The End of a Year, The Start of a New Decade

As I write this during the week of Christmas, I am compelled to look back at the year we have all endured. 2009 was certainly one of the most headline inducing market environments of the last 35 years, with extremists from all political and economic beliefs screaming that the second Great Depression was upon us. Of course, now that those forecasts have proven to be incorrect, no retractions or corrections have been written, no TV specials announcing the error have been aired, and no one is offering to help the millions of investors who jumped out, only to watch the stock market rise (almost straight up) from 6,500 to 10,500 in less than one year. Granted, that’s still a long way from the top of 2007, but it serves to underscore how quickly fear can turn to greed, and optimism can trump pessimism.

Larry Summers, President Obama’s chief economic advisor, said on television the other day that the recession is over. You might ask, how can that be, when the majority of the government’s stimulus has yet to take effect? I will answer that with some auto sales data. One of the more written about (and more successful) stimulus programs was the “Cash for Clunkers” program. Designed to spur consumers to buy new cars, trucks, and SUVs - the clunkers program had more than a few critics. The popular outcry from those arguing against governmental intervention in free markets was that the program would merely “borrow” sales from future months, or future years. In other words, if you were planning a new car purchase in late 2009, or 2010, you might advance your timetable to take advantage of the government cash available for a limited time. By definition, this means you would not make that purchase in late 2009 or 2010. The argument was that a new sale had not been created; it had merely been pulled forward on the calendar. The worry from these critics was that the months immediately after the program ended would show a sizeable decline in sales volume, which would be publicized at a time when the economy might be vulnerable to the “double-dip recession.” Well, the data is in. According to Robert Stein, CFA and Senior Economist at First Trust in Chicago, Americans bought vehicles at an annualized pace of 9.7 million in June, the last pre-clunker month. In October, after the clunkers program ended, Americans bought at a 10.4 million annual rate, and last month’s sales annualized at 10.9 million. What the Keynesian economists and politicians failed to count on is the powerful, indefatigable, and regenerative force of the market economy.

So, the headlines touting the second Depression have faded away. But I save articles and newsletters all year long and frequently refer back to them for perspective. One article I saved was an op-ed piece from the August 31st Wall Street Journal. Written by Allan Meltzer, a published author and economics professor at Carnegie Mellon University - it takes a hard look at whether we needed the stimulus at all. Titled “What Happened to the Depression?” the article posits that the facts of the economic and market declines of the last 20 months have been distorted. He writes, “Day after day, economists, politicians and journalists repeat the trope that the current recession is the worst since the Great Depression. Repetition may reinforce belief, but the comparison is greatly overstated and highly misleading. Anyone who knows even a bit about the Great Depression knows that this is false. The facts we face today are very different than the grim reality Americans confronted between 1929 and 1932. True, this recession is not over. But it would have to get improbably worse before it came close to the 42 month duration of the Great Depression, or the 25% unemployment rate in 1932.” Almost four months have clicked by on the calendar since that was written, months that have seen GDP begin to grow again, the dollar strengthen, unemployment fall, and some TARP monies paid back with big profits for the government. The article appears more and more accurate with each passing day. Professor Meltzer also discusses the singular event that created the panic that drove the markets to ridiculously oversold levels - the failure of Lehman Brothers. After more than 30 years of bailing out almost all large firms, the Fed made the horrendous mistake of changing its policy in the middle of a recession. Most of you are aware that I am a huge fan of Chairman Bernanke. His clear cut answers to the hearings on Capitol Hill, and his inventive and creative ways to get capital flowing in the height of the panic will be written about in textbooks for decades to come. However, allowing Lehman to fail was a major mistake that had global repercussions. At a time when the public’s distrust of Wall Street and the markets in general was rising, Lehman’s failure set off a scramble for

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liquidity around the world and froze markets. Meltzer writes, “Allowing Lehman to fail without warning is one of the worst blunders in Federal Reserve history. Extrapolation caused many market participants to conjecture that we were in a depression. The New York Times and others piled on, speculating foolishly about the end of capitalism. Now, with recovery in sight, we need to ask what kind of recovery to expect, and what kinds of policies are appropriate.”

If the 14 month roller-coaster ride of the stock market can be largely attributed to a massive global panic from a Fed policy blunder, then perhaps the idea of a complete and robust recovery is more plausible. In other words, if you take the "V" shape out of the stock charts, and attribute it to a global wave of fear that didn't need to happen from an economic standpoint, what economic conditions are you left with going forward?

Many of you have heard me reference a study done by Davis Advisors, available on their website, which shows stock market history grouped into ten-year periods. The study shows that we have had a ten-year period of no return in the markets before, three other times, in fact. It also shows that we have had six ten-year periods with no real return, that is, no growth of capital after inflation and taxes. What is interesting is not that we have had tough market decades before, but that the recovery over the ten years following those bad decades has always occurred. Now, past performance is never a guarantee of future success, or even future occurrence, but the Davis study points out that nine times we have had a bad decade, and nine times we have had a good decade following that, with the average gain being 13% per year. Maybe each time the government stepped in and “primed the pump,” or maybe the headlines caused an unnecessary panic in prices that was corrected over time, or maybe, just maybe, capitalism, and all of its requisite innovation and value creation could only be held in check for so long, before surging ahead again.

Last month both Warren Buffet and Bill Gates made some interesting public statements. Both were speakers at a forum held at Columbia University on November 12th, which was filmed and aired on CNBC. Buffett said that “the financial panic is behind us,” but more important for the future, and those of us that invest for the future, Bill Gates said, “Even in the country’s darkest hour, American businesses were still innovating.”

If that is the case, if American businesses did not give up because speculators (not investors) pushed their prices to ridiculous lows, and if the rest of the world is still thirsting for a better, freer, more capitalistic way of life – we all have every reason to believe that the next ten years might just feel different than the last ten that we’ve had to endure. A recent commentary from Kinetics Asset Management points out that very possibility. Peter Doyle, the president of Kinetics, wrote his opinion of the likely nature of the economic recovery. He believes that the global economy will recover more quickly than the headlines lead many to believe, and that China will take an increasingly large leadership role in that recovery and beyond. One fact he mentioned stuck with me. He wrote, “There are approximately 990,000 villages in China. The Chinese Government has mandated that they will have a healthcare clinic in every one of those villages by the year 2012. If you think about that, who is going to supply those? The cotton swabs they need, the rubber gloves, the needles, etc. China only has one medical supply company that is publicly traded. The growth there is going to be staggering, it is something that mankind has never seen before.” More succinctly, Jim O’Neill, Head of Global Economics and Strategy at Goldman Sachs, said, “We believe that by 2027, China could be the largest economy in the world.”

These two smart guys aren’t saying anything that most of us don’t already know or believe, but there is one small difference. They continued investing their own capital, their firm’s capital, and that of their investors during the market decline, despite the headlines of doom and gloom during the last year. Even though the media assured us that this was the worst financial crisis of our lives, and that the second Great Depression was upon us, they kept their eye on the prize. Worldwide, capitalism is still innovating, and I’ll say it again – the indefatigable, powerful and regenerative force of the market economy can go on. One doesn’t buy stocks today as a bet on the U.S. economy and its nascent recovery; stocks are bought today in expectation that two billion or more people want all that we take for granted. I believe capitalism will help lift their lives in every way, and we can benefit from that rise. And no matter how hard they try, the writers of all of the negative headlines along the way cannot change that upward trajectory. Let’s all have a Happy New Year – one that could be the start of a new decade, in more ways than one.