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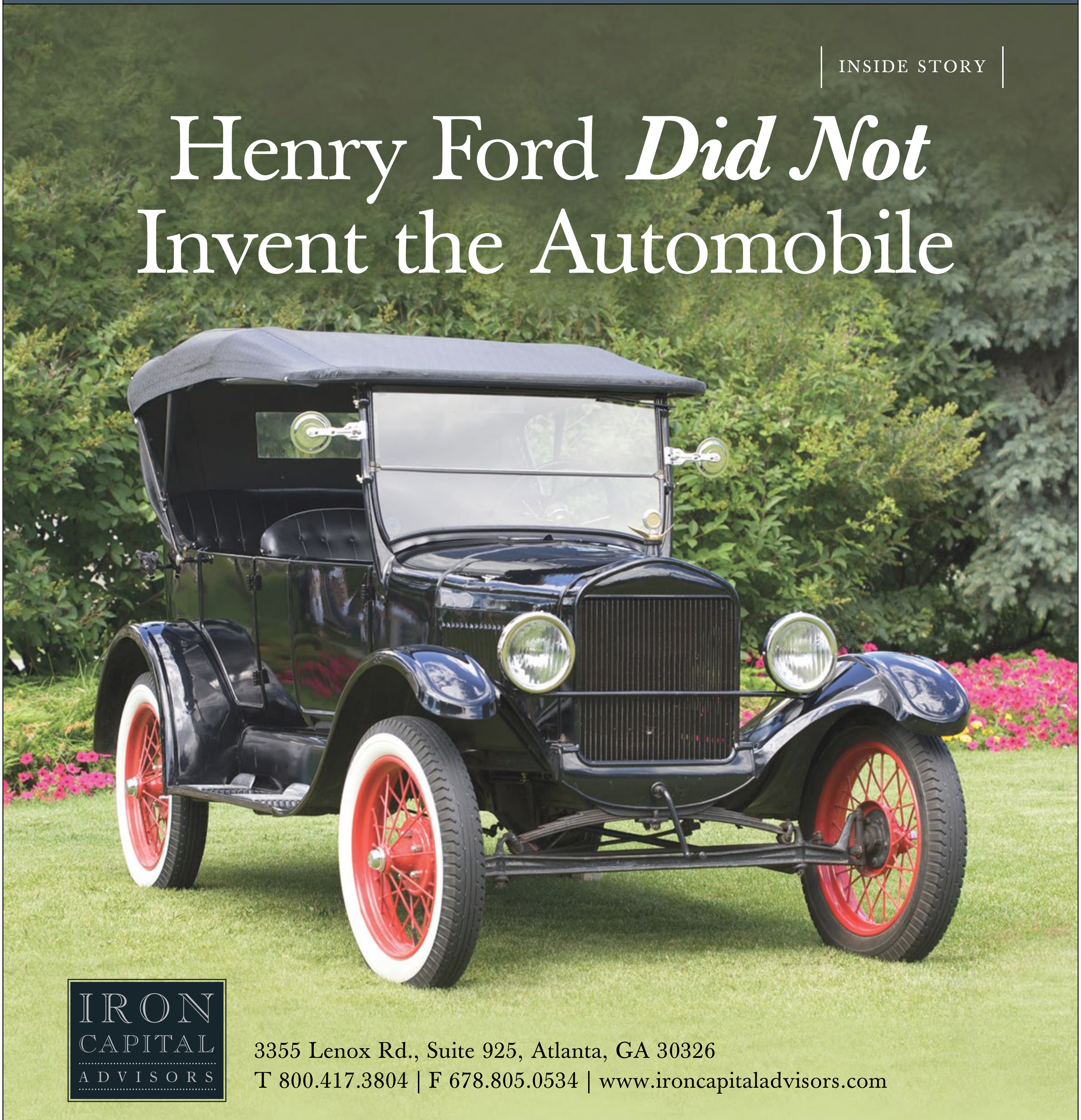

INSIDE STORY

Henry Ford *Did Not* Invent the Automobile

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Henry Ford *Did Not* Invent

A few years ago I was sitting in church paying close attention to the minister's sermon when he mentioned that Henry Ford had invented the automobile. He lost me right then and there, because for the rest of the sermon I kept wanting to shout out, "Henry Ford did not invent the automobile!" I kept looking around and thinking, "Certainly these people know that Henry Ford did not invent the automobile."

The automobile, like most inventions, evolved. Stating clearly who really invented it is difficult; however, most give credit to Karl Benz, who made the first car with a gasoline-powered internal combustion engine. His car had three wheels. Shortly afterward, Gottlieb Wilhelm Daimler created the first four-wheeled automobile. Both men were German, and, of course, they eventually formed Daimler-Benz, which continues to make the Mercedes Benz to this day.

