THE VIEW FROM PRINCETON

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The Legacy of the First Decade of the Twenty-first Century

"Heaven Protect Us"! "Mon Dieux"! "Gott im Himmel"! Or, Whew! Get Lost!!

Well, what words would you use to describe the first decade of the 21st century as it is now written into the record books? For a decade that began with visualizations of a larger-than-life future, its legacy is widespread visualizations of a smaller-than-life future: And more, a widespread desiccation of spirit. Major market averages are well below ten-year-ago levels.

A Review of the Extraordinary and of the Absurd

Remember: The prologue to the century included a feared panic called Y2K — concern that computer systems everywhere might not be able to step synchronously from the passing century into a new century. This led to a huge overbuild of installed equipment preparatory for a panic that did not happen. This did, however, bring a great slump in sales of both equipment and software thereafter, a difficult matter for the industry at that time.

The new century was but a few weeks old before shares of nearly every company with Internet involvement fell as an avalanche, followed soon thereafter by prices of nearly all shares of companies with biotech in their names. All these fell to small fractions of their bubble-built-capitalizations of a future that was visualized as much bigger than life. Or stated differently, expectations could be fulfilled only more slowly than enthusiasm-sponsored hopes had anticipated. Before the century was two years old, there had been these three confidence-shattering blowouts.

To call those early years of the decade tumultuous is really an understatement. And matters did not get much better thereafter. Ill-conceived and misrepresented wars east of the Mediterranean brought enduring agonies, and lasting immeasurable costs. The price of oil advanced more than fivefold to its peak carrying the whole energy complex with it. Still, the greater of aberrations for the nation evolved slowly in an extension of more than a decade-long stretch when wage earners' incomes could not keep up with living costs, while corporate managements and financial managers and traders gained extraordinary (and beyond) compensation. In financial terms only, this seems to have brought one of the largest disparate allocations of wealth in America's history. We have recurrently referenced this phenomena as a "gusher upwards" policy, opposite to Mark Hanna's late 19th century widely accepted explanation of the system as "trickle down". Personal use of credit increased to unprecedented percentages of personal wealth and incomes.

The financial industry was given a carte blanche as national policy, as well as the direct support of an unbalanced Federal budget that flowed debt into the markets on which banks, dealers, and traders prospered (as they had for many years preceding). Amid the exhilarating euphoria of this financial prosperity, most participants seemed willing to consider any sows ear as made into a silk purse, and to be traded as such, having been gilded by some third party guarantor (with rating agencies going along with the game). The aberrations that followed not only stand as perhaps the greatest in American history, these were so complex and massive that central banks and national legislative bodies in most industrialized countries were required to come forth with massive measures of rescue effort. Excessive leverage and trading, and the delusions of risk attenuations through devices and guarantees of third parties were blown away by the grand collapse that stemmed therefrom. The experiences and follies of these single-digit-years of the 21st century need to be remembered for their lessons, not for the glory, lest similar dislocations return if cure is not complete.

This was certainly no decade to buy the averages, which despite ten years of growth, are well below levels of the decade's beginning. There is nothing comparable in the past century. Call 2000 to 2009 the bubble decade if you will, a decade when the system showed propensities to lose its bearings and balance out of a willingness to accept almost any shoddy financial instrument so long as money could be made on its creation and sale. Bubbles are fun during the inflation period, and become illuminating as they burst. The bubble building of recent years provides a list no other decade can match. If for no other reason, no other decade had some of these new industries, or new facilities (as provided by programming into computers just about anything you want a computer to instruct you to do — except of course, casting some light into the future). Those bubbles, more or less in sequence, were: Y2K, Internet related, biotech, energy (oil, gas, ethanol, solar), residential building, credit proliferation, derivatives, default insurance, banking, and, finally, a cash bubble.

A Forward Scan; Troubled Hope Yielding to Resuscitation of Spirit

So why should one be optimistic now concerning equity prices (as we have been throughout the year)? Valuations alone were sufficient motivation after the financial system was rescued from itself. This has been one of the best of years for equity investors with so much from which to choose, and with so much to evidently be avoided (as, for that matter, is always the case).

Take heart from the acerb remark attributed to Winston Churchill to describe our nation. "You can always count on Americans to do the right thing — after they have tried everything else." Surely, there are directional changes underway, however much obscured by protest and by rhetoric, now that America has exhausted, or discredited, many alternative options.

For the immediate future the cash bubble (still here) seems to be the most significant for equity investors. Its force gains in the context of a greater overall factor; that is the pervasive influence of the extraordinarily low interest rates in leading nations. This stands in first place as stimuli, by far. (Lowering interest rates tends (syllogistically) to raise the nominal value of all items of economic worth.)

When, if ever, have wealthy foreigners who prefer to diversify into commercial real estate in America had such advantages as now given by our cheap dollar, low money costs, and a fall in valuation of commercial properties? The same can also be said of marketable equities. This has begun to attract capital flows into the United States as represented, it seems, in the recent gains in the valuation of the US dollar. Some relief from the universality of bearishness regarding the dollar was to have been expected. Capital flows and a smaller trade import net balance for America are working to bring some recovery to the dollar at this time. Perhaps this will not be a lasting force, nevertheless one to be taken note of for the time being.

The main reason to be optimistic is seen simply in the fact that the forces of growth are vastly more universal and enduring than most observers seem to acknowledge. In simplest terms, these come out of the inherent aspirations of populations and inventiveness in those societies that are well ordered. Though America, among all of the leading nations, seems to have the largest basket of problems at the moment, America just as surely has the most adequate means of dealing with these, in a context of a growing world.

Growth is driven by major corporations, which have ample cash positions and universal presence, beyond that commonly perceived here and elsewhere. This is one of the interpretations that has distinguished our viewpoints from those of so many others who have not been as positive-minded in months past. They place more weight upon problems, especially constrained consumer purchasing impacted by debt burdens and the effects of unemployment. Too little import is attributed to so many of the world's major corporations having prospered well through the past decade. These have financial power to execute their creative, competitively driven strategies to form one of the most reliable of universal driving forces.

The legacy of the decade is too suffused with dubiousness to lift the heart. Let strong, self-reliant minds lead when the heart is weak. Soberness shall be a moderating factor, not a stifling seizure. Coming out of the problems, as now, is surely safer than heading into troubling distortions as in years gone by. Slowly spreading growth and refractory high rates of unemployment are expected to be a persistent characterization for America for immediate years, ameliorated by higher rates of growth in other leading nations (except for the UK that is financially impacted much as the United States is).

We expect 2010 to offer equity investors another outstanding year. Those who deploy their cash intelligently in anticipation of change seem likely to have a much better year again than those who look primarily on the dark side of life, or visualize a smaller-than-life future, and prefer to remain uninvolved.

To each and to all, Happy New Year!

James Fitzpatrick