



## California Dreamin'

"California, California,  
Much has been told me about your beautiful sunshine,  
mountains and snow tops, valleys and rich crops,  
California, home so far from mine"  
Chuck Berry, *California* (1979)

I took a well earned holiday last week and took my bride Sharon to a city we've been looking to get to for several decades now, San Francisco. It was part of a celebration of our 30<sup>th</sup> Wedding Anniversary.

We started with a couple days in the beautiful wine producing Napa Valley, followed by a long trek south on Route #1 down to Monterrey, Carmel and the spectacular 20 or so miles around Big Sur. We finished with four days in San Francisco, which with its rolling hills, history, vistas and restaurants, is truly a world class city.

California, despite its 38 million residents which represent 12% of the entire US population (including majors in LA, San Diego, San Jose, San Francisco, Fresno, Sacramento and Long Beach, all over 500,000 residents), and despite its spectacular climate and topography, and despite its seemingly diversified economy strong in agriculture, defense manufacturing, financials, wine producing, Hollywood film making, Silicon Valley and its technology, and of course tourism.....California along with 10 other states (Illinois, New Mexico, Alabama, South Carolina, Kentucky, Ohio, New York, Maine and Mississippi), all have more people receiving some sort of welfare from government than they have taxpayers paying into the government (Source: Gartman Letter Oct 31, 2013), and it's probably going to get worse.

California has approximately \$150 billion in total bonded debt as of March 2014 (Source: Toronto Star Mar 21, 2014) even though the

California government is required to balance its book every year since 2004 (Thank you Governor Schwarzenegger for that) and the legislature now requires a two-thirds majority to pass any tax increase. These constraints seem to be the excuse to help explain why California has a low credit rating and a problem funding its debt, despite having an economy whose GDP is currently almost \$2 trillion. If California were a country, it would have the sixth largest economy in the world.

The numbers look like this:

	California – March 2014
Total GDP	\$2 Trillion
Total Bonded Debt	\$150 Billion
Bond Debt to GDP	7.7%
Bond Debt per Capita	\$3950
Interest Expense per Year	Almost \$6 Billion

(Source: Fraser Institute)

California has been a left leaning, mostly Democratic, liberal state for many decades, interrupted by Governors Reagan and Schwarzenegger who definitely leaned to the right.

One who notices can see government interjections everywhere. The state likes to think itself as "green." All shopping bags at all retail or grocery outlets will set you back \$0.10. Every restaurant tab in San Fran has a little notice on the bottom that says 3 to 4% will be added to each bill to pay for employee benefits.

At the end of June, state officials in California were to review a petition to gain a vote in November that would reduce prison sentences for non violent felonies. Backers say they have 800,000 signatures already (which far exceed the 504,000 required). If passed, the law would reduce the long sentences for minor drug possessions, shoplifting, check forgeries and other such non-violent felonies to misdemeanors.

This is a curious turn of events for several reasons.

California became a tough-on-crime state, mostly through a brilliant union campaign that created a fortuitous cycle. In 1980, California had approximately 24,500 inmates and approximately 2500 correctional officers. Then came the campaign supported by the union that eventually led the state to become the first to embrace the three strike rule, and here's what happened:

### Growth of a Union Powerhouse

Year	Inmate Population
1980	24500
1983	34640
1991	97309
1999	165166
2005	172000

From 1980 to 2000, the state of California built 21 new prisons, and the numbers of correctional officers went from 2500.....to 31,000 members of the California Correctional Peace officers Association (CCPOA). The state now spends \$10 billion a year, or 11.5% of the state's general fund managing its prison system. If the new initiative is passed, it will save taxpayers \$250 million per year (Source: Wall Street Strategies Jan 25, 2014).

Strangely enough, the CCPOA now takes in about \$22 million a year, and is using that powerful influence. It funneled \$42 million (yes, you read that right) into Governor Brown's 2010 campaign. There's even a push from the left now mounting nationwide to allow felons to vote. With up to 3 million felons in prison at any given time, and another 5 million having served their time, it would create a giant voting bloc, and prevailing thinking would assume this bloc would vote overwhelmingly Democrat.

But the one thing that stood out more than anything was the boom that Technology has brought to San Francisco. It is an incredibly expensive city to live in, so few raise families there. Rent for an apartment 900 square feet runs \$2500-3000 per month.....if you can find one.

Sure, San Francisco is the home of Wells Fargo, one of the biggest banks in the USA whose roots go back to the stage coach era. Charles Schwab is also there. Healthcare giant McKesson is also there as are retail giants Levi Straus, Gap Inc, Anthropology and Forever 21. But it is in technology where the region shines. "Old" giants like Oracle, Apple, etc.....are there, but it's the "new" upstarts that are making an impact. Names like Riverbed (Communications), Craigslist, Instagram, Pinterest, Reddit, Salesforce.com, Splunk, Twitter, Trulia, Yelp, Opentable.....are all San Fran based among many others. But while I was there, one name kept popping up, and it was a name with relationships to web giant Google: Uber. A couple weeks earlier Google had unveiled its new electric car, which could be the first towards a driverless vehicle.