Why the confusion? I believe it comes from a lack of understanding of capitalism itself and, in particular, capitalistic innovation. To understand what I mean, we need to look at what Henry Ford actually did invent: Henry Ford invented the assembly line, which is a far more capitalistic invention.

What do I mean by that? Henry Ford took an invention which, until that point in history was available only to the very wealthy, and found a way to produce it at a cost that all of his workers could afford to pay. This is precisely what capitalism does: it finds ways to provide the masses access to luxuries that were once available only to a select few.

There was a second part to that: He paid his employees enough to be able to purchase a Model T. This is also part of capitalism. In thirty years of business, I have yet to meet a successful businessperson who did not feel passionately about taking care of his or her employees. This is not to say I have not met such people; I have, and invariably they are the ones whose business is constantly struggling. One of my old bosses used to say, "Our most valuable asset goes down the elevator every night." Human beings only work well for someone who actually cares

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about them. The world is full of middle managers that do not understand this basic principle, which is why they will never be more than a middle manager.

The image today of capitalism is one of oppressed workers and an owner class that wants to raise prices in order to maximize profits for themselves. This image is one of pure ignorance. It comes from people who have no understanding, and frankly do not want to have an understanding. They shout down anyone who dares to say, "Look at the facts."

Having said that, the image of capitalism is not completely negative. People believe that capitalism leads to invention, and this is also not really the case. It is far more accurate to say that capitalism leads to innovation, and there is a huge difference. Innovation involves items that have already been invented; it finds new ways to use them or make them. It does not create something new out of nothing.

The late Clayton Christensen was a Harvard Business School professor and the pioneer of the concept of disruptive innovation. Ford's Model T and the assembly line that made it possible is a perfect example. The automobile industry had been around for 30 years when Ford launched the Model T in 1908. His innovation was not a better car, but a car that was affordable to those who previously could not afford a car.

Christensen argued that a disruptive innovation was an innovation that created a product that was not as good as existing products, but good enough and a fraction of the cost. The Model T was not a better car; it was an affordable car. Fast forward 70 so years and a young Bill Gates started a company with a mission. His mission was not to become the wealthiest person on the planet, although he did end up holding that title for a while. His mission was to put a personal computer in the home of every American.

Those early computers, running the Microsoft DOS operating system, were not anywhere near as powerful as the mainframes that technology professionals had access to, but they did

the Automobile

what most people needed at a fraction of the cost. They kept improving and improving until one day a man name Steve Jobs said we can put a PC in the pocket of every American.

Those phones and tablets were not as powerful as the desktops of the time, but they did what was needed at a lower cost, and we could have them with us everywhere we went. Disruptive innovation – that is what capitalism actually does.

Perhaps the best example in recent years is Roku. For those who are not familiar, Roku is a service that is installed on some televisions, or one can buy an add-on device, which allows for easier access to programing that is streamed over the internet instead of the traditional cable TV system. In other words, it allows one to "cut the cord." We did this in our house about four years ago.

Streaming, whether through Roku, Apple TV, or other such device, was not as good as having cable. It did not offer the hundreds of channels or the guide or the ease of recording shows that our state-of-the-art cable service provided. However, we could get just about every channel we actually ever watched with the flexibility to change plans monthly, and with streaming content, the need to record things on our own devices was pretty much gone. In other words, it wasn't quite as good, but it was good enough, and it saved us considerable money.

This is the power of capitalism: It is a constant process of making the luxuries of our time more accessible. So why does capitalism get such a bad reputation? Where do the critics go wrong? There is confusion, especially in politics, between capitalism and business. Disruptive innovation, the life blood of capitalism, does not come from big established companies. In fact, disruptive innovation destroys big established companies.

Most successful businesses start out as innovators, or copycats, but either way they are providing consumers with something of value that was either unavailable or really expensive until that point. Then they grow. Then they start to slowly lose the ability to innovate. Then they start to listen less and less to their customers and more and more to Wall Street analysts.

Then the death knell rings: As their business matures and starts to slow down, they hire consultants – young, intelligent, ivy league-educated people who have never actually done anything in their lives, who are now going to tell these seasoned businesspeople how to run their company. This is when a switch is flipped. The company that was all for free markets before suddenly thinks regulation is a good idea.

Don't believe me? These very words came out of Mark Zuckerberg's mouth just a few months ago. "From what I've learned, I believe we need new regulation…." Of course he does. Zuckerberg is no longer a capitalist; he has become the owner of an established big corporation, and innovation is now a threat. The greatest protection from innovation? That would be regulation.

