

## 2020 In Review

If you controlled your emotions, ignored the talking head Chicken Littles, owned and continued to fund a diversified portfolio of stock and bond funds, you should be happy about your portfolio's performance in 2020. Vanguard's Total Stock Market Index Fund ETF (VTI) had a total return of 21% and its Total Bond Market Index Fund ETF (BND) gained 7.7%. My Lazy Golfer portfolio contains five Vanguard index funds -- allocated 40% to the Total Stock Market Index Fund (VTSMX), 20% to the Total International Stock Index Fund (VGT SX), 20% to the Inflation Protected Securities Fund (VIPSX), 10% to the Total Bond Market Index Fund (VBMFX) and 10% to the REIT Index Fund (VGSIX). It returned 13.6% in 2020. Not too bad if I do say so myself. One great advantage of the buy and hold and rebalance strategy is that it is so simple. To paraphrase Winston Churchill – buy and hold is the worst form of investing, except for all the others.

Last year provided clear evidence of two investing realities - the economy cannot be forecasted, and the stock market cannot be timed. Market timing is a hopeless task because you must be right twice. You must get out close to the top and get back in close to the bottom and no one can do that consistently. Market volatility made market timing impossible in 2020. There were 110 days in which the S&P 500 Index rose or fell more than 1% (65 up and 45 down). In the previous seven years, there was an average of  $44 \pm 1\%$  days and there were just eight such days in 2017. The stock market is not unpredictable because it is volatile; it is volatile because it is unpredictable.

Successful investors do not let volatility scare them out of stocks. Instead, they learn to accept a level of portfolio risk and volatility that is appropriate for their financial goals, time horizon and risk tolerance. They understand the link between risk and expected return and let time smooth out short-term volatility. They do not attempt to avoid drawdowns; they learn to outlast them. I cannot prove it, but I'd bet that investors who spent the most time listening to the financial media and tinkering with their portfolios also had the biggest investment regrets in 2020.

## A History Lesson

A survey of our national mood would likely reveal that Americans are in a melancholy funk. A recent *Wall Street Journal* article noted that when asked if life in the USA is better or worse today than 50 years ago, 41% of Americans say it is worse. (1970? They must be crazy.) There's no need to rehash all the unhappy news of 2020 or minimize its effect on our national psyche. Instead, I'll try to bring some perspective on this past year by looking back to another presidential election year - 1980. Those of us who were adults in 1980 have probably forgotten most of that year's events and for those readers who are too young to remember, this review will provide an important history lesson.

There was not much optimism in the land in 1980. The unemployment rate was 7.5% and annual inflation was a staggering 13%. The "misery index" - the sum of these two numbers - exceeded 20% for the first time in history. CDs yielded double-digit interest rates, but after inflation and taxes savers were lucky to break even. Tax brackets were not inflation adjusted in 1980, so high inflation was pushing middle class Americans into higher and higher tax brackets, even as the purchasing power of their incomes was declining. In the decade prior to 1980, domestic stocks yielded a 6.1% annualized average return while inflation averaged 7.4%. The cover of the August 13, 1979 issue of *Business Week* infamously proclaimed, "The Death of Equities", assuring readers that stock investing was no longer a way to build wealth. Just like today, gold was pitched as an inflation hedge. The inflation adjusted price of gold (in 2020 dollars) hit an all-time high in January 1980 of \$2,200/oz. By June of 2001, it had fallen to \$394/oz. and at year-end 2020, its inflation adjusted price was still below its 1980 peak.

Our national political leadership was incompetent and impotent. President Carter, who ran for office as a competent centrist, was revealed as someone whose values and personality were incomprehensible to most Americans. In 1980, he declared a blanket amnesty for Vietnam War draft dodgers and canceled cost-of-living pay raises for active duty military personnel. Consider these quotes from an issue of Time magazine from the summer of 1980 -

*"Jimmy Carter has been his own calamity for so long that it's hard to get out of the habit of living with disappointment and near disaster...An avalanche of mismanagement still follows on Carter's heels and could engulf us at any moment...Underlying the current tensions between the U.S. and its principal allies is one essential fact, that the world's perception of the U.S. - and particularly Europe's perception - has changed substantially in the past few years. Among*

*Americans, it is still commonplace to regard the U.S. as the world's foremost power, economically, militarily and in almost every other way. Among Western Europeans, however, the view is quite different. As the highly respected French political scientist Raymond Aron sums it up, "The U.S is no longer number one."...Virtually nothing is as vital to the Western world as secure oil supplies. Yet nothing seems so far from reach. By their failure to blunt the initiatives of OPEC or develop their own energy sources, the U.S. and other oil-importing nations have left themselves vulnerable to oil-fired crises that would be havoc-wreaking...Once again in May, wages and salaries failed to keep pace with inflation... Initial indicators showed last week that the American economy is declining at roughly an 8% annual rate, the second steepest drop since the Depression and the worst since early 1975."*

In January, President Carter signed the Chrysler Corporation Loan Guarantee Act making a \$1 billion government loan to Chrysler to prevent it from sliding into bankruptcy. Four days later Honda announced it would build Japan's first US passenger car assembly plant in Ohio.

