FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

Issue #27
August 13, 2021

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Woke Capital

If you want to start and operate a business, you need two things: capital (i.e., cash, which can be used to buy land and buildings, machinery, vehicles, equipment, tools, supplies, parts, inventory, etc. and to pay for operating expenses) and labor. Labor is plentiful (if the government isn't paying a lot of people to *not* work, as is currently the case) and thus relatively inexpensive. Capital (i.e., savings) is much more scarce, especially now when the national savings rate is low (due in large part to the Fed keeping interest rates artificially low since 2008) and most people don't have any savings at all.

Providing equity capital to a business (by buying shares of its common stock) is a much riskier proposition than just working for it as an employee. That's because if a business goes bankrupt, its employees merely lose their jobs; usually, they don't really lose anything. But common shareholders receive whatever is left over after all other creditors (employees, suppliers, bondholders, the government, etc.) have been paid. So when a company goes bankrupt, usually the common shareholders lose their entire investment.

Because of the scarcity of capital and the great risk involved in providing it, common shareholders are the owners of a company. They elect the board of directors, who have a fiduciary duty to manage the company for their benefit. Thus, historically, companies have tried to earn a profit, which usually results in dividend payments for shareholders and a higher stock price (so greater capital gains when shareholders sell). Over the long term, large company stocks have produced an average annual return of about 11%, with up to about 14% for small company stocks.

For decades, savers have relied on the stock market to help fund their retirement and reach their other financial goals, as stocks have been one of the only asset classes that produced a significant positive real (after inflation and taxes) return. This was a huge boon to investors (as well as to the economy, which used the plentiful and easy-to-raise capital to create products and services, jobs and wealth), as it reduced the number of years they needed to work and/or the amount they needed to save.

But since common shareholders get whatever is left over, any additional expenses that a company incurs (such as higher taxes, higher interest payments, an opulent new headquarters and excessive perks for management, or a rich premium paid to acquire another company) reduces what shareholders receive, making their shares less valuable and their dividends lower and less secure.

It's actually not that difficult for management and/or the board of directors to separate shareholders from some, much or even most of the profits to which they are legally entitled. That's because management's interests are usually not aligned with those of shareholders because they don't own enough (or any) common shares, where they would be at risk of loss. (Usually they own plenty of stock options, which do not require them to put any of their own capital at risk of loss.) Consequently, management—who works in the business every day and has more knowledge about it than anyone--has a tendency to use the business to enrich themselves at the expense of shareholders, who are anonymous and not present and thus can't see what's going on.

This model of corporate governance suffers from the same problem as political governance: concentrated benefits and dispersed costs. If management and/or the board of directors can find a way to use the company to benefit at the expense of shareholders, those benefits will be concentrated among a few, whereas the costs will be disbursed over many thousands or millions of shareholders. So management and/or the board of directors have a keen interest in featherbedding, whereas the average investor who owns a few shares of a stock index fund, which in turn owns stock in 500 or more companies, is not going to have the time, information, energy, analytical ability or financial incentive to evaluate the actions of management at any one of those companies, where he/she has no idea what is even going on.

This problem is even more pronounced when management de facto controls the board, such as when the CEO (who is supposed to work for the board) is also the chairman of the board (an egregious but common practice) and can nominate his cronies or unqualified airheads who will never ask any tough questions (especially if they want to keep their richly remunerated job as a director) as "independent, outside" directors.

Given my knowledge of this major flaw in American corporate governance and how much money it can cost my clients (and myself), I am sensitive to the many ways that corporate profits can be misappropriated before shareholders can receive them. One trend I've noticed that has become increasingly pervasive in recent years is management and/or the board of directors using a business (including its assets, employees and cash) to support political causes that have nothing to do with its business purpose. Bizarrely, 99% of the time, these (mostly large) corporations support policies (and politicians) that will ultimately increase their costs, regulations and taxes, and/or weaken property rights, and thus harm the shareholders that own them, in clear violation of the board of directors' fiduciary duty to shareholders.

For example, last year dozens of corporations donated hundreds of millions—perhaps billions—of dollars to Black Lives Matter, even as BLM supporters were looting and burning their stores (!). While no one can argue with the statement “black lives matter,” neither can one argue that the self-described “trained Marxists” who lead BLM would very much like to see these corporations nationalized or abolished and their shareholders wiped out (or even worse). Another example: Lululemon, which sells yoga pants for $180, invited its Twitter followers to an event on how to “resist capitalism” and “decolonize gender.” Talk about “useful idiots”!

A similar phenomenon is how most of the wealthiest Americans not only have leftist political views, but have increasingly been using their companies (which are also owned by millions of other shareholders) to promote them. These include Jeff Bezos, Bill Gates, Mark Zuckerberg, Warren Buffett, Larry Ellison, Larry Page, Sergey Brin, Michael Bloomberg, Phil Knight, Laurene Powell Jobs, Eric Schmidt, etc. Have these people not studied history? Do they not know what happens to the wealthy after the revolution?

