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September 2019 Investment Commentary

How might the impeachment of Donald Trump impact your investments? Last month, most investors likely asked themselves this question. In this month's commentary, we'll review how stocks reacted to two historical Presidential impeachments: those of Nixon and Clinton. We'll discuss how stocks have thus far reacted to the possibility of a Trump impeachment, and why we think it's unlikely that impeachment proceedings would succeed. Finally, we'll explain why it's crucial that investors tune out the news headlines and instead remain focused on their long-term financial plans.

As with any geopolitical event, it's important to consult historical data when determining how a Trump impeachment could impact U.S. stocks. Regarding historical presidential impeachments, we can look to the Nixon and Clinton impeachments for clues as to how the stock market could react. With Nixon, stocks reacted negatively. From the beginning of impeachment proceedings, February 1974, until Nixon resigned in August 1974, the S&P 500 declined 13%. With Clinton's impeachment proceedings, U.S. stocks made a large positive move. From the beginning of the Clinton impeachment proceedings in January 1998 through his acquittal in February 1999, the S&P 500 increased 28%. So strictly looking at these two data points would imply a 50% chance that U.S. stocks would increase or decline on Trump impeachment proceedings. This result doesn't strike us as particularly insightful given that guessing the stock market's short-term movement is always a 50/50 game, with break-even results over time[(1)].

While formal impeachment proceedings for Trump haven't begun, an impeachment inquiry was announced on September 24th, and U.S. stocks declined 1% on that news. So, a muted response from stocks thus far. The subdued response from stocks partly reflects the low probability of a Trump impeachment. While Democrats control the House of Representatives, and the House could therefore possibly vote to impeach Trump, impeachment would then require conviction by the Senate, which Republicans control. We therefore find Trump's impeachment unlikely[(2)].

The impeachment inquiry began just a couple weeks ago, and will likely drag on for quite a while. While various headlines could pop up during this time period and create short-term market volatility, we think the historical examples of Nixon and Clinton show that ultimately, the state

of the economy matters far more for stocks than whether or not the President gets impeached. During the time that Nixon resigned, major economic headwinds battered the U.S. economy, such as the OPEC oil embargo, which brought about stagnant economic growth coupled with high inflation. Hence, stocks declined during the Nixon impeachment. Conversely, when Clinton faced impeachment, the U.S. economy was just beginning to enter the end stages of a bubble that lasted another two years. Thus, stocks increased during the Clinton impeachment. Similar to those two cases, a theoretical Trump impeachment wouldn't matter as much for stocks as the overall direction and strength of the U.S. economy.

Ultimately, the recent impeachment headlines reinforce the need for long-term investors to tune out news headlines and noise, and instead remain committed to a long-term, proven investment process. Unprecedented crises have continuously battered U.S. stocks over the 20th and 21st centuries: two world wars, the Great Depression, the Cold War, the Korean War, nuclear brinkmanship, the Vietnam War, the assassination of a U.S. President, the resignation of a U.S. President, double-digit inflation, the bursting of the dot com bubble, the September 11th terror attacks, the bursting of the real estate bubble / financial crisis, the downgrade of the U.S. credit rating, and the U.S.'s near default on its debt. Yet despite this continuous stream of crises, U.S. stocks have increased 35,245% from 1900 to 2018 (and don't forget 2018 ended on a low note with a 20% bear market decline in stocks). The annual return comes out to about 7% a year, which, as we mentioned in last month's commentary, has outperformed bonds, gold, and residential real estate[2].

As we look at U.S. stocks today, we do see long-term risks, but they aren't related to impeachment. They relate to the risks we often see at the later stages of economic cycles. Mainly, over enthusiasm for certain companies and industries, following the crowd, and the potential for future fallout from financial bubbles. As we've described in past commentaries, U.S. stock indexes have endured periods of no long-term gain in the past. In more recent history, this occurred from 2000 to 2013, when the S&P 500 remained flat, and 1964 to 1981, when the Dow Jones index remained flat. Warren Buffett attributed the dismal '64 to '81 performance in part to over enthusiasm for auto and airline companies, the hot technology companies of their time. The flat performance of the S&P 500 from 2000 to 2013 can of course be attributed to over enthusiasm for both technology companies and real estate[3].

Similar risks of no long-term return exist today for investors who follow the crowd into popular stocks and indexes. Our Group adheres to four pillars of risk management in making sure we protect our investors from financial bubbles and market crashes, while generating long-term returns that allow them to achieve their financial goals.

First, we don't follow the crowd into what's popular. The fact that an investment has gone up a lot over a few years says absolutely nothing about what that investment will do over the next five or ten years. For example, an article published in the Wall Street Journal earlier this year pointed out that of the four largest market value companies in the year 1999 (Microsoft, Intel, Cisco, Oracle), only Microsoft has a larger market value today[4].

Second, we only select investments where – after careful and prudent analysis – we can conclude that we understand the long-term profit dynamics of both the company and industry. Only under these circumstances can we calculate a reasonable price to pay for the investment.

That takes us to our third investment criterion, which consists of paying reasonable prices for investments. As we described above, three of the four most popular investments in 1999 have lower market values today, twenty years later. This has happened because those stocks became highly overvalued. Seeking to pay a reasonable price helps protect our investors against this scenario.

Finally, for clients living off of their assets in retirement, we maintain three to five years' worth of living expenses in cash and bonds. This provides our clients with a stable source of liquid funds to live off of during a prolonged stock market contraction, so that clients don't need to sell stocks at depressed prices.

Our Group's approach to the current market brings to mind what Warren Buffett wrote in last year's shareholder letter: "The less the prudence with which others conduct their affairs, the greater the prudence with which we must conduct our own…What investors then need instead is an ability to both disregard mob fears or enthusiasms and to focus on a few simple fundamentals. A willingness to look unimaginative for a sustained period – or even to look foolish – is also essential[5]."

Best Regards,

The Crescent Group
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Sources:

(1) Barron's
(2) Dow Jones S&P Indices LLC
(3) Fortune
(4) The Wall Street Journal
(5) Berkshire Hathaway 2017 Chairman's Letter

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