Perspective

A Virtuous Circle: The Minimum Wage and Quantitative Easy

What Goes Around Comes Around

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A Virtuous Circle: The Minimum Wage and Quantitative Easy

If there has been a common economic theme in recent years it has been the wealth disparity in America and ways to correct it. A number of ways have been suggested to get the country going in the right direction. For example, quantitative easing had at its core, the belief that monetary policy could put enough free money in the hands of financial institutions that those bodies would find ways to lend such money to deserving corporate clients who would get the economic engine going with individuals in the train behind it on for the ride. While unemployment has declined, the engine is certainly not pulling its weight or at least the weight of all of its potential passengers. The failure of the availability of free money and low-rate policy to fundamentally raise the poor up the economic ladder resulted in a steady drum beat for all companies of all sizes to finally step up and offer all their employees the natural right of a minimum wage. Other took up their own drums to bang on their own personal policy prescription to redress the lack of economic growth or the failure of society to promote greater economic equality; free junior or college education, free job training, free this or free that.

Once being an academic, I have been taught to question anyone when the word “Free” is brought up. In economics we even have the word, Pareto Efficiency, for an event in which at least one person wins and no one loses. For such an event or economic policy, there would seem to be no one who could ever object. Unfortunately, in all my years of economics, Pareto Optimal events were like Lewis Carroll’s Boojum, the mythical beast who could never be found and if found, it’s finder would vanish such that the event was never recorded.

With policies such as quantitative easing and minimum wages (as well as other free effort to reduce wealth disparities), had the various supporters actually discovered the mythical Boojum beast and returned to tell the tail. Was quantitative easing Pareto Optimal, is raising the minimum wage Pareto Optimal, is free this and free that Pareto Optimal or am I simply PO’d. I understand the desire for simple solutions to difficult problems. I understand the concern that individuals, for whatever reason, should be entitled to a basic wage which covered their basic cost of living (housing, food, …). I understand the hope that every individual should have a job and that firms should be funded such that such job growth

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in encouraged and if the youth is not prepared for those jobs, there should be a form of funding to make sure that they are prepared for such opportunities when they arrive. I also understand the desire for the existence of unicorns and blue fairies. I only question if the word “Free” should be associated with the process or that the impact on other individuals in society is well thought out, as to see who the winners or losers are. One needs to make sure that of us knows that when we support a policy which benefits us it often comes at the cost to others. In short, I should know who has the right to be PO’d in the short run and who is getting a “Free” ride at a cost to others.

As I understand the argument, the problem is who is to pay for the minimum wage, who pays for the free money to corporations, who covers the costs of free college. The answer from the pro free camp was simple. There are no negative impacts. In fact, since more money finds its way into the hands of poorer people (leaving aside teenagers from wealthy families who take lower pay summer jobs etc.) more money will find its way into the economy raising demand for a wide range of other services. In short, there is no negative impact, more minimum wages means more money, more money means more demand, more demand means more products being sold, more products being sold means higher wages for all – the virtuous circle. Similar arguments were made for money making its way into financial institutions, corporate coffers and students’ college accounts.

What surprised me was that no one from the ‘anti-minimum’wage side, television newscasters, monetary economists, or hardworking taxpayers did not at this time fall down laughing or at least go to the blackboard to show the fallacy in the underlying argument that if a little was good a lot had to be better; that is, for minimum wage if $15 why not $20 and if $20 why not $30. If fact why not simply hand out $ bills based on how many currently reside in one’s bank account. Print little Washingtons until the world is awash with pictures of George. If a little bit of money in financial institutions helps grease the wheels of commerce why not a lot of grease? If free college is the source of higher educated students, free education for everyone seems the reasonable follow up.

Unfortunately, my college professor, Father Vincent Tegador’s face looms in front of me and his voice echoes; there is no free lunch. In his mind the story is told in the simple.

