Client's Corner

The Curious Case of the Five Percent Apocalypse

IN THE 13 YEARS (LESS THREE MONTHS) FROM ITS CLOSING LOW in the Great Panic (March 9, 2009) to its most recent all-time high (January 3, 2022), the Standard & Poor's 500-Stock Index went up seven times, and delivered an average annual compound return in excess of 17%.

At that point, a couple of noteworthy things happened. (1) There was an absolute explosion of consumer inflation, unlike anything seen in more than 40 years. (2) In response, the Federal Reserve implemented the sharpest, fastest interest rate spike in its 110-year history.

The result was a howling bear market in both stocks ***and*** bonds—an outcome many investors had been encouraged to believe could not happen.

The S&P 500 went down 25% in ten months, then stabilized somewhat, to the point where it ended the year down "only" 18%—its fourth worst year of the previous 50. The price of the benchmark 10-year Treasury bond was down more than 15%, its worst year ever. Thus the much vaunted 60/40 portfolio—regarded in some quarters as the thinking person's defense against "volatility"—experienced ***its worst year since 1937.***

As all this was taking place, and continuing on into the current year:

- The West has engaged in a proxy war with Russia in response to the invasion of Ukraine.
- The Middle East has once again descended into violent conflict, as Iran edges steadily closer to nuclear capability.
- The southern border of the United States has effectively ceased to exist; millions of migrants have entered the country illegally, devastating local economies and increasingly burdening the resources of several large American cities.
- In those cities, crime, homelessness and addiction have reached critical levels.
- Our country's budget deficit and national debt have continued to increase at rates which appear unsustainable in the long run.
- Social Security and Medicare have continued on parallel paths to eventual insolvency unless reformed.
- Though the rate of inflation has slowed considerably, prices themselves have not come down, seriously stressing middle class households. The affordability of the single-family home is at a low ebb.
- Serial shutdowns of the government continue to loom, while a presidential election is now less than a year away.

Where does that leave those of us who must try to invest intelligently for retirement—or who are already retired, and quite legitimately concerned about the stability of our investments? After this two-year (and open-ended) gauntlet of negative trends/developments, where do we find ourselves?

Well, one narrow answer is: It leaves us down five percent from the all-time high.

Because, as I write on the morning after Thanksgiving, that's about where the S&P 500 sits, relative to its previous peak of January 3, 2022. Down five percent. (And that ignores cash dividends, which went up 11% in 2022, and are projected to reach another record high this year.)

There appears to be something of a disconnect here.

You would think—given the fiscal/monetary/political/geopolitical litany of perilous phenomena listed above—that the mainstream equity market might very well be reeling. Why isn't it? What doesn't it understand about the gravity of the situation?

That is, of course, one of two ways to phrase the same question. The other way is to ask ***what might the market be correctly perceiving that investors who regard themselves as realistically gun-shy are failing to see?***

I have no answer to this question, whichever way it's posed. (No shame in this for me; I'm convinced that no one else does either. There are always innumerable opinions about the future, but never any facts.) The purpose of this little essay is simply to think out loud, and to state the issue, as follows:

It is very clear that there are myriad intractable problems that America and the world must deal with. How these quite genuine crises will be resolved is not at all obvious or predictable. Yet an index of the values of 500 of the world's most successful companies doesn't seem as frightened as one might very reasonably expect it to be. It isn't even in a classically defined correction (-10%) from its all-time high.

Having thus accomplished what I set out to do, I will only add one very personal observation, for whatever it may be worth. To wit: every time, in my roughly half century of investing, I became convinced that I knew something the market didn't, it wasn't the market that turned out to be wrong.

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Sources: S&P 500 prices/dividends, Treasury bond prices and the 60/40 portfolio: Standard & Poor's, NYU Stern School.