In economics we call this rent-seeking. Any regulation of social media would have a marginal impact on most of us, but an enormous impact on companies like Facebook. This

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REVIEW *of* ECONOMY

The 3rd quarter 2020 GDP growth came in up 38 percent on an annualized and seasonally adjusted basis. In plain English, economic activity was up just under 10 percent from the 2nd quarter. The 4th quarter is expected to show solid growth as well.

The official unemployment rate is 6.7 percent in November. Jobs have come back at a rapid clip. While still higher than we like, this is getting back to normal range. The traditional belief was that 6 percent represented full employment, although we had been well below that before Covid-19.

Inflation is 1.2 percent based on the latest consumer price index report. That is improved from the crisis but still well below the Fed's 2 percent target. Expect the Fed to continue to be very aggressive. +

REVIEW *of* MARKET

The market finally rotated. For the quarter the S&P 500 finished up 12.15 percent and small company stocks represented by the Russell 2000 index were up 31.37 percent. Value had its long-awaited comeback outperforming growth for the quarter.

Bonds were up slightly for the quarter. The Barclays U.S. Aggregate Bond index ended up 0.67 percent. High yield bonds rose 6.48 percent.

International stocks outperformed as well. The EAFE index finished up 16.09 percent while the MSCI Emerging Markets index ended the quarter up 19.77 percent. +

MARKET *forecast*

We have finally gotten a rotation into value and small stocks.
The question is, can this last or is it yet another false start? We believe it can last.

Value stocks and small company stocks still have more room to run. International stocks have had a lost decade and their outperformance should continue as well.

Bonds still make no sense at these prices. High yield bonds may be the only place to get positive long-term returns. +

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provides social media companies with a strong incentive to lobby for favorable regulation while the rest of us have little incentive to do anything. Regulation usually enshrines the status quo and makes it very difficult for potential competitors. That hurts capitalism, but helps business.

> *Great companies all have a higher purpose.*

The most extreme examples today would be in places like Russia. Putin is certainly no free market advocate, but he loves the oil business. He is all for Russian oil interests, and running an oil company is a great gig in Russia, as long as you remember who the real boss is. As I write this Jack Ma, the founder of Chinese technology giant Alibaba, is missing. In late October he made some public comments that were less than flattering towards the Chinese regulators. He has not been seen in public since. China loves big business – the jobs they provide, the income to the state – but they have soured toward capitalism over the last several years. Too much freedom.

Innovation requires freedom, which, in the end, is what capitalism actually means. As Milton Friedman said, "Underlying most arguments against the free market is a lack of belief in freedom itself." Especially the freedom to earn a profit. Profit is a bad word; it is associated with greed and the cutting of corners. This is only really true if profit becomes the purpose of the business. This, unfortunately in my opinion, is often taught in business schools: "The purpose of a corporation is to increase shareholder profits."

That is just wrong. Profit is an absolute necessity of survival, and that is true whether we are talking about corporations, individuals, or charities. Every entity must spend less than they bring in if they wish to be sustainable, and spending less than what is brought in is the definition of showing a profit. Being profitable is a necessity of business, but it is not the purpose. Innovators are people of vision, and their desires are far loftier than money.

Henry Ford wanted every American to have a car. He was a businessman, and he knew a profit was necessary for survival, but his purpose was to build cars that everyday Americans could afford. Bill Gates wanted to put a PC in the home of every American. Jeff Bezos has ignored profitability perhaps more audaciously than any business leader of our time while building an empire at Amazon. Great companies all have a higher purpose. There is a move a foot today for so-called "stakeholder capitalism," which means running a business for more than just the shareholders. My take on this is that it is much to do about nothing, because all truly great businesses have always cared for employees, their communities, and the world around them. One cannot be successful for any period of time without caring about these things.

Only in the classroom does business care only about shareholders, or to be more accurate, only in the classroom does caring for shareholders not include taking care of employees and the community, etc. Businesses that do not do these things do not stay in business, and nothing destroys shareholder value like going out of business.

Henry Ford did not invent the car; what he invented was so much more important than that. He showed the way for Bill Gates, who did not invent the computer, and Steve Jobs, who did not invent the cell phone, and Jeff Bezos, who did not invent the internet. The disruptive innovation of capitalism has improved the lives of the masses in too many ways to count. We need to think about that when people start vilifying and calling for change without even understanding what Henry Ford actually invented.

Warm Regards,

Chuck Osborne

CHUCK OSBORNE, CFA *Managing Director*