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MV=PQ

Where money = money, v=velocity, P=price and Q equals quantity

So while we all know there is virtue in providing “Free” stuff to others, we should at least know there is a cost to being virtuous, In short follow the virtuous circle for its eventual return home with the knowledge that no good deed goes unpunished.

1) Just print more money for everyone, drop it from planes and while there may be some cost in the production of George Washingtons it would be minor compared to its face value However, soon the circle turns. In short in money goes up with no change in V or Q, prices have to rise to equate the rise in M such that the real value of money stays the same (the poor stay poor in nominal terms (Venezuela all over again). Ok some may to a little better if some goods do not rise in price as fast as others or if you can grap more of the dollars than others do or if those who do grap it put it to better use in raising the growth of Q than the Growth in Money but you get it). So simply printing money does not do it except in stories repeated in fairy tales (see Lewis Carroll).
2) What of just increasing the money that banks hold and who then can lend it out to those well deserving who will get this engine going. Well, I remember the second law of my Professor’s econ course. The banks create the money. In short, if a bank gets an additional dollar in reserves, it can lend it) out to someone who can take a portion of it to create something (let us say Q) and on and so on. The issue here is that the source of this increase in bank reserve is not created by merely handing banks more money (see answer to number 1). The Fed has different avenues to do this (change reserve requirements or buys bonds from the bank or others who would put the money in a bank) which results in banks having more cash while the Fed holds the bonds. Now here is the rub, in the case of the bond repurchase what you have done is simply switch the bond (held by someone) for cash and in the process often having to pay a higher price for the bond to convince them to switch. The next question is what will individuals or banks do with this cash? Having more M does not lead to greater Q unless those who give up the bonds to get the cash are better at increasing Q then where the money was held previously.

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If in addition, ones puts increased regulation on how and who can get that new cash (see Dodd Frank) it is even possible that growth in Q might decrease as the money is either not lent out or is simply placed in purchasing other financial assets from others thereby raising the price on financial assets (stocks and bonds –lowering yields) such that those the wealth of those with financial assets value increases while those negatively impacted by lower yields or higher financial prices lose.

3) OK let's give the money directly to those who you think deserve it. I know you could raise taxes on everyone to simply transfer wealth and hope that those who get it will do a better job of it then those you took it from but that is hard even if you control congress. To lessen the scale of those paying, you can tell a firm to increase minimum wage so Bill gets another dollar in the bank but Jim, Bill's boss may have to take a dollar out of the bank to pay Bill. Now Walmart may can if Bill buys something a Walmart but BMW may lose if Jim now buys a Chevy and so on and so on. In short no gain. Just a transfer of wealth, so in time Jim may just hang it up close his firm, take the cash out of the bank, forcing the bank to call in loans from other firms and soon all the economy is in freefall. Even worse, Bill has been convinced of an economic fallacy but a political reality; that he should be paid a salary not based on his productivity or value to the firm, but on his ability to elect a politician.

4) The other forms of "Free" money are just as deadly. What if the U.S. Government wants to cover the cost of college etc? It can borrow money from Betty (give her bond as proof of U.S. debt), and give the cash to Joe our college student). Ok Betty's dollar is no longer used to buy something at Walmart but maybe our new student will - Results Student +1, Betty -1. Walmart 0. This also works if the U.S. bond is bought by someone in China (put China's name in place of Betty and redo story.

In short, there is no simple way that increasing the minimum wage by fiat, jump starting the economic with "free money" through banks, or providing free money to some by simply borrowing it from others without a host transfer effects that that even in the case that somehow you have "chosen wisely" (see Harrison Ford's choice of the right chalice among many in the Raider's of the Lost Ark) and found someone who increases global the real value of Q. Now wealth transfer by itself is not a bad thing. But call it what it is. I am taking money from others (the individual who keeps his money in low yield bank

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deposits, the truck driver whose son or daughter does not go to college and thus does not receive the "free money". It works as long as there are enough people willing to give or who will not react politically if forced to give.

