First Quarter 2021 Commentary

There is a light at the end of the pandemic's tunnel. With each passing day, millions more doses of vaccine are being administered, and the number of coronavirus-related deaths continues to decline. Travel is beginning to pick up, traditional spring sports like March Madness and the Masters have returned on schedule, and even Disney World is now allowing guests to briefly remove their masks for photo ops.

We are not out of the woods yet, though. Only about one-quarter of all U.S. adults have been fully vaccinated. For those in the most vulnerable age group of 65 and up, a bit more than half have been. Masks will continue to be a part of our daily life for the foreseeable future, and we still need to be careful when congregating indoors.

The stock market is a forward-looking indicator, so it is able to envision a life in which we have fully emerged back to a sense of normalcy, perhaps by 2022. That, plus the trillions of dollars which will soon be making their way through the economic machine due to various recent Congressional actions, along with an accommodative Federal Reserve board, propelled market averages higher again during the first quarter. The S&P 500 index returned 6.2% in those first three months, while the Dow Jones Industrial Average advanced 8.3%.

Lessons Re-Learned

Some lessons never grow old, some are just as fresh today as they were two thousand years ago, but sometimes we humans are prone to forget the fundamentals as we get caught up in our daily lives. We are now a little more than one year removed from the depths of the market panic at the beginning of the coronavirus pandemic (the market bottomed on March 23, 2020), so this strikes us as a good time to remind ourselves of a few timeless lessons on investing. They have always been true, and they will be forever more, but this past year brought them into focus again for anyone paying attention.

Lesson 1: The stock market is not the economy, and the economy is not the stock market.

We have written several times before about the disconnect between GDP growth and market returns. Some of history's best years in the stock market occurred during severe recessions. Just because things are bleak at any given moment does not mean that the stock market will tank. Whatever headlines you are currently reading today were probably already anticipated and digested by the stock market many months ago. As a famous investor once said, "If it's in the news, it's in the stock."

Lesson 2: Volatility in market prices is a feature of the system, not a bug.

"You shouldn't own common stocks if a 50% decrease in their value in a short period of time would cause you acute distress," according to some wise counsel from Warren Buffett. Really take a minute to think about that sentence. What if we purchased a stock in your portfolio one day at a price of, say, $80 per share, and then that very stock declined to $40 just a few months later? Would you be able to handle that? When thinking about those questions, be sure to consider that sometimes (see February/March 2020), *all* stocks go down together. So you wouldn't necessarily be contemplating a 50% decline in only one little stock that made up, say, 4% of your portfolio; it might be a 50% decline in your entire portfolio. Things like these happen with a nearly regular frequency in the stock market, and you must be mentally prepared for them.

Lesson 3: Only invest money that you do not need access to any time in the next five years.

Which brings us to our next lesson. The reason you can react with equanimity to those 50% declines when they come along every now and then, is because you know that you are not in a position where you need to sell any stock to fund your living expenses. You have the luxury of time on your side, and you know that every time the market does go down it will recover again. Sometimes that recovery is staggeringly swift, like it has been in these four most recent quarters, and other times it takes a bit longer. But if you give yourself at least five years, then you can rest assured that you'll be able to recoup any "losses" you suffered along the way. We put "losses" in quotes, because—if you never sold—then those down drafts will hopefully have turned out to be merely temporary and quotational in nature.

Lesson 4: Sometimes the best time to buy something is the time when you're most apprehensive.

Having said all that, we acknowledge that it can be mighty difficult to click that "buy" button when things seem terrible. We did our best to take advantage of the falling market in March 2020. We bought $8.2 million worth of stock that month, compared to an average outlay of $1.5 million for each of the other 11 months of 2020. When the market bottomed on March 23, we bought $1.2 million worth of stock that day alone—almost equal to an average month for us—but we wondered as we did so whether the things we were buying would continue to fall in price in the days and weeks to come. We had no idea that the market would bottom on that day, but we knew we were buying at bargain prices.

Lesson 5: Be ready to act fast when opportunities do present themselves.

To steel our nerves on days like that one, we remind ourselves that extreme bargains do not come around very often, and we have to take advantage of them when we can. When the market was allowing us last June to purchase shares of Berkshire Hathaway for a smidgen above its quoted net worth—something that has only happened a couple of times in the last twenty years—we were buying as fast as we could, hand over fist. When Amazon.com was selling for a P/E lower than it had in many years last March, while taking advantage of the pandemic to widen its lead over its brick-and-mortar competitors, we welcomed the stock into our fold. There are other examples as well, but as of this writing Berkshire and Amazon are selling for 50% and 81%, respectively, more than we paid for them just a few months ago.

Lesson 6: This too shall pass.

No matter how bleak things seem in the stock market on any given day, history tells us that things will one day get better. And no matter how wonderful things may seem any other given day, history tells us too that things could easily and quickly get worse. Contrary to their oceanic counterparts, there is never a time table for when the financial tides will turn. Therefore, we strive to conduct our operations as Virgil wrote in The Aeneid so long ago: “through chances various, through all vicissitudes, we make our way.”

How to Respond?

So what’s an investor to do with these lessons re-learned? How should we respond? We believe the answer is as simple as it is constant: the best approach is to estimate a value for each contemplated investment, be patient for the market to offer you a price below that, buy, and then hold on for what’s sure to be a wild—but hopefully profitable—ride.

We look forward to our next report to you in July.

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