Stewart Financial

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Thoughts that count

Nutritional Knowledge

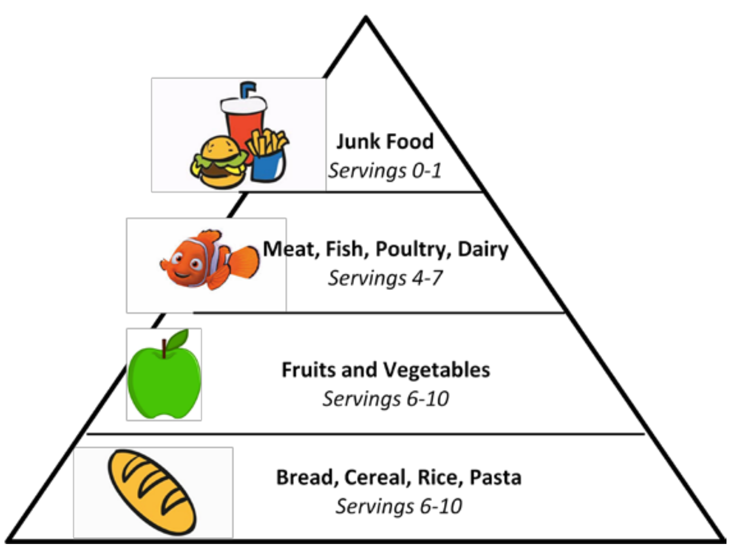
Beginning August 2017, the city of Chicago introduced a special tax on all sugary beverages sold within the city limits. The new tax raised beverage costs by as much as 20% and residents began protesting immediately. Chicagoans held rallies, organized petitions and launched lawsuits in an attempt to communicate their hatred for the new tax scheme. Chicago retailers reported beverage sales immediately declined 50%, but not because people were consuming less soda; they were just buying their drinks outside the city limits where the new tax didn't apply. Due to the angry response the special tax had an extremely short life. It was repealed 70 days after becoming law.

Chicago's 'soda tax' was introduced with good intentions. Politicians were simply trying, though perhaps in a heavy handed way, to address the epidemic of childhood obesity currently facing the developed world. According to the Chicago Department of Public Health, an astounding 37% of Chicago's kindergarten students are severely overweight or obese. This rises to almost 50% by 9th grade. In contrast, the prevalence of obesity among American children in 1980 was below 7%.

Never in the history of the world has so much time, effort and money been spent on convincing people to be healthy with their own bodies. The vast majority of people know which activities are associated with good health (eating responsibly and exercising regularly) and those which are harmful (eating too much and leading a sedentary lifestyle). However, even with the enormous effort expended on education and behavior modification programs, the prevalence of childhood obesity continues to accelerate. How can this be?

A large part of the answer has to do with how humans make decisions. There are two components inside our heads which help us make decisions; emotion and logic. Whether we like it or not, human brains are first saturated with emotion before allowed to consider logic. We make decisions first with emotion and use logic as a justification after the fact. This is almost always an unconscious process, but it is extremely powerful.

Emotion is the junk food of the healthy eating pyramid; consuming it feels good but is supposed to make up the smallest part of our overall nutrition. Decision making based primarily on emotion, is akin to maintaining a diet primarily of hamburgers and fries; it is going to feel good for a while, but eventually we will have to pay the piper.



When it comes to evaluating the health of the economy we face a similar phenomenon, though it's not as obvious as the results of poor eating habits. Economic health can be measured by many thousands of data points, but some are far more important than others depending on what we are trying to ascertain. Generally, we can divide data into two camps; *soft data* and *hard data*. *Soft data* is generated by asking groups of people how they feel about specific things and then aggregating the answers to form a picture. This data is a mixture of opinions, suggestions and interpretations (example: surveys). Here human emotion is at its highest potency; *soft data* directly accesses our mood, a purely sentimental phenomenon. *Hard data* on the other hand does not include feelings; it is statistical, quantitatively measurable and objective (example: percentage profit growth). In other words, it is logical.

Both *soft* and *hard data* are important, but neither gives a whole picture on their own. Furthermore, it is highly common that individuals disagree about which specific data points are most meaningful. Even veteran investors will have difficulty ordering information into levels of importance. But here is the critical point; perceived shifts in the economy are typically marked by a change in the type of data focused on. When investors are feeling optimistic about the future, they tend to look to *soft data* for confirmation. However, when we become more pessimistic, we turn to *hard data* to get a more logical reading. This is typically evidenced by a change in messaging in the political arena, media and economic/investment periodicals. A collective change in interest to *hard data* from *soft data* is like recognizing we need a diet. The bingeing of junk food (and emotion laden data points) eventually causes us to re-evaluate our nutritional regime.

Over the past few years, both *hard* and *soft* data have been telling the same story; the economy is pretty good. Not great, but good. Over the past few quarters however, a divergence has emerged.

Six months into 2018 and most *soft data* suggests positive economic growth continues around the world. One of the most important ways of obtaining *soft data* is through surveys. Three of the most important formal survey examples are manufacturing surveys (asking purchasing managers if their businesses are growing), confidence surveys (asking consumers if they feel safe enough to make large purchases) and stock markets (asking investors how confident they are their investments will increase in value over the short term). The vast majority of these *soft data* points show that, economically speaking, things are good. Manufacturing is vibrant, consumers are still buying big ticket items and the stock market has been quite resilient given the recent flow of troubling headlines.

Some of the more important sources of *hard data* are the pace of bank loans (are banks giving money to individuals and businesses who need additional funds), retail sales (is the volume of consumer consumption increasing; consumer spending is 2/3rds of GDP) and wage growth (are workers making enough money to keep consuming). As of the last 12 months, *hard data* has been telling a far more pessimistic story than has *soft data*. Bank lending has fallen to a level last experienced in 2011, retail sales have been disappointing in most categories and wages have not kept up with inflation for several years.

The first six months of 2018 have seen a re-emergence of some of the volatility that was missing during 2017. The Canadian and US markets have increased slightly, while International markets and bonds have lost money. Partially taking our cue from the signaling from *hard data*, we are conservatively positioned. Thanks largely to record setting low interest rates, the economy has gotten overweight. There are many reasons to be optimistic about the future, but we need to stay cautious for the near term. The economic cycle follows one of the most reliable patterns, and after 10 years of growth we need to stay alert.

Your *admittedly enjoying too much ice cream this summer* investment advisor,

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