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THE LONG-TERM EXPECTATIONS OF A HIGH PERFORMING ECONOMY

Michael Anderson
Chief Investment Officer

At Hi-Line Capital Management, our intrinsic-value philosophy and decision-making principles drive how we approach investing and provide guard rails for thinking during periods of extreme uncertainty and volatility. Our piece, *Foundational Decision-Making Principles,* details the seven pillars of our decision-making process and its critical function in long-term success and rationality.

ABOUT HI-LINE CAPITAL MANAGEMENT

Hi-Line Capital Management, LLC ("HLCM"), based in Watertown, SD, provides investment management and advisory services for institutional and individual clients. The firm was founded in July 2009, became a registered investment advisor (RIA) with the U.S. Securities and Exchange Commission ("SEC") in March 2010.

The standard of living depends on the ability to produce goods and services and is described by the size of Gross Domestic Product (GDP), in total, and per person. The advancement of living standards depends on the "growth" of GDP, which is the combination of population change and productivity change. And "real growth" of GDP comes after the effects of inflation. Population change is easier to influence while productivity improvements are more difficult and challenging.

Economics is the study of choices….and each decision has consequences. Choices include how people make decisions and are best described by opportunity cost. Choices include how people interact - with comparative advantage (trade) best describing the benefit to all parties. The following will seek to outline several important elements that describe what is required for a high performing economy and why the USA continues to be well positioned from a long-term perspective and expectation.

Economic Variable #1: Population Growth: Successful nations fight demographic decline as there has never been long-term economic growth with a declining population. Population growth has contributed 40 – 50% of total economic growth. Particularly important is the "working age" population, which needs to grow at least 2.0% to propel economic growth. The U.S. is advantaged given continued net birth rate and attractiveness of options among potential immigrants.

Economic Variable #2: Productivity Growth: Several elements may contribute to productivity growth, but the following are judged highly important:

a) Successful nations **invest** heavily and wisely. Investments averaging 20% of total GDP in infrastructure, technology, factories, roads, robots, communications, housing, etc. are necessary to continue improving productivity. But not all "investment" spend is good. Bad investment spends historically included commodity-based extraction, since there is limited "value add" from the commodity itself, and real estate, primarily due to the maximization (versus optimization) of debt and leverage used.
b) Successful nations invest more heavily in robotics and **automation**. In the last 25 years, nearly 20 million additional jobs have been created – 1/3 of which didn't previously exist. And the USA has more robots than 25 years ago and far more robots than other developed nations.
c) Successful nations avoid **debt** mania. The pace of growth is far more important than the level of debt versus GDP. And nearly all financial crises are born due to private debt growing far faster than GDP for 5+ years, which includes the USA from 2002 to 2007.
d) Successful nations have a strong currency. The US Dollar is the world's reserve currency, and it has become stronger in the last five years. More global transactions involving trade, commodities, and financing involve the US Dollar. The US is presently a major beneficiary of this money flow, and money flow matters.

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Economic Variable #3: Controlled Inflation: Successful nations control real inflation. High inflation is always a threat to economic growth, but low inflation (or even deflation) has not always been a threat. And high and persistent food inflation has historically been a dangerous outcome raising the prospect of populism and political instability. The primary weapons in fighting inflation include:

a) Global trade which improves the standard of living for all parties via the economic principle "comparative advantage"
b) Central banks that are independent and free from political pressure.
c) Sound fiscal management including trade deficits and budgets near balanced.

Economic Variable #4: The Role and Limitations of Government. It is assumed by many that government and politics play an outsized role in the economy. It is true that poor choices repeated over decades contrary to sound economic principles will slow or reverse the course of economic growth. But for the US economy, due to its size and dynamics, government actions are unlikely to be a long-term concern as the past is filled with many examples of very poor economic policy. Government cannot create growth or increase wealth by stimulus alone, but the stimulus can accelerate economic growth. Government cannot make all better off together, but it can redistribute income. Lastly, government cannot make people perform, but it can incentivize activities. Governments of successful nations invest between 35-40% of GDP in infrastructure, commerce, incentives, social programs, law enforcement, etc. Too little spending increases the prospect of spending instability without a safety net, more crime/corruption/tax evasion, and compromising national security interest primarily related to food and energy.

The USA advantages versus the rest of the world. It is easy to see many negatives at the present time, but the list of positives for the continuation of real economic growth in the future includes the following important tailwinds:

1. Population that is younger, more fertile, and growing compared to other developed countries.
2. Productivity that is higher than average compared to other developed countries.
   a. More hours worked than average
   b. More goods and services produced than average
   c. Innovation far higher than average…. USA owns 20% of all foreign patents which is greater than China and Germany combined
3. Monetary stability with the US Dollar as world's reserve currency.
4. Government being more stable and favorable than average regarding:
   a. Total spend (including federal, state and local) between 35-40%
   b. Business friendly – easier to start, restructure, reorganize labor, sell.
   c. Rule of law with private ownership protections and less corruption

It is easy to find things "gone wrong" but the list of things "better than average" remains robust allowing for continued tailwinds of future improvements towards living standards. These positive attributes cause the US to be a favorable nation in which to lend money via bonds and own businesses via stocks.

HI-LINE CAPITAL MANAGEMENT, LLC
1200 33rd St. SE, Suite #309
WATERTOWN, SD 57201

EMAIL: INFO@HI-LINECAPITAL.COM
PHONE: 605.878.0897
WWW.HI-LINECAPITAL.COM