

# *The Quarterly Report*

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| INSIDE STORY |

# SCARCITY

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# SCARCITY

## *Where have all the good clichés gone?*

Long before an entire generation was weighed down by student loans bigger than their parents' first mortgages there was a collective wisdom which was passed down from generation to generation through worn out clichés. We all knew things like, "There is no such thing as a free lunch." "A bird in the hand is worth two in the bush." "The early bird gets the worm." And, my personal favorite, "Waste not, want not."

One did not need a college education to understand that nothing is free. Everything has a cost. Why? Because everything is scarce. Scarcity is the primary issue of the study of economics: how people, corporations, governments, and societies as a whole deal with the fact that "money doesn't grow on trees." Even if it did, it would be in limited supply – like Georgia peaches, for example. The crop would be impacted by the weather. So when the first part of winter is very mild, almost like spring, and the trees start to bud only to be rudely greeted by a late freeze, then there will be a much smaller than normal crop. What is one to do? It is summertime and Georgia peaches are in scarce supply.

This is the basis of economics. How do we deal with scarcity? In the history of mankind there are really only two systems that have ever been created to answer this problem. The system we live under is based on the freedom of individuals to own their own property and make their own choices. In our system, Georgia peaches are owned by Georgia peach farmers. They are dealing with a much smaller than normal harvest.

Georgia farmers sell their peaches, eventually, to me and people like me who cannot imagine going through the summer without raw peaches, peaches and cream, peach cobbler, and of course homemade peach ice cream. I remember hand-cranking it at my cousin's house when we were children. Once it started to harden one of us would sit on top of the ice cream maker so we could really crank it and see if we could get it as hard as the stuff you buy in the store. My parents were always on the cutting edge of technology so we had a fancy electric ice cream maker. I had one Uncle who embraced the best of both worlds – he would use the electric motor until it stopped and then put the hand crank on for a few more minutes.

Probably more than you needed to know, but suffice it to say there is a demand for Georgia peaches every summer. That demand may vary slightly year to year, but for the most part it is consistent. The supply, on the other hand, is not. Some years farmers have bumper crops and there are tons of peaches, and some years are like this year. Our system of economics deals with this by allowing individuals to

make their own decisions in a free marketplace. If the supply is low, then farmers may demand higher prices. Some consumers may not be willing to pay those prices. If one does not know the difference between a Georgia peach and, say, a California peach, then one might buy those instead. "Ignorance is bliss" after all. (I, for one, will pay.) If the supply is high, then farmers can afford to sell for less and more people will buy peaches. If the prices get too low, then farmers won't sell. This is how we deal with scarcity, allowing the supply and demand for an item to determine the price of that item and people voluntarily deciding to use that item or not.

There is another way. In the alternative system no one owns anything. A central authority would ration peaches. Everyone gets a certain number of peaches based on how many peaches are available. People who like peaches and who would be willing to pay more for them would get the same number as people who do not like peaches. The farmers would get paid the same, regardless of crop size, so there would be no incentive to maximize yields. This would work fine in good years, but



*Scarcity exists in an item as important  
and as personal as health care.*

eventually we would have a year like 2017 where the crop is too small. Then we would have something that is similar to scarcity but far worse: a shortage.

Never mind the fact that such a system requires that there be someone in charge. That person has a great deal of power, and in the real world, power has the unfortunate effect of corrupting. This power only grows when there is a shortage, and in most real-world situations we find that those who are friendly with the authority end up getting peaches and those who are not get none.

In his book, "The End of Doom", Ronald Bailey points out that in the economic history of the world, no shortage has ever occurred when free individuals willingly participating in a market have been allowed to do what they do. The laws of supply and demand may be inconvenient at times, but they do work. Rationing, on the other hand, does not have a very good track record. I'm old enough to remember what price fixing – a form of rationing – did to gas lines in the late 1970s. I had to go with my older sister to get gas in case someone was needed to push the pea green-colored Pontiac Ventura the last block. We would turn off the air conditioner to conserve gas...which is why vinyl seats no longer exist. It is no longer the '70s, which is thankfully why pea green-colored cars no longer exist.

Yet, rationing still has its fans and free exchange has its enemies. One of the questions that I have struggled with most of my adult life is, how could anyone be against freedom? I have always assumed either bad motives – if one gets to be the authority in charge, then the alternative system is pretty good – or ignorance. The Soviet Union's collapse made ignorance hard to come by for a generation. Unfortunately that was a generation ago, and here we are again.

Our current environment encouraged me to re-read F.A. Hayek's "The Road to Serfdom." Hayek answered my question.

He explains that what people hate about the system of freedom I have described – which the world calls capitalism – is scarcity itself. In other words, people want free lunch, or at least "free" contraception. They want to have their cake and eat it too. They want high-paying jobs with a great work-life balance. They revolt against scarcity itself, which they believe is caused not by nature but by the system under which they live.

Nowhere is this dislike of scarcity more evident than in our current debate over healthcare. Healthcare is just like every other good or service in that it is scarce. There are only so many doctors, nurses etc. They each have the same 24-hour day that we do. There is only so much care to go around. That is true in America and in China. It is true in Canada and Russia as well. Scarcity is reality, but we don't like it, and we certainly do not wish to admit it.

