

Never Bet Against America

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Previously we have written about the King and the conman trading their understanding of financial compounding. Luckily, what the King lacked in financial acumen he more than made up in regal authority.

If there is a modern monarch of finance, it is surely Warren Buffett.

Now known to investors as the “Sage of Omaha,” in 1951 Buffett enrolled himself on Benjamin Graham’s course at Columbia University securing an A+ from the acknowledged “father of security analysis.”

Famously, with \$100,000 of capital secured from family and friends, he went to turn a little-known textile company called Berkshire Hathaway into one of the world’s most valuable companies and, until the rise of Big Tech, making himself the world’s richest individual

To this day, investors flock to his annual investor day in Nevada where he and his long-term partner, Charlie Munger prognosticate on financial matters in their folksy homespun way, can of cherry coke, Buffett’s tippie of choice, in hand.

At the same time, investors in Berkshire are treated to the annual Berkshire Hathaway Shareholder’s Letter in which the Chairman articulates the successes and failures (mostly successes) of the year and offers insights into investment thinking. This letter is keenly sort after and widely read.

In the 2021 issue Buffett had this to say:

“In its brief 232 years of existence... there has been no incubator for unleashing human potential like America. Despite some severe interruptions, our country’s economic progress has been breath-taking. Our unwavering conclusion: Never bet against America.”

It was an interesting thing to say in the midst of Covid and in the immediate aftermath of the experiment with Donald Trump. Yet Buffett’s optimism proved prescient.

Alone amongst the major economies, only the US that has regained not only economic output lost to Covid but also output relative to the pre-Covid trend. Europe, UK and much of Asia are still struggling to reach the absolute level of pre-Covid output, much less trend-level.

Measured in 2012 dollars, the US economy is now worth more than USD twenty trillion and rather more if measured at current prices. That is ten times the value of the British economy and the same magnitude as the whole of Europe.

But the success and strength of the economy casts its own shadow.

The Federal Reserve is now under considerable pressure to cool it whilst managing the risks associated with this tightening of monetary policy. The problem is inflation: in the US it is “demand-pull” whilst for much of the rest of us, inflation is a problem of “cost-push.” Put simply we have rising prices due to supply and trade constraints, the US simply has too much demand: too much money chasing too few goods. This is reason why the Federal Reserve has been raising interest rates for much of the last year.

It is impossible to disagree with Buffett. Certainly, since the turn of the 19th century, the US has eclipsed the rest of the world in innovation and sheer financial heft. It is no surprise that 5 out of the ten most valuable companies in the world today are American (2 are Chinese, 1 Japanese, 1 Anglo-Dutch and one German).

That said, whilst he is surely right in the medium-term (even with competition from China where history suggests command economies are less innovative than open economies); in the near-term, there is room for some concern.

There are two trends which worry us with respect to America.

Firstly, as alluded to above, since Covid abated, US consumers have gone the races. US household consumption is already nearly a tenth higher than it was in 2019 whereas everywhere else it is at or below 2019 levels.

That means the Federal Reserve will have to maintain interest rates higher for longer. This will depress activity, house prices and “animal spirits.”

Secondly, and in its way more worryingly, US investment having recovered immediately after Covid has since stalled and gone into decline since the third quarter of 2021.

Since investment today paves the way for consumption tomorrow, the growing gap between the two aspects of the economy points to a gathering fault-line. The Federal Reserve wants to raise rates to curb consumption (and inflation) but it wants to lower rates to stimulate investment. It is a path fraught with difficulty and reason for caution until the outlook for inflation becomes clearer.

In an earlier letter to shareholders Buffett noted that, “The babies being born in America today are the luckiest crop in history.” We wouldn’t bet against America in the long-term either but in the short-term, even the luckiest babies suffer from colic from time to time.

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