

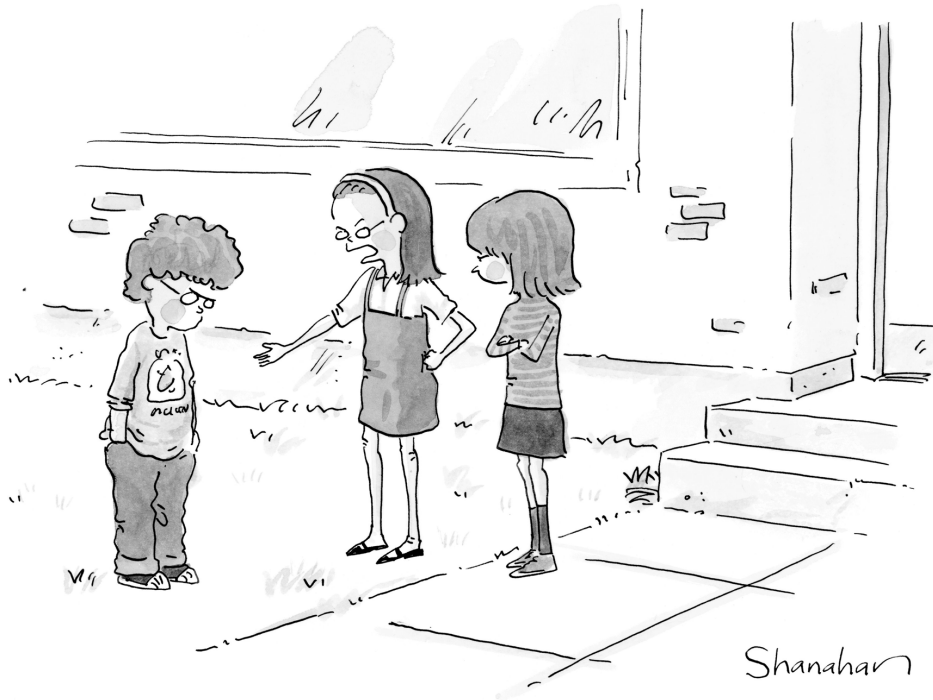


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INVESTMENT OUTLOOK – APRIL 2021

Peer Pressure and Performance Competitions

“Most conduct is guided by norms rather than by laws. Norms are voluntary and are effective because they are enforced by peer pressure.” – Paul Collier



“What’ll it be, Tyler—your lunch money or heaps of verbal abuse?”

Who likes working from home? I do, my wife does, and I’m betting most of my readers prefer to work from home rather than commute into an office.

Working from home allows many of us to sleep-in later – and who doesn’t love sleeping-in? Also, commuting by either car or public transportation is expensive, physically exhausting and time consuming.

As a family, my wife and I may be saving more than \$1000 per month, having eliminated our daily trek into San Francisco from our quiet home in San Anselmo. This figure doesn’t even take into account take-out lunches, which can easily run greater

than \$10 per meal. I miss almost everything about life pre-COVID, but the office commute is not one of them.

However, there is a dark side. Employees are working longer hours and harder than ever before. Many people are finding it difficult to clock-out both physically and mentally from work, as the home and the office have become one and the same. For many old time commuters, it is just not possible to stop working at the usual quitting time, as the excuse of rushing back home to make the ferry, or eat dinner with one's family is no longer a thing. Agree with it or not, peer pressure in a competitive organization is a reality.

After a while, the long hours and excessive competition cannot help but take a toll on all of us. It's not if, it is just a matter of when a breaking point is reached – and this is where the burnout phase begins.

I came across the below article published in Andrew Ross Sorkin's, Deal Book section of the New York Times, and found the author Corinne Purtill's commentary, on the money. The more things change, the more they stay the same.

Why Companies Can't Stop Overworking

By Corinne Purtill

"We want them to be challenged, but also to operate at a pace where they're going to stay here and learn important skills that are going to stick. This is a marathon, not a sprint."