So maybe the virtuous circle is not that virtuous, at least the next time you go to McDonalds, and see the owner, just feel a little guiltier as you order the beef with extra cheese. You and your waiter win at the expense of the owner so say a little thank you. Oh, by the way, you have a better choice. If you think the poor food provider, stock boy or girl etc. deserves a house, food, and education, just let the market determine the proper price and let us all pay up the difference through higher taxes and direct payments. The workers are not led to believe that they are really worth $15, and they will know the money he or she is getting is really a gift from others (they could send a thank you card to all of us). And oh yes, in addition to the low wage worker learning to face the reality and risk of their situation the financial market may also actually start to reflect the risks involved in their world.

Remember Virtue has its own rewards and should not come from forcing others to give when we ourselves refuse to share. Sometimes, the virtuous circle should return home.

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Perspectives

Hedge Funds: Why Not Just Bonds

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Hedge Funds: Why Not Just Bonds

In an earlier blog, I questioned those who focused on hedge fund fees and used the S&P 500 as the benchmark for hedge fund performance. In brief I pointed out the that oft quoted 2 and 20 performance fee was in fact a rarity among institutional investors and the comparing hedge fund strategies with the S&P 500 flew in the face of 70 years of financial theory in which the risk return characteristics of a strategy should be compared directly only with similar return/risk strategies. Now there are many reasons for institutions or individuals not to invest in hedge funds including lack of liquidity, lack of transparency, internal costs and similar concerns. There may even be better more liquid, more transparent assets with few internal management costs that may be reasonable alternatives to hedge funds.

The benefit of the "WHY NOT JUST ABOUT ANYTHING ELSE" approach to hedge fund alternatives is that they often use historical data to find some asset that for some time period, in some way, based on some performance measure seems superior to hedge funds as an investment alternative. Often the relative benefits of these investment alternatives are based on their relative performance when added to an equity portfolio. In a recent blog, a well-known blogger even suggested that fixed income bonds may be regarded as a more suitable alternative to hedge fund investment. This blogger cited an earlier Vanguard study that suggested that for the period of the Vanguard analysis (11/2007-12/2011), the correlation of various hedge fund strategies increased relative to a traditional stock/bond portfolio and the performance of hedge funds relative to this portfolio did not warrant investment in hedge funds. As a final sidebar, the blogger's final nail in the coffin of hedge fund investment was that he maintained that for long term investors, for whom he said have little concern over risk, why waste one's time with low risk\low return hedge funds.

Where to start? First yes, for many hedge fund strategies the return correlation of many strategies with a stock and bond portfolio have increased in recent years. Many hedge fund strategies have the lowest correlation with traditional stock and bond investments should be in periods in which their diverse sets of strategies actually offer an alternative. When stock and bond investments are doing well, one would hope their correlation would increase. In any event, correlation is a poor statistic to actually measure the potential benefits of a strategy relative to stock and bond investment. In the Vanguard study the correlation in the later period was based on less than thirty-six months of monthly data. A single period with such limited data points almost proves nothing. One single month can dramatically impact reported results (Schneeweis, 2013). Please enough with the monthly correlation results (especially over short time periods). Now never do this; that is what I am about to do. I am going to use historical data to prove a point. Why? Because the historical past may not reflect the expected future returns or risks of current investment strategies. Still we continue to do it and the following Table's results are based on the historical returns of a series of traditional set investments (S&P 500, Barclay

Aggregate Bond Index of an equal weighted portfolio of the S&P 500 and the Barclays Aggregate Bond index) and a series of CISDM hedge fund indices (equal weighted portfolios of reporting hedge fund managers). But in the following Table the correlation of most of the hedge fund strategies with a standard equal weight stock and bond portfolio were lower in 2013 than in 2008. So how about that? How about it? Are some hedge funds better now? Garbage – It proves nothing. You tell me the market environment and I will tell you which strategies had higher correlations with a stock and bond portfolio and which probably did not.

