StraightTalk

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Does Anything Make Any Sense Anymore?

Obviously, we are in uncharted waters as far as "business as usual" in our national and local economies. The number of closures changes daily, and we do not know when we will all get back to our normal lives. The stock market is gyrating wildly, going down much more than it goes up, and every day brings a new press conference or briefing on the virus, on our action plan to combat it, or on the self-inflicted damage to our economy that is required as a result of that plan.

As I have steadfastly maintained in my 27 years in this business, I do not have to know how this current crisis will be solved, I just have to know that it will be. *This time is not different,* we will get past COVID-19, and the economy will come back to life as we do. The question is always do we choose history, or hysteria? In order to answer that question – I have an investment hypothetical for you to think over…

Imagine you are planning for, or are already in retirement, and you have just heard about investing in a company that is foolproof – you can't lose your money. This seems appealing to you, but before committing any money you decide to do a bit of research on the company's numbers. This enterprise has $3.4 million in revenue each year, but is spending $4.4 million – effectively losing $1 million per year. Further research reveals that this company owes a total of $21.6 million in debt. Given those numbers, how many shares would you be willing to buy?

Assuming that you are now skeptical about owning a piece of this company, you instead decide to investigate the "safer route" of lending them some money, i.e., buying their bonds. These bonds are guaranteed against loss, so you feel like this makes sense for your golden years. The terms of your loan to them are that the company will pay you 1.7% in interest every year for the next 30 years, with a return of all that you have loaned them at the end of the third decade, for you (or for your heirs.) Of course, this rate of interest is taxable, so you actually pocket a bit less – but at least it is guaranteed. By the way, inflation is currently historically low at 2.1%, however even at that low rate it is silently eroding your spending power each year, so that you, almost invisibly, lose the ability to fund your lifestyle in retirement. So, the question now is, how much are you willing to lend to this company?

By now, you may have a guess about which investment I am illustrating. It is actually not a company, it's our Federal Government, except the numbers cited above need to have six more zeros behind them – so that those millions become trillions. At today's rates, to invest money in Treasury Bonds is suicide on the installment plan. On one hand, you are guaranteed to get some interest after taxes and inflation, and to get your money back. On the other hand, this entity spends more than it takes in every year, borrows more each and every year, (with no end in sight to either) and it pays you less than inflation for the duration of your loan. You are guaranteed to watch your income purchasing power decline for the period of time that you can afford it least – your years without a paycheck. And, when you get your principal returned to you, it will buy about half of what it did at the beginning of the loan. And yet, this idea is held out as the safest investment available, and money has poured into these government bonds as the Coronavirus news reporting cycle approaches maximum volume…what am I missing?

In my opinion, it has everything to do with our *national obsession with invested value* and short term loss in that value, rather than potential growth over time. That growth can be in earnings, dividends, or original principal invested, or all three. This is the argument that people far wiser than I have made for years, to no avail. The financial "news" channels all obsess every minute of the business day about the prices of the great companies of America and the world, and what the crisis of the hour is doing to those prices. This misguided media driven focus on the price of our principal ends up affecting all of us negatively. For those that heed the siren song to "do something," it hurts their long-term lifetime return, and for those of us that resist that behavior, the cost is unnecessary heartburn and stress. The question for any of us to ask in times of turbulence is, *have you, or anyone you know ever taken your account statement to the store to buy anything?*

The answer, of course, is NO – we do not live on the invested balance – we live on what income that balance can provide. If the dividends don't change, then the share price changes are irrelevant. For those that favor growth investments with little or no dividends, income is often defined as the withdrawal rate we have set against our portfolios. As long as that withdrawal rate is well below the long-term growth rate, then the share price changes are irrelevant. We must have faith in the fact that every time there is a negative news headline and prices go down in the short run, that they will not stay down for the long run, which means that our withdrawal strategies are not in jeopardy. This "endowment spending model" is what every college, university, charity and hospital foundation in the country uses to fund their existence – you are not alone in using this income strategy.

And here, the factual, historical evidence is quite clear. There are few things on earth that protect your long-term buying power (your income) from the ravages of taxation and inflation better than the long term growth of a well-run company. Of course, prudence dictates that you might want to own more than just one well-run company for diversification purposes, so most of us own a collection of them, what I often refer to as the great companies of America and the world. The fear of the unknown – be it a decline in prices like the Coronavirus has brought us, or even greater misplaced fears of an economy that will never, ever recover from quarantine measures in a viral outbreak – those fears always lead to the urge to "preserve principal." FDR said it best nine decades ago when he said, "The only thing we have to fear is fear itself." And this was spoken at a time when the only information source was a morning newspaper, edited and fact-checked by professionals, and written by people unmotivated by likes or retweets! Yes, social media and the connectivity of the internet has made the spreading of news easier, but this means that sensational bad news spreads faster in today's world, and unintentional misinformation spreads faster still. However, information alone isn't knowledge, and knowledge isn't wisdom.

I would add that knowing the exact price of everything in your life every day is also probably not helpful. Do you go online to check the value of your home each night using the website Zillow? Get an appraisal done on your house every thirty days so you can track your real estate value in a monthly ledger? Maybe check the amortization schedule and residual value of the car you are financing every month as interest rates change? I sure hope not!

Why then do we all need to check the value of our thirty year money each day, week, or month? And, if you are not planning to die as you make your last dollar withdrawal from your account, why check the value of what is likely fifty year money for the generation left behind? Are you really worried that there are any fifty year periods of principal loss in the stock market? (There aren't.) In my opinion, the answer remains to lend to companies and governments sparingly, and invest in the great companies of America and the world as often as possible. Thousands of people in hundreds of companies you own pieces of, all working hard and making pragmatic decisions about allocating capital for a profit just may be the last bastion of rationality in a world that appears to be going crazy.

Yes, the government will pull out all the stops to help blunt the effect of a slowdown caused by sequestration to halt the spread of a virus. Yes, some companies will struggle and fail as always, but the overwhelming majority of those that you own will not only survive, they will thrive on the other side of this and into the future. Have faith that this time is not different, and that this too shall pass. And the answer to this newsletter's title question is yes - owning the great companies of America and the world still makes a great deal of sense.

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