which is the last place the Fed ever wants to be. The Congress could, should they so choose, change the Fed's charter giving the Congress – heaven forbid – more control over the Fed's operations. Subsequent to the Financial Crisis, perhaps the most important thing that the Fed has done to prevent something like this from ever happening again is that, shortly after the crisis, on an annual basis, the Fed began to require that all financial institutions that have been deemed “too large to fail” to be given “stress tests”.

These are computer simulations that are designed to mirror horrible conditions like the Financial Crisis. Wisely, they change these scenarios every year. The Fed wants to see how your bank, with its current capital structure and reserves would fare under dire economic conditions such as the crisis. If your bank does not pass the stress test, the Fed gives you specific objectives to accomplish over the next twelve months and then the Fed will decide how many of their regulators they will put in your bank on your payroll to accomplish those objectives.

Has it worked? Have you heard or read of any banks failing since March of 2020? The results have been nothing short of magnificent. According to the FDIC website, in 2008, 25 very large banks failed and were shuttered by the FDIC. From the insurance fund, they had to issue checks for insured deposits totaling \$373,588,800,000.00. Yes, that's over \$373 billion dollars. In 2009, 140 banks failed and were shuttered. Checks issued by the FDIC from their insurance fund to cover insured deposits totaled \$170,909,400,000.00. 2010 was the year with the greatest number of bank failures: 157 with insured deposits totaling \$96,514,000,000.00.

The numbers began to drop dramatically from there. In 2020, a grand total of only 4 banks in our country failed and were shuttered by the FDIC. The total of the checks written by the FDIC for insured deposits was only \$458,000,000.00. Yes, that's only \$458 million. In 2021, not a single bank failed in the United States of America. So far in 2022, none have failed. Impressive.

***“A nickel ain't worth a dime any more” Yogi Berra***

## **Inflation**

One of the concerns which has arisen over the past year or so has to do with whether or not the price inflation we have seen will continue into the future. Most – not all – of the price inflation that we have seen is the direct result of supply chain issues. The supply chain issues that we have experienced are the direct result of Covid-19. It is therefore reasonable to believe that if and when we move past Covid-19, the supply chain issues will be resolved and the current imbalances between supply and demand will level out and most prices will fall. One of the few exceptions will probably be oil and gasoline (more on this in a few minutes).

Between effective vaccines that exist right now and those that will continue to be developed to treat possible future variants, effective anti-viral medications that are very close to getting emergency use authorization and our ever-increasing knowledge of Covid-19 and how to prevent it and treat it, I believe that we will, sooner rather than later, move past it.

Because one variant can crowd out and make extinct a previous variant, it is theoretically possible that the Omicron variant, which is far more contagious and much more highly transmissible than the Delta variant, can not only crowd out and make the Delta variant extinct, but also if the number of Omicron cases continues to grow exponentially like it has been – assuming no mutations occur that would create a more contagious variant which would make people sicker – it is possible that the Omicron variant will peter out and Covid-19 goes away. Granted, very unlikely, but theoretically possible. Time will tell.

Regarding oil and gas prices over the near to short term, assuming no economic downturns, I think it most likely that prices will not go down any time soon. Other than the reduction in supply due to the war in Ukraine and increase in demand precipitated by a recovering economy, the other reasons for price increases aren't so obvious.

I remember well the Arab Oil Embargo which began in October of 1973. In Maryland, I remember the even and odd days (the last number on your license plate) when you could buy gas, the long lines and the limit on the number of gallons of gas that you could buy on your even or odd day. The impact on the average American was great and the embargo made it painfully aware to all of us how dependent we had become on foreign oil and the power that gave certain countries over us.

In response, the 1975 Energy Policy and Conservation Act was signed into law by President Gerald Ford. This law directed the president to ban crude oil exports except for select types of oil. The result was that U.S. producers could no longer sell their products overseas. Their market was just the U.S., the world's largest consumer of oil. At just 5% of the world's population, we consume 25% of the world's oil.

The problem was that most of our oil was much more expensive to extract from the ground than countries such as Saudi Arabia and Kuwait. So U.S. engineers began to work the problem of the costs of extracting oil here. By 2005, they had solved the problem.

