



### The Long & Short of It Quarterly Newsletter First Quarter 2019

#### Mr. Market on The Couch

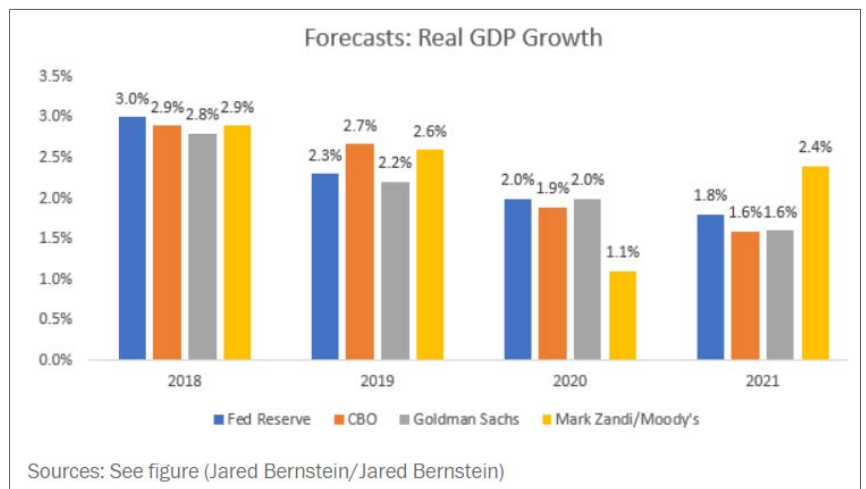
*“It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair.”*

The famous opening to Charles Dickens’ *A Tale of Two Cities* could just as easily describe today’s stock market as the French Revolution. There is an old expression that a bull market climbs a wall of worry and a bear market slides down a slope of hope. As we enter the tenth year of the “Great Recession Bull Market,” Mr. Market appears to be spending a lot of time with his therapist and oscillating between worry and hope. Markets are skittish, up one day and down the next.

On the bright side, as we have mentioned in previous letters, the market has historically performed well following midterm elections in a first-term presidency, especially when the result is a congressional gridlock like in 2018. The market appreciates predictability. As the White House no longer has a mandate, it is refocusing its efforts on the 2020 election and pushing fewer new initiatives that would increase uncertainty. Similarly, Congress is less likely to impose sweeping new regulations in the next two years.

On the dark side, economic growth appears to be slowing and fiscal policy stimulus is less likely due to the gridlock. Year-over-year earnings comparisons may look bleak in 2019 without many of the one-time accounting benefits of the Tax Cuts and Jobs Act of 2017. Corporate profit margins are at record highs and appear somewhat vulnerable. By some measures, stocks appear overpriced. The yield curve, whether near flat or inverted, reflects semi-tight monetary policy. Watch for weakness abroad in 2019 as a tighter monetary policy in the US could actually make its greatest impact on foreign economies.

The Conference Board, a business research group, states: “While the US economy in 2019 is likely to grow at a slower pace than it did during the middle of 2018, due to both the expiration of fiscal measures and slower global growth, Federal Reserve policy will play a key role in shaping the scale of this slowdown.” Monetary policy is largely reflected by the flatness (restricting) or steepness (accommodating) of the yield curve. However, the Fed only controls the shortest end of the yield curve, the Fed Funds rate. If the current semi-restrictive fiscal and monetary policies lead to greater-than-expected slowing in 2019, long-term US Treasury rates would decline and further invert the yield curve without any further action by the Fed. This could create considerable consternation and a sense of uncertainty among investors. The “fix” for this problem would be other countries responding with their own stimulative monetary or fiscal policies, thereby creating a significant boost for our stock market.



#### Providing Professional Therapy

Many of the trends we identified last year are still present in 2019. An activist Federal Reserve, as led by Jerome Powell, may have overtightened the money supply in 2018, the full impact of which is yet to be realized. Indebtedness at the federal, state, municipal, corporate, and household levels could further exacerbate any



contraction in credit. A bifurcated stock market, in which only a few stocks continue to generate the bulk of the S&P 500's performance, could create an irrational bubble.

For a little perspective, we take a look back at our own Fourth Quarter 1999 issue of "The Long & Short of It." In late 1999, pundits were excessively enthusiastic about the "new economy," especially "hypergrowth stocks in a transient state." The cover of *Barron's* in December of 1999 asked, "What's Wrong, Warren?" and asserted that Warren Buffett and value investing were no longer effective. Yet by the end of the 2001-2003 bear market, value-oriented investment strategies—including Buffett's Berkshire Hathaway—had made a strong comeback relative to the broader market.

After the yield curve inverts, the stock market rally often continues for over a year before running into trouble. This reality is consistent with economic theory as described by the Federal Reserve, which states that monetary policy's "major effects on output can take anywhere from three months to two years . . . the effects on inflation tend to involve even longer lags, perhaps one to three years, or more." Today's business cycle faces greater structural headwinds than prior cycles, which explains why stimulative policies have been relatively ineffective and restrictive policies can be surprisingly effective.

As in 1999, fundamental analysis matters over the long term while psychology matters more in the short term. Discerning what stocks are worth, understanding how they will hold up in various market environments, assessing possible threats to long-term viability such as debt and obsolescence, and having the necessary fortitude to buy when they are on sale—all of these disciplines are required to steward a stock portfolio.

### ***The Prescription***

Yet again, the Federal Reserve will probably play a starring role in the 2019-2020 stock market drama. Consumers also have a part. They remain relatively unencumbered by interest payments on debt and could therefore carry the economy a bit further. Global trade talks, resolution of the Brexit dilemma, improvement in the Chinese economy, and calming of pre-election posturing all wait in the wings as the plot unfolds.

So it is important to stay the course. At Robinson Value, we are committed to rigorous analysis of each investment. Stocks are inherently risky. We prioritize risk management in the construction of investment portfolios, looking for industry leaders with strong balance sheets, long operating histories, defensible market share, and pricing at a discount to their long-term valuations. Though still volatile, aggressively defensive stocks with staying power help clients to weather "the best of times and the worst of times."

Wishing you a festive and fruitful spring.

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