December 31, 2019

Clients,

With the new year our thoughts turn to the past year, the past decade and what the stock markets might hold for us.

The chart below shows the average change in price plus dividends for the largest 1,000 stocks over the past four years. Looking at the numbers at the top of the chart, the price change over the last three months was 7% which is phenomenal if that rate extended for a year (which it won't). The numbers for a year or more are annual rates. The market return for the past year of 24.3% is high because the year began following a severe market decline. The trendline for the 2.5 years beginning about 4/16 reflects an annual return of 15%. Looking at the flat trendline I've drawn in across tops, the market went a year from October to October without a new high. The lower trendline for the last two years has a slope/return of 4%. It is good to use a trendline of the lows when thinking of a portfolio's value. Everything above is money on the table to play the game. The market's annual return for the chart's four years was 6.2%.

These various perspectives illustrate how investing requires a good zoom lens looking at multiple time frames and levels of detail. I look for the big picture, as conjectured below, and also review chart details of our 250 unique positions at least two or three times a week. The review only takes fifteen minutes or so if nothing comes up to sell. Buying takes more time.

The investment experts in the press are projecting modest growth for the next year between 3% and 8%. Statistically we know that for individual stocks as well as for markets, the degree of volatility is more predictable than the direction of price movements. We have just come through a volatile market which happens to currently be up. The recent breakout above the tops trendline portends an up market for a while. However, I expect we will see individual weeks during the next year with price changes in both directions exceeding 8% and the end point a year from now is not likely to be within 8%. A statistical profile I discovered taken from antecedents to down markets indicates a down market within the next year. Wenzel Analytics' holdings tilt towards defensive portfolios. In addition, I plan to move defensively towards undervalued international positions.

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Most U.S. investments are managed by admirers of President Trump's policies. It is easy for political views to skew one's investment perspectives. While I'm immersed in the daily political drama, I tend to minimize the economic impact. The influence of the presidency and of government in the economy is much less than commonly perceived. Our economy runs on innovation, hard work, people taking risks, rents from natural resources and network effects, availability of capital and a system of trust supported by a legal framework.

Government influence is generally perceived to be fiscal and monetary policy. Monetary policy is controlled by the Federal Reserve Bank, which is not a government agency but rather independently chartered. The significant deficit spending resulting from the tax act of 2017 has definitely had a (short-term?) stimulative effect. Protectionism in trade policy redistributes economic benefits while limiting economic growth. Government procurement is a bigger variable for the economy than typically acknowledged, as are the benefits of holding the world's reserve currency. In sum the perception of a president's influence is a greater variable than the actual levers available.

As for the bigger picture and the economy, the overarching threat and opportunity is related to energy. The risks attendant to fossil fuels are becoming more evident. What will also become more evident is that the renewables of wind and solar are only partial solutions. If one is given a month to live and the doctor has only 98% of the solution, the chances of dying within a month are 100%. A carbon tax is only a redistribution when we need a technical solution giving cheap and clean energy. The only complete solution lies with advanced nuclear technology and its ability to supply clean and safe energy at a cost less than for natural gas. I see that coming. With no other technologies, such as our cars or phones, do we evaluate a technology based on what it looked like sixty years ago. At this point the investing opportunities for advanced nuclear lie with governments and private equity rather than with public markets. If you are an interested accredited investor, I can provide further information.

Another major disruption in progress is the disintermediation of payers for medical services. We don't need single payer, medical insurance or Third-Party Administrators (TPAs). United HealthCare is becoming a provider. In any other industry the level of supervision involved in medical claims would consider them employers rather than contractors. Cigna and Aetna are becoming providers through mergers. Why can't we enroll with Mayo, Allina, Fairview or one of the other medical systems and cut out all the expensive and tedious claim processing? We don't pay for education with claims at the end of each classroom hour or by insuring against ignorance. Medicare Advantage could lead the way. If so it would reduce the role of government in medical delivery and price fixing.

A third major economic issue is wealth distribution and how technological development and capital are replacing the function of labor in our economy. Stuff is cheap. Professional services are expensive. The function of capital with sophisticated technologies has altered the traditional function of the Federal Reserve using short-term interest rates to balance full employment against inflation. Americans currently have a net worth of 98 trillion dollars or an average of about $300,000 per person. Ignoring the issue of who deserves what and why, shaped in large part by the arbitrariness of pricing, that amount of capital could provide a family of four with approximately $60,000 a year in addition to normal government redistribution, i.e. Social Security.

Work will increasingly be for psychological rather than economic reasons. Witness myself and this letter. Thanks for your trusting my boutique services in an age of commoditization.

Lee