Climbing the Wall of Worry

John M. Gustafson – 29 September 2023

"Bull markets climb a wall of worry – bear markets slide down a river of hope." - Anonymous

As I sit and write these comments, it just struck me that 30 years ago, this month, I was set loose as a fully trained and licensed Merrill Lynch Financial Consultant. (And one of you reading this note became a client in October of 1993 and remains one today.) Things in the investment business and global markets have certainly changed dramatically over those years, but many of the core principles of investing have remained the same.

One old saw that I have quoted here in the past – climbing the wall of worry – was also promoted ad nauseum by one particular mutual fund family. They sent everyone a giant poster outlining the slow climb of stocks throughout the decades and included illustrative labels indicating what was going wrong in the world in the background of that rise. Things like: Korean War - Cold War – Bay of Pigs - Kennedy Assassination – Vietnam – Civil Rights Riots – Oil Embargo – Watergate - Hostage Crisis – Stagflation – Attempted Assassination – Iran Contra - Desert Storm – and on and on. The constant was that despite the outside events, commerce continued to progress, companies adapted and over the long haul, balanced portfolios outpaced taxes and inflation.

With all the insanity we currently see and hear daily, might this be the time where that pattern finally falls apart? Maybe... (But I'm not yet convinced)

"Bull Markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria." - John Templeton

The disfunction of current American politics has gone from an annoying buzzing sound in your ears for the past decade or two, up to a dull roar that invades our lives daily and generally blots out the light of anything else occurring in the world. Everything is bad, we're all doomed and a third of the country believes things so outlandish that they cannot exist on the same plane with each other – classic *1984* "Doublethink." Reality has become subjective; nobody is allowed to change their minds when new evidence is uncovered (which is the essence of "science" that everyone also shouts about) and it has completely obscured economic reality.

I'd rather not even attempt to guess as of this writing whether or not Congress will allow America to "shut down" over the weekend – honestly at this point, neither outcome would be a surprise. I say that because nobody in D.C. actually cares about the economy, all they want to do is remain in their cushy seats.

If I must speculate, I don't see how they make the midnight Saturday deadline. There has been nothing serious to come out of the House as of this point (Friday morning) and anything the

Senate is working on will not even be entertained (according to the Speaker) for discussion or a vote if it gets to the House.

I will say this, unlike the potential debt-default scenario that was incredibly concerning back in the summer, this isn't nearly as devastating to the economy or our portfolios in the near or long term. It's not great, as you can see by the market retreat of the past couple of weeks while the deadline drew near. However, it will be another blow against inflation if things pause for a week or two. An outcome that will get us closer to the Fed pausing their rate tightening for good and still not likely to roll the economy over into the recession that everyone has been predicting since early last year.

"Risk comes from not knowing what you're doing." - Warren Buffett

As you may have noticed, our portfolio rebalancing we performed in August was particularly timely. The markets have done significantly better this year than last, but we did appear to hit a short-term peak at the end of July. Nothing has changed appreciably in terms of economics, so my supposition based on experience is that this is the "pause that refreshes" rather than a consequential change in attitude. Depending, of course, on the length of the shut down and amount of damage caused b y our "leaders."

"Inflation is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man." - Ronald Reagan

The first of two simple things the current Administration could do that will considerably help our economy and continue to lower inflation would be to revoke the stupid, uneconomic tariffs on Chinese goods that were implemented under the previous administration. They are a direct tax on American consumers as we all understand – not "paid by China."

It is naive, ineffective and accomplishes nothing other than weakening our economy while continuing to boost inflation as we can't easily and suddenly replace the items (especially core components for our own manufacturing of goods) we have purchased for decades from China.

If the government wants to incentivize companies to return to America to produce their goods, the carrot – such as the CHIPS Act - works far better than the tariff stick.

"A truly American sentiment recognizes the dignity of labor and the fact that honor lies in honest toil." - Grover Cleveland

The second thing that would be an immense help to continue the growth in our economy and significantly cut wasteful spending would be allowing the migrants / illegals / asylum seekers (I don't care what political label you choose) that are here, to work and pay taxes. These are able-bodied individuals who didn't necessarily risk their lives to come to the U.S. simply to get free food and sleep on a church floor. It's not ideal, but once again, it is reality. Stopping more from crossing the border is not the same problem as utilizing those who are already here for our country's mutual benefit.

