January 3, 2020

Dear Clients and Friends:

It is always extra fun to look back on history when milestones are passed, in this case, the dawn of a new decade. Please spare me the pedantic finger-waving lecture as to how the next decade doesn't really begin until 12/31/2020. For those old enough to recall the Y2K hysteria, and sadly for me as the aging process recently shifted into overdrive, there are surprisingly many who do not, we celebrated the dawn of the new millennium on 12/31/1999, not 12/31/2000.

What was the world like the last time the year ended with a 20? Like today, the world was in an unsettled state, with the Great War having ended and the Wilson administration with its very activist view of government essentially finished. The slogan of the ultimately winning campaign was "a return to normalcy" and the future president was Warren G. Harding. He was widely mocked by the intelligentsia of the day as a typical dullard from the Midwestern state of Ohio who could barely speak the English language. The "Dullard from Ohio" ran his campaign from his front porch and won in a landslide. Good call by the smart folk, and yes, many things never seem to change! How about now in 2020? Is there a chance for a return to normalcy in our markets? The economy? Politics? The answer on the last, I am afraid, is most assuredly "no," but how about the first two? Is our system so skewed by the shenanigans of the last decade that we find it irretrievably broken?

If we revisit the world a year ago, the Federal Reserve was well on its way to normalizing the rate structure, or so they said. The forecasts for the coming year from most investment banks were, if not dire, completely off the mark by skewing negative. Again, it is comforting that so many things never really change. As we all know, virtually all assets had a blockbuster year, the widely feared and forecasted recession never arrived, and the Fed reversed course from normalizing.

So what is normal and how far from it are we? Is it possible to ever know? We believe, given an appropriate time span over which to measure such things, that the answer may be "not very far at all." Far too often emphasis is placed on the recent past. The stock market was up a lot so it must be expensive, or rates rallied a lot so they are likely to rise. The reality is, when observed over appropriate time periods, much of the world seems to be in balance. Some things to the expensive side, others a bit to the cheaper side. This includes valuations on stocks, bonds, currencies, real estate, etc. When combined with the low level of volatility, this can make markets very difficult to stand out in or take advantage of. Witness the closing of hedge funds at a rapid pace. Mispricing of assets and/or volatility are their oxygen. Thus deprived, the majority will struggle.

So what if we have returned to normalcy? What implications does that have for investors? Well, that of course depends on the asset class and the objective. For equities and riskier assets, it may mean that while their returns have been good recently, they do not have to automatically give back those returns and, in fact, may continue to provide a reasonable rate of return. For fixed income, the one area of the investment universe that seems very stretched, it is a much more challenged proposition, as the future returns are by definition going to be low and the compensation for taking risk is rather small. Given the traditional role fixed income plays and the low but broadly normalized current level of interest rates on treasuries and agency securities, it would seem to us that a position of normalcy should be maintained with respect to overall duration, with a skew toward high quality.

As to how long this normalcy might last, the decade of the 20's was of course referred to as the roaring 20's…apparently markets like normalcy…but like all good things it eventually ended with the crash in 1929. We will be on guard for that, just in case.

Sincerely,

Mark M. Egan, CFA
Managing Director