Over the years they created and developed the technologies of horizontal drilling and hydraulic fracturing – “fracking”. The oil began to gush from U.S. oil fields. In a few short years, we became the world’s largest producer of oil. The problem was that U.S. producers couldn’t sell their product overseas because of the 1975 law. Oil and gas prices began to drop. When the Great Recession began, demand dropped precipitously as did gas prices. Because oil companies had borrowed so much money to cover the costs of using these new technologies, they couldn’t stop pumping. They had to make sales to pay the monthly interest on their debt.

Falling demand and increased production led to a huge oil glut. There was such a shortage of storage facilities that railroad cars were being used for storage. The price of a gallon of gas dropped precipitously and remained very low for many years. This equation began to change starting in 2016. On December 18, 2015, President Barack Obama signed into law the Consolidated Appropriations Act of 2016, which included a provision to end the oil export ban that had been in place since 1975. U.S. oil producers could now sell their product abroad instead of being limited to just the United States market. The ability to sell oil abroad lessens the possibility of a new glut forming here and therefore lessens the possibility of lower prices at the pump.

I have researched the various times that we have experienced significant inflation since World War II and the circumstances that led to those bouts of inflation. The factors which led to the inflation that we experienced over those many decades simply don’t exist in today’s world.

After World War II, the U.S. was the world’s only superpower. Our industrial capacity was unparalleled. Most of the industrial capacity of Europe and Asia had been destroyed. Because manufacturing was a much larger percentage of our economy than it is today (we are still the world’s second largest manufacturing economy), unions played a much larger role in the ultimate pricing of any given product. Because there was so much rationing in the U.S. during the war, when the war ended, there was huge pent up domestic demand for goods. Adding to this demand was the creation of the Baby Boom generation. This demand, combined with the demand from abroad, despite our industrial capacity, producers simply could not keep up with demand. Because U.S. producers had very little competition from abroad, U.S. producers were able to raise their prices at will. If labor unions negotiated higher wages, producers simply raised their prices to offset this cost.

Over the next fifteen years or so, the infrastructure and manufacturing capacity of Europe and Asia was restored. The U.S. now had competition from abroad. As demand surged, they were no longer able to raise their prices at will. As unions negotiated higher wages, they weren’t able to raise their prices at will. To protect their profits, U.S. producers began to look for cheaper labor (non-union) within the United States. They were able to find cheaper pockets of labor within the U.S. for several decades.

There were 77 million babies born between 1945 and 1964 – the aforementioned Baby Boom generation, the largest group of consumers ever born in a 20 year period in U.S. history. In 1965, four out of ten people living in this country were under 21 years of age. We were everywhere. Materially, we wanted everything that our parents had. But we wanted bigger, better and faster. Most importantly, we wanted it now. Unlike our parents, we were willing to borrow the money to buy it.

While individual daily behavior is highly unpredictable (just look at the daily paper), what people spend and when they spend it is highly predictable and determined primarily by their age. In modern societies, people tend to buy certain things at certain ages. From an economic standpoint, the Baby Boomers have been compared to a basketball being forced through a garden hose. As we move through various life stages where we buy very specific things, the areas of the economy that produce those items explode with growth.

As we began to move through the 70's, we were buying so many big ticket items that supply in the U.S. could not keep up with demand. So prices went up significantly. U.S. producers continued to look for pockets of cheap non-union labor within our borders (the local example is when Black and Decker built a manufacturing plant on the Easton bypass). By the mid-eighties, all of the cheap pockets of labor in this country had been exploited. U.S. producers had more domestic and international competition than ever before, so their ability to raise prices was severely reduced. What did they do? If you can't raise prices because of competition, to protect your profits you have to cut your costs. On average, two-thirds of the cost of all goods and services produced here is labor. So if all of the cheap pockets of labor in this country are gone there's only one thing that you can do – find cheaper labor in other countries. Our local example, Black and Decker, ultimately shut down their production plant in Easton and moved that production to Mexicali, Mexico.

By the late 1980's, because of personal computers and advances in communications (like cell phones), information became more readily available – at the speed of light - to individuals and businesses than at any time in history. This enabled manufacturers to keep supply and demand within close proximity to each other. The long-sought concepts of Just-in-Time Inventory, Manufacturing and Delivery became a reality. So this is when a confluence of several things began to work together to keep inflation in check.