One of the most significant long-term issues we continue to endure across the country is a lack of labor availability. There currently remain more open jobs around the country than people actively seeking employment. The numbers of workers quitting, and "job-jumping" (especially in high tech) has slowed significantly over the past six months, but the actual “labor” openings have continued to go unfilled.

Regardless of politics, this in no way solves our border issues and our ridiculously broken current immigration system. It would, at least, turn a current expense into potential tax revenue and allow companies who employ plenty of Americans, who may want to produce more goods here rather than in China, to solve their most pressing needs.

“Propaganda does not deceive people; it merely helps them to deceive themselves.” - Eric Hoffer

To continue the societal battle described in our last quarterly note, the reality versus perception wars, especially as it relates to the American economy, continues to rage.

Once again it is helpful to remember that most of life can be viewed through a three-sided discussion – your side, their side and the truth that likely lies in the middle. That is not how information is delivered anymore in the age of algorithms and one must search honestly to find reporting that interprets similar situations through differing eyes. Everything / everyone is biased – as long as you know what that bias is, you can derive value from the information.

There are no such things as “alternative facts” in investing / economics (or in real life) but I do like to consume differing viewpoints of factual situations (earnings, employment figures, interest rates, the Fed, etc.) to put it up against my 30 years of experience and generate the conclusions used here.

“An investment in knowledge pays the best interest.” - Benjamin Franklin

One recent situation that deserves examination is the Federal reserve, their current stance on inflation and how they will likely influence interest rates going forward. After their most recent meeting, it seems as though that situation remains in flux with a slight upward bias. Chairman Powell didn’t say much differently in his press conference than the one prior, but the increased rate projections for next year caused people to take note.

The consensus is that the Fed is willing to be a little patient at this point and allow their medicine to slowly take effect (again, something that may be enhanced by the Keystone Cops in Congress in the near term) but they also signaled that they may be less aggressive in cutting rates later next year, once an obvious slowing occurs.

Is that more jawboning to keep people cautious? Is it signaling they would like to keep their powder dry to react to any political developments later next year? My guess is probably both, however Powell did mention at his press conference that they were confident in continued stronger economic growth keeping rates at slightly higher levels rather than an ongoing problem with inflation. As with many things in life, growth cures all.

“It is not so much our friends' help that helps us, as the confidence of their help.” - Epicurus

One storyline that has become quite noisy - and concerning to our expectations - outside of the U.S. is the growing lack of confidence by foreign pools of money looking to invest in America.

It’s fortunate that the bills that did pass Congress last year were geared toward incentivizing corporations (mostly American) to invest more here than abroad. It would be better if foreign corporations continued to have the same confidence. It’s not a zero sum game - we should be able to have both.

However, this is again where the continued divisive rhetoric coming from D.C. is almost like a poison pill for investment. It’s difficult to make long term capital plans, especially in a foreign land, if you aren’t confident agreements you enter today won’t be wiped away within months. Definitely a concern that isn’t going away and likely puts a slight damper on growth. Good for inflation, not great overall.

“Great spirits have always encountered violent opposition from mediocre minds.” - Albert Einstein

It has definitely been a roller-coaster over the past few years in the global markets and that is unlikely to change significantly in the near term. Analyzing pure economics and the performance of corporations where we place our capital, the future is no cloudier than is historically normal. (The “Wall of Worry”) However, we do live in an era that tends to be much more volatile because of non-economic, human interactions and interference because those actions are amplified far more than at any time in the past.

What people “feel” or “believe” is happening in the economy is not necessarily reality, but in the near term that may not matter. For that reason, we must have a strong hand on the tiller and sail ahead rather than constantly tacking away from the mere perception of danger. We can’t go blindly on our way without reflection of course, but nothing is currently so urgent to warrant moves made in a panic.

The facts remain that the best way to outpace inflation and taxes over the long term is with good balance in a portfolio allocated globally, where the best opportunities are viewed with an eye to the future rather than the past. Making adjustments along the way as the winds change, always with the confidence of an ancient mariner who knows the goal is ahead and not in the past.

Thank you, as always, for your business and friendship and never hesitate to reach out if you have questions, comments or just want to catch up on the world.
Cheers!