That was David Solomon's response to complaints of grueling working conditions for junior analysts at Goldman Sachs — in 2013. (The bank's current chief executive was then Goldman's co-head of investment banking.) Shortly thereafter, the bank announced a "Saturday rule" forbidding most work from 9 p.m. Friday to 9 a.m. Sunday.

Eight years later, there's a Groundhog Day quality to the discussions about burnout and long hours, prompted by a group of first-year analysts at Goldman who described "inhumane" labor conditions involving 100-hour workweeks.

Goldman's "Saturday rule" is technically still on the books, but flouted as much as it is observed. Enforcing it more diligently was one of the actions Mr. Solomon pledged to take last month.

Overwork and burnout aren't just issues at investment banks. For many, the pandemic has essentially erased the boundaries between work and home: white-collar workers feel stretched to their breaking point. And when offices reopen in earnest, few expect overwork to vanish or burnout to be relegated to the past.

Research suggests all of this excess work isn't good for anyone, employers included. So why are so many companies still encouraging it? And when companies do claim they are trying to reduce long hours, why do these efforts so often fail to make a difference?

The diminishing returns of overwork

"There is now a mountain of careful research showing that people who experience long hours of work have serious health consequences," said John Pencavel, professor emeritus of economics at Stanford and author of "Diminishing Returns at Work: The Consequences of Long Working Hours."

A review of more than 200 studies over two decades on the relationship between long work hours and health found a correlation between extended workweeks and a higher incidence of heart problems and high blood pressure. People who worked longer hours (which in most studies meant 50 to 60 hours a week — practically part-time by some industry standards) were more likely to suffer injuries on the job and poor sleep at home. There was also a strong link between long work hours and behaviors that end up affecting workers' health, like smoking, alcohol and substance use.

It's not only employees' health that suffers when regularly working long hours. It's also their work. Research has suggested relationships between rest and problem-solving ability, between time away from work and some aspects of job performance, and between sleep deprivation and lower cognitive performance.

An eye-opening study by Mr. Pencavel explored how long hours affect work output by examining detailed data about munitions plant workers during World War I, who, like today's investment bankers, often worked 70 to 90 hours a week. (The importance of their work, or at least the danger of it, is hard to compare with editing slide decks at an investment bank, but white-collar work is hard to quantify in a similar way.)

For the first 49 hours of the week, there was a direct relationship between time and productivity — the more employees worked, the more they got done. Starting at hour 50, employees still produced more the more they worked, but the output for each additional hour worked started to shrink. And after about 64 hours, productivity collapsed — there was little to show for all that extra time except for a lot of additional on-the-job injuries. Mr. Pencavel also found that workers who worked seven

consecutive days without rest produced less than people who worked the same number of hours over six days in a week.

There's no magic number of hours at which returns diminish that applies to all workers and all industries, he said. But research doesn't support the idea that extreme work schedules directly translate to extraordinary productivity.

Why efforts to reduce overwork fail

Even in demanding fields, companies have had some success with models that produce high volumes of quality work without decimating employee health and engagement.

Over the past decade, Boston Consulting Group and PricewaterhouseCoopers have both rolled out flexibility policies that allow for greater work-life balance, in large part thanks to demands from younger workers. PwC granted all employees the right to ask for flexible work schedules, and this past week announced it will pay a \$250 bonus, up to four times a year, to employees who take a full consecutive week of vacation. Boston Consulting introduced options for employees to take up to two months off or reduce their work schedules while remaining on their career tracks. The gradual return to the office also offers employers an opportunity to experiment with flexible schedules.

Organizations can change. Their people are often better off when they do. But they have to actually want to do so. And when it comes to ultracompetitive firms like Goldman, and the people who choose to work there, the incentive to change may simply not be there.

That's the conclusion that Alexandra Michel has reached after two decades observing investment bankers, both in the depths of analyst hell and, for those who eventually leave, in their post-banking lives. Ms. Michel, an adjunct professor at the University of Pennsylvania's Graduate School of Education, also worked at Goldman for five years: three as an analyst and two in the chief of staff's office before leaving to get her doctorate at Wharton.

