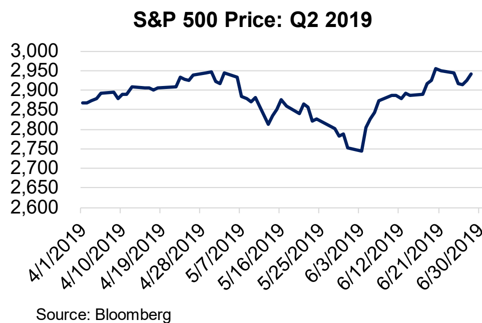
It Was A Mad World



The market dodged and weaved its way throughout 2019's second quarter, as the nearby chart shows. Investors were nervous in May as stocks declined, but were no less worried in June. In a 24/7 cable news world, a whole host of issues were news. In May, trade tensions between the U.S. and China intensified as the U.S. blacklisted Huawei from its supply chain partners – pressuring stocks both overall and within the technology sector specifically, where many firms were banned from doing business with the Chinese behemoth. At the margin, in June, investors began to believe that a potential slowdown in economic growth could lead the Federal Reserve to reverse course and actually lower interest rates, and the market recovered.

The edginess in May might have been attributable to fears that an escalating chance of a trade war could derail our economy, but why are investors still nervous now after a healthy rebound?

We believe investors are antsy about the markets not because of news cycles, but for an age-old reason: that is, we are programmed to believe that what goes up must come down. Investor anxiety is attributable to the fact that our stock market is near an all-time high and our economy has been in 'recovery' mode since 2009. If an 'average' business cycle lasts 4.5 years, well, you can fill in the rest.

Andy Kessler, a Wall Street Journal columnist, recently wrote that an expansion that started in 1991 lasted for ten years, and we only now have broken that record. He pointed out that changes in inventory management to 'just-in-time' have changed the cycle dynamics – possibly forever – and there are no material reasons why this expansion cannot continue apace. With 'just-in-time', a manufacturer's parts for that day arrive that day. For a grocer, the predicted goods it needs to satisfy its customers today arrive, you guessed it, today.

Historically, changes in inventory levels have explained many of the changes in real Gross Domestic Product (GDP). However, during the 1990s this contribution became significantly muted. The advent of the internet and 'just-in-time' inventory management has helped companies of all sorts become exponentially more efficient.

The 'Internet of Things' (IoT) – a system of interrelated computing devices, mechanical / digital machines, and big data that enables the transfer of data over a network without human or machine intervention – has the potential to create unprecedented efficiencies. For many firms, it already has. Companies are learning how investing in efficiencies can create sustainable competitive advantages. Let's consider just a couple.

Honeywell is a worldwide diversified technology and manufacturing company that believes fully in the power of IoT. Its 'Honeywell Forge' software solution helps organizations – including its own – collect, analyze and implement insight from data coming from all parts of its operations. You may remember a time when firms would have to shut down for a day each quarter to 'count inventory'. Today, an enterprise using Forge can manage its supply chain in *real time*.

TJ Maxx is another example of excellent supply chain management. This preeminent discount retailer is consistently asked how it can always have product available. The company has painstakingly built a flexible, value-driven, “global sourcing machine” that sources product from over 100 countries. Its sophisticated inventory systems allow it to get the right merchandise to the right stores, almost without fail.

MAD Magazine Mascot Alfred E. Neuman

Certainly, this economic expansion – like all human undertakings – will end someday, but it will not end simply because of time. Human adaptability is legendary, and examples abound of endeavors that last far longer than originally had been foretold. Just before the Fourth of July, MAD magazine announced that after 67 years, it would no longer publish new material. The venerable humor magazine that gave us “Spy vs. Spy” in the 1950s was also able to spoof, well, “Spy vs. Spy” today. In its heyday, it had a subscription base of nearly three million readers – and it refused to take advertising until 2001, when it ultimately had to do so to survive. While its current subscribers have dwindled to about 100,000, its end had originally been predicted in the 1950s, and then again in the 1970s. However, it adapted – and it even thrived – influencing countless cartoonists and humorists along the way.

MAD magazine didn’t die because it was old, it died because it could no longer adapt to the changing mores of its potential audience. Like MAD, this expansion will someday die, but not of old age. We believe holding a diverse portfolio of high-quality companies that demonstrate consistent strength and continue to invest in their competitive advantages – during both expansionary and recessionary markets – is the best prescription for facing the uncertainty of what is to come. We strive everyday to find the best companies for that portfolio, and we welcome the opportunity to describe for you how excellence and quality can help you sleep at night.