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INSIDE STORY

Who Ate the Last Cookie?

IRON CAPITAL ADVISORS

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Who Ate the Last Cookie?

I don't know if this is true in your house, but in mine nothing is quite as dangerous as eating the last cookie. Not only will the guilty party be scolded over his/her offense, but he/she also will be accused of eating "all of the cookies." This is especially true this time of the year as the Christmas aftermath is slowly but surely consumed.

In our house we go much of the year without any cookies at all. Perhaps if there is a special occasion, there might be one batch of one type of cookie. Around mid-December, that all changes: We receive cookies as gifts; the children participate in cookie swaps; and of course, we feel obligated to make our own traditional favorites to celebrate Christmas. Most years the cookie supply peaks around December 23, at which point either my wife or I will usually make a comment about over-doing it and finally say, "We will never be able to eat all of these."

Photo by John Cameron on Unsplash

At that moment, no one in the house cares who eats what cookie; the cookies have practically no value. No one is fighting over cookies or hiding cookies, as we are living in the land of cookie abundance. Then Christmas passes. We continue to indulge in cookies through the New Year holiday, and in early January, certain individuals begin to notice certain varieties getting low in supply. As this happens, behaviors start to change: Some cookies will suddenly "disappear" from the usual cookie location. Individuals will start declaring ownership of other cookies. Gifts that were addressed to the family suddenly become the possession of the person closest to the giver. Then, finally we are down to the last cookie. Woe unto thee who eats the last cookie. The last cookie is never eaten openly; it must be consumed in secrecy so that the guilty party may claim innocence. "What cookie? I thought those were gone days ago."

What we witness every holiday season is a perfect example of the economic law of supply and demand. When cookies are in overabundance they have little value, but as the supply shrinks, the value of each cookie grows until we are down to only one.

One of my most frequent comments over the last several years has been that I no longer understand how they teach economics today. I started saying that roughly around the time when the Fed kept saying that inflation was "transitory." I was an economics major in college, and I still think like an economist. More specifically, I think like a microeconomist. Microeconomics is the study of how individuals and individual businesses make decisions. It gives us the laws of economics – laws that are consistently observed in reality. Macroeconomics is the study of top-down national and global economies. It is more used in policy-making and is what most people think of when they think of economist. It is also what give economics a bad name.

I saw governments forcibly restricting supply while also attempting to stimulate demand. That is a recipe for inflation. It was so simple for anyone who had a passing grade in Micro-econ 101 that I could not understand how an institution like the Fed, which is largely staffed by individuals with PhDs in economics, could possibly misinterpret what was happening… which makes me wonder if microeconomics is even taught anymore.

Supply and demand are like lots of fundamentals, which we seem to have lost in our modern society. It is really a simple concept, but understanding it is incredibly useful because it explains so much of what happens in our world, both good and bad. Several years ago, I read an article about the teaching of phonics in California elementary schools. They had moved away from it and saw literacy rates go down, and so they brought it back. It worked and literacy rates rose, but the teachers hated it, because it was boring to teach such simple fundamentals. They killed it again, and literacy rates once again declined. Has the same happened in schools of economics?

The same thing certainly has happened in sports. Youth coaches used to understand that their job was to teach the basic fundamentals, but it is so much more fun for the coach if they skip straight to strategy. Simple fundamentals are boring, but they are also essential.

The price of everything is determined by the supply and the demand for that item. The "right" price is the price where supply and demand are in balance. If the demand for an item increases, then the price will increase, which then incentivizes suppliers to increase the supply. When the supply then outpaces demand, the prices will fall, which will stimulate more demand and incentivize suppliers to cut back. Ultimately a balance arrives where supply and demand match if given the freedom to do so.

I suspect that if you asked most people on the street if they understand supply and demand, they would say yes. I also suspect if you then asked them how a business could maximize its profit, they would say by raising prices...which is proof that they do not, in fact, understand supply and demand.

Let's start a fictional manufacturing company that makes the almighty widget. The current price of the widget is $10, and we sell a million of them at this price for total revenue of $10 million. The cost of making widgets is $8 per widget, so we have a $2 million profit. Many believe we could increase our profit by increasing prices to $15. However, the increase in price will reduce the amount demanded. Now we only sell 600,000 for a revenue of $9 million. If we produce less then costs will also go down, but a good portion of the previous $8 per widget cost is fixed, so the cost per widget at the lower production level is $12.50. While our profit margin rises a little to $2.50 per widget vs. $2.00 per widget the total profit drops to $1.5 million.

On the other hand, if we lower the price to $8 then we could sell 1.5 million units, which would mean $12 million in revenue. The higher volume would reduce our cost per widget, but only to $7, which would lower our total profit to $1.5 million. So, in this fictional example, $10 is the "right" or equilibrium price.

The incentive of all business owners is to increase volume by reducing price and to use scale to reduce the cost of production per unit. This incentive is balanced by the fact that price alone does not determine demand; Quality must be maintained, otherwise the widgets lose utility to the buyer and demand disappears completely.

This is how supply and demand work. So, will reducing tax rates actually increase tax revenue? Some will say yes while others argue of course not. The truth depends on where we are lowering from. As with everything, there is a balance. Taxes are the price of profitable economic activity; if that price is too high, then people will reduce economic activity and less tax revenue may be the result. It is also true that there is a limit to lowering rates, which we explained in detail in our third quarter 2010 issue of The Quarterly Report, "A Taxing Debate." Neither political party seems to understand this simple truth.