Ms. Michel has been following four cohorts of investment bankers for the past 20 years. She has documented a business model that relies on inexhaustible waves of new talent. Most workers endure grueling working hours, and around the fourth year on the job many analysts start seeing their bodies break down. Yet after countless hours interviewing current and former bankers, she believes that discussions of flexibility and work-life balance are moot in a culture that values the process of competition at least as much as the actual result.

DealBook recently spoke to Ms. Michel by phone. The interview has been edited and condensed for clarity.

DealBook: As both a former bank analyst and someone who has observed culture at investment banks in depth over the last 20 years, what are your thoughts on this discussion?

Ms. Michel: None of this is new. This situation has been the same for decades since I started as an analyst at Goldman in 1996. Even though the banks are, of course, very sensitive to reputational issues, I don't think that an analysts' survey is going to change anything.

Why not?

When I talk to journalists and to bankers and so on, when they hear that people work 100 hours a week, they don't ask, "Is that bad for your health?" They ask, "Is that bad for your performance?"

What's interesting is that for the first four years, it isn't. People are selected by banks based on their exceptional stamina. These people are extraordinary.

After four years, they get ill. Their hair falls out. They gain weight. But nothing bad happens to performance. After about year seven, something happens to performance that the banks really care about, mainly creativity decline. And at that time, bankers leave because their bodies are depleted.

But banks hire in cohorts and fresh blood is already pumping into the organization. From the perspective of the banks, the fact that people leave after seven years isn't a problem. When you have a constant supply of top talent streaming into the company, the argument that people are scarce and we'll lose the investment we made in hiring these people — that doesn't apply.

What about from the perspective of the people?

It isn't a problem either. I mean, it would be nice to have better working hours. But in the end, you signed up for these hours because you know that in the long run, this will benefit you, because you will assume leadership positions in other organizations.

But there's another argument that doesn't really operate at the rational level, but at the level of the embodied habit. People leave the banks because they don't want to work these hours anymore, but then they go into their new jobs and reproduce those same working hours. Even people who get their Ph.D.s and work by themselves.

When these sorts of companies enact work-life policies, why don't they seem to stick?

Look at the reward structure. You have an OK base salary, but then the bonus is allocated based on how you're stacking up at the end of the year against your peers. It's like a tournament. It's like a race. And all you know is that the people next to you, against whom you will be measured, are just as smart as you. They work just as hard. And so, the only lever you have is try to outwork them. These reward structures perpetuate this work ethic.

When an organization says "we value work-life balance, we want our people to not work on weekends, we want blah blah blah" — there is still this competitive structure where people have an incentive to work all they can because others are doing the same thing, and only winners get rewarded.

Churning through talent may work for a company. But you found that many employees choose these grueling schedules, even when they come at great personal cost. One associate told you: "I work hard because I want to."

The people who get hired at banks have been through performance competitions all their lives. When I talk to students at the beginning of their undergraduate career and ask them, "what do you want to be?" very few want to go into banking.

So what happens? When these firms descend onto campus, people start competing because that's what they have been conditioned to do throughout their lives. They chase after what everyone else chases after, regardless of whether they actually care about the work. Regardless of whether there are consequences or not, these people want to win.

This is maybe the final part that locks people into these intense work schedules. It is the idea that there is a cadre of individuals who are the best and brightest, and if you don't keep up the pace you'll end up at some kind of second-tier firm — part of an undefinable "rest."

What's so bad about that?

The people in the best and the brightest group, they have opportunities, they earn a lot, they work with other interesting people, they work on global deals. The rest push paper with uninteresting colleagues and over time, you'll become like them. That's what people sincerely believe. They believe that if you don't work for an elite organization, you fall into an abyss of personal social status descent.

In the end, if you ask me, what is the one true fear? That's it. It's the loss of social status. It's not the money. It is that people who formerly looked at you with respect and esteem will all of a sudden ignore you.

