STEDMAN CAPITAL
MANAGEMENT

"Going Dutch: Securing Financial Independence in an Insecure World" – Gilbert Shaw of Stedman Capital

The Dutch are an intriguing people. Statistically, they are the tallest people in the world, yet they hardly have room for themselves within one of the most densely populated countries in Europe. They are known for their strong individuality and quick defense of personal liberty, yet they hold consensus-driven politics and business management in the highest regard. They walk as often on land they've reclaimed themselves as that created by nature. Their agricultural exports are greater in value than those of Canada, or Russia, or China, or Brazil – indeed, they often rank second in value only to the United States, but they achieve it with an arable land area no bigger than the very smallest of US states.

Who would have expected this from a country situated in such a precarious and insecure geographic position? After all, the Netherlands comprises effectively the largest river delta of Europe at the edge of the rough and unforgiving North Sea. This is not a place upon which fortune would have been said to have smiled! Nevertheless, the Dutch have used a combination of good governance, social organization and technical innovation to reduce their vulnerability while also achieving enviable prosperity.

As we consider our own vulnerabilities in today's global economy, it may be prudent to reflect upon the lessons Dutch experience might offer. For today, the statistics on wealth and income among developed economies portend a future of financial insecurity for the majority of those starting a new job or midway through an existing career. Meanwhile, economists like Thomas Piketty tell us income from capital is growing faster than income from labor, so the financial rewards of our careers, in effect, accounts for progressively less and less.

In light of these phenomena it would seem unwise to build our financial security singularly upon a foundation dependent upon job quality or working salaries alone. After all, our total income is ultimately derived from both our labor *and* our capital. Moreover, the fact total wealth is relatively and predominantly concentrated in the hands of the few suggests a chance for improved capital growth in the hands of the many. In fact, today it may be more meaningful than ever for most of us to give long overdue attention to the "capital" side of our personal balance sheet. Mind you not to the exclusion of one's day job, but rather as an important complement to it.

This is not a new idea.

When one cycles the bustling canal-lined streets of Amsterdam, one moves at once through past, present and future. Here amidst the everyday monuments of the Dutch Golden Age – the ubiquitous and unique canal houses of the inner rings of the city – one can easily slip into a contented feeling of quaint nostalgia for a bygone era. But before succumbing to Amsterdam's charms spare a thought for how our modern world has been shaped by the ideas and institutions that coalesced in this place at the end of the sixteenth and through the seventeenth centuries. The world of the Dutch Golden Age – so richly revealed to us by modern writers like Russell Shorto and Simon Schama[1] – has bequeathed to the enterprising individual a world of seemingly limitless opportunities and freedoms on the back of both economic and political liberalism. Yet, it also has created a world of uncertainties for those frightened by dynamic change. Indeed, in our increasingly global and rapidly automating world many feel increasingly vulnerable to the seas of fortune.

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[1] Such works include: Russell Shorto's, Amsterdam: A History of the World's Most Liberal City; and Simon Schama's, The Embarrassment of Riches: An Interpretation of Dutch Culture in the Golden Age.

Perhaps this uneasiness with change has existed in every age and amongst all peoples. But the pace and degree of change today has manifestly hastened compared to the past. We communicate in writing, in speech and in video at the speed of light to every corner of the globe. Meanwhile, our minds have remained unchanged in their fundamental capacity to comprehend. Today, we travel in minutes and hours what once took days, weeks and months. We raise capital for businesses or even for personal purchases at a keystroke, the tap of a smartphone or the swipe of a credit card. Many of these modern realities and conveniences owe their genesis to the Amsterdam of old and the world the Dutch shaped by trade, liberal democracy, corporate finance and corporate governance.

Yet, for many people – perhaps a majority in Europe, Japan and the United States – the level of economic growth today feels inadequate to the rising costs of living or the implicit cost of our own improved longevity. Between 1991 and 2012, for example, real wages in the United States grew on average by only 1% annually. In Germany, it was considerably less at only 0.6%. For Japan and Italy, it was even worse still; they saw almost no growth at all.[2] Meanwhile, the 20th century institutions of the welfare state – created to enhance economic security – have withered along with the diminished level of economic growth thus far experienced in the early 21st. Increasingly, whether thru 401Ks or Roth IRAs – the individual retirement savings vehicles found in America, the provision of future financial security lies increasingly in the hands of individuals, not in companies' or in countries' pension plans. Indeed, when it comes to retirement many in the modern world are being asked to pay their own way – or more colloquially: to 'go Dutch'.