I wanted to try to understand this strange situation, so I just read the new book The Dictatorship of Woke Capital: How Political Correctness Captured Big Business by Stephen Soukup. This is a deeply intellectual and fair-minded book. The author goes back a century to tell the fascinating history of how we got here. Basically, by the 1920s, communist intellectuals had realized that history was not unfolding according to Marx and Hegel's theory. Workers in the industrialized countries had not become woke and thrown off their chains, and the only place where the revolution had succeeded was Russia, which should have been one of the last places, given its peasant population.

As a result, these communist “thought leaders” began to advocate a Long March through the institutions of Western liberal democracy to seize the commanding heights of society: education, the media, entertainment, the church, etc. This would allow the proletariat to awaken from their slumber and realize that the revolution was in their best interest. This strategy (today known as Cultural Marxism) has been very successful, having conquered every major institution except one: business.

This unconquered territory was a major problem, because business provides the proletariat with jobs and goods and services that make their lives quite comfortable and pleasant, especially compared to any other alternative. Being employed and shopping also occupies most of their time and energy, making them usually unavailable to participate in protests, occupations, riots, looting and arson.

One trend that has helped the Left seize control of capital in recent years is the rise of index funds and ETFs. Index funds and ETFs exacerbate the problem of "concentrated benefits, dispersed costs" by maximizing the dispersion of costs. This ensures that virtually no one is watching the store, and even if the stewards of your capital advocate for the destruction of capitalism, the stock of their company will still be included in at least several index funds and ETFs and thus be bought anyway.

The managers of these huge funds are still responsible for voting their investors' shares, but they don't have the time or energy to research and vote on every board nomination and shareholder proposal; that's not their core competency anyway. So they outsource that to a proxy advisory service (which are opaque and unregulated), and just two firms (Institutional Shareholder Services and Glass Lewis) have 97% of the market share. Both of these firms increasingly support shareholder proposals that are politically motivated, have nothing to do with a business' purpose and/or harm shareholders.

The book also describes how easy it is to force a company to adopt policies and procedures that harm the interests of shareholders. By owning as little as $2,000 worth of stock, a shareholder can submit a proposal for consideration, and if the SEC (which I'm sure has plenty of Deep State career bureaucrats who are hostile to free markets) approves it, it must appear on the ballot at the annual meeting. The book profiles one small leftist nonprofit that, with an annual budget of about $1 million, files hundreds of proposals every year, many of which are adopted. Usually these proposals are cleverly worded, so as to embarrass the company (and feed the Twitter outrage mob) if they are not approved. The Left is using the rope produced by the free market to hang capitalism.

Another recent trend that has helped helped the Left seize control of business is the consolidation of the investment management industry into a few major players, all of which (BlackRock, Vanguard and State Street)--perversely--support woke capital. When Larry Fink is minding the store, it makes your will to power much easier to achieve.

The book profiles three companies: Apple, Disney and Amazon. The author notes how the first two have a symbiotic relationship with China (Disney's recent CEO is now the U.S. ambassador to China), but so does Amazon. Much if not most of the goods that Amazon sells are made in China. Selling these goods provides millions of jobs in China, which helps to ensure that the Chinese Communist Party remains in power.

Interestingly, while these companies and others (Netflix, Salesforce, virtually all of Big Tech, etc.) are quick to condemn and threaten to boycott U.S. states over obscure new laws (such as the heartbeat bill in Georgia), they suddenly clam up or talk about how "complicated" the situation is when asked about, say, pro-democracy protesters in Hong Kong or the one million Uyghurs in Chinese concentration/forced labor/reeducation camps. That's because they don't want to lose access to China's enormous market by irking the Chinese Communist Party. These companies are not speaking Truth to Power, they are virtue signaling frauds.

Consider this to be Part II of Issue #5: The Case Against [U.S.] Equities. The barbarians are inside the gate.

What You Should Be Doing Now

I plan to cover the why and how of these in future issues (if I haven't already), but here are some actions I recommend you take (or at least start thinking about) now:

1. Cancel Culture works both ways. If you don't like what a company is doing, you don't have to patronize them. There are resources available online that allow you to keep tabs on what various companies are doing. For example, if you're a conservative or libertarian, you'll probably like 2nd Vote. If you're on the Left, you're probably OK to just avoid Koch Industries and buy everything else. Open Secrets allows you to see which corporations donate how much to which politicians, PACs, etc.

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I would love to hear from you! I thrive on feedback from readers. If you have any comments, suggestions, insight/wisdom, or you'd like to share a link to a great article, please email me.

Generally, I don't have time to answer questions about your specific situation, but if you have a general question that I think other readers also have, let me know and I will provide an answer in a future issue.

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