COLBERT
INVESTMENT
MANAGEMENT

Annual Letter 2020

On March 23, 2020 the S&P 500 Index was down roughly 31% from the beginning of the year. Markets had gone from worry to total panic in 3 terrifying weeks. The next day, instead of waiting until the end of the quarter, I wrote the following in our Letter to Clients:

> *Nobody ever knows exactly how much markets may go down. If you stay the course, you will not lose your money. You will make back the drop. And I am working constantly for us to come out of this ahead, just like before. No guarantees. Just my total determination.* ***The time to invest in stocks is now.***

There was no lack of doomsday scenarios for what a pandemic-induced shutdown would mean, including the catastrophic consequences for nearly all businesses. On the other hand, we had an equally, or perhaps bigger, opposing economic force: the sheer magnitude of economic stimulus programs being announced and implemented. The extraordinary actions taken by the American Congress, the U.S. Treasury and the Federal Reserve (the U.S. central bank) are mainly why I thought back in March 2020 that the economy and the stock market would rebound. There was a wide discrepancy between stocks reflecting the worst of outcomes and economic stimulus programs nearly neutralizing the negatives. When stock prices got so low, and the worst possible outcome was thought to be averted, the odds of success shifted. It was time to buy.

For reasons I elaborated in my letter then, that period turned out to be the lowest point of the year for the stock market, the days of maximum pessimism, when almost everybody was sure everything may be lost in the end. As a result, not only have those who didn't sell not lose their money, they also made back the drop. It was also one of the best times in history to invest new money in stocks.

To those of you didn't sell, you made the right decision. Courage has its merits. Congratulations.

To those of you whom swallowed hard, and, at what seemed like the worst of times, invested new money in stocks? All guts and glory. Hats off to you. Bravo.

Why Markets Boomed in a Year of Human Misery

We have been in the worst pandemic in 100 years, mismanaged by a callously incompetent U.S. administration, and yet the stock market is at record highs within a few months of hitting lows? How can that be?

For full a full set of details I encourage you to read the excellent article by Neil Irwin, a senior economics correspondent for The Upshot in the New York Times, co-written with Weiyi Cai: "Why Markets Boomed in a Year of Human Misery" (here's the link: https://www.nytimes.com/2021/01/01/upshot/why-markets-boomed-2020.html . The article starts like this:

> *"The central, befuddling economic reality of the United States at the close of 2020 is that everything is terrible in the world, while everything is wonderful in the financial markets. It's a macabre spectacle. Asset prices keep reaching new, extraordinary highs, when around 3,000 people a day are dying of coronavirus and 800,000 people a week are filing new unemployment claims. Even an enthusiast of modern capitalism might wonder if something is deeply broken in how the economy works."*

Income

Although millions have lost their jobs, the industries most affected by the pandemic like restaurants, hotels, cruises and entertainment venues employ more people with lower income levels. The number of unemployed Americans has increased a lot, but the total compensation for all Americans has declined a lot less. That total employee compensation decrease amounts to $43 billion in 9 months, or only -0.50%. As Irwin and Cai explain:

> *"The arithmetic is as simple as it is disorienting. If a corporate executive gets a $100,000 bonus for steering a company through a difficult year, while four $25,000-per-year restaurant workers lose their jobs entirely, the net effect on total compensation is zero — even though in human terms a great deal of pain has been incurred."*

The income drop has been massively offset by a myriad of government programs like the CARES Act, the Pandemic Unemployment Assistance, the Paycheck Protection Program, etc. The net effect of it all was that from March to November 2020 Americans had an after-tax income *increase* of about $1 trillion ($1,030 billion).

Spending

But that's not all. Due to the pandemic work-from-home situation, we were spending more on things consumed and used at home than before; while we were not taking planes, staying at hotels, eating out at restaurants, and going to the movies and concerts. Moreover, when the Federal Reserve cut interest to near zero, it meant that Americans with loans saved billions on interest payments. This resulted in total household spending *decreasing* by $535 billion.

Net effect

During that period Americans thus received $1 trillion more than in 2019, spent $535 billion less, for a total net personal savings *increase* of $1.5 trillion in 2020, or over 170% in 2020. Amazing.

Markets boosted

Some of that money was saved in bank accounts. Some of that money went to invest in real estate (home prices are up). And a lot has gone into stocks, helping propel markets even higher. The articles further states:

> *"For those comfortable with a lot of risk — and with taking advantage of the market's momentum — there was buying a market darling stock like Tesla or trading options.*
> *Certainly the Federal Reserve plays a role. The central bank has lowered interest rates to near zero; promised to keep them there for years; bought government debt; and supported corporate bond markets. But the surge in asset prices has made its way into many sectors far from any form of Fed support, like stocks and Bitcoin. And the surge has, if anything, accelerated this fall despite a lack of additional stimulative action from the Fed.*
> *The Fed played a big part in engineering the stabilization of the markets in March and April, but the rally since then probably reflects these broader dynamics around savings."*

In the end though, the central bank represents the single biggest ongoing catalyst to the sustainability of higher asset prices.

Where do we go from here?

Nobody in their right mind would have believed if you had said that 9 months after the worst health crisis in 100 years stock markets around the world would be higher than ever. Yet as we saw, the fiscal stimulus and the Federal Reserve monetary policies have driven asset prices to stability first, and later, higher.

Fast forward to today. Would you believe me if I told you that: 1) many countries would be in the midst of a second (and worse) wave of the pandemic; 2) that an American President would incite a mob to invade the U.S. Capitol to subvert an election process he had already lost; 3) that stock markets would still be higher than ever? Well, here we are now.

We are in an environment where about 70% of businesses are doing very well and 30% are doing very poorly. We have the uncertainty of the US. Elections being now over, with a new President taking office, hopefully for the better, with an expectation for promptly expanded additional stimulus programs. And, there are several vaccines against COVID-19 rolling out and bringing hope. Investors are looking through the winter of pandemic to the spring of normalcy promised by these vaccines.

Nobody knows the future obviously. Market prices are generally high, with many asset prices somewhat overheated, and some excessively so. It would not be surprising to have some hiccups ahead, nothing goes up in a straight line forever. One should have lower expectations for returns going forward due to high asset prices overall and near-zero interest rates. Yet prevailing conditions are good, the outlook is good.

Sincerely yours,

Karim Armand
President

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