StraightTalk

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"Yes, But What About…?"

As the numbers of us becoming vaccinated grows exponentially over the next month or two, you might expect the news media to exalt in this modern day scientific miracle. But, as any of us who has been alive in America for more than a decade knows, the news media never really trumpets good news, nor do they often retract incorrect "end of life as we know it" predictions that turned out not to be so – they simply pivot, *en mass*, to the next negative news story. Which in a general sense is manageable, unless watching the news headlines becomes the basis for decision making in your life, and specifically in your financial life. That becomes a problem. The number of times in my career that I've discussed how a previous end of the world headline did not come to pass, and the markets instead rose higher is too many to count. And almost as numerous are the times the next words out of client's mouths are "Yes, but what about ______?"

It turns out my view of negative news bias is not just my opinion – the non-partisan government body that, among other duties, declares the starts and ends of recessions has studied this phenomena as it relates to the top story of last year, COVID-19. The National Bureau of Economic Research wrote in November, "We analyzed the tone of COVID-19 related English language news articles written since January 1, 2020. Ninety-one percent of stories by major news outlets are negative in tone, versus fifty-four percent for non-U.S. major sources." The report continues, "The negativity of the U.S. major media is notable even in areas of positive scientific developments, including school re-openings and vaccine trials. Media negativity is unresponsive to changing trends in new COVID-19 cases or the political leanings of the audience." The NBER report concludes, *"U.S. major media readers strongly prefer negative stories about COVID-19 and negative stories in general."* So, there – it's absolutely our own fault!

Given the fact that we clearly like negative news stories, how do we keep that bias from seeping into decision making, particularly about markets and our portfolios invested in those markets? In other words, how do we separate being right about a particular news story from being wrong about how it might impact the markets? The simple answer is to have an emotional lobotomy when it comes to your financial life. Consume all of the negative news you want, discuss with your friends how it will ruin our lives, or the American Way all that you care to – just don't allow those emotions to seep into your decision tree regarding your investments. Because many, many more times than not – that turns out to be the wrong course of action for your financial health.

As an example, you may have been among the early group of people in predicting the havoc that our government's response to the virus would have on the economy last spring. However, if you used the fear of our nation's economy stalling as a reason to make a change in your portfolio, it turned out hideously wrong (12,000 Dow points up and counting…) Similarly, if you were correct in reading the political tea leaves and called the election right, but allowed emotion about the outcome to alter your investment mix, you got that one wrong, too. In both instances, the markets figured it out, and resumed an upward trajectory, making last year one of the better stock market years in recent history.

Setting aside the non-productive (and inaccurate) fretting over politics that occurs every four years, the obvious worry for most investors during the last twelve months has been the novel coronavirus. Specifically, the never before tried closure of our economy as a policy response to the virus, which had disastrous implications for huge parts of our national economy. The big question on the minds of most investors over the next year is, when will the news about COVID-19 improve, and the economy fully rebound? The question for behavioral investment advisors like me is – when the news about COVID-19 can no longer be spun as negative, due to herd immunity, or vaccinations, or both – what will the media discuss next? (Knowing, of course, that it will be another negative news story for "markets to worry about.")

A good bet for that next negative news topic, in my book, will be the amount of money that has been printed, and the amount of debt that has been created as a result of combatting this virus. Graphics on the money states have spent on care and vaccinations crushing their budgets, charts of our national debt exploding past the overall size of our economy, and red news banners shrieking about the unsustainability of our deficit spending will be on every channel, predicting imminent financial doom.

To be clear, I am not one of these new Modern Monetary Theorists who thinks debt does not matter simply because it is issued by us, and is denominated in our own currency. A six week crash course in Economics will teach you that it does ultimately matter, and every country that has legitimately tried this experiment has crashed and burned spectacularly. However, I also believe that it does not matter *today* to your portfolio nearly as much as the negative news hype will make you think it does – for a few reasons. For starters, with the exception of a couple of years of accidentally balanced budgets in the late 1990s, our government has spent more money than it took in every single year of your life. Period. Full stop. And the U.S. stock markets have gone straight up over that same period of time. Why is that?

Well, as I have frequently said, usually about international markets, "we don't invest in countries, we invest in companies." And to make my compliance department happy, I will state that past history does not guarantee a similar outcome in the future. But the historic data is quite clear – there are zero 20 year periods in which the market is negative. None. According to Standard & Poors research, since 1926, every single rolling 20 year period for the stock market has been positive. Furthermore, 99.6% of all rolling 15 year periods, and 94.4% of all rolling 10 year periods were also positive. So, if your money is designed to last at least for the next 10 years, getting emotional about the negative news story of the day, and then cashing out of the market flies in the face of the very clear long-term data above.

But back to debt and deficits for a moment. Aside from the government always spending more than it takes in, it is critical to note that our government never pays off our debt. Well, almost never…President Andrew Jackson did pay off the entire national debt in 1835, but that's the only time this has ever happened. No…what the government does is constantly *refinance* our existing debt. This changes the way you and I should think about the national debt – in other words, if you were never intending to pay off your mortgage, the balance owed becomes far less important than the amount of the monthly mortgage payment. Applying this logic to the national debt means that the interest paid, referred to as the "debt service," is what matters in the near term. And because interest rates have dropped so low (again) we are continuously refinancing our debt at generational lows in interest rates.

Much as people across America have delighted in 30-year mortgage rates at or under 3%, our government is enjoying the same scenario with our national debt. As a result, the Treasury Department just reported that for the most recent fiscal year, our debt service was only 1.6% of the size of our economy, compared to 1.7% in 2019, and roughly 3% through much of the decades of the 1980s and 1990s. So, in spite of the size of the debt increasing, and a concurrent temporary plunge in national economic activity, the interest we owe on our debt is about half of what it was 30 years ago!

This does not mean we should greenlight ever increasing amounts of debt issuance, because, even if we lock in some of our total debt at 10, 20 or even 30-year low interest rates, at some point in the future that debt will need to be refinanced again, and will likely face higher interest rates at that time. However, what makes us different than the failed nations on the scrap heap of history is our freedom to continuously create, innovate, and produce as a national economy. When our rate of growth resumes its historic expansion, the math reverts to ensuring that the rate at which our debt is growing stays at or below the rate of our economy's growth. In plain English, you likely owed more at age 50 than you did at 25, but it wasn't a problem because your income was higher and you could service that larger debt.

So for now, ignore those fear-inducing headlines, and look forward to the economic reopening that is right around the corner. The markets can sense it coming, and your investment managers are already hard at work identifying the improving revenues and earnings of the great companies here and around the world. The kinds of companies that have a history of growing over time, even if the countries they operate in are constantly filled with negative news headlines…