The bond market has stabilized while the acceleration witnessed over the past few months towards higher interest rates has abated. As mentioned in a previous commentary, the market's move to price in higher future inflation went far beyond what I had expected and as a result, both bond positions and large capitalization technology stocks were repriced considerably lower. In contrast, certain sectors such as value, commodity related industries and banks began to take off. I think the recent reversal back into large capitalization technology stocks is here to stay with us, and believe interest rates (the main driver in the market) will ultimately be headed lower.

Lacy Hunt is the chief economist at Hoisington Investment Management. Anyone who has had a focused career in the bond/interest rate market knows who he is, and that his analysis should not to be taken lightly.

In a video interview he gave to [Real Vision](#) (subscription required) Dr. Hunt cites three main factors which will continue to suppress interest rates. They are:

- Higher Productivity through technological advancement
- Increased Debt loads which have a negative effect on GDP growth
- A Decline in the Velocity of Money

Dr. Hunt argues that monetary growth is only one piece of the inflationary puzzle, the other being the amount of times money exchanges hands throughout our economy. This expression is defined as the velocity of money. Please see the link [here](#) which explains the concept of velocity of money through an animated cartoon. I found it very helpful myself.

So where is inflation today? Well, as he explains in his interview, it is trapped inside the financial system, which then finds its way into various financial assets, real estate markets, etc. The money however, never finds its way into the real economy as many people would think.

What do I believe this means for investors? Expect both financial and real estate markets to continue to rise as long as interest rates stay low and money growth continues along at a high pace. Full steam ahead.

Please see charts below for a visual representation of my comments above.