The Soviet Union was taking advantage of an aimless American administration, advancing its plan for world domination with seeming impunity. It invaded Afghanistan. The gloomsters assured us that this was the prologue to an invasion of Iran and eventual Soviet control of all Middle East oil reserves. To counter the Soviet invasion, President Carter boycotted the Moscow Summer Olympics. He appeared to subscribe to the "Brezhnev Doctrine" -- what's theirs is theirs and what's ours is up for grabs. The idea that the Soviet Union was eleven years away from total collapse was incomprehensible.

A fundamentalist regime in Iran was holding four dozen American hostages. Our response was a botched rescue mission, in which two of our aircraft collided, killing eight servicemen. Saddam Hussein's Iraq invaded Iran, beginning an eight-year war that put Persian Gulf oil supplies at risk.

In the Pacific Northwest, we experienced a natural disaster on May 18<sup>th</sup> when Mount St. Helens erupted after remaining dormant for 123 years. Actress Mae West ("I was Snow White, but I drifted") died in Hollywood and John Lennon, one of the Beatles, was shot and killed outside his New York City apartment building. In a long-forgotten example that most politicians are incompetent gas bags who should keep their big noses out of business, the Massachusetts Secretary of State banned the sale of Apple stock - arguing that at \$22 per share the price was too high.

For those who could not afford to buy gold, silver was touted as the next best thing. In 1979, its price jumped from \$6 per ounce to over \$49 per ounce. Unknown to silver investors was the fact that the price rise was being manipulated by the Hunt brothers of Texas, who attempted to corner the silver market. They borrowed heavily to finance their purchases and it is estimated that they eventually owned one third of the global supply of silver. But when the price of silver dropped, they were issued a \$100 million margin call (\$315 million in 2020 dollars). Unable to meet the margin call, they faced a potential \$1.7 billion loss, sending panic throughout the financial markets. Many government officials feared that some large Wall Street brokerage firms and banks might collapse, so a group of banks led by J.P. Morgan made a bailout loan of \$1 billion (\$3.15 billion in 2020 dollars) to the Hunt brothers.

In the spring, President Carter signed an executive order imposing credit controls to reduce inflation. Credit availability plunged and GDP experienced its steepest drop in 50 years. A two-year worldwide recession began in 1980 during which yours truly and many of my airline pilot brethren were furloughed. Suddenly, a career as an airline pilot did not seem that rewarding. A recently retired Western Airlines pilot told me to cheer up, things would turn around. I doubted him. To me it seemed that this time things surely were different.

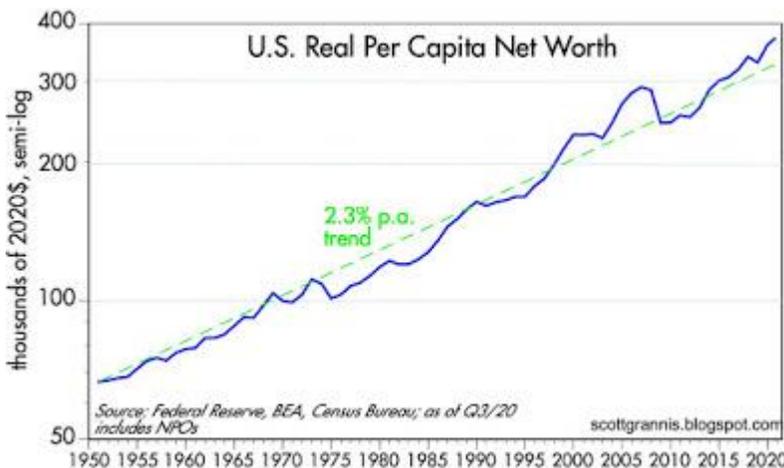
Fortunately, I was wrong. Since 1980, there have been seven bear markets, two wars in Iraq, 9/11, the greatest single day market decline in history and three stock market crashes, each of which was the worst since the Great Depression. Yet, there have been only seven down years for stocks and 34 up years. Since 1980, the largest intra-year pullback in the S&P 500 has averaged 14%; nevertheless, on an inflation adjusted basis, a \$1,000 investment in an S&P 500 Index fund in 1980 would have grown to over \$30,000 by year end 2020. So much for the death of equities. Events occurred in 1980 that none of the gloomsters could comprehend. IBM selected Microsoft to create MS-DOS - the operating system for its first PC. Hewlett-Packard introduced its first personal computer. Cable TV began to impact television in the US with a 20% penetration and Ted Turner started CNN.