The peak spending year for the average American is 46.5 years of age. The Baby Boomers – the largest group of consumers ever born in a twenty year period in U.S. history – started to be born in 1945. Add 46.5 years to 1945 and you find yourself in the middle of 1991. We had a mild and brief recession between July of 1990 and March of 1991. In the middle of 1991, you have the leading edge of the Baby Boomers moving into their peak earning and spending years with 77 million more Baby Boomers bringing up the rear. What was the result? The best 10 years of economic growth in U.S. history. Economic growth (GDP – Gross Domestic Product) was in the 4.50% to 5.00% range in most years versus the typical 2.00 - 2.50% GDP we have seen most years since the Great Recession.

Certainly, the incredible increase in demand during this time frame should have send prices soaring. But it didn't. Between manufacturing jobs being sent overseas to get very cheap labor, advances in automation - new machines producing more goods at a fraction of the cost of human labor, computer algorithms replacing humans (think travel agents) - and Just-in-Time Inventory, Manufacturing and Delivery, these things combined allowed supply to keep up with demand and because labor costs went down we did not have very much inflation at all. In fact, in 2003, we came very close to having deflation in the United States – something that we haven't had here since the Great Depression. As a result, both short term and long term interest rates continued their downward trend.

Here's another thing that has changed: Starting on January 1, 2008, 10,000 Baby Boomers began to retire each and every day. When people retire, their income and spending goes down – and with the exception of a new car every 5-10 years – retirees have made most of the major purchases that they will make in their lifetime. If you think about it, if the result of the Baby Boomers moving into their peak earning and spending years starting in 1991 creates the best 10 years of growth in U.S. history, what would be the likely results be when they begin to move into retirement? Shouldn't economic growth slow? It did. Shouldn't inflation go lower? It did. With lower inflation, shouldn't interest rates go lower? They did.

So here is our situation today: We have more competition domestically and internationally than at any point in history. This will make it hard for producers to raise prices. Over time, the amount of global competition will do nothing but increase. Due to technology, Just-in-Time Inventory, Manufacturing and Delivery have done nothing but get better – and will continue to improve. Automation – whether it is a machine that makes a product better and faster and cheaper than humans – or computer algorithms that replace humans (again, think travel agents and Turbo Tax replacing you tax preparer) – the number of machines and algorithms that exist and that will be created will do nothing but increase over time, actually reducing the price of many things we buy. Then there is the power of the consumer: For example, you can download an application (App) on your smartphone which you can use to scan a QR code at the store and the App will tell you where you can get the same product at a lower price. The backbone of every supply chain is trucking. Today, a big part of the price inflation that we are seeing now due to supply chain issues is just that! We don't have enough truck drivers. Most people don't want to do that type of work anymore.

Well, hold on to your hat! This is going to change rapidly over the next several years and it's going to start happening in a big way in 2022. According to *Go By Truck News*, a trucking industry trade publication, by the end of 2022 – this year – 188,000 autonomous, driverless tractor trailers and buses will have been sold. Transport companies and retailers that have their own trucking divisions (think Walmart and McDonald's) will be spending \$35 billion dollars on these vehicles this year alone.

These autonomous tractor trailers will do it better and faster – from the Port of Los Angeles to Baltimore in 2.3 days versus the current 4.84 days - (law requires that humans can only drive so many hours a day and then they have to stop and rest) and cheaper and with fewer accidents than humans. It's happening even as we speak. So much for the weakest link in the supply chain.

Auto manufacturers are forming joint ventures with Asian computer chip manufacturers (it takes 6 months to make a computer chip) to build chip manufacturing plants in the U.S.. When we had the economic shutdown in the spring of 2020, many people were forced to work from home, so sales of laptops and PC's went through the roof. Kids had to stay home from school and sales of X-Boxes and other games went through the roof. All of these things require computer chips. At the same time, sales of automobiles (which require computer chips) went way down. Like any other business, computer chip manufacturers (88% of all computer chips are made overseas) shifted production from what wasn't selling (cars) to what was selling (computers and video games). When the economy began to open up in the U.S. and people started shopping for cars again – Oops! – There was a chip shortage and it takes six months to make a chip! – Car manufacturers couldn't deliver a finished product because of a lack of a little computer chip. You can rest assured that U.S. auto manufacturers will never be caught with their pants down ever again! Once chips start flowing again, the supply of cars will go up and prices will begin to move back down

