The Long & Short of It

Quarterly Newsletter
Fourth Quarter 2019

Ode to the Ticker Tape

In the early days of the stock market, prices were printed on small strips of paper using a ticker tape machine. By 1966, with the advent of fully automated pricing, stocks were streaming across electronic boards. Around this time, a very young Charles and his mother made trips to the local brokerage office. There, he was asked to watch the electronic tape for CCI (Citibank) and call out its price to her each time it traded. The trips provided good lessons on fractions and paying attention.

Charles' mother and first trading partner, Joan, passed away at the New Year after a full and loving life. At Robinson Value Management, we are indebted to Joan for having the patience to teach a wiggly young boy about the stock market and ignite a passion for investing that has fueled his lifelong commitment to the industry.

Stock Prices Were Up

Stocks ended the decade on a solid note. The S&P 500 returned 32% for 2019 while the NASDAQ returned an eye-popping 35%. However, if the weak fourth quarter of 2018 is included in the average, the S&P 500 only returned a cumulative 11% over five quarters, 9% annualized—not as dramatic a return as the calendar year number would have us believe.

Growth stocks led the charge higher, returning about 37% vs. 27% for value stocks and 23% for small caps in 2019. Notably, the S&P 500 Technology sector index rose about 50%. Apple and Microsoft alone accounted for 15% of the S&P 500's return. For the three years ending December 31, 2019, the S&P 500 returned 15%; growth and value returned 20% and 9%, respectively. Bonds also turned in solid performance due to the general decline in interest rates.

What economic fundamentals drove this run in the stock market? Not earnings, which were flat in 2019. In 2020, the S&P 500's earnings are only expected to grow by mid-single digits, assuming Phase 2 of the China trade deal continues to progress. Job creation was also not the reason; according to the Labor Department, 2019 was the weakest year for job creation since 2011.

The one clear fundamental that did push stock prices higher was the decline in long-term interest rates. In 2019, the 10-year Treasury yield fell from 2.66% to 1.83%.

When economic growth isn't driven by significant job creation or productivity gains, then it has been and continues to be driven by the cycle of credit creation. As Herbert Hoover said, "[C]redit is the lifeblood of business, the lifeblood of prices and jobs." If credit makes the wheels go around, then the Federal Reserve is the conductor of our economic train and the stock market is the caboose.

In the 1960s, business cycles were interrupted by shorter, more frequent bull and bear markets. Today, the longest bull market in history continues without the abrupt reversals of the past due to an unprecedented level of government-managed markets and economies. Monetary policy seems increasingly designed to fund government deficits and help with rolling the existing debt. The Fed is again purchasing significant amounts of the Treasury's new issuance. In addition, the Fed is providing bond dealers with 14-day and overnight liquidity. These policies would have been unimaginable even just a decade ago.

Fuel for the Locomotive

While the Fed wouldn't call it such, its accommodative moves over the latter part of 2019 are an admission of a policy error. In late 2018, the Fed overtightened with its 0.25% increase in the federal funds rate on December 20th. By January 2019, the Fed quickly committed to not raising rates further and, in August 2019, reduced the fed funds rate by 0.25%. It then cut the fed funds rate again in both September and October.

Ordinarily, this rapid policy reversal would be considered a sufficient response to a manufactured economic slowdown. But the Fed took it one very large step further. Deciding that reductions to the fed funds rate were not enough, it conducted roughly $6 trillion worth of open-market operations between mid-September and year end. It also purchased $350 billion of Treasury instruments outright. This act "levered up" the Fed's balance sheet even more rapidly than Ben Bernanke did at the height of the 2008-2009 credit crisis.

Problems in the cash and repo markets in the late summer were the stated reason for this extraordinarily accommodative response. Chairman Powell said this is not quantitative easing (QE) and we agree. QE was meant to be limited to cleaning up bank balance sheets and reserves by trading the Fed's higher-quality paper for the banks' lesser-quality paper. But this "not-QE" QE appears simply to be money printing. Critically, it's happening during a period of decent economic growth, not a crisis. Not-QE also reverses the progress made toward Bernanke's 2008 promise that the buildup of the Fed's balance sheet would be undone sometime in the future.

This shift in policy goes against all the nostrums of stable and reasonably predictable monetary policy. We will soon discover if this activism represents: 1) an advancement in the Fed's capabilities, 2) an ill-advised and excessive confidence in its own abilities, or 3) a crisis already in the making. As we mentioned in our third quarter 2019 newsletter, "There is roughly a one-year delay between the date monetary policy is announced and its 'peak impact.'" No one can know what this rapid-response monetary policy will do a year out, but it certainly represents a profound gamble with the Fed's credibility.

In addition, Chairman Powell has recommended modifying the inflation target from "targeting" 2% inflation to "averaging" 2% inflation. "Averaging" will allow for even more accommodative monetary policy. We see a once bold Fed Chairman beginning to show a politician's stripes. It calls to mind Nobel Prize-winning MIT economist Lester Thurow's observation that politicians will always choose inflation as the lesser evil, since with inflation it is just a matter of who gets rich the quickest, while in deflation people go broke.

As long as the Federal Reserve accommodates and inflation remains low, these vast sums of money will be beneficial to the stock market as money-printing finds its way into riskier assets. How quickly inflation might rise as a result of this new policy and what the consequences might be is yet to be determined. As long as the champagne flows, the party continues for the foreseeable future. At Robinson Value Management, we remain sober and increasingly skeptical amid the growing exuberance. We will continue cultivating enduring investments with care, discipline, and loyalty to our clients' well-being.

Amy Abbey Robinson, CIMA
amy@robinsonvalue.com

Charles W. Robinson III, CFA
charles@robinsonvalue.com

This newsletter is furnished only for informational purposes and contains general information that is not suitable for everyone. The information herein should not be construed as personalized investment advice or considered as a solicitation to buy or sell any security. Investing in the stock market involves gains and losses and may not be suitable for all investors. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed. It is also subject to change without notice.

Robinson Value Management, Ltd. ("RVM") is an independent investment management firm, not affiliated with any parent organization. Founded in 1997, Robinson Value Management, Ltd. is an SEC registered investment advisor and serves both individual and institutional clients. Past performance is not necessarily indicative of future results. Robinson Value Management, Ltd. claims compliance with the Global Investment Performance Standards ("GIPS®"). To receive a complete list and description of our composites and/or a presentation that adheres to GIPS, call (210) 490-2545, email amy@robinsonvalue.com, or go to our web site at www.robinsonvalue.com.

Please contact Robinson Value Management, Ltd. if there are any changes in your financial situation or investment objectives, or if you wish to impose add or modify any reasonable restrictions to the management of your account. Our current disclosure statement is set forth in Part 2A of Form ADV and is available for your review upon request.