Client's Corner

The National Debt and "The Stock Market"

IF YOU'VE BEEN GETTING THESE LITTLE ESSAYS FROM YOUR financial advisor for any length of time, you may already know that I distinguish very sharply between two financial concepts.

One concept concerns an index of the share prices of five hundred of the largest, most consistently profitable, most innovative and—in adverse economic times—historically most resilient businesses headquartered in the United States. This is the Standard & Poor's 500-Stock Index. The other concept is—employing my own very deliberate quotation marks—"the stock market."

Logically, these two concepts should describe essentially the same thing. That's because the value of the S&P 500 accounts at any given moment for about 80% of all the publicly held common stock equity in this country. But deep in the psyche of the investor—which is where all the really big investment decisions get made—they can be like night and day.

If you think of equity investing in terms of owning diversified portfolios of enduringly successful businesses for the long term, it's my belief that you stand a pretty good chance—with your advisor's constant help and encouragement—of being a successful investor.

If on the other hand you are glued to a screen a lot of the time, and find yourself cycling through alternating phases of joy and fear as "the stock market" endlessly gyrates, I can't hold you out a lot of hope.

This is always an issue. But it tends to migrate toward the top of investors' minds when there is an identifiably dark economic cloud on the horizon—as there is these days. I refer, of course, to our quite rapidly rising national debt. And I think it's fair to say that more and more people every day are incubating the question, "What is the debt situation going to do to the stock market?" (Or, in its more acute form, "Shouldn't we get out of the stock market before this crisis causes it to crash?")

Let's begin by assuming that no country—not even ours—can go on indefinitely increasing its debt at a more rapid rate than its economy is expanding. If that's true, we may then assume that ***at some point, in some way,*** this trend will start to give evidence that it's unsustainable.

At the end of that chain of seemingly irrefutable logic, a whole bouquet of questions bursts into bloom, including (but not limited to):

- when will we arrive at that "some point;"
- in what way will the resulting strains manifest; and most particularly
- what will this do to "the stock market," and when?

It should be immediately obvious that these questions are unanswerable, and that it is therefore not possible to make rational investment policy out of them. (It's certainly possible to make impulsive—that is to say nonrational—decisions, but let's assume you'd rather not do that.)

This is precisely the point at which you have to decide whether you are a long-term owner of portfolios of businesses that have endured in good times and bad, or whether you are a participant in "the stock market." Because all the historical evidence suggests that, whatever the crisis, superior businesses ultimately find ways to work around it as opportunistically as possible, and go on to further success.

Well within the last 20 years, investors experienced ***both*** the greatest financial crisis ***and*** the greatest economic crisis in living memory. In the fall of 2008, the global credit system entirely ceased to function; there was effectively no money anywhere in the world to be lent by anyone to anyone on any terms. (From its earlier peak, "the stock market" went down 57%.) In 2020, as the COVID-19 pandemic struck, the entire global economy locked down. ("The stock market" went down by a third within the space of a month.)

On September 12, 2008—the Friday before the Lehman Brothers bankruptcy triggered the Global Financial Crisis—the Standard & Poor's 500-Stock Index closed at 1,252. As I write it is around 5,200. How is that even possible?

Evidently, the better companies (1) absorbed both existential crises, (2) husbanded their shareholders' capital as best they could, (3) took selective advantage of opportunities spawned by the chaos, and (4) continued to innovate even as the crises raged. Reason and logic, as well as history, confirm that this is what they do. (Speaking strictly for myself and my family: this is why we own them.)

It will be suggested, with regard to the rising national debt, that "this time it's different." Surely it is. The Global Financial Crisis was also very different. As was COVID. And if one were focused on "the stock market," there's a good chance one fled from equities on one or both of those quite different occasions—to lasting regret.

But if one saw oneself as a long-term owner of historically resilient and innovative businesses—and just hung in there—one's patience and fortitude have been amply rewarded.

Concern, confusion and even fear regarding our nation's current fiscal path are only natural. But giving expression to fear by abandoning one's long-term investment plan has not worked well in the past. I'm confident that you'll find your financial advisor ready and willing to serve as the circuit breaker between the impulse and the act.

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Source: Standard & Poor's, Yahoo Finance, NYU Stern School.