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Second Quarter 2021

The second quarter marks a milestone for me in my professional career. That has put me in mind for some reflection. It is said that on Wall Street history doesn't rhyme, it repeats. I've been thinking about the last 6 decades in investing, a period of time that more or less covers my lifetime.

The 1960s were the Go Go era, a period of rapid innovation. Many professionals and other investors felt compelled to own the so-called Nifty Fifty stocks. Companies like Coca Cola, General Electric, IBM, Kodak, Polaroid and Xerox were said to be One Decision stocks. You only had to decide to buy them, you never had to decide to sell them, because they only went up. This assumption and their popularity led them to trade, by the peak in 1972, at extraordinarily high price to earnings ratios. The Nifty Fifty of the 1960s have been compared to the FAANG (Facebook, Amazon, Apple, Netflix, Google) of today. They were mostly good companies but eventually they became too popular and therefore expensive.

In the 1960s President Johnson declared a war on poverty and fought a war in Vietnam. The large rise in government debt and deficits led to an increase in inflation. The Dow Jones Industrial Average hit a high of 960 in 1966 and didn't go above 1,000 until late 1982. During those 16 years an investor in that average would have lost two thirds of their purchasing power to inflation. In the 1970s alone the Consumer Price Index went up 7% a year. It doubled in 10 years, so every dollar of spending lost half of its buying power. In the 1970s commodity prices went up 24% a year. In 1970 the price of gold was about $36 an ounce. I well remember people lining up outside in the freezing snow to buy gold bullion for over $800 an ounce in January 1980.

The stagflation of the 1970s was marked by rising inflation and a stagnant economy. War in the Middle East and Vietnam, Watergate, and oil price shocks from OPEC embargoes were the backdrop. In 1979 newly appointed Fed Chairman Paul Volker set out to break the back of inflation by targeting money supply. He raised the Fed funds rate from 11% in 1979 to 19% in 1981.

The 1980s began with the worst recession since the 1930s. Then interest rates started to fall and stock prices rose. The 20-year Canada bond yielded more than 20% in 1981, and only 1.64% today. The 1980s and '90s were the two best decades ever for the S&P 500. The 1990s ended with the great technology stock bubble. In the final years of that decade the S&P 500 was seeming to go up 30% a year. I remember in 1999 clients were asking me why I was buying bonds that yielded only 7% when stocks could go up that much in a week. The internet was the fantastic new thing. Companies were being valued by the number of eyeballs that looked at their websites that might be of value to a potential advertiser. This was akin to today's popular measure of a company's TAM - Total Addressable Market, as if a successful company could fill up their TAM.

In the Naughts, the first decade of this century, the S&P 500 returned -1.0% per year on average for the decade. The technology laden NASDAQ Index lost some 78% of its value from the peak in March 2000 until October 2002 (anyone remember Nortel?). The Great Financial Crisis of 2008-2009 capped off a lost decade.

The 2010s were another decade of low inflation and low interest rates. The S&P 500 averaged gains of 13% a year. Central banks held interest rates extremely low after the financial crisis, below zero in several countries. This has caused most types of assets to become expensive compared to historical norms.

Are we back to the Roaring Twenties? Or are debts taken on by governments during the pandemic going to lead to inflation or stagflation? I do think there is an advantage to knowing the historical record if only because it reveals a range of possible outcomes. It does seem to me that in investing there is nothing that is genuinely new. But I manage portfolios based on the assumption that the future is uncertain, that markets move up and down in a random walk. Keeping exposure to stocks and bonds within predetermined limits is the key to successful long-term investing. Within those limits we are generally fully invested bears, as TINA, there is no alternative. We will guard against getting caught up in the popular enthusiasms of the day. In a bear market the winner is he/she who loses less than other people.

I feel we all owe a huge thank you to all the first responders, caregivers, medical personnel and essential workers who have done so much for all of us over the last 18 months.

Thank you for reading. Call anytime.

Sincerely,

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Portfolio Manager, Vice-President
Please visit us at www.georgestedman.com