2001-2013	S&P 500	BarCap U.S. Aggregate	Equal Weights SP500 and BarCap Aggregate	.90 EW SP500 and BarCap Agg. Port. And .10 EW CISDM HF Indices	EW CISDM HF Indices	CISDM Equity Market Neutral USD	CISDM Convertible Arbitrage USD	CISDM Event Driven Multi-Str USD	CISDM Merger Arbitrage USD	CISDM Distressed Securities USD	CISDM Equity Long/Short USD	CISDM Global Macro USD
Annualized Return	4.65%	5.24%	5.30%	5.44%	6.53%	5.43%	7.14%	7.25%	5.00%	9.13%	6.00%	5.50%
Annualized Stdev	15.54%	3.60%	7.78%	7.29%	3.76%	1.95%	5.84%	5.85%	2.86%	5.57%	6.05%	3.19%
Sharpe Ratio	0.16	0.87	0.41	0.46	1.17	1.69	0.86	0.88	1.01	1.26	0.64	1.06
Maximum Drawdown	-50.95%	-3.83%	-27.11%	-25.53%	-11.93%	-2.79%	-22.47%	-20.19%	-5.65%	-21.22%	-17.21%	-2.60%
Correlation With EW STK/Bond Port.					0.74	0.49	0.53	0.74	0.62	0.65	0.77	0.33
Breakeven Return					3.3%	2.5%	3.4%	3.9%	2.8%	3.6%	4.0%	2.5%
2008	S&P 500	BarCap U.S. Aggregate	Equal Weights SP500 and BarCap Aggregate	.90 EW SP500 and BarCap Agg. Port. And .10 EW CISDM HF Indices	EW CISDM HF Indices	CISDM Equity Market Neutral USD	CISDM Convertible Arbitrage USD	CISDM Event Driven Multi-Str USD	CISDM Merger Arbitrage USD	CISDM Distressed Securities USD	CISDM Equity Long/Short USD	CISDM Global Macro USD
Annualized Return	-37.00%	5.24%	-17.94%	-17.16%	-10.02%	0.61%	-19.11%	-19.04%	0.09%	-19.54%	-14.43%	3.71%
Annualized Stdev	21.02%	6.09%	11.91%	11.33%	6.96%	3.00%	14.35%	10.62%	5.57%	10.99%	8.58%	2.43%
Maximum Drawdown	-37.66%	-3.83%	-19.86%	-19.00%	-11.17%	-2.79%	-22.12%	-19.04%	-4.87%	-19.75%	-15.27%	-1.40%
Correlation With EW STK/Bond Port.					0.86	0.36	0.84	0.83	0.86	0.84	0.69	0.03
2013	S&P 500	BarCap U.S. Aggregate	Equal Weights SP500 and BarCap Aggregate	.90 EW SP500 and BarCap Agg. Port. And .10 EW CISDM HF Indices	EW CISDM HF Indices	CISDM Equity Market Neutral USD	CISDM Convertible Arbitrage USD	CISDM Event Driven Multi-Str USD	CISDM Merger Arbitrage USD	CISDM Distressed Securities USD	CISDM Equity Long/Short USD	CISDM Global Macro USD
Annualized Return	32.39%	-2.02%	14.08%	13.49%	8.25%	6.02%	7.54%	13.29%	4.75%	9.89%	14.66%	2.05%
Annualized Stdev	8.48%	3.19%	5.01%	4.69%	2.07%	1.22%	2.15%	3.42%	1.34%	3.32%	3.66%	2.38%
Sharpe Ratio	3.79	-0.72	2.76	2.82	3.85	4.73	3.39	3.81	3.36	2.90	3.93	0.75
Maximum Drawdown	-2.90%	-3.66%	-1.70%	-1.56%	-0.70%	-0.01%	-0.70%	-0.96%	-0.27%	-1.29%	-0.82%	-2.00%
Correlation With EW STK/Bond Port.					0.86	0.54	0.74	0.75	0.56	0.76	0.86	0.56
Breakeven Return					5.2%	2.1%	4.6%	7.3%	2.3%	7.3%	8.9%	3.9%

The above provides historical return and risk comparisons for the period 2001-2013 as well as the years, 2008 and 2013. One does not have the time or space to point out all of the obvious comparisons, but please read my previous blog. For those who want a summary, these numbers indicate that hedge funds may (not will) provide relative return to risk benefits to very simple stock/bond portfolios.