But the comforting coddle of the welfare state did not exist in seventeenth century Europe either. Not even in Holland during its Golden Age. And in most countries of the time, it was fear of change – of new ideas and of new discoveries – that was the norm. Security was derived from conformity rather than individuality – but for a few places and especially in Holland. As Russell Shorto has captured so engagingly in his book, Amsterdam: A History of the World's Most Liberal City, within the Netherlands emerged modern liberal (small "L") economic and political thought and discourse. The Dutch of the day – a people increasingly sprinkled with immigrants and their yearnings for a better life – associated economic and political security less with conformity than they did with individuality and its ultimate potentialities for the common good.

Now, as we face a kind of back-to-the-future return of uncertainty in our own time, let's consider the experience of the Dutch for possible lessons. Among the complex elements of Dutch identity and history can be divined simple rules for financial security in an insecure world. The most salient among these being: the central importance of frugality; the discernment of value independent of price; and the conviction to make your own luck by recognizing and seizing opportunities.

Rule 1: Be frugal.

Limited time and abundant good manners constrain my use of Dutch national stereotypes to but one: frugality. This is not a trait unique to the Dutch, and – as with all stereotypes – is not a trait actually shared by all Dutch people. Nevertheless, if one were to ask both non-Dutch and Dutch alike for a list of Dutch characteristics, frugality is apt to show near the top of every list. While frugality can have a negative connotation of miserliness, the Dutch embrace it in the more positive meaning of efficiency of use or un-wastefulness. This isn't to say the Dutch don't embrace the odd indulgence, rather these treats are seen as the just reward for abstaining on most other things not truly needed. In short, frugality matters to the Dutch.

It should to us too.

For those not fortunate enough to inherit their riches or to win the lottery, wealth must be created from scratch. There are two basic ways to create this excess "scratch," or capital, from which one can invest in hope of becoming wealthy or, at least, financially more

[2] For all statistics on real wage growth, see The Economist, Oct. 4, 2014.

secure. Either, one must earn a very high income and have enough after living expenses to put into savings, or one must – essentially regardless of income – hold ones expenses to the barest minimum. For the Dutch of all ages – including today – as for most people everywhere, the distribution of individuals earning a truly large salary is exceptionally small. Among this popularly called "one percent" of income, there are some well-paid professionals, corporate titans and the rare celebrities of the arts, media and sports, all of whom will have significant annual incomes, even after potentially lavish lifestyle expenses.

But most people have much more modest annual wage income. Yet, they can increase income outside of their wages with other earnings, say, from interest on savings or from dividends and capital gains on investments. Too few do this. And for many, there seems a contradiction: if they don't have high incomes, then how can they have money to invest? Could it be, however, people are poorer because they don't save enough? Or do they not save enough because they are poor? Of course, every personal situation is different, but throughout their history the Dutch have shown that it pays to be frugal because frugality pays. Or, as we have too rarely taken to heart: a penny saved is a penny earned. Those earnings can be invested to produce income and, ultimately, capital gain.

Thus, anyone who wishes to attain some level of financial independence and security in our world of languishing wages would be well advised to complement their earnings from labor with earnings from capital. To have the required capital requires most of us make frugality a personal virtue. This sounds hard. There are many temptations. But remember: the level of material abundance – and at relatively low cost – around us today would be unimaginable to earlier generations of Dutch and non-Dutch alike. So, embrace frugality. It is a source of secondary income that can be invested for future gain and security.

Rule 2: When you invest your savings, don't confuse price for value.

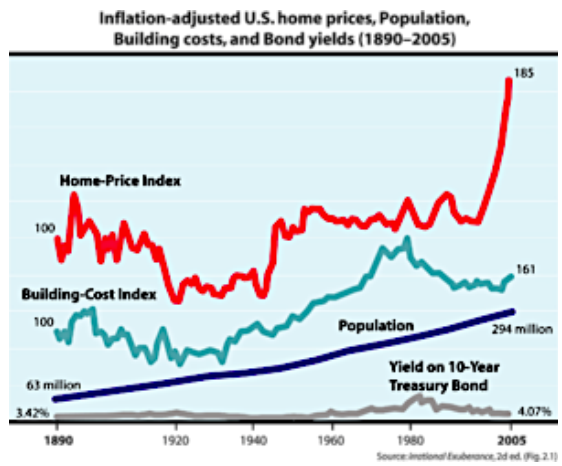
Behold the tulip. When brought from the Ottoman Empire to the Netherlands during the Dutch Golden Age, the tulip captivated the imagination. Here was a flower of unparalleled color, boldness and brightness. Its bulbs survived the cold, dreary months of Holland and took root in its rich alluvial soils early each spring. But for reasons not completely understood and agreed upon, it rapidly became a popular object of desire and – as its price rose from ever-higher demand – it became a status symbol of wealth and taste. This was especially true of certain varietals plagued by a virus that caused both limited supply and exotic patterns of color at the same time. In today's terms, the price for the most rare approached the equivalent of about $100 thousand. And the equivalence was not for a bunch of tulip bulbs, mind you. It was for just a single bulb.[3]

