

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

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Uncertainty and Risk

A new realm begins. I had expected that women's votes for Kamala Harris would hand the victory to her. I was wrong. In what I write below, I discuss what I see to be the economic and investment aspects of Mr. Trump's successful campaign.

Risk. As my headline suggests, I see two significant matters for us as investors. I will take the latter first, the risk part. In normal times, we hold large investments in equities, because the stock market rises over time. But there are cycles in this and painful periods of sharp declines. Because of its cyclical nature, after a big fall in stock prices, the returns to be earned in the future are very favorable. It goes the other way also. After stocks have risen very substantially, future investment returns are generally weak.

Where are we now? The American stock market stands at levels, in relation to underlying values, that have been experienced very rarely. Those times have preceded big bear markets. Prices in relation to profits of companies—the price to earnings ratio or the PE ratio—now exceed twenty two. The long-term PE ratio is below seventeen. If one measures prices against book values of the underlying companies or prices against sales of the companies, these are some two standard deviations above the norm. These valuation levels have preceded the worst stock market declines of the last century. There always is risk in stocks, but now the risk is very high.

In passing, let me remark that Warren Buffet, the most renowned investor in our lifetimes, has recently sold two thirds of his very successful investment in Apple. After the Apple sale, Berkshire Hathaway, Mr. Buffett's company, now holds some \$325 billion in cash; that cash earns about four and one half percent per year. One must think that Mr. Buffett expects that lower stock prices lie ahead and he wishes to have the cash on hand to take advantage of those opportunities.

Uncertainty. As Mr. Trump campaigned, he made many statements about his intentions. Sixty percent tariffs on Chinese imports, various tax cuts, closing the Department of Education, deporting millions of the "illegal aliens," and more. Consider whether and how these campaign promises may become American policy. The president has the authority, by executive order, to raise tariffs. If he imposes such huge tariffs on Chinese goods, what might China decide to do to retaliate? (Retaliation is not unheard of in such matters.) Apart from the many things America imports from China, China also holds significant reserves of rare earth elements needed for our modern devices. We need those rare earths and, for some, China is the only supplier.

By

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Other campaign promises may only be realized by legislation enacted by both houses of Congress. Although Republicans have a majority in the House and in the Senate, their majorities are very slim. Significant tax cuts would increase America's already huge federal deficit; it is not hard to imagine that some fiscally conservative Republicans may balk.

Rounding up and deporting millions of immigrants might be undertaken without Congressional action. But an attempt to expel millions of men and women—the illegal immigrants—would surely cause crises never before seen here. Many of these immigrants have been in America for decades and are deeply embedded in their communities. After being rounded up, where would they go? Would the countries to which Mr. Trump's administration would send the immigrants be willing to accept them? Would we have internment camps, camps to hold millions of women, men and children? What effect on the American economy would we experience when these millions were taken from our work force? Initial estimates suggest that America's economy would shrink by four percent or more, causing a very serious recession.

Some of Mr. Trump's cabinet nominations raise eyebrows. Robert F. Kennedy, Jr., the vaccine skeptic as head of Health and Human Services? Wow! How many more diseases do we wish to suffer? The tattooed news guy on Fox as Defense Secretary? Why not? No problems in the world that might require the reminder of America's military force? Matt Gaetz as Attorney General? Hey, who needs the rule of law anyway?

In short, what may unfold when Mr. Trump becomes president again is highly uncertain. Uncertainty is a problem for financial markets. The combination of uncertainty with the present risk from very high valuations in the stock market is a recipe for market turmoil. It may well be that clarity on the matters discussed above will be forthcoming; the present uncertainty may only be a temporary concern. For now, though, in the immediate aftermath of the election, I consider it prudent to be cautious in the investments I make for us. Hence, following Mr. Buffett's example, maintaining large cash balances addresses the present risk levels and the present uncertainties.

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