Uber is the application company taking the world by storm with its on demand service currently focused on the taxi industry, but expected soon to branch into all forms of delivery. The private valuation is growing by leaps and bounds, and with the hand held device millennial generation, only expected to go higher.

Hailing a cab in San Fran can almost be impossible. But with a smart phone, you can summon one in minutes. Several cabbies told me their business was down 30-40% because of Uber, but they complained that Uber drivers didn't compete by the same rules. For instance, they don't have to own a taxi medallion (which I'm told are at \$250,000 in San Fran) and they don't carry the same liability insurance licensed taxis have to have (\$1,000,000). In fact, a couple months ago, an alleged Uber driver struck and killed a pedestrian but the defense's case was that he was not on "Uber" duty. The drivers who used Uber claimed they picked up 10-15 fares extra per day. The deal is the fare is split 80/20 from drivers to Uber. As techies will do, the bonanza and lack of barriers to entry is attracting others, with the new name Flywheel appearing in several cabs we rode in. Their split, I am told, is 90/10. Interesting enough, several cabbies told me they were not unionized, and when Uber tried to penetrate Toronto, they were rebuffed.

As the world continues to be ever-increasingly urbanized, disruptive technologies like this will only have unlimited growth potential.

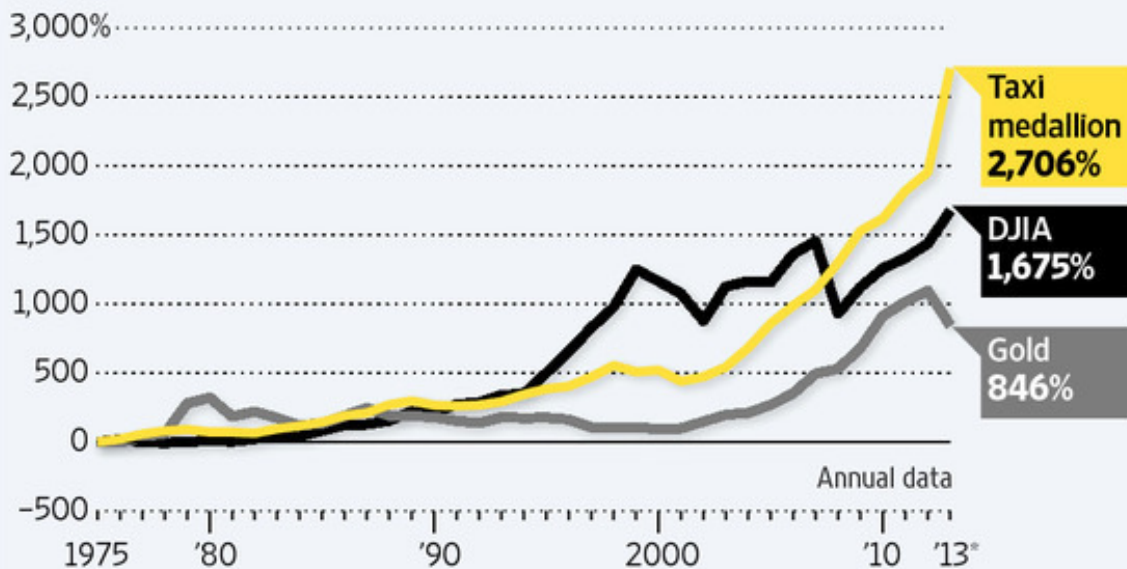
Last year Uber announced its intention to purchase 2500 driverless cars from Google for \$375 million. It is reported Uber drivers were earning nearly \$100,000 per year, which is eye-catching because the average cab driver in New York City earns just \$38,000 per year. Recently the CEO of Uber said that one day, the company will shift its fleet to driverless cars. Where would that leave Uber drivers? Out in the cold of course.

But in cities like New York where the taxi industry has been run like medieval fiefdoms for decades, innovation and competition never seem to stand a chance. From what I saw and heard, Uber has amazing potential, but there will be some fall out in the transition where the disruptive technology will hurt the men and women who currently support families by driving cabs.

Owning a taxi medallion in the Big Apple has been very profitable as can be seen below, no wonder they are trying to keep companies like Uber out:

## Upwardly Mobile Commodity

Change in the value of individual New York City taxi medallions compared with the Dow Jones Industrial Average and gold prices



\*As of September

Sources: NYC Taxi and Limousine Commission; WSJ Market Data Group The Wall Street Journal

Yes, Napa Valley and San Francisco should be on everyone's bucket list. The views on Route 1/Big Sur were some of the most amazing vistas I have ever witnessed and pictures cannot do them enough justice. Unlike Tony Bennett, I didn't leave my heart in San Francisco. I liked it, will go back one day, but the Big Apple of New York City is still it for me. But right now, the new technology boom feels different than the dot-com boom of the late 1990's. These companies are not just "cool" ideas; they are finding ways to monetize the ideas mainly through mobile applications.

Yes, San Fran is booming and hot right now, maybe too hot. As one cabbie (who surprised me with his knowledge of Canada) said, "it's way too hot and crazy expensive. It's time for a good earthquake to bring things back down" – Wow.

Stay tuned,

Vito Finucci  
Vice President and Director  
Investment Advisor

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