Some consider the "tulip mania," which reached its peak in March of 1637, to be the first modern asset bubble. Whether or not this is true – and some argue it was not a bubble at all – the related but distinct concepts of price and value can be examined. Famed value investor Warren Buffett calls out the distinction when he opines that "price is what you pay, value is what you get."[4] In other words, what you pay for something might change, but the underlying qualities

[3] This is a rough guess and could significantly understate the price. It is premised on reports claiming some tulip bulbs traded at the equivalent of 10x the annual wages of a skilled laborer. A low-income annual US salary equivalent has been used and 10x multiple applied to it for purposes of illustration.
[4] See the 2008 Berkshire Hathaway Annual Report

of a product or service are more constant and have some intrinsic worth. Did the intrinsic value of a tulip change so radically as did its price in the span of a day, a week or a month? Did the 10x price paid only months later than previously more accurately capture the true value of the flower? Or was it the 2x price? Or 50% discounted price?

Too often the human animal values what others value, not something we must try to evaluate for ourselves. Indeed, a kind of popular psychosis – or what is more typically and unhelpfully termed "conventional wisdom" – replaces wise and critical thinking altogether. Investment fads and fashions become "no brainers" that only fools would not jump to join. The Dutch experienced this briefly in the seventeenth century with tulips, but we see it elsewhere today perhaps. Index fund investing comes to mind as the latest conventional wisdom and 'no brainer' that may leave those getting in late (i.e. now) consigned to very poor returns indeed. While modest amounts invested consistently over time may work well with index funds, to jump in with relatively *large* bets when the market is at an historic high is likely unwise.



Such 'jumping in' was equally imprudent a decade ago in housing in the United States (and in Holland). Yet many did so in a kind of feeding frenzy in which banks, that should have known better, only abetted the phenomenon. Banks lent pro-cyclically – lending more when house values rose more. This lending, in turn, helped fuel further house price rises. And, as we have seen, such gains do not persist forever. For, ultimately, things that don't make sense… stop. Indeed, how can a community sustain itself when a fireman or a teacher or a waitress cannot afford to live in the communities in which they work? Is the house really worth what the market will bear, or does the market sometimes bear irrational results?

The lesson of the Dutch tulip mania is not only that price and value often diverge, but also – and most essentially – that there simply are no "no brainers". If frugality is the general precondition for most people to have surplus capital to invest, critical thinking is the requirement for estimating intrinsic value. Many Dutch made money by selling tulips. Many more lost money by spending too much for what they got in fleeting return. But certainly, quite many more still saved their money for other things and other ventures. Some of those looked beyond the local flower markets – and the financial futures markets these flower centers innovated – to embrace the new opportunities for investment in the global spice trade via the first of the world's engines for popular capitalism: the stock exchange. There, in addition to getting a share in the first public corporation, the VOC (or Dutch East India Company), they could secure fractional ownership in other promising companies, including a trading company establishing a new trading post on the eastern shores of America upon a large wooded island known to aboriginal peoples as Manhattan.

Rule 3: Have luck! If you lack it, make it.

What is luck and what is its nature? Over millennia philosophers and writers have remarked on the interconnectedness of luck and fate and fortune. Seneca said, "Luck is what happens when preparation meets opportunity." Shakespeare's idealistic Brutus in *Julius Caesar* says:

There is a tide in the affairs of men.
Which, taken at the flood, leads on to fortune;
Omitted, all the voyage of their life
Is bound in shallows and in miseries.
On such a full sea are we now afloat,
And we must take the current when it serves,
Or lose our ventures.

As these quotes evince, there is a temporal and often fleeting nature to opportunity on which good fortune and good luck depend. Moreover, if opportunity comes along, there can only be resultant 'luck' when the opportunity is, in fact, met by a person's willingness and capability to seize it. Fundamentally, therefore, making one's own luck comes down not to the thing you can't control – the moment and timing of an opportunity – but rather the thing you can: your own preparation. This is what Charlie Munger of Berkshire Hathaway means when he says, "More important than the will to win is the will to prepare."

