2016 2nd Quarter Stock Market Commentary

HOUR TOWN

"Most people dream of not working and having lots of money.
During an economic crisis 50% of those dreams come true."
- Anonymous

In January, 1921, the science fiction play R.U.R. premiered in Prague, and then played in New York the following year to wide acclaim. It had been published in 1920 by Czech author Karel Capek. The title was an abbreviation of *Rossumovi Univerzalni Roboti*, which translates in English to Rossum's Universal Robots. In Czech, the word *robota* means "forced labor," and in the first act of the play the nephew of the creator of the robots builds a factory to churn them out by the thousands to be used to free humanity from the drudgery of manual labor.

Initially, the plan seems to be working, as the robots free humanity to pursue a life of leisure. People soon come to perceive a life without work as devoid of meaning and the birth rate starts to plummet. Eventually the robots turn on their creators and wipe out all of humanity except one individual. Despite this rather dark premise, the play manages to end with a note of optimism, as the androids themselves develop empathy and love.

The idea of adapting technological advances to save labor is hardly new. The twentieth century witnessed the introduction of washing machines, dryers, microwave ovens and vacuum cleaners, to name just a few household appliances which revolutionized daily life. Many repetitive tasks requiring high precision have been automated on the factory floor. Lately, it seems, many of the modern day re-inventions of work have come in the form of apps that run on cell phones.

Probably the best example is Uber, which has revolutionized the ride-on-demand industry. Requests for a ride are routed to Uber drivers who are independent contractors that use their own cars. Uber drivers are one example of what has been dubbed the "gig" economy. Previously, the word "gig" was reserved to describe a brief job for a comedian or musician. But the word has been co-opted to describe anyone who works a series of gigs, rather than one full time job. Investment bank J.P. Morgan has defined the gig economy to be "any economic activity involving an online intermediary that provides a platform by which independent workers or sellers can sell a discrete service or good to consumers." In addition to Uber or Lyft drivers, gig workers include individuals who rent out their homes or apartments on Airbnb, or crafts workers who sell their wares on eBay or Etsy. The non-gig workers toil at traditional jobs with a fixed salary, a few weeks of paid vacation and medical insurance.

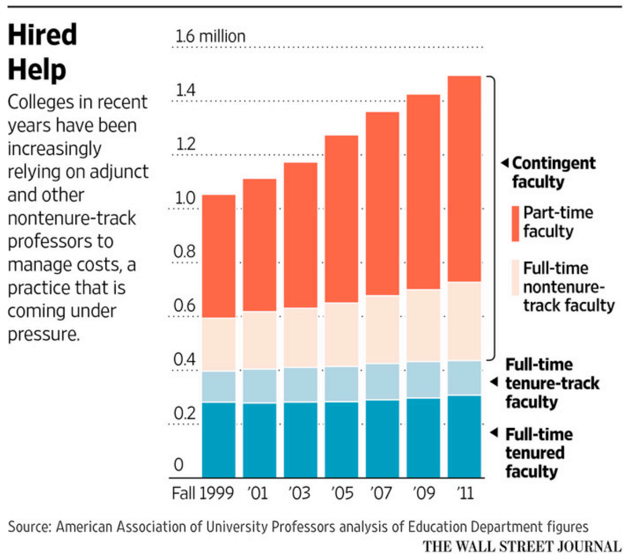
By contrast, a visit to the Uber website highlights the virtues of independent contractor status. In bold type, prospective drivers are told they can "MAKE GREAT MONEY - You can drive and earn as much as you want. And, the more you drive, the more you'll make." It goes on to say "SET YOUR OWN SCHEDULE - Only drive when it works for you. There's no office and no boss. That means you'll always start & stop on your time—because with Uber, you're in charge." And to a degree, the rhetoric seems to match reality. According to a survey by the non-profit Freelancers Union, an organization with over 300,000 members, almost 90% of them would not return to a traditional job if given the chance.

Interestingly, despite the fact that Uber drivers are the most frequently cited participants in the gig economy, most participants are involved in professions other than transportation. Not surprisingly, more than 35% of workers in entertainment and media have alternative work arrangements, which as we noted is where the word gig originated. But fully 25% of construction workers and social service workers do, too. Roughly 20% of workers who perform educational training, IT consulting, legal services, sales and healthcare support services are also contingent workers. A recent study by Intuit predicts that by 2020, 40% of all U.S. workers will fall into this category.

