AMI INVESTMENT MANAGEMENT
Registered Investment Advisor

Quarterly Investment Commentary

Third Quarter **October 2020**


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Stock prices continued their strong rebound from the March lows, hitting all-time highs during the quarter. Stocks have now returned +5.6% year-to-date after a +8.9% return in the third quarter.[1] Foreign developed and emerging market stocks returned +4.9% and +9.7% in the quarter, respectively, bringing the year-to-date tallies to -6.7% and -1.0%.[2] Bonds have returned +6.0% year-to-date after a +0.2% return in the third quarter.[3]

There is a lot going on in the world right now, to put it mildly. But we thought the following story might be relevant for investors today. It begins at a gathering of Warren Buffett's friends and fellow investors in 1975:

> [Buffett's friend Bill] brought a chart showing the price of gold, which for years had surged past Berkshire Hathaway's. He asked, the others thought jokingly, whether he should be buying metal. It would turn out that he had, in fact, been buying gold coins…
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> [Buffett's friend Henry] pulled Buffett into a separate room and asked him to promise that Berkshire stock wouldn't drop below $40. By October 1975, the stock had been cut in half after trading at $93 just two years before. "Look, I love you," Buffett recalls saying, "but I can't promise that." "The world is ending," said Henry, or words to that effect. "I've got every dollar I own in this stock."
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> The world continued to end. Even though the rest of the stock market was recovering, Berkshire was not. Henry panicked and called Buffett, who offered him $40 a share. Then he called [their mutual friend] Walter and said, "Warren will pay me forty dollars and I want fifty. What should I do?"…
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> Walter was dismayed to hear Henry telling himself he was better off without Berkshire stock…"I thought I convinced him," says Walter. But the U.S. economy by then was in so much trouble that New York City was almost bankrupt; the country was in a mood of such profound pessimism that it affected people's judgment. "On Monday he called his broker," says Walter, and began selling…until half their shares were gone.
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> Immediately afterward, President Ford refused a bailout of the New York City economy; the *New York Daily News* captured the feeling of the times in a huge headline: "Ford to City: Drop Dead."
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> The partners who had been given Berkshire stock in 1970 when it was trading around $40 seemed no better off five years later. "To anybody who held our stock," says Charlie Munger, "it looked like not much was happening favorably for a long, long time. And that was not the way our partners, by and large, had previously experienced things. The paper record looked terrible, yet the future, what you might call the intrinsic record, the real business momentum, was gaining all the while."
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> Buffett's own net worth, based on where the stock was trading, had likewise been sliced to the level of when he closed the partnership. Yet despite this apparent destruction of wealth – which would have frightened almost anyone else – his pulse never seemed to flutter. He just had the companies he controlled keep buying, and buying, and buying.

[1] As measured by the S&P 500 index.
[2] As measured by the relevant MSCI international indices.
[3] As measured by the Citigroup 1-10 Year Government Bond index.
[4] See *The Snowball: Warren Buffett and the Business of Life*by Alice Schroeder (slight edits were made in the interest or readability).

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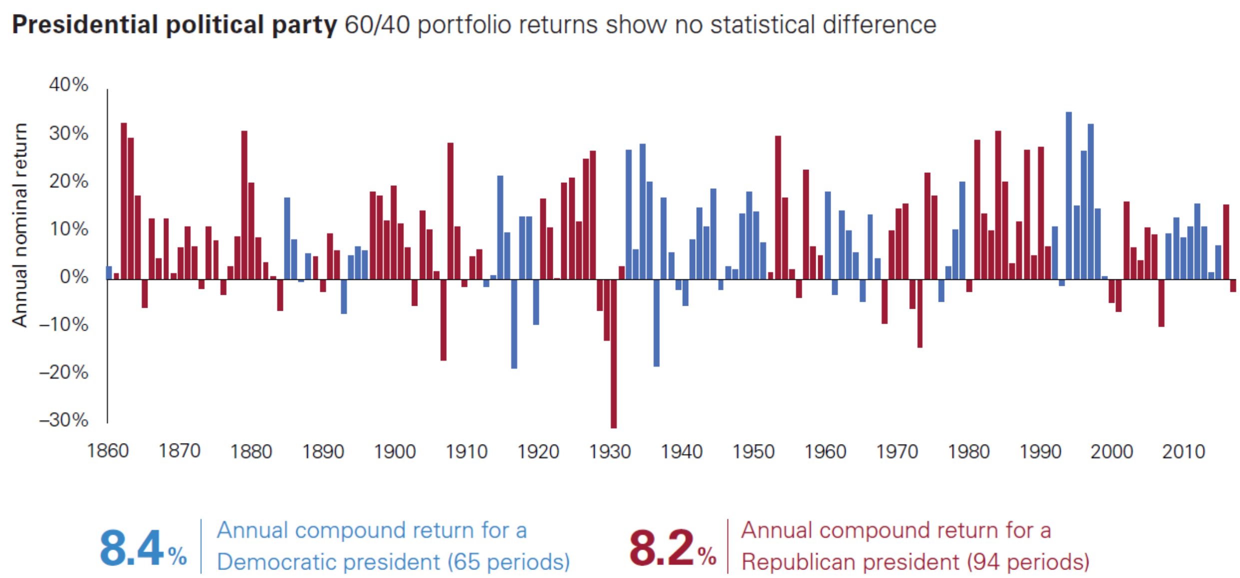
It was a tumultuous time indeed. Richard Nixon had recently resigned the presidency and the Vietnam War had just ended. Riots had engulfed the country during the preceding years and the inflation rate was beginning to reach double-digits. Yet over the next four-plus decades, from the end of 1975 through the end of 2019, $100 invested in Berkshire Hathaway stock turned into over $828,000, a return of nearly 23% per year.[5] $100 invested in gold would have turned into just over $1,000 by the end of 2019.[6] Fear, of the kind induced in the 1970s or now, can precipitate flawed, short-term oriented investment decisions.