Broadly speaking, the Dutch have 'made' much of their luck by preparing the world around them for new opportunities. As the old chestnut goes, "God created the Earth, and the Dutch created Holland." Today, nearly 40% percent of the country has been to some extent "man made" or reclaimed through human ingenuity. Ironically, it was perhaps first Dutch fears of calamity, rather than dreams of opportunity, that propelled them to prepare thoughtfully against the prospect of apocalyptic floods. More thoughtful still was their refinement of wind power to do the work of pumping water for them. The tedious and time-consuming effort to raise water— from the lowest polders to higher bordering transit canals and then, again, up into rivers flowing to the sea— was outsourced to enormous windmills. This enabled the transformation of vast areas of the Netherlands (or literally low, bog lands) from seeping, creeping marshes and peat bogs into highly fertile, flat agricultural land.

Such a transformation is no small thing even today. But in the years before the Industrial Revolution it was absolutely world-changing. In doing so the Dutch not merely made their luck, they compounded it. First, by creating their own land at a time when the primary source of wealth and status was land-based and agricultural, land reclamation fundamentally augmented their wealth potential by leaps. Then, due to their adaptive use of wind power beyond water pumping to include milling, iron working, glass blowing, and so on, they augmented their labor – and thereby supplemented their income from labor – through capital. As such, some people were freed to devote themselves to other more productive, creative or recreational endeavors. Meanwhile, the reduction in the costs of production, combined with greater speed of work, meant the Netherlands effectively prepared itself for the world's opportunities: its growing population's demand for improved goods and services at better prices.

And the Dutch were characteristically ready to seize these opportunities. Ready in their minds and in their means. For making one's own luck is ultimately about both a manner of thought as well as a mode of action. The popular refrain to "think globally, act locally" hints at it, and the Dutch have exemplified it for generations. Actually, their local actions have effectively been global too! When the seventeenth century cleaning girl (wearing a pearl earring?) – perhaps a Sephardic Jew whose great-grandparents came in exile from Spain – could pop down to buy some shares in the Dutch East India Company at the stock market created in Amsterdam in 1602, she was not only acting locally, but globally. Long before others in Europe, the Dutch embraced immigration, published heretical ideas, tolerated diverse religions and established the modern corporate form and stock exchange for promoting commercial enterprise. All of these activities brought the world into the Netherlands while simultaneously enabling the Dutch to strike out into the world with confidence as well as with capital.

Perhaps a modern Dutch example illustrates the value of thinking not just critically – and globally – about future opportunities, but also acting on it here and now. The largest flower auction in the world is located in Aalsmeer, just south of Amsterdam. Indeed, Dutch flower auctions are a contributing factor as to why the total value of agricultural exports from the Netherlands ranks so highly in global league tables. Flowers produced all over the world – not just those grown in Holland – are flown in, auctioned and exported to end markets around the globe from Aalsmeer. In multiple cavernous trading halls, flowers continuously roll through on automated, digitally identifiable trolleys to be auctioned. In seconds – during a 'reverse auction' or what is, in fact, known as a 'Dutch auction'[5] – specific flower lots are auctioned while rolling onward to be claimed by flower trading houses or sent via subterranean robotic conveyors to airplane hangars at Amsterdam Schiphol Airport over a kilometer away.

In truth, the modern flower trader exemplifies all three rules for securing financial independence in an insecure world. She must be frugal in saving her capital for the right flowers; she can't buy everything. Then she must – and especially must do so in a Dutch auction – independently determine what the value of the flower is in advance of the auction; she will only get one bid. And then she must be prepared to secure it with a single (and only) bid when an opportunistic market price relative to her own value estimation is reached.

Fortunately, the promise of our modern world – one intimately shaped by the Dutch – is we need not reside in Amsterdam or even be Dutch in order to "go Dutch" ourselves. We can be frugal wherever we are, and wherever we go. We can avoid modern tulip manias by remembering to think for ourselves. We can identify and seize opportunities, if we are but willing to prepare. Like Amsterdam, however, we should drain away the stagnant and permit the free flow of the new. In ways hardly imaginable only a decade ago, we can gather information from anyone about nearly anything from virtually anywhere. In short, our seas of fortune and possibility are perhaps broader and deeper than ever. The Dutch remind us to have confidence in our ability to reason and to remake the world as a more pleasant and productive place. They have demonstrated humanity can earn not only from its labor but also from its capital. They admonish us to develop the discipline to save, the confidence to think and to evaluate for ourselves. In short, their example inspires us to prepare ourselves for a world not only full of challenges but also one filled with opportunities.

[5] In a Dutch auction bidding starts from a high value and a value clock counts *downward* in price increments until the first bid. The idea is that it speeds up the process and allows for a high volume of auctions to be completed. The first to bid is the last to bid. Everyone is hoping to wait as long as possible, but the fear of missing the chance encourages bids to be made promptly. In contrast standard auctions start at a low price point and bidders have the chance to keep bidding up the price, potentially over an extended timeframe during a bidding war. Dutch auctions are a kind of nuclear option that terminates conclusively in one stroke.