Where is the hitch in the above? I do not care what these numbers say. They are monthly numbers and often from very short time frames. If one knows the hedge fund strategy one generally knows when that strategy will perform similarly to a stock and bond portfolio and when it may offer some returns benefits. In the following Table for the period 1994-2013, I have merely ranged the performance of the six hedge fund indices with the ranked performance of the S&P 500 and the Barclay Aggregate Bond Index.

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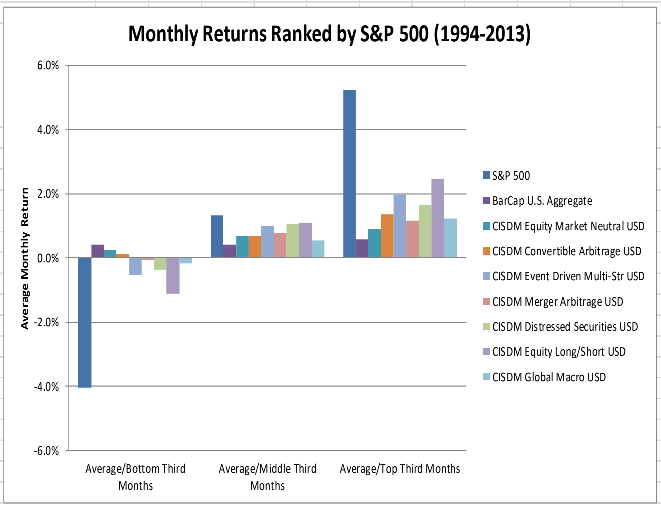
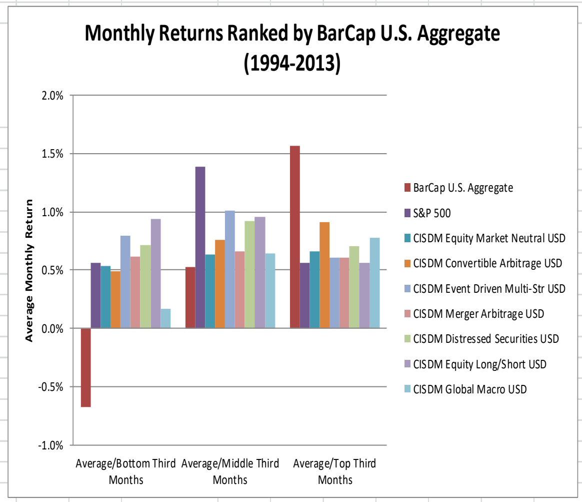
What do the results show? Well we have limited space here so let's concentrate on periods in which the S&P 500 has its worst/best performance and those periods in which the Barclay Aggregate Bond index had its worst/best performance. Let see how various hedge funds performed. The results show that in the worst months of the S&P 500, the various hedge fund strategies had somewhat similar performance to the Barclay Aggregate bond index and in the worst months of the Barclay Aggregate Bond index the various hedge fund indices had similar or somewhat superior performance to the S&P 500. In periods where the S&P had its best performance, the various hedge funds outperformed the Barclay Aggregate Bond index and in the periods where the Barclay Aggregate had its best performance, the various hedge fund strategies again had similar or better performance than the S&P 500. In short, in the past hedge funds have offered diversification benefits to investors in stock and bond portfolios. As to the future benefits of hedge funds, please check out the individual hedge fund strategies primary market factor determinants.





