

## The Wedge Goes Deeper

By Patrick Watson | June 30, 2017

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“Nearly all men can stand adversity, but if you want to test a man’s character, give him power.”

– Abraham Lincoln

“If more of us valued food and cheer and song above hoarded gold, it would be a merrier world.”

– J.R.R. Tolkien



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**PUBLISHER’S NOTE: John Mauldin is off this week on a well-deserved honeymoon vacation. In his place, John asked his longtime colleague and protégé Patrick Watson to write *Thoughts from the Frontline*. John will be back next week. – Ed D’Agostino, publisher**

In last week’s letter, John Mauldin had some harsh words for the Federal Reserve leaders whose hubris pushed us into our current monetary corner. Now, with no good choices left, all we can do is pick the least-bad one.

I could easily pile more criticism on Janet Yellen and the gang, but I have a different question: ***Why are powerful people so consistently clueless about the harm they inflict on everyone else?*** We’ll look at some new research for a possible answer.

Then we’ll apply that information to last month’s biggest corporate news story: Amazon’s \$13.7 billion takeover of Whole Foods Market. It will have effects way beyond those two companies. You’ll see what I mean shortly. Fair warning: It’s not good news.

First, a little business. John had a fascinating interview at our recent Strategic Investment Conference with Altegris Investments CIO Matt Osborne. Along with the economic outlook, they discussed some personal investments of John’s that he rarely reveals. Due to the nature of those investments, we had to restrict the session to “qualified purchasers.”

If you fit that description but missed the conference, we now have an audio recording, slides, and transcript available. Just [follow this link](#) and answer a few questions to see if you qualify. You will then be given direct access to the materials.

Now, on to our story.

## **Sharpened Edge**

John wrote a letter last year called “[Life on the Edge](#)” that I think was one of his most important ever. It drew more reader feedback than anything else of John’s I’ve seen. You may want to read it again after you finish with this one.

Drawing on Peggy Noonan’s Protected vs. Unprotected theme, John described how our economy has left so many people behind. Their anger, much of it well-justified, is one reason Donald Trump is now president.

The issue is broader, though.

Powerful people everywhere routinely make decisions that hurt others. We see it in central bankers, politicians, corporate CEOs, religious groups, universities – any large organization. The old saying is right: Power really does corrupt. And corruption is a barrier to sustainable economic

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growth. This is more than a political problem; it has a serious economic impact.

[Recent psychological research](#) suggests that powerful people behave remarkably like traumatic brain injury victims. Controlled experiments show that, given power over others, people often become impulsive and less sensitive to risk. Most important, test subjects often *lose empathy*, that is, the ability to understand and share the feelings of others.

For instance, researchers asked people to draw the letter *E* on their own foreheads for others to view. To do that, you must mentally place yourself in the other person's viewpoint. Those who reported feeling powerful were *three times more likely* to draw the *E* from their own vantage point instead of the observer's.

Powerful people also lose a capacity called "mirroring." When we observe other people doing something, our brains react as if we were doing the same thing. It's why, when you watch a sporting event, you may unconsciously mimic a golf swing or the referee's hand signals. Some portion of your brain thinks you are really there. But when researchers prime test subjects with powerful feelings, their mirroring capacity decreases.

You can see why this is a problem. The Protected-class members of the Federal Open Market Committee must feel quite powerful when they gather in that fancy room to make policy decisions. It's no wonder they forget how their decisions will affect regular working-class people: Their empathy circuits get turned off.

Similarly, as John wrote in "Life on the Edge,"

Business executives meet in a nice office, tweak a few numbers, and somewhere down the line people lose their jobs. Those folks are thousands of miles away, and the decision-makers never even see them. This is what it means to be "protected."

So if hubris is a disorder, can we treat it? Not easily. As with drug addictions, the patient must recognize the problem and want to change.

I once told John, jokingly, that we would get much better Fed policy if all FOMC members had to spend two weeks a year as Uber drivers or bank tellers. As it turns out, the research says that might actually help. Putting the powerful in situations where they must interact with regular folks helps restore empathy.

Everyday interactions used to happen naturally. Powerful and wealthy people have always had privileges, but they still shared certain common life experiences with the general public. Everyone went to the driver's license office and waited. We all drove the same roads in the same traffic. We went to the same hospitals when we got sick. We bought our groceries in the same places.

These small points of commonality add up to a stable nation and economy – and we're losing

them. The Protected class is withdrawing into its own protected world. It hasn't always been this way.