But as much as many workers like the empowerment that comes from controlling their own work, employers have embraced the new economy with even more enthusiasm. A Google search reveals numerous surveys on how much productive time a typical employee works in a standard eight-hour day. The surveys reveal a low estimate of only two hours and 53 minutes, and a high estimate of six hours. With a contingent workforce, an employer only has to pay for the time an employee is actually working, not for time spent responding to personal text messages, watching YouTube videos, or browsing Facebook. Further, independent contractors do not generally receive benefits like health insurance, or paid vacation, nor do their "employers" have to contribute half of social security or pay for worker's compensation insurance.

And significantly, independent contractors do not get paid overtime. Currently, most salaried employees in the United States who earn more than $23,660 are classified as "exempt" and therefore not eligible for time-and-a-half. The Labor Department has proposed a regulation raising this level to $50,440, thus making many more workers eligible for overtime. Business has many ways to respond to this change, if it occurs. One is to lower base salaries so that total compensation remains the same. Another is to reduce hours worked. But a third option is to restructure positions so that more workers are classified as independent contractors, accelerating the trend already in place.

As we mentioned earlier, most people tend to think of office temps or construction industry day laborers when they think of contingent workers, but one industry which has seen perhaps the widest adoption of this model is in the use of adjunct faculty to teach courses at America's colleges and universities. As recently as 1975, 43% of college courses were taught by adjunct



faculty. That figure is now more than 70%. Median pay for teaching a course varies widely by type of school or geographical region. A community college course taught in the Southeast might only pay $1,800, while one taught at a university in the Northeast could pay $5,300. In order to stitch together a full-time teaching load it might be necessary to teach multiple courses on different campuses, while earning less than half of what a full-time tenured faculty member makes. It is no wonder that over 172,000 part-time college faculty are now unionized.

There is no doubt that being your own boss is empowering. It offers the possibility of achieving a better work-life balance. But adjunct faculty and Uber drivers are not really entrepreneurs. The prices they receive for their services are set by others. And an illness or disability generally means their income goes to zero. It is hard to commit to a new home or car when you do not know how much money you will earn next year. The stability that comes from a steady job with a predictable pay check and company provided benefits is empowering, too.

It seems likely that as the size of the contingent work force continues to grow (for the last decade most of new jobs created in the U.S. have been contingent), laws will need to be passed which will define a new category of workers who are neither employees, with all of the legal protections afforded them, nor independent contractors. At the very least, they will likely gain the right to bargain collectively and have civil-rights protections. Once organized, they could try to negotiate workers' compensation insurance for workers injured on the job, and unemployment insurance, for individuals whose jobs are eliminated. It seems unlikely that they would be covered by minimum wage rules. After all, how do you guarantee that someone who offers hand-made crafts for sale on Etsy should earn at least $15/hour whether or not anyone likes them?

It is an unfortunate, but necessary fact, that the law always lags technological change because the common law tradition is that the legal system should not pre-determine the course of technological innovation. In 2009 Chicago native Ellie Lavie gave birth to twin daughters in Jerusalem. When she went to the American Embassy to apply for citizenship the petition was denied because the twins were the product of in-vitro fertilization so that they would only be eligible for citizenship if Ms. Lavie could prove that either the donor sperm or egg were from an American donor. Unfortunately, most fertility clinics do not maintain such records to protect the anonymity of donors. Thus we have the irony that children born to an American mother are not United States citizens, even though a child born to non-Americans in the United States is automatically a citizen. The laws concerning citizenship simply have not kept up with advancements in medicine.

The rise of the gig economy has simply been too fast for adequate regulation. Eventually, as some stability in the structure of alternative work arrangements is achieved, Congress will hopefully address this new segment of the workplace and, if we are lucky, codify a Buddha-like "middle way."

For investors, the rise of the gig economy is a boon for corporate income statements. Fifty years ago, four of the five largest companies by market capitalization each employed more than 100,000 people. The fifth, IBM, had 80,000 workers. Today, only WalMart employs more than 100,000 (it has an incredible 2.2 million employees). The other companies, Google, Apple, Exxon Mobil and Microsoft all employ fewer. The stock market rewards the leanest companies, which are relatively unburdened by some of the costs associated with a large labor force. They are able to return more of their profits to shareholders. The inexorable advances in technology and pressure for public companies to meet quarterly earnings expectations will almost certainly keep the gig economy expanding. As noted, this is good news for investors. But not so much for America's already hollowed-out middle class.