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February 2021 Crescent Commentary

"Remember, my son, that any man who is a bear on the future of this country [America] will go broke." J.P. Morgan spoke those words more than a hundred years ago. As much as the U.S. economy has changed over the past century, Morgan's words remain just as true and important today as they did when he spoke them. Over the past one hundred years or so, the U.S. economy has experienced World War I, the 1929 stock market crash, the Great Depression, World War II, the Cold War, nuclear brinkmanship, the Korean War, the Vietnam War, the assassination of a President, the 1970s oil shock and double-digit inflation, a trade war with Japan, the first Gulf War, the dot com bubble and bust, 9/11, the second Gulf War, the real estate bubble and Financial Crisis, a trade war with China, and most recently, the coronavirus pandemic, as well as dozens of other adverse events. Despite that continuous stream of unprecedented crises, the amount of inflation-adjusted wealth per person in the U.S. has increased more than fourfold since 1929[1][2].

The U.S. economy and indeed the entire world economy experienced its latest crisis a year ago. The coronavirus crisis included a frightening period of financial market pandemonium. As we discussed in last month's commentary, the policies our government has used to save the U.S. from a deeper economic crisis last year have led to some areas of speculation in financial markets. As we pointed out last month, speculative bubbles have historically not ended well for the gamblers involved with them. But at the opposite end of the spectrum, some investors strongly remember the fear of the market panic one year ago, and that fear prevents them from doing what's needed to succeed with their financial plans.

It turns out that it's perfectly natural for investors to remember the pain of loss more than the pleasure of gain. Behavioral economists have inferred that on average, the pain of loss could be twice as high as the pleasure of gain. Another factor which can contribute to lingering investor pessimism from last year's panic is what psychologists call the availability heuristic. It's essentially a mental bias where people rely on recent examples to form judgments about what will happen to them. For example, if people read about a horrific airline accident in the news, they may perceive and increased risk of an accident the next time they fly, even though the probability that their flight has an accident is completely unchanged by the previous accident. Similarly, the strong memory of last year's market panic can cause investors to perceive that another crash is just around the corner, even though crashes of the magnitude we experienced last year have only happened an average of once every ten years over the past fifty years[3][4][5].

As our Group surveys current economic conditions, we see strong cause for optimism. In parts of the world where the pandemic is under control, corporate executives have reported that business has strongly recovered, with society returning to the activities they enjoyed prior to lockdowns. Even without full vaccine distribution and herd immunity, the U.S. unemployment rate has declined every month since its peak of 14.8% last April. In fact, at 6.3% at the end of January, the unemployment rate isn't far off from the 5% level economists consider full employment. With a comeback that dramatic and fast, we can understand why Warren Buffett told his investors to "never bet against America" in his letter to shareholders last month. Imagine how well the economy will do as the population continues to receive vaccines and our society approaches herd immunity[2][6][7].

Pessimism has not paid off for investors. Despite the continuous stream of unprecedented crises we mentioned at the beginning of this commentary, the Dow Jones Industrial Average increased from 66 in 1900 to 30,606 at the end of 2020. Investors who allowed pessimism to direct their investment decisions and sat out of U.S. stocks were sadly left behind. Over the coming decades, we believe that investors who adopt a pessimistic view and sit on the investment sidelines will face a similar fate, to the detriment of their financial plans. It's important to mention that our Group feels this way because of the highest level of confidence we have in our approach to investing. Make no mistake, financial markets will experience turbulence along the way, occasionally as severe as we experienced last year. Think of our group's investment approach as the seatbelts on an airplane. When turbulence hits an aircraft, seatbelts protect passengers from hitting their heads and experiencing injury. But passengers not wearing seatbelts have received severe injuries (and even died) as a result of heavy turbulence. Similarly, those who invest with no risk controls, and who follow the crowd into popular investments they haven't properly evaluated because they see the price going up, have repeatedly suffered wealth destruction over time. Often, those investors mistook easy gains for long-term investment skill. But the cycle eventually turned. Whether you look at auto and airline stocks in the 1960s and 1970s (many of which filed for bankruptcy by now), dot com (and some big tech) stocks in the 1990's, or real estate in the early and mid 2000s, the long-term end result has been the same poor ending for crowd-pleasing investments. Our Group will continue to work to make sure our clients remain positioned to capitalize on human ingenuity and growth in order to succeed with their financial plans – with their seatbelts securely fastened[8][9].

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Sources:

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