TOCQUEVILLE

The Resilient Bull: Investing Amidst Global Turmoil

BY PAUL KLEINSCHMIDT ON *NOVEMBER 1, 2024*

Markets, it is said, need a “Wall of Worry” to climb. Rarely has Mr. Market had such a formidable wall in which to drive his crampons than the current one. Growing war in the Middle East, the sturm and drang of ongoing inflation, unemployment, the enthusiasm and abundance of spending on AI (being met by little end demand), interest expense on the federal debt outpacing military spending, a migration crisis at our borders, China’s faltering economy amidst rising tensions with the US and Taiwanese, extreme weather events causing unspeakable damage, the list of bricks in this wall goes on and on. Oh, and we hear there is a tightly contested US presidential election just days away.

Against this backdrop the market for stocks have climbed ever higher, reaching forty-four (and counting) record closes for the S&P 500 this year. What’s more, the quarter just ended saw increasing breadth in market performance with several members of the Magnificent 7 faltering while Utilities and REITS and Industrials led the way. Meanwhile, the current earnings season has been marked by solid performance from financials thus far.

Such is the power of falling interest rates, or at least the expectation of them. Among old Wall Street adages like “Bull Markets Climb a Wall of Worry” is “Don’t Fight the Fed.” Investors who have, this year anyway, have reason to regret it. But, what if the Fed has less control over interest rates than is commonly believed?

What if deficits do matter? What if the national debt figure is obscenely high and the cost of carrying it unsustainable?

This is what keeps us up at night, notwithstanding the roaring bull market. Of course, this is why one retains someone to manage their family's financial affairs. But a sleep deprived money manager isn't much use to anyone unless the occasional insomnia leads to a conviction or insight that benefits the client and the investor themselves.

What we know for sure is that which cannot be, will not be……which leads us to the state of the American fiscal picture. While this may prove to be a longer dated concern, the sheer trillions of dollars involved make it a greater one for financial markets than all the others mentioned above, save for the possibility of all-out war between China and the US. But while war between China and the United States is (and must be) avoidable, the fate of a nation with $34 trillion in debt is not. This is not a figure that a country can solve through growth or taxation. Indeed, if we assume the debt remains constant (which is unlikely if you listen to either candidate for the presidency), 14 years of a 5% US GDP growth rate would cut the debt to GDP ratio in half, from roughly 136% to about 68% around the average from 1940 to 2023. Of course, 5% growth for such a long period of time is unprecedented for a mature economy. There is only one thing to do, in our estimation, when a country with the reserve currency status has debt obligations it cannot hope to meet, and that is to turn on the printing presses and inflate its way out.

Whether inflation is contained for the moment is not an immaterial concern. Neither is a recession. Same for stretched valuations for many stocks. All, however, are akin to missing the forest for the trees. When the bills of the US government come due, and the mandarins guarding the temple of the economy in Washington reach for their only tool, investors will want to own real assets and stocks of high quality companies that own them, as well as companies with pricing power. Until then, we will have volatility. In and of itself, volatility is not necessarily a bad thing and can present a patient and conservative investor with opportunities. Inflation, however, is a bad thing, for nearly all investors, and to keep pace with it and preserve one's patrimony will be a not insignificant challenge. Staying invested in actively managed, risk conscious portfolios, in the face of all these global worries is the best alternative for meeting it.