I started out this section on inflation by saying the following: Most – not all – of the price inflation that we have seen is the direct result of supply chain issues. The supply chain issues that we have experienced are the direct result of Covid-19. It is therefore reasonable to believe that if and when we move past Covid -19, the supply chain issues will be resolved and the current imbalances between supply and demand will level out and most prices will fall. Even if Covid-19 becomes a permanent part of our daily life, the things that I've mentioned above will still happen, keeping inflation in check.

The other thing I said was this: I have researched the various times that we have experienced significant inflation since World War II and the circumstances that led to those bouts of inflation. The factors which led to the inflation that we experienced over those many decades simply don't exist in today's world. And they don't. Please remember that price inflation is a political hot potato and it is unlikely that politicians from either side of the aisle are going to give you the real skinny regarding inflation.

## A Few Words About Electric Vehicles

I think that the whole electric car “thing” is going to happen a lot faster than most analysts are predicting. First, a background on all new innovations. When any new innovation comes along, prices to the consumer tend to be high and initial producers have very little competition. As more people buy the product, entrepreneurs, looking for a piece of a growing financial pie, begin to provide competition. They improve on the previous product to set themselves apart so that they can gain market share. As time goes by and more consumers are able to afford the product in question, more competition sets in, products get better and prices continue to fall.

I remember a television commercial in 1984 for Faberge Organics Shampoo with wheat germ oil and honey. The model, Heather Locklear, said “When I first tried Faberge Organics Shampoo with pure wheat germ oil and honey, it was so good I told two friends about it and they told two friends and so on and so on and so on.”

To visually illustrate the power of compounding, every time Heather Locklear said “and so on...” her image on the screen doubled. Pretty soon many images of her face filled the television screen. It was a very effective illustration.

To provide a personal anecdote to reinforce the idea, in 2006 my wife and I renovated our home. We gutted the house down to the original studs and floor joists. As we approached completion of the project, we agreed that each of us would allow the other one decorating indulgence. I have never been one who needed to be “the guy” who is the first on the block to get the newest toy. Far from it, I had always preferred for prices to come down significantly before I would make any such purchases.

So here was my one indulgence. Please remember that this was back in 2006. I had never seen in anyone’s home, but I had seen at the electronics store, the brand new 55-inch plasma televisions. I said to myself, “I got to get me one of these!” Here was my chance without getting in trouble with my wife. I bought it! Cost? It was \$5,500.00! I couldn’t believe I did it! Today, you can buy a much better 55-inch T.V. for less than \$400.000!!!

So, I invited my friends over to watch the Super Bowl on my brand new TV. None of them had ever seen a football game on a 55-inch screen. They marveled at the quality! Some of them said, “I got to get me one of these!” Some of them did and invited others to their home to watch something on their new TV. And so on and so on and so on.....

The truth is, most people in our country have never been in an electric car. They have no idea how incredibly fast – they are like rocket sleds on wheels – nor how quiet they are. They have no idea that electric cars have 98% fewer moving parts than do piston driven cars. In the past month, 60 Minutes did a segment on electric vehicles. Leslie Stahl was interviewing Dr. Herbert Diess, Chairman of the VW Corporation. Like most major auto manufacturers, VW and the brands that VW owns (such as Porsche) are moving production of their products to electric in a very rapid fashion. Like most Americans, Leslie Stahl had never been in an electric vehicle before. So they are driving along slowly and without her previous knowledge and consent, Dr. Diess slams the accelerator pedal to the floor. Her head snaps back and she screams! Zero to 60 miles per hour in just 3 seconds!