All economic and financial pessimism is rooted in two mistaken ideas. The first is that things have never been worse than they are today. The worst economy, the worst president, the most incompetent Congress. The generation just coming into its own is poorly educated, self-consumed and sure to ruin everything. Things are different this time because today's problems are different in new and terrible ways. (Sound familiar?) This mistaken idea is always making the rounds because we tend to view the world through our own current circumstances, beliefs and experiences instead of the lessons of history. The second mistaken idea is the error of extrapolation. The belief that today's negative trends are not cyclical, but permanent, have no solution and will keep getting worse. Were it not for these two mistaken ideas, pessimism would

be impossible because it never aligns with history. It must be supported by an idea of the future which is not just different from history - but the opposite of everything that has happened. The same human spark that led James Watt to invent the steam engine and Thomas Edison to invent the light bulb brought us the iPhone, 3D printing and Tesla automobiles.

Considering how many things can go wrong, it should come as no surprise that there will be something that everyone is worrying about on any given day. But it's the negative trends, not progress, which are temporary. The positive trends - technological innovation, the rise of the global middle class, free trade carried out in free markets by free people seeking to better their lives are permanent. And in a very real sense, these trends are just getting started. These trends are the iceberg; our current problems are the Titanic. Today in America we face no military threats from a foreign power. We have food in abundance and live peaceful lives of almost unimaginable prosperity. We have economic opportunity and leisure time that our grandparents could not imagine. And yet we despair. All the problems that we face, all our worries about the future, are the result of our self-indulgent, debt induced lifestyle. We are our own worst enemy.

The work of a financial advisor is not rooted in prediction -- I cannot tell when, why or how current negative trends will reverse -- but they have always ended and, so long as people are free to choose, I believe that they always will. Human progress is unstoppable, and despite current problems, life will continue to improve in all measurable ways. The problem in our affluent republic is that we become motivated to change course only in a crisis. The election of Ronald Reagan in November 1980 was the direct consequence of economic stagflation and President Carter's belief in American minimalism. Statist, collectivist, redistributionist regimes -- such as the one about to take its place in the executive and legislative branches of the federal government -- always arrive in power carrying the seeds of their own destruction. Full of themselves, they enact policies that upset people who work hard for a living, meet payroll, pay off mortgages, save for retirement, pay college tuition and vote when they get angry.



This chart shows that real (inflation adjusted) per capita net worth (national net worth divided by population) has risen by an annualized average rate of 2.3% since 1950. From 1975 to 1985, the blue line sagged, leading to the gloomy outlook of many commentators in those days. But the world didn't end. Today, the per-capita net worth of your fellow citizens is about \$370,000 - an all-time high. The real aggregate wealth of our country has never been higher and is three times greater than it was in 1980. It would have been impossible for most of us who were alive in 1980 - when there was only one Starbucks store - to imagine the improvement in the quality of life that most Americans have experienced since then.

Why are we nostalgic for past eras that seemed difficult and dangerous to those who were alive at the time? Perhaps we think that since we survived past dangers, those problems must not have been as perilous as ours. At any given point of time there will be good news and bad news, a case for optimism and a case for pessimism. If your life has been anything like mine, it has oscillated between peaceful times when things were going according to plan and stressful, uncertain times. During peaceful times, the future seems bright. During stressful times, the future seems dark. But whether times are good or bad, the future is unknowable. This is probably no great revelation to any of you who have been around long enough to earn a few gray hairs but for you youngsters out there it might be useful to spend some time pondering this.

Today, as in 1980, investors must face the future with optimism and courage. All my study and experience, as well as our collective experience over the past four decades, bears out the view that the only way to invest successfully is to maintain discipline and a long-term focus. To have a good plan and stick with it - never losing sight of the fact that long-term goals demand long - term thinking. I remain steadfastly optimistic about the future of this nation and its economy. I agree with Warren Buffett who said last May, *"I remain convinced...nothing can basically stop America. The American miracle, the American magic has always prevailed, and it will do so again."* So, if Marty McFly stops by my house with his time traveling DeLorean and asks me if I would like to go back and visit 1980, I'd say "No thanks Marty, been there, done that, got the t-shirt. I'm much happier here in 2021. It's the greatest place and best time to be alive in history."

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