

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

February 18, 2021

It has been a Long Year. Already.

An eventful beginning to the year; 2021 seems to have lasted a year already. Early January saw an insurrection when a mob entered the Capitol building to wreak havoc and death there. Disrupted by the mob, our Senators and Representatives took cover instead of concluding what usually is a formality--accepting the electoral college results of the presidential election. After the mob was cleared, Congress resumed its deliberations. In response to the actions of Mr. Trump and the mob, the House of Representatives impeached the president for inciting the insurrection. Mr. Trump lay low after the mob's riot in the Capitol building, then slunk out of town on January 20th, rather than attend the inauguration of his successor. A most unusual transfer of executive power. Mr. Biden maintained quiet dignity during the coup attempt and has kept the temperature down since assuming office. The impeachment trial ended in acquittal; 57 Senators voted to convict the former president and 43 to acquit; the Constitution provides that a two thirds majority is needed to convict. Hence, Mr. Trump was acquitted.

The extraordinary political events in this young year are quite unprecedented and, indeed, threatening to the well-being of our republic. But the stock market largely ignored the mayhem and its aftermath.

These matters—shocking though they be—seem not to have registered on Wall Street. Stocks rose on January 6th as hundreds broke into the Capitol building and, as I write, the S&P has risen modestly since 2020 ended. In previous letters, I have noted that the Federal Reserve has taken extraordinary measures over the last year to combat the effects of the Coronavirus and the very sharp collapse in the stock market that occurred when the seriousness of the plague was still unknown. The Fed's actions and Congress' enactment of disaster relief measures certainly have aided the stock market. Investors appear to have regarded the assault on the Capitol and the impeachment as 'noise' that can be ignored, probably because of the sense that America's institutions and practices would survive despite Mr. Trump's claims that his re-election was 'stolen' from him.

This is all the more remarkable in that stock prices by any normal measure are very, very high. The list of unusual aspects of overvaluation includes the fact that unprofitable companies listed on US exchanges have far outperformed the S&P 500. In the last six months, unprofitable companies have done 30 percent better than the broad market. Purest speculation. In former times, when stock investors have been impelled by greed and uninformed by history, the outcome for them has been unhappy. The divorce between economic reality and the prices of stocks is striking. By most measures, the present extreme of valuation only is matched by conditions just before the dot.com bubble burst at the turn of the millennium and in 1929 before the stock market crash.

By

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The chart below shows the various financial stocks, including major banks, insurers, securities firms and others. It has recovered well from its collapse last year. Banks, a major component of its holdings, benefit from the Fed's actions, but also from the increasing yields on long-term bonds. As such, this investment offers a hedge against declines in the prices of long-term Treasury bonds, a substantial holding of ours.

Those who think it wise to keep buying with stock prices at these remarkable levels point to two significant factors: firstly, the effective vaccines, and secondly, the low level of interest rates. Yes, we now have vaccines and more are on the way. Growing numbers of folks have already been vaccinated. Although the roll-out of vaccinations did not go terribly well in December and January, we can reasonably expect supply and administration of the vaccines to improve. Against this are the problems of Coronavirus variants, for which the vaccines may not be effective, and the unwillingness of many to be vaccinated.

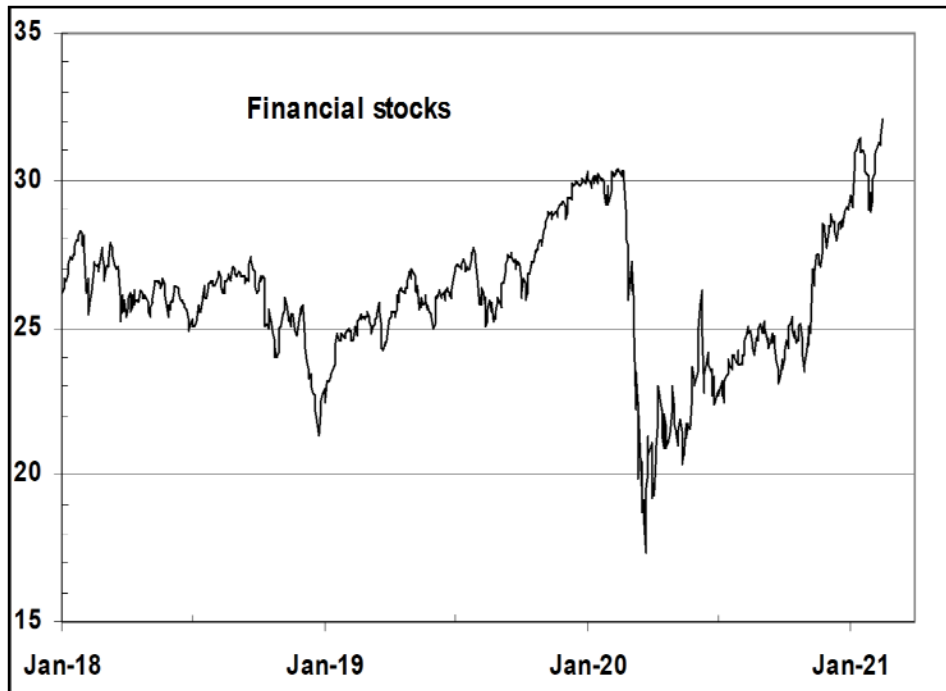
Low levels of interest rates mean that stock prices, high though they be, are not unreasonably high. So goes the argument. Perhaps. But neither of the two principal reasons for low rates should provide much comfort to stock investors: Firstly, low rates suggest that economic weakness will continue, secondly, rates are so low because the Fed has increased its holdings of bonds by more than \$3 trillion

since last March, an increase of about 75 percent of its holdings last March. The Fed's purchases of bonds certainly increased bond prices and lowered their yields. The Fed promises to continue its bond buying and to continue its repression of short-term interest rates for a long time. But, for how long can and will the Fed continue these policies?

The Fed's promises have emboldened stock investors to continue buying stocks, despite almost unprecedented over valuation. And, so it may continue: stocks may keep on rising and the day of reckoning may be postponed longer. In my judgment, however, the risks presented in stock markets are too high

for comfort. In the last month, I have sold down some stock holdings in the portfolios Core supervises and have invested the proceeds in far less risky securities. I may be selling too soon, of course, but hanging on to large equity positions at these levels is, to my thinking, reckless.

Given these factors, I concluded that the time had come to reduce equity positions in your portfolios. It is impossible to know, of course, when comes the next day of reckoning in the stock market. But come it will. In recent weeks, the sale of the stock positions and additions of other investments lower risk and offer decent returns in our portfolios. The idea is risk management: We had good investment earnings in 2020, so let us keep those earnings and add to them without undue risk. By selling stock positions, we make funds available to invest when the next day of reckoning arrives.



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