Years ago, I saw Michael Dell at the Austin airport. This was the late 1990s, when he was already a well-known billionaire. I'm sure people recognized him, but they left him alone.

This billionaire, who was perfectly able to fly in his own jet had he wanted to, stood in line to buy frozen yogurt, then took a seat at his gate to eat it. I was on a different flight, so I don't know if Dell was in first class that day. He probably was, but otherwise he had the same experience as everyone else.

That was 20 years ago. How many of today's top-level CEOs fly commercial? Not many, I suspect, and those who do probably wait for their flights in special lounges. Their boards may require this because they want the CEO to use time efficiently.

That's not unreasonable, but it has a cost. It means the CEO (or government official, central banker, etc.) loses awareness of everyday life as most people live it.

### **Steak or Spam**

Something else we all need is food. Except for the very wealthiest, who have household staff, we all visit grocery stores. Some buy steak, and others buy Spam, but we go to the same stores and through the same checkout lines. You know you are in the Protected class if you can't identify with that experience.

President George H.W. Bush learned this the hard way. Running for re-election in 1992, he [marveled at seeing a supermarket scanner](#). He had no idea they existed, and he reinforced the clueless-patrician stereotype his opponents used against him.

When Bush saw the scanner, he had been president for three years and vice president for eight years before that. Of course he hadn't done any grocery shopping recently. No one expected him to. But voters expected him to *know what it was like*. The revelation that he *didn't* know was politically problematic.

A few months later, a voter tried to catch Bill Clinton in the same trap. Bill was ready. The *Los Angeles Times* [recorded the event for history](#).

Debbie Gilbert, the mother of two boys and a part-time employee at a local hospital, said her exercise was prompted by a lack of confidence in politicians.

"I don't believe that politicians know what it's like to be in the shoes of the average American family," she said on the program. "I want to know if you know how much it costs to buy a pound of hamburger, a pair of blue jeans, a tank of gas and a visit to the

doctor's office?"

Without pausing, Clinton weighed in like a contestant on "The Price is Right:"

"Gasoline is about \$1.20, hamburger meat is a little over a dollar. A gallon of milk is two dollars. A loaf of bread is about a dollar," Clinton said, adding that a doctor's visit differed from area to area.

"Blue jeans run you anywhere from \$18 to \$50, depending on what kind you get," he said.

At that point, Clinton had been either governor or attorney general of Arkansas for 12 of the last 14 years. Had he done much grocery shopping? Probably not, but he knew he might get the question, and he was prepared for it.

Which brings us to today's grocery story.

### **Groceries to Go**

If you are a shareholder in either Amazon (AMZN) or Whole Foods Market (WFM), their combination ought to please you. Both stocks rose on the news while the rest of the grocery industry dropped. But in the long run, I'm not sure their deal will work out well for any of us.

No one outside Amazon (and possibly within it) really knows what Jeff Bezos plans for Whole Foods. We do know he's been trying to break into groceries for years. We also know he sometimes acquires companies and then leaves them mostly alone. Amazon bought Zappos in 2009, but today it's still Zappos.

Much of the Whole Foods analysis revolves around Amazon's using the stores as a kind of delivery hub or pick-up zone. I don't think that will happen. First, the stores don't have much extra space. They can be grocery stores or warehouses but not both. Second, Whole Foods stores are usually in high-end shopping centers. Amazon could probably find lower-rent space not too far away if it wanted logistics hubs.

So, I think Whole Foods stores will still be grocery stores – but they will change. They'll get new technology. [Amazon Go](#) could be the model: a grocery store with no check-out. You get an app that tracks you through the store, identifies whatever you pick up, and charges you for it.

That would work pretty well at Whole Foods – they're already halfway there. Consider the price labels on their shelves.



Instead of paper tags, most Whole Food products have these little digital devices. Presumably they're networked and a central office can change them instantly.

We also know that Amazon – the online part of it – uses [dynamic pricing](#) that can change frequently. Whole Foods is already set up to do the same in its physical stores. You can bet Jeff Bezos noticed.

The genius of Amazon Prime is that the free shipping reduces your price sensitivity. They don't force Prime on you, but they don't need to. Many folks search for what they want and filter by the items that are Prime eligible, then choose. They never know whether a less expensive non-Prime option is available.

