StraightTalk
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Summer Reading – Economics 101 and Risk

August is typically the slowest month of the year in the markets, and this year has proven no different. With the slower pace of summer, I try to get to some of the books on my reading list. Two of them that I did manage to read this month were the recently updated sixth edition of "Stocks For The Long Run" by legendary Wharton finance professor, Dr. Jeremy Siegel, and "An Economist Walks Into A Brothel" by Allison Schrager. The second of those books did get a sideways glance or two from people walking by my beach chair!

The first book is an absolute classic for any investment professional (or investor) who wishes to get past the cue-card reading news anchor chattering about the crisis du jour, and really understand long-term building of wealth. The second of the two books was a fascinating analysis of managing risk – using a variety of workers in everyday America; a big wave surfer, a paparazzi photographer, and yes, even sex workers in a brothel. Both of them are worth adding to your own reading list…

Speaking of Professor Siegel, I had the chance to hear him last month at our annual Summer Development Conference. As you might expect, the room was packed for his session, but I managed to get there early enough to secure a seat near the front. He reviewed the current economic and market conditions, while also making it quite clear that he was not a fan of the government's actions after Covid. His disdain was not just towards the President and Congress – he also included the Federal Reserve on his policy mistake list.

What drew much of his ire was how surprised all governmental parties seemed to be that inflation had erupted, and that their late response only further eroded the public's trust in our institutions. He harped on the $6 trillion that was printed to combat closing the economy. After showing a PowerPoint slide that depicted a one year, 41% increase in the supply of money in America, he paused, and barked out "Week 2 of Econ 101!" For anyone who has ever taken Economics, this is when you learn the laws of supply and demand, and the basics of money supply. And as I mention frequently in our conversations, many of our elected leaders either did not learn these things, or have long since forgotten them. So…our government printed lots of money that we didn't have, borrowed from the Fed to monetize it, and was somehow surprised when that sparked the fiercest explosion of inflation since the 1970s.

That sums up the bad news – but he also pointed out the good news, which is that the supply of money in our economy is now shrinking, not growing. Economists call this measure of cash in our system M2, and it is now growing more slowly than at any time in the last 90 years. He then pointed out that during the persistent inflation of the 1970s and 1980s – *the Fed never lowered M2*, not even for one month. This is a profound policy difference, and it is important. Put simply, it means that inflation should be (and is) coming down faster than it did in that decade. He further detailed how slowing global population growth and increased use of technology are deflationary forces in the near term, and that we are headed for a lower interest rate environment within the next three years.

Then, to drive home the "stocks for the long run" thesis, he showed statistics from the first edition of his book. That PowerPoint slide showed the real return on stocks (after inflation) was 6.7% from 1802-1992. The following slide was the most important of his entire session, in my opinion. He updated the long-term data from that first published book edition to include the last three decades. For the time period of 1802 through 2022, the return is now 6.75% - almost identical! In other words, *all of the news events of the last 30 years* have been totally irrelevant to the long-term investor's return. Where have you heard that before?

The second book, "An Economist Walks into a Brothel" was much more of a beach read, covering such disparate occupations as a big wave surfer, horse breeder, a retired three star general, and a professional poker player, among the others already mentioned. Allison Schrager conducts a deep dive into understanding risk using those everyday occupations. She explains in easy to understand examples how every day, each of us navigates risk in our own way. Sometimes we use facts and history to make astute decisions on risk, and other times we rely on emotion and "gut feeling' to make decisions that don't turn out as well.

Comparing using options on a stock portfolio to using a jet ski in big wave surfing, and sprinkling in discussions of predicting movie box office success and dating risk on Tinder, the author takes a dry economic concept of risk and makes it relatable. It was a quick, but fascinating read.

One paragraph caught my attention as it relates to the investment markets and human behavior. *"If we let our emotions influence our decision making when risk is involved, then we may not accurately measure the risks we face, or we may plow ahead without a clear goal. Even when we have a firm grasp on our goal and all the risks are clearly presented to us, we still make choices that don't appear to be in our best interest."* Amen.

Imagine that I presented you with only two facts regarding the investment of your lifetime accumulation of savings:

<u>Fact #1</u>, at 3% baseline inflation, your costs of living will more than double during a three-decade retirement.

<u>Fact #2</u>, according to Standard & Poor's research, since 1926, the *worst* thirty-year period of owning stocks averaged 7.8% per year. Put simply, costs up 242% and investments up 850%.

Yes, there are taxes to consider, and yes, you will not only invest in the S&P 500 Index – but back to my two facts. Where is the risk? If you did not watch any news or political commentary, didn't subject yourself to the angst of monthly reviews of values, and just patiently allowed history to play out as it always has (so far) - where was the risk?

In my humble opinion, the greatest risk any of us face in our financial lives is *not owning enough* of the great companies of America and the world! With every news story that comes out, the best long-term answer is to ignore it. "News" like the person who won any election being unpalatable, a foreign country invading another country, a global pandemic arriving, the economy going into recession, the government spending too much money, inflation spiking…the list of stories designed to erode your investment conviction goes on and on. The news media's job is to keep you glued to the screen so the advertisers are happy, and running a headline that investments have historically tripled inflation doesn't meet that goal – so they go with politics, or forest fires, or protests, or something similarly pessimistic.

I think most of us know who Warren Buffet is, but not many of us know his partner, Charlie Munger. He will turn 100 this coming January, and has been Buffet's self-described "closest partner and right hand man" for almost 50 years. Munger's timeless quote on long-term investing success is the exact opposite of the news. He said, "The first rule of compounding is not to interrupt it unnecessarily."

And one final quote from Allison Schrager's book brings this all full circle. It is from the only General to become President of the United States during the 20th century. Prior to being President, his titles included Supreme Commander of Allied Forces in WWII and Army Chief of Staff. Having planned and supervised the D-Day invasion, five-star general Dwight Eisenhower knew a thing or two about planning. His famous quote sums it up, "Plans are worthless, but planning is everything."

Economics 101, ignoring the news, and having a financial goal plan – that is the recipe for success.

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