

Keep Calm and Carry On

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“If it bleeds it leads” the old saying goes, and indeed, roiled equity markets have been front page news every day for about a week now, butting their way into the final days of summer vacations everywhere. Memories of the 2008/2009 crisis, the 2000 dot com bubble burst and even the 1997 Asian Contagion are still fresh in most investors’ minds, so severe fluctuations like the ones we have seen lately raise legitimate concerns. Under the circumstances, one can be forgiven for putting down his book and trying to figure out what’s going on.

Of course, nobody knows, but we think it is a long overdue correction. Overdue, not for any particular fundamental reason, but simply as a product of the length of the bull market.

Now, we believe there are many reasons to be pessimistic—weak U.S. leadership (and the very real prospect of continued weak U.S. leadership) leading to global entropy, stifling and misguided regulations, the highest corporate tax rates in the developed world, policies that encourage companies to relocate and list elsewhere, climate proposals with potentially damning economic consequences,

unaccountable Federal agencies, out of control Federal spending, vast public debt all over the developed world, highly unfavorable demographics in most developed economies, religious fanatics in charge in too many places, and the seemingly inept in charge elsewhere. But, all these things have been true for a long time, and they didn't prevent markets from rising.

China has been something of a Madoffian con game for some time, indicating expectations for x% of growth at the beginning of the quarter and, by and large, printing that exact number at the end of it. People seem, finally, to be getting wise to that. (Few believe U.S. numbers, much less theirs). To us, a weaker yuan is no reason for our markets to react negatively. A slower Chinese economy and a weaker renminbi make both our commodities and our imports cheaper. To the extent that a rising China has been something of a military or diplomatic concern, a weakened China should alleviate some of that problem for now.

Nor do we believe the prospect of a modest rate rise justifies a market panic. Markets have been much more richly valued in the past when there were much higher rates than now, or in the foreseeable future.

What we do not have now is an overleveraged financial sector as it was back in 2008/09. We expect there will be bankruptcies in the Energy sector, if the government allows it, and, since this is not a politically well-connected industry, unlike say, Autos or Banks, they probably will. But, we don't see a repeat of the earlier financial crisis, because, simply, this isn't one. The U.S. Economy, growing at the historically anemic pace of the post crisis years, just hasn't created the kinds of excesses that can lead to a recession. As Nobel Economist Paul Samuelson famously once said, "The Stock Market has predicted nine out of the last five recessions."

Our biggest worry actually is that the government steps in to "help," as they did in 2008 and 2009, making things worse. With the Fed backed into a corner of its own making, options are limited. An overhaul of the tax and regulatory environment is what is needed, but that doesn't seem likely given the current political environment. QE IV or negative interest rates are about all the Fed has left. That may buoy the market in the short run, but it is not a long term fix.

These things always go on longer than one expects, but we would not be surprised to see some kind of rally by year end. By then, increasingly, the markets will be focusing on the 2016 elections. While the current headlines surrounding the race for president aren't particularly encouraging, it is hard to see how investors won't be cheered by the prospect of a regime that is almost certain to be less hostile towards industry than the one currently in place. If neither party has put forth a strong candidate by then, it may take longer for the markets to feel better, maybe after Iowa or New Hampshire. In the interim, dislocations of this magnitude can present investors with an opportunity to purchase sound businesses at attractive prices and at Tocqueville, that is where our focus is now.

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