I suspect Whole Foods under Amazon will become a more sophisticated version of what it is now: a premium-price grocery store catering to well-off people. They'll either dash in to grab what they want or have it delivered. In either case, this service will further insulate the Protected class from once-common experiences.

The process has been underway for some time. My colleague Robert Ross and I co-edit an options service called [Macro Growth & Income Alert](#). About a year ago we started seeing trading opportunities in the low-end retailers and dollar stores. Another one popped up on our screens after the Amazon-Whole Foods announcement sent grocery stocks down.

As John keeps saying, we're overdue for recession. I agree, and I think it makes sense to own stocks that tend to do well in times of economic weakness. The dollar stores are tailor-made for that. But [others see the opportunity, too](#).



Aldi and Lidl are European grocery chains with big plans to expand in the US. I've never lived where they had stores, so I have no personal knowledge; but Robert has, and he describes Aldi as "Dollar General with produce and meat." The atmosphere is spartan, but the prices are apparently low.

See where this is going?

### Value at the Extremes

One of the fascinations of economics is the way market forces nudge people and businesses in new directions. Unraveling cause and effect can be tough, but things don't happen randomly. Every trend is really a long chain of actions and reactions.

The Protected class's increasing separation from mainstream society is a trend that we increasingly see reflected in retailing. Stores that cater to either the top or bottom extremes – luxury retailers and dollar stores – are doing well. Those that cater to the middle are struggling.

Now that trend is reaching the grocery segment. The outcome won't be all bad, either. Customers at Whole Foods and Aldi may define "value" differently, but both will probably get more value for the money they spend. But they will inhabit even more starkly different worlds than they do now.

In the process, we will probably lose one more of the common experiences that keep society stable and help us value each other's humanity. The Protected-Unprotected divide will widen even further, and people will cross it less frequently.

I have tried to imagine scenarios where this divergence ends well. I haven't come up with any.

I mentioned the first President Bush above. The grocery-scanner criticism wasn't really fair. He is a genuine war hero. Yes, he was born into wealth, but he also volunteered to face danger.

His generation believed the Spiderman principle: "With great power comes great responsibility."

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That's not so common anymore.

If we are to avoid the worst, then the Protected class – and I'm admittedly a member – will have to work at it. We'll have to go out of our way to stay connected with the other side and help them climb the ladder, too.

This won't happen automatically and may not happen at all. It's a collective-action problem. Any particular member of the Protected class has little incentive to sacrifice any privileges. But if we all make nothing but individually rational choices, we will not like the outcome.

The alternative is to do nothing and let the chasm grow wider and deeper. I'm pretty sure none of us want that. If we don't, then we have to make some changes. Now is a good time to start.

### **Before He Was Famous**

This is where John usually tells you about his travels and meetings or plans for treating guests to a holiday dinner. I can report he is presently in the Virgin Islands on a honeymoon with his new wife, Shane. That's all the rest of us need to know.

However, since John has kindly lent me his microphone, I have a few words to add.

I have known John Mauldin longer than 99% of you reading this letter. I went to work for him full-time in 1989. He had just sold one company and started another. For the next three years, the two of us and a few others shared a small office in Arlington, Texas. You know how it is if you've ever worked in a start-up. You get to know everyone really well.

This was long before John was famous. He had his quirks, as we all do. He worked hard and expected the same. But otherwise, he was just John. We leaned on each other and made good things happen. It was a wonderful education for me. I moved on to a different kind of career until we hooked up again five years ago. Now it's much like old times.

I repeat that history to make this point.

The John Mauldin I know now is the same one I met all those years ago. In this letter I talked earlier about the way power and fame can change people. I can attest it hasn't changed John, except for the better. He still seeks wisdom wherever he can and shares it freely in these letters, because he genuinely wants to help people.

I haven't known Shane as long, but I can tell she and John have a special connection. They deserved a break, and I am honored to have helped make it possible by writing this letter. Please join me in wishing them many decades of happiness together.

John will be back in the saddle next week. If you want more Patrick, you can...



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- Subscribe to [Yield Shark](#), my income investing newsletter, or
- Subscribe to [Macro Growth & Income Alert](#), in which co-editor Robert Ross and I help investors generate more income with simple option strategies.

You can also follow me on Twitter [@PatrickW](#). Just remember, the opinions you see there are purely mine. John Mauldin and Mauldin Economics don't necessarily endorse them.

With that, I will hit John's send button and get this letter on its way to you.

See you at the top,



Patrick Watson

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