This is why eight years ago our government promised that everyone could keep their doctors and premiums would not go up, even though they knew that was impossible. This is why, even with eight years to dream about repeal and replace, the current Congress cannot come up with an agreement on health care reform. Because no one wants to admit that scarcity exists in an item as important and as personal as health care. No one wants to admit that health care must either be distributed via the market's pricing mechanism or through rationing. Either way, someone is not going to get to see the doctor of his choice and that person, and all of his family and friends, is going to be mad. They are going to feel hurt and will blame the system. The only answer that partially makes sense is to say that health care is complicated. But it is not, really. It may be more complicated than selling peaches, but what does it mean to be complicated?

Something is complicated if it takes more than one simple step to accomplish. Selling peach cobbler is more complicated

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## REVIEW of ECONOMY

### The first quarter 2017 GDP

growth came in at 1.4 percent and second quarter is thought to be stronger. The optimism for more pro-growth policies has waned because of doubts about the administration's ability to get their policies through congress.

The official unemployment rate dropped to 4.4 percent in June. The labor market is continuing to grow in strength.

Inflation had kicked up but the latest readings are showing no growth. The Fed continues to raise rates and is unlikely to change course even with inflation showing signs of slowing. +

## REVIEW of MARKET

### The rally continues.

For the quarter the S&P 500 was up 3.09 percent. Growth outpaced value for the second quarter in a row. The Russell 1000 Growth index finished up 4.67 percent, while its value counterpart was up 1.34 percent. Small companies held their own with the Russell 2000 index finishing up 2.46 percent.

Bonds rose slightly during the quarter. The Barclays US Aggregate Bond index ended up 1.45 percent. High yield bonds ended the quarter up 2.16 percent.

International stocks led the way. The EAFE index finished up 6.37 percent and the MSCI Emerging Markets index ended the quarter up 6.38 percent. +

# MARKET *forecast*

**The rally remains due for a pause.** The rotation back to growth reflects the lack of confidence in the administration's ability to get anything done. The hope for more growth-friendly policies needs to be fueled by some actual policies. We remain optimistic for the year but would not be surprised if we have a short-term slow down.

Emerging markets still look attractive and the rally in international stocks should have more legs. Bonds remain our biggest concern over the long term and will until the yield on the 10 year treasury exceeds 3 percent. The run in high yield bonds will likely slow down, but not stop. +

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than selling peaches. Peaches have one ingredient: peaches. Peach cobbler has several ingredients, including but not limited to peaches, sugar, butter and flour. There is a market for each one of those ingredients, and then there is the baker's time to consider, and finally a market for peach cobbler. Outside influences can also play a role. For example, if one is selling peach cobbler in a restaurant and the restaurant does not sell vanilla ice cream, then the demand for peach cobbler will be far lower than it will be in a restaurant that can put a scoop of ice cream on top. Who would even eat cobbler if it's not a-la mode?

In the same way, health care is complicated because there are so many moving parts, and if one really gets sick it gets even more complicated. You have multiple doctors, multiple facilities, and then all the extras. When one starts to think about it, it will make you just want to sit down and bury your concerns in a comforting bowl of peach cobbler. However, just like peach cobbler, the complexity is really made up of many simple parts, each of which could be divided up using market choices or central rationing.

In America we have gone the middle path. We didn't really make that decision, we just let it evolve. We used to pay doctors directly for everything, getting reimbursed for large unexpected costs through insurance. Then managed care came around and insurance paid

for more and more. Insurance payments used to go to the consumer after they had paid the doctor directly, but then the insurance company started paying doctors directly. Over time the insurance companies started looking more and more like government planners rationing out care rather than true insurance companies reimbursing claims. They started telling us which doctors we could see and which brand of drugs we could take. At the same time most doctors were private business people running their own practices. Those who cannot get private insurance get insurance through one or more government programs. It is a mix of both systems, a middle path.

Hayek discusses the middle path. He describes it as the worst of the three options. This is where one sees the worst of both worlds – the sometimes high prices found in capitalism combined with the uncaring rationing of socialism. Just this past six weeks, I tried to get my father in to see a specialized doctor. His primary care physician recommended a doctor that by chance I had seen, so we felt good about that. He could have seen my father in six weeks if we wanted to wait, but we were able to get in to see one of his partners after two weeks so settled for him. He ran some very expensive tests which were only partially covered by insurance, and that took us four trips to his office to complete. Fortunately my father is in good

health. No further treatment was needed, but this is the middle road: luxury costs with economy-level service.

To really solve health care we need to pick a path. This is why finding consensus is impossible. I'm not here to make policy recommendations, but we could try something with health care which is logical when one looks at our country's full name. The United States of America is one nation organized as a federation of fifty states. Why are we fighting over a one-size-fits-all disaster when each of those states could be experimenting with their own, more manageable systems?

Regardless, we need Washington to move one way or the other so we can move on to things we care about as investors: tax and regulatory reform. Meanwhile, it is summer. "Live for the moment" and enjoy a Georgia peach if you can find one.

Warm Regards,



CHUCK OSBORNE, CFA  
*Managing Director, Peach Aficionado*