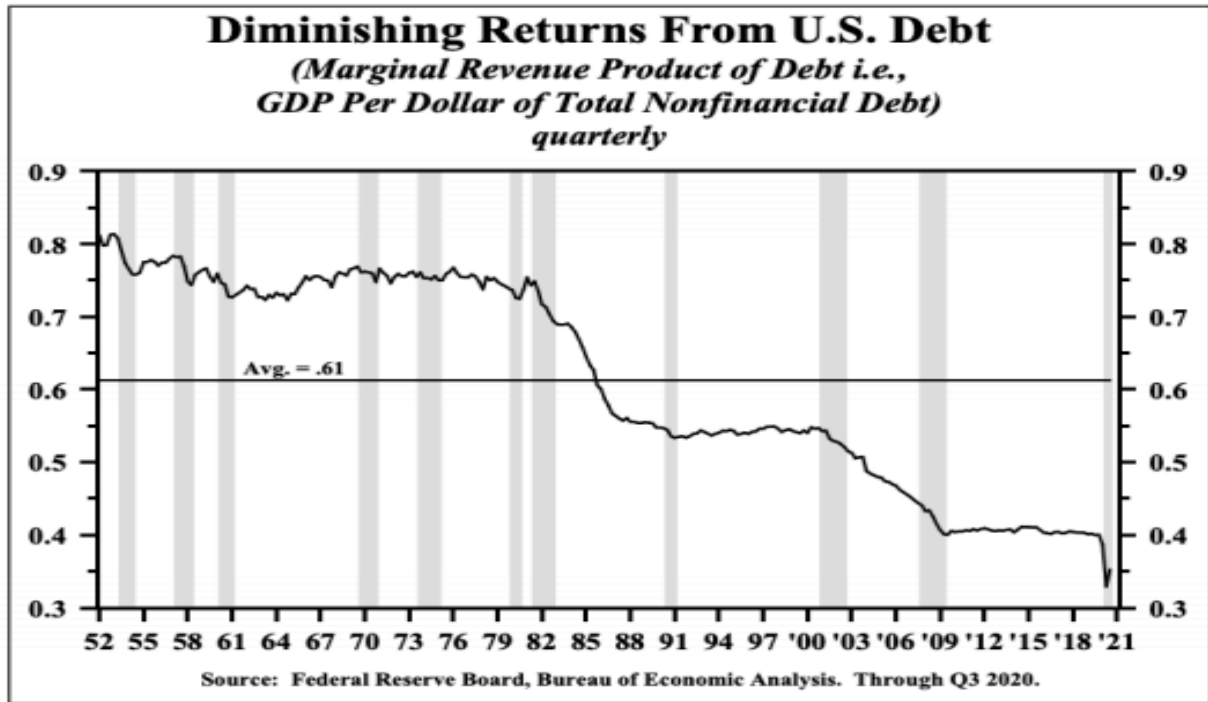


Chart 3

Source: Hoisington Investment Management Company

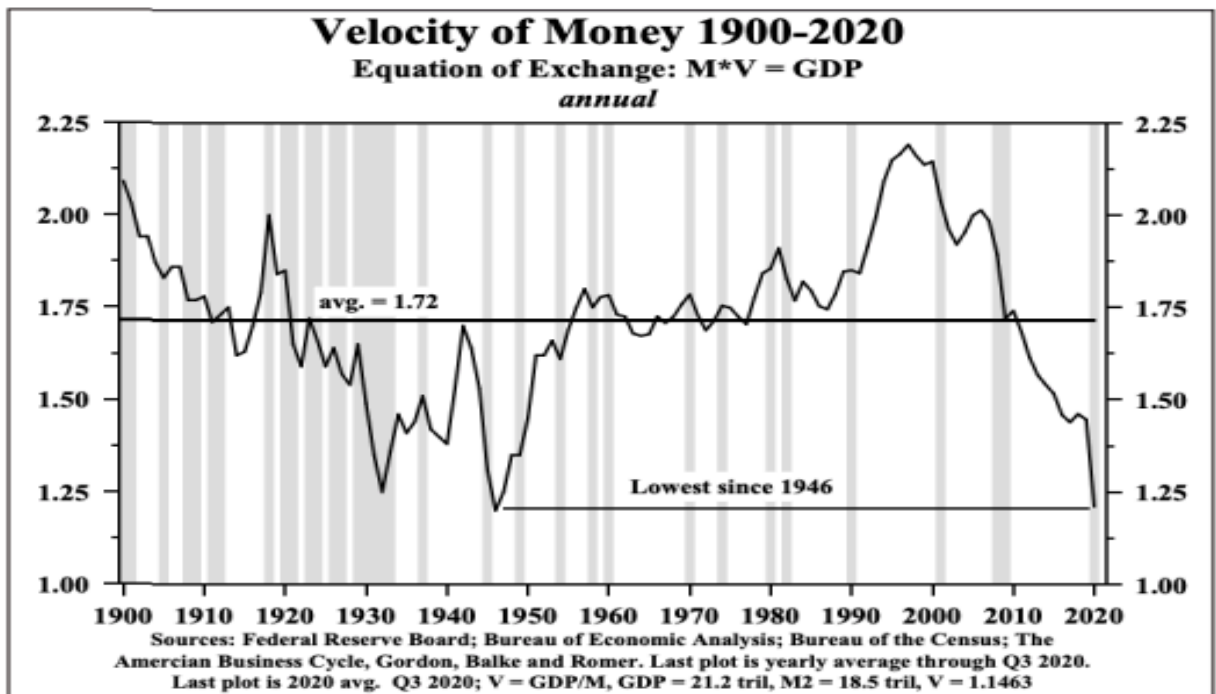


Chart 4

Source: Hoisington Investment Management Company



ASSET CLASS & SECTOR OPINIONS		
OVERWEIGHT	NEUTRAL	UNDERWEIGHT
U.S. Real Estate & Related Equities	Communication Services Sector	Energy Related Equities
Large Capitalization Technology	Healthcare Biotech & Pharmaceuticals	Financial Services Sector
Consumer Discretionary Sector	Healthcare Equipment	Consumer Staples
Small Capitalization Stocks	Mortgage Backed Securities	Materials Sector
Aerospace & Defense	Local Currency EMG Bonds	Leverage Loans (Floating Rate Debt)
Leisure & Hospitality	High Yield Corporate Bonds	Treasury Inflation Protection Securities
Emerging Markets Equities	Investment Grade Corporate Bonds	Gold & Gold Miners
U.S. Treasury Notes & Bonds	International Developed Market Equities	

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Justin Kobe, CFA
Founder, Portfolio Manager & Adviser
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