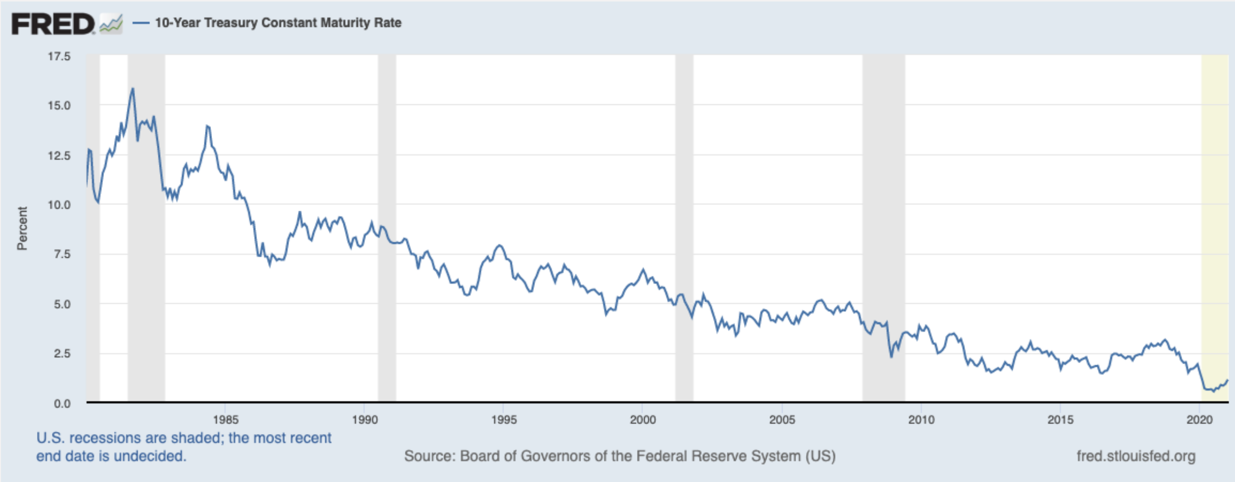
The Long Run

INVESTMENT LETTER | JANUARY 2021

“We got to live together.”
-- ‘Everyday People’ by Sly and the Family Stone

Waves are common, yet hardly predictable. Some barely get going and others travel thousands of miles. Individual small wavelets often die out, yet many combine until they break and lose their energy at the shore. The process continually repeats. And so on and so on.

Successful investing is about riding the lasting waves and avoiding those about to crash. Stocks have been riding the wave of lower interest waves since 1981 when the average annual rate was almost 17%. Since then, stocks have been in a fairly consistent uptrend – and even the pandemic-induced recession couldn’t stop the surge. In fact, the S&P 500 index increased by 18.4% and the MSCI World index swelled by 15.9%. Your account performed extremely well in this environment.



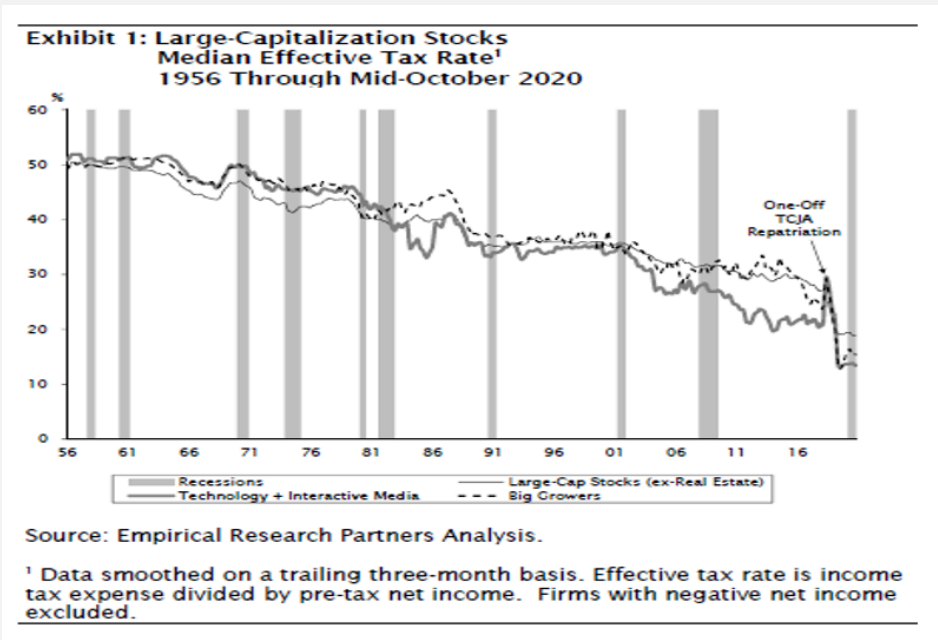
Will the long-term decline in interest rates crest this year? With the Federal Reserve saying they won’t raise interest rates until inflation is consistently above 2%, the consensus is that this wave won’t break for another few years. After all, inflation has been below 2% for the past twelve years. While some temporary inflation will show up in May (after all, oil prices did go negative last May), the bet by Wall Street is that this will disappear later in the year and stock valuations have nothing to worry about.

We aren’t so sure and this certainly bears watching. We’ll call it the “We got to live together” return to economic populism and believe it may be the most important new wave forming on the horizon. One impact of nearly a year’s worth of quarantining is that America has more clearly seen the economic disparity of our society. Essential workers have borne the brunt of the wave of Covid-19, but the economic rewards have gone to corporations in the stay-at-home sectors. One lesson of the recent election is that, while the country remains divided on cultural issues, American voters have migrated to the left on economic policy.

The first real sign of this gathering momentum comes from Florida, which predictably voted for Republicans in November. And yet, the populace overwhelmingly voted by 61% to 39% to hike the minimum wage to $15. Before Covid-19 hit, 48% of Republicans said they wanted a higher minimum wage. Now 62% believe it's a good idea. (87% of Democrats also support it, up from 80% prior to the quarantine.) Some cities in California are also considering mandating an increased $5 per hour hazard pay for grocery and pharmacy workers.

What will come next? Likely an increase in corporate tax rates and a renewed emphasis on antitrust policy. Both these measures will hit the technology sector – which led the stock market's performance in 2020 – the hardest. While the following chart shows the downward trend for corporate tax rates, technology leaders have been the most effective at eluding taxes. A study by Empirical Research estimates that Biden's tax plan would reduce earnings for the typical company by 5%, but by 10% for the technology sector. Antitrust action may also lower the industry's growth rate by changing current monopolistic business practices. We will likely continue to take some profits in technology stocks – and look to move to other assets, particularly if an overdue correction in the stock market occurs soon.

Corporate tax rates have trended down for over 70 years, with the TCJA of 2017 acting to accelerate the trend:



As we have discussed in our quarterly missives throughout the past year, both the American society and economy have undergone many changes during a most challenging year. While the tragedies of 386,000 deaths in the U.S. cannot be forgotten, we remain optimistic that the benefits of learning to live together position us for more equitable growth ahead.

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