Why is potential risk reduction important? Well, the same blogger who was critical of the potential risk benefits of hedge funds, also maintained that if they did what they said they did (that is reduce risk), why use them. He maintained if one has a long term investment horizon risk the concern over short term risk reduction is less important. I had thought that the fallacy of time diversification had been finally but to bed, but I would again note that risk is not necessarily reduced just because it is measured over a longer period (increasing the investment period (e.g., from ten to twenty years) does not reduce risk (the expected variance of a twenty year period is twice that of the ten year period all else equal). As a final sidebar remember that long term geometric return is benefited if per period volatility is reduced (all else equal). As shown in both Tables, this is potentially provided by selective addition of hedge funds.

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Again, as mentioned in my the last blog, I understand the reluctance of certain large institutional players to invest in certain investment strategies which are not scalable enough to impact their bottom line especially given some internal and external perceived risks. There are many alternatives. But blindly rejecting hedge fund strategies as investment vehicles since one can always invest in fixed income (especially given the current rate environment) is not one of them.

I look forward to your comments.

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Perspective

The Last Wave: A Simple Proposal

An Economic Solution

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What I ask is simple. To work in my dotage and play in my youth. What of the cricket who wastes his\her youth in gay abandon only to continue into his golden years, to refuse to return to corporate prison?

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The Last Wave: A Simple Proposal

Not withstanding, MTV, rap music, and hats worn backwards, we, as the entire world, are growing older, both absolutely and relatively. By the year 2020, the number of Americans over 60 has increased by over 25%, in the UK the number will have grown from 25 to over 35 %. Other dramatic increases are found throughout the globe. Think of it, in many countries (UK. Ireland, France . . .) one-third of the population will be over 60. Already we support senior golf, senior tennis, as our population wave ages and crests, we can anticipate watching the elder tour complete with wheelchairs and loudspeakers for the hearing impaired.

What is to become of us as this wave finally washes ashore? Will can sellers outnumber umbrella salesmen on the sidewalks of New York. Will aged muggers grasp as often but miss even oftener. Meanwhile as the young become increasingly bitter over their role of care providers for this aging mass of humanity, what is to keep us from committing ageacide?

The solution may simply be in the old (no pun intended) idea of reversing the time of our participation in the work force. Simply put, one retires from twenty to forty and works from 40 to eighty. As one who has spent most of his twenties and thirties inside wishing to be outside, sailing, skiing, running looking forward to retirement only to find I could no longer capable. As an aged man of fifty I now find myself longing for the air conditions office, the three martini lunch, the three day trip away from my wife, children.

What I ask is simple. To work in my dotage and play in my youth. What of the cricket who wastes his\her youth in gay abandon only to continue into his golden years, to refuse to return to corporate prison? In truth, I see none of my contemporaries who desire to spend hour upon hour upon the park bench. Give them a duty, a task and watch their eyes light up. Moreover the youth would be

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relieved of the burden of learning specific skills only to have them no longer required as the age. If the aged learn this skill by the time they are no longer require, the aged are dead.

Surely, the thunder of the last population wave is really only a message. "to free the youth, free the aged”. Let the aging get off the golf course and back into the air condition offices where we belong.