As a practical matter, the costs of a nice electric car are now achieving price parity with nice piston driven cars. I am on the waiting list for a 2022 Kia EV6 GT. Its electric motors generate 550 horsepower and it goes from Zero to 63 MPH in 3.2 seconds. It is a gorgeous and very comfortable car! The driving range is 310 miles on one charge. When I take delivery sometime later this year, I will invite all of my friends to go for a ride, most of whom have never been in an electric car. I will give them the same experience that Dr. Diess gave to Leslie Stahl and I can just hear them say, “I’ve never been in a car that is this fast and quiet in my life and it is gorgeous and comfortable!” “Scott, how much does it cost you every month to charge your car?” “About \$45.00 per month”, I will say. To which I think they will say “\$45.00 a month? I am spending over \$50.00 per week on gas!” “Are you kidding me?” To themselves, some of them will certainly say “I got to get me one of these.” And some will. And then they will take their other friends out for a drive and so on and so on and so on. Competition will increase, the cars will get better and prices will continue to fall.

I have had people make the following comment to me: “What good does it do if the electricity used to charge the car is produced by oil or coal?” My response is always the same: “The average U.S. consumer will not care what produced the electricity. They will care about saving \$150.00 per month or almost \$2,000.00 per year!”

As a practical matter, 84% of U.S. workers commute to work by car. The average commute is 16 miles each way or 32 miles a day or 160 miles per week. The average range today for an electric car is 194 miles per charge. Most commuters could charge their cars on the weekend. The cost of \$45.00 per month to charge your car is if you have a home charging station. Many stores on the highways, like Wawa and Royal Farms have charging stations where you can charge for free.

I have had other people say, “Well what if I want to take a long road trip?” The number of charging stations across the country will continue to grow to keep up with the demand. Over the near term, if you don’t want to be troubled with planning your route using the charging stations that are currently available, you can always rent a piston driven car for your trip and you’ll still be saving money.

As of 2020, there were 286.9 million registered cars and light trucks in our country. In 2021, 14,926,000 new cars and light trucks were sold in this country, 607,600 of which were fully electric. Sales of electric vehicles doubled from 303,800 in 2020 to 607,600 in 2021. I have never been one who has been prone to making predictions, but I would not be surprised if within five years if at least 50% of all new vehicles sold in this country are electric.

For reasons that are not apparent, this could be very good for our economy. When we had the Great Recession, the average monthly decrease in spending on a per person basis in this country was \$150.00. Moving forward in time, if the average person has \$150.00 more per month to spend on things other than gasoline, it stands to reason that that would be very good for the broader economy.

### **A Few Thoughts on the Fed**

When we had the Housing Bubble, Financial Crisis and Great Recession, severe damage was done to the economy as well as to the banking and financial system. Ben Bernanke was the Chairman of the Federal Reserve. Prior to the crisis, the primary tool used by the “Fed” to either slow the economy down or to speed it up, was the raising or the lowering of the Federal Funds interest rate. This is the rate that banks charge each other for 24 hour loans to meet their reserve requirements. This rate is determined by the Federal Open Market committee, which has eight scheduled meetings per year.

In 2008, Mr. Bernanke and the Federal Open Market committee, for the first time since its creation in 1913, lowered the Federal funds rate to a target range of 0% to .25%, where it remained for seven years until their December 2015 meeting when they raised the rate by .25%. At the time, the speculation regarding the timing and degree of future interest rate increases was rampant. It seemed that nearly everyone in the financial world was questioning the wisdom of these rate increases at the same time believing that rapid growth and inflation were sure to soon follow.

After all, the thinking went, the economy would certainly return to its historic norms as would interest rates.

During this same time, I reminded my clients of all of the damage that had been done to the economy and the banking system. I reminded them of the likely lower rates of growth for our economy in the future due to the Baby Boomers retiring and a general population that was simply growing older and to the improving but still fragile nature of the economy and banking system. I reminded everyone with whom I spoke that prior to the Great Recession, raising and lowering rates was the Fed’s primary tool for modifying economic activity.

I suggested that the Fed would, very gradually and over a long time frame begin to slowly raise rates. If they did it too quickly, that would have the unintended consequence of slowing the economy down, which would be contrary to their stated objectives of trying to speed things up. That left just one reason for them to raise rates up at all – so that in the future when we got to the next economic downturn, they could lower them!

The Federal Open Market Committee waited one year until their December 2016 meeting before they raised rates again by .25%. There were only three .25% rate hikes in 2017 and only four .25% rate hikes in 2018. The Federal Funds interest rate ended up at a target of 2.25% to 2.50%.