The lack of understanding of simple supply and demand also explains the failures of the Affordable Care Act. To balance supply and demand, the price must be known. The Affordable Care Act does not do anything to reduce costs in our healthcare system; if anything, it does the opposite. It produced a wave of healthcare professionals who have left the traditional healthcare world by either retiring, or by starting so-called

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REVIEW of ECONOMY

The 3rd quarter 2025 GDP growth came in up 4.3 percent, better than we expected. GDPNow shows the economy growing by 2.7 percent in the 4th quarter, so economic growth is holding up. This fits with what we have seen from corporate earnings which have been much better than expected through 3 quarters.

The official unemployment rate was 4.6 percent through November. The economy created 64,000 jobs. That isn't nearly enough for a healthy economy. We seem to be in a strange place where companies are neither hiring or laying off employees, so while new job growth has been slow the unemployment rate is still not that bad. The question is which breaks first? Do companies begin hiring or are layoffs coming?

Inflation is 2.7 percent based on the latest consumer price index report. Inflation has inched down since the last quarter but is still above the 2 percent target. The producer price index has still not been updated since the government shutdown. +

REVIEW of MARKETS

The market rose in the 4th quarter.
For the quarter the S&P 500 finished up 2.66 percent, while small company stocks represented by the Russell 2000 index were up 2.19 percent. Value outperformed in large caps while the growth index was up 1.12 percent. For small companies value also outperformed up 3.26 percent, and the growth index was up 1.22 percent.

Bonds rose slightly. The Bloomberg U.S. Aggregate Bond index ended up 1.10 percent. High yield bonds rose 1.35 percent. Bond yields were steady.

International stocks kept up the solid performance. The EAFE index finished up 4.91 percent and the MSCI Emerging Markets index ended the quarter up 4.78 percent. +

MARKET forecast

The S&P 500 has delivered good returns three years in a row, but the real story is more complicated. We continue to flip back and forth in terms of leadership and we suspect that fast growing technology stocks, which got punished last quarter should bounce back hard to start 2026.

From there, international will likely continue to do relatively well as a weak dollar will assist U.S. investors in foreign markets and valuations are better overseas. Small companies remain a better value at home, and they maintained good momentum this past quarter. We suspect that will continue.

Bonds have done their job and stabilized in this range just above 4 percent. The Fed has begun to lower rates as we suspected. This will likely steepen the yield curve with short-term rates falling, but the longer-term rates remaining in their range. +

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concierge doctors' groups. Then it subsidizes the cost to keep the price artificially low. Now it is easier to be insured, but harder to actually see your doctor; it reduces supply while simultaneously stimulating demand through subsidies. This occurred because it focused largely on the cost of insurance, which was a symptom, while not focusing on the actual cost of healthcare, which was the disease.

The same Fed PhDs who missed inflation a few years ago do not understand that tariffs are not going to cause inflation today. Prices are set by supply and demand. While finding the equilibrium price takes some experimentation, a well-run business figures it out pretty quickly. That price has little to do with their cost. Tariffs raise the cost of doing business, which makes the business less viable. Tariffs reduce economic activity and if they are bad enough, which they were in 1930 but have not been thus far this time, they cause depression and deflation.

Today the same mistake is being made in New York City with its real estate affordability issue. If affordability is an issue, that means the supply of whatever item we are discussing has been suppressed. If we want to make apartments in New York more affordable, then we must find ways to increase the supply of apartments. Rent controls do the opposite; they provide a disincentive to increase the supply, as do zoning regulations, building codes etc. They increase the cost, which reduces the viability of building new apartments. Please don't misunderstand – we may decide that certain zoning rules are desirable and building codes absolutely necessary, but we also have to understand that they come with a cost.

The search for the equilibrium of supply and demand is full of tradeoffs; the reality of supply and demand forces us to face those tradeoffs and deal with them as mature adults. We have to make the hard choices. Even if the local authorities in New York City do everything right, the city will still be a very expensive place to live. There are millions of people, which means demand is very high, and it is made up of islands, which means the supply of land is not going to increase. That may be unpopular to hear, but it is the truth.

Apartments will always be more affordable in my home of Atlanta; we have far fewer people, and there are no natural barriers to expansion. This brings about other issues because there are always tradeoffs. The traffic in Atlanta is horrible. A simple understanding of supply and demand does not solve every issue, but it does help crystallize the question at hand.

This mindset helps immensely in investing. The new year marked the end of Warren Buffett's famous career as he retired at age 95. One of his investing principles was to invest in companies that had competitive moats, which restrict the number of competitors and therefore the supply of their product. These moats boost these businesses in the same way that the Hudson River boosts New York real estate prices. Supply is the key.

If we want a more affordable world, then we need to stimulate the supply of things we need and want. We need housing, education, and healthcare to be as readily available as cookies on Christmas Eve. Until we learn that lesson once again, we will continue to have the high cost of limited supply, which only leads to the blame game. Who ate the last cookie? Was it you?

Warm regards,

Chuck Osborne

CHUCK OSBORNE, CFA Managing Director