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Perspective

STEM: For Dummies or

Beware Math Awareness Month

Thomas Schneeweis

December, 2019

In the end it all comes down to numbers

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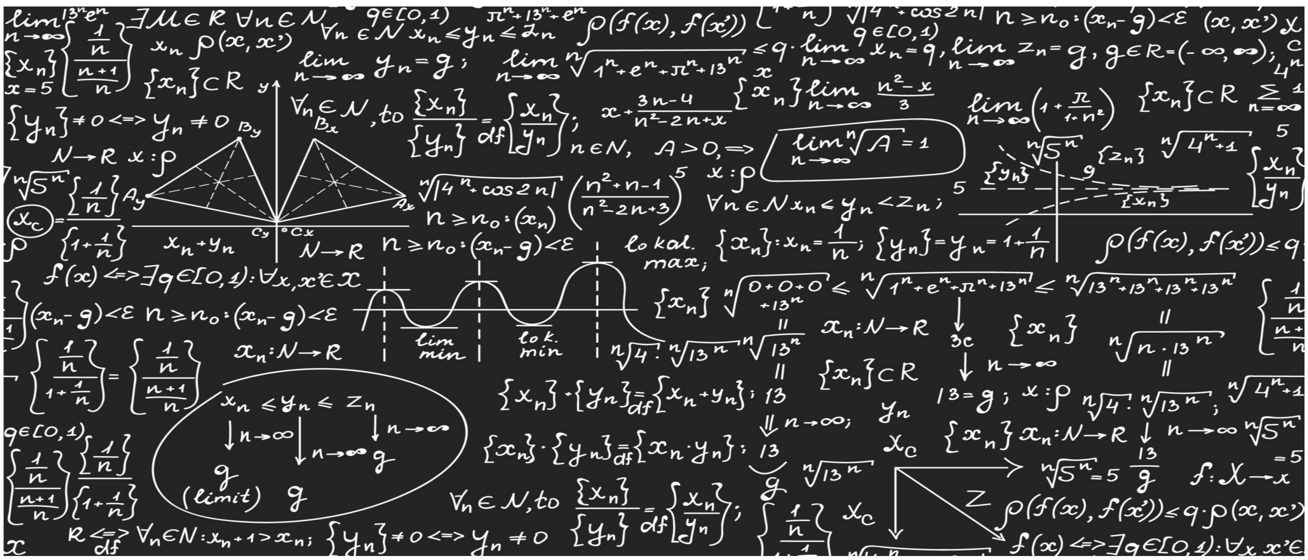
STEM: For Dummies

For many who read this article, I suspect they are hoping to find that STEM offers some information on 'How to Grow Something out of Something or 'Summer Offshoots…' For others who do not have a life, they may believe that we are trying to refocus us on the importance of new technologies and their impact on our lives or even to learn enough to carry on a conversation with their kids when they bring home their "Math Awareness Month' project. Note my kids did not expect me to have a discussion on any project they were prepared to do. They realize that we have created a World in Which we are simply no longer needed; We are not needed in Science (S), we are not needed in Technology (T), no one needs us in Engineering (E), and we are certainly not needed in Math (M). For others, such as myself, I left the dining room table with the full understanding that I was no longer needed as a parent.

This End of Life Scenario is the result of our own doing. We all carry with us the cause of this destruction – The Cell Phone and the World Wide Web. Want to know something about some disease, just Search for it. Want to Know How to run any new machine just go to WWW.UserManual.org. It is all there. Engineering or how does something really work. Simply Put no one cares. Look for a Car's Engine – I almost have no idea what I am looking at and some Cars (those with a long extension cord) don't even have one. Does anyone really understand how nuclear power works, Wind Power, or Solar Power? No one asks how they get started in the morning if there is no Wind, or No Sun (its dark at night) or if the Nerds at the local energy plant decide to go to a Nerds convention. This gets me to the real part of the story. We are never going to learn enough to be scientists, technology wizards or engineers but maybe, just maybe we can learn enough math to have a discussion with our kids at the evening repose. How hard can it be? A recent walk through Amazon produced a host of Math for Dummies Books but no Science for Dummies, or Engineering For Dummies, or even Technology for Dummies so obviously the “Word” is out.

What did I find out from my foray into the World of Math? I obviously am on the wrong Educational Channel. I should have been on the SYFY Channel. This stuff is from outer Space or at the very least Today’s Math is something entirely different from the old “One plus One equals” or even the X+Y= Z type of stuff. I was even ready to tackle a few [X*X]/(Dm) or somethings with little numbers above them but this is what I got.



The only answer is for me to open up my old ‘Boy Scouts in the Wilderness’ handbook and learn to start rubbing a couple of sticks together and wait for the Apocalypse. If all goes, as I fear it might, I really will be needed.

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