There were three .25% reductions in 2019, taking the target range down to 1.50% to 1.75%. In 2020, when the shutdowns began, between their March and April meetings, the Federal Open Market Committee quickly lowered rates, for only the second time in their history, to a target of 0% to .25%.

In March of this year, the Federal Open Market Committee raised short-term interest rates by .25%. Once again, rampant speculation has resumed regarding the timing and amount of future rate increases, creating volatility in the stock and bond markets. Last time, the Housing Bubble and Financial Crisis caused significant damage to the broader economy as a whole well as to the banking and financial system. This time around, damage was pretty well limited to the leisure and hospitality sector of our economy (which accounts for only 4.1% of our country's entire economic output) with no real damage done to the banking and financial system.

It stands to reason that the Federal Open Market Committee can raise rates more quickly than before because very little damage was done to the economy. The most recent speculation is that the Fed will begin to aggressively raise rates  $\frac{1}{2}$  of 1% at a time to try to reduce the current levels of inflation. It certainly makes sense for the Fed to raise rates so that they have the ability to lower them when we have the next economic downturn at some point in the future. As I mentioned before, most (not all) of the price inflation that we have seen over the past year or so have been due to supply chain issues. I believe that most of these supply chain issues – and it will vary from industry to industry – will be well on the way to being resolved within the next six months or so. As they do, supply will increase to meet demand and then prices will begin to fall (without the Fed having to do anything) due to unparalleled competition for consumer purchases. As producer prices begin to fall, to capture your business from their competition, producers will have to lower their prices. Only one business gets the sale, not three.

Because most price increases are due to supply chain issues and not because the economy is growing too fast, should the Fed engage in a series of  $\frac{1}{2}$  of 1% increases in their effort to combat inflation, they run the risk of slowing the economy down. The problem with that is that our economy shrank in the first quarter of this year at an annualized rate of -1.40%, the first such economic contraction since the second quarter of 2020. The contraction in the second quarter of 2020 due to the Covid-19 shutdowns was the sharpest in U.S. history.

It doesn't make sense to me that they would run the risk of slowing the economy down further in an effort to quell inflation when most of the price inflation is due to supply chain issues that will resolve themselves in the next six months or so. Time will tell.

## Ukraine

I was almost finished writing this report at the end of February when Russia invaded the Ukraine. The section on electric vehicles and the Fed are thoughts that developed for me in March and April. Because of the invasion, I stopped writing altogether. I was hopeful that a clear picture of what might transpire in Ukraine would reveal itself sooner rather than later. Because I wanted the other parts of this report to remain timely, I decided in the last week of April that I simply had to get it done, even though it is not at all clear to me at this point in time what the end result will be in Ukraine.

Preliminarily, it seems likely to me that the war will remain regional and conventional in nature. The resolve of the citizens of Ukraine has been remarkable. The men and women there who are fighting and dying for their country and their freedoms is inspirational. The international response has been swift and unique. It is unprecedented for historically neutral countries such as Switzerland to unilaterally impose sanctions (on Russia). For companies across the globe (such as McDonalds and Apple) to shut down operations in Russia is also unparalleled. The sanctions appear to be having some effect. It has been estimated that Russia's economy has contracted by some 50% since the invasion began.

It occurs to me that Mr. Putin has three groups of people within his country to think and worry about in his decision making regarding the Ukraine. The Oligarchs, the Kleptocrats and the average Russian citizen. All three groups will have limitations with regard to how much financial pain they will be willing to suffer. My biggest assumption is that, above all else, he wants to remain in power. If that assumption is correct, then it would make sense to me that if Russia can control the Donbas region, creating a land bridge between Crimea and mainland Russia, Mr. Putin will claim victory and relinquish any other expansionary goals that he may have had.

I hope that the members of the free world will continue to support the Ukraine in their fight for freedom. While I fear that the war will be long with ongoing loss of life, I pray that the support of freedom-loving people from around the world for the people of Ukraine, will greatly shorten this horrible conflict.

As always, I thank you for the privilege of your time. I hope it was well-spent.

Yours most sincerely,



Scott W. Eglseder

Note: Unless otherwise indicated, Bloomberg is the source of the information contained in this report. All indices are unmanaged and investors cannot actually invest directly into an index. Unlike investments, indices do not incur management fees, charges or expenses. Past performance does not guarantee future results.

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