Unfortunately, we don't know what stock prices will do over the next five years. And as much as we'd like to, we have no ability to predict when stock prices may peak or trough. We admit to being surprised that stock prices rebounded so quickly from their March lows and concerned about risks that could materialize in the future. Yet we retain our belief that the best long-term investment is a diversified portfolio built around high-quality, reasonably-priced stocks.

What about the election? The following graph from Vanguard shows annual returns to a portfolio with 60% invested in U.S. stocks and 40% invested U.S. bonds over the past 160 years:



As you can see, the annual return under the two political parties is nearly identical. On a more anecdotal basis, we've had clients express concerns over the potential electoral outcome during the last three presidential elections (2008, 2012 and 2016). Yet stocks performed well during the subsequent four years in each case:[7]

President Elect	Party	Begin Date	End Date	Annual Return
Barack Obama	Democrat	11/04/08	11/06/12	11.59%
Barack Obama	Democrat	11/06/12	11/08/16	13.00%
Donald Trump	Republican	11/08/16	09/30/20	14.54%

[5] Berkshire Hathaway 2019 annual report.
[6] Federal Reserve.
[7] As measured by the S&P 500; periods are based on election dates.

We are not arguing that government policies don't matter or that they can't impact stock prices. For instance, an increase in corporate tax rates could pressure future corporate earnings, which may have an adverse impact on stock prices. But there are many factors that influence stock market returns, including valuations, interest rates, economic growth, growth in productivity, etc. Often times, worst-case fears over the impact of election results on stock market returns have not come to fruition.

This year provides a useful example. If we would have told you in December of 2019 that 2020 would bring a worldwide pandemic that would prompt the global economy to shutdown, some of the worst political polarization seen in a generation, and a historically large government deficit, would you have considered selling your stocks? Yet during the first eight months of the year, stocks returned +9.7%.[8]

If you get out of the stock market, when do you get back in? What if the stock market doesn't drop as you expect? If it does drop, how do you identify the bottom? If you are not going to invest in any stocks, how will you generate adequate returns in a world of ultralow interest rates?

One other point is important to make, although it can be difficult to explain. The stock market is forward-looking, meaning that stock prices are based off of investor expectations of future events and outcomes. Accordingly, even if you are personally disappointed and worried about the eventual outcome of the election, it may not come as a surprise to the stock market. And if it isn't a surprise to the stock market, it likely won't have much of an impact on stock prices (at least in the near-term).

Again, we think that the right long-term strategy is to maintain a diversified portfolio focused around high-quality, reasonably-priced companies. Of course the investor's time horizon matters. If you need the money next week, next month or next year, it shouldn't be invested in the stock market. And each investor's own comfort with their investment strategy also matters. If you can't sleep at night, then we need to come up with a different investment strategy. But outside of these two concerns, we think the bar for cashing out of the stock market based on near-term concerns is high and that such a decision should be approached with caution. We don't know if stock prices will be higher next year or the year after. But we do believe that high-quality stocks purchased at reasonable prices will do well relative to the alternatives over the next ten to fifteen years, although there are no guarantees.

If you have any comments, questions or concerns, please don't hesitate to contact us. As always, we thank you for your continued confidence.

Sincerely,

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[8] As measured by the S&P 500.