

Memo to: Oaktree Clients
From: Howard Marks
Re: This Time It's Different

I first came across the title of this memo in an article titled “Why This Market Cycle Isn’t Different” by Anise C. Wallace in *The New York Times* of October 11, 1987. It went as follows:

The four most dangerous words in investing are “this time it’s different,” according to John Templeton, the highly regarded 74-year-old mutual fund manager. At stock market tops and bottoms, investors invariably use this rationale to justify their emotion-driven decisions.

Over the next year, many investors are likely to repeat these four words as they defend higher stock prices. But they should treat them with the same consideration they give “the check is in the mail. . . .”

Nevertheless, in the bull market’s sixth year, the “this time it’s different” chorus is beginning to be heard. Wall Street professionals predict that, before the bull market ends, individual investors, who have mostly stayed on the sidelines, will be swept along in the mania characterizing a market peak.

They will invest in stocks despite the fact that the Dow Jones Industrial average has more than tripled in the last five years. They will be hearing overwhelmingly compelling reasons why stock prices should go higher, why the bull market should last considerably longer than any other in history, why this boom will not be followed by a 1929-like crash and why “this time it’s different.”

Many of these arguments will be tempting because they will have some element of truth to them. Even Mr. Templeton concedes that when people say things are different, 20 percent of the time they are right. But the danger lies in thinking that the different factor – like the recent investment in United States stocks by the Japanese – will be uninterrupted.

Wallace’s essential message is that investors must take heed when the four words are in widespread use. Why? Look back at the paragraph introducing the above quote: when you first read it, did you happen to notice the date of publication? **It was just eight days before Black Monday (October 19, 1987), the worst day in stock market history.** We know how bad it feels when the market falls 20% in a year. Try 22% in a day!! Wallace’s warning was particularly important at the time the article was published, but for me it’s always important.

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Typically in investing, historical norms put limits on asset prices. Thus, for example, bull markets can generally go to extremes only if investors discard the notion that the p/e ratio on the S&P 500 stock index shouldn't go much above its post-World War II average of 15 or 16. If the earnings of the S&P's underlying companies grow at 10% a year, by definition the index can rise 20% a year (as it did in the 1990s) only if the ratio of price to earnings is viewed as highly expandable. It was such a perspective that allowed the index to reach 32 times earnings at the start of this century (with highly negative implications for equity returns in 2000-02).

Think of a rocket launched from Cape Canaveral. Gravity has to be overcome in order for it to escape the earth's atmosphere. Likewise, the limitations imposed by past norms have to be overcome in order for asset prices to slip their historic moorings and blast off into outer space.

Today we're not hearing much about historic valuations being irrelevant, as they're not terribly high. **Instead, what we're told is different this time is the relevance of restrictions on future economic and market performance:**

- There doesn't have to be a recession.
- Continuous quantitative easing can lead to permanent prosperity.
- Federal deficits can grow substantially larger without becoming problematic.
- National debt isn't worrisome.
- We can have economic strength without inflation.
- Interest rates can remain "lower for longer."
- The inverted yield curve needn't have negative implications.
- Companies and stocks can thrive even in the absence of profits.
- Growth investing can continue to outperform value investing in perpetuity.

I rarely participate in a meeting these days without someone asking about one or more of these propositions. **The bottom line is that for any of the nine to be true, things really have to be different this time.** I'll discuss the outlook for each below.

The avoidable recession – The questions I get most often these days are "Is the U.S. heading for a recession?" and "When will it start?" My answer to the first is a simple "yes." (At least I can never be proved wrong.) We've always had economic cycles, and I believe we always will. Eventually, favorable developments will lead people to engage in behavior premised on excessively optimistic assumptions, and eventually the over-optimism of those assumptions will be exposed and the excesses will correct in a period of negative growth. Moreover, even economies that aren't marked by excesses are subject to exogenous shocks.

When people ask about the coming recession, what they mostly mean is "Might it be a long way off?" Well, the longest U.S. recovery on record lasted ten years, and the current one is in the twelfth month of its tenth year. There's no reason a recovery can't go beyond ten years; no gate will come down on June 30, foreclosing further progress. And it's important to note that since this has been the most sluggish U.S. recovery since World War II, it hasn't been characterized by excesses to the upside, meaning there needn't be a recessionary correction on the usual schedule.

Very soon, the current recovery is bound to become the longest in U.S. history. However, I believe the odds are that it's closer to the end than the beginning. (We never know for sure what's going to happen in the future. At best we can think in terms of the probabilities. That's the thinking behind my latest book's subtitle: *Getting the Odds on Your Side*.) The recovery is likely to go on longer, but perhaps not much longer. Still, I wouldn't place a wager on when it will end.

About a year and a half ago, following the enactment of President Trump's stimulative tax cuts, people started to ask me whether the U.S. might emulate Australia, whose last recession was in 1990. While not quite the same as asking "might there never be another recession?" the idea of 28 years between recessions would represent a radical difference this time.

My answer to the above question is "probably not," since there are significant differences between the two countries that probably render Australia's example inapplicable to the U.S.:

- A much bigger part of Australia's GDP is based on exporting natural resources such as iron ore and coal, of which it has so much. Thus in recent decades it has drafted off the unusually strong growth of its much larger neighbor to the north, China.
- In addition, ". . . having a conservative, domestically focused, highly concentrated banking system meant that Australia wasn't stuck importing other countries' financial contagions when crises hit." (*The New York Times*, April 7, 2019)
- In fact, I see in Australia a conservatism and discipline capable of extending financial good times without creating excesses. My favorite example is the Australia Future Fund, which the government formed in 2006 to deal with the country's pension liabilities, with funding that came from fiscal surpluses (!) and the privatization of Telstra, the formerly state-owned telecommunications company. The fund's assets, now standing at A\$154 billion, were essentially put into a lockbox until 2020, which now appears likely to extend until at least 2026. What's the likelihood that U.S. politicians would (a) fund government pension obligations up front, rather than deal with them on a pay-as-you-go basis, and (b) keep their hands off the assets for 20 years, rather than use them to pay for constituent-pleasing spending increases or tax cuts?

So no, I don't think the U.S. is about to emulate Australia's 28-years-and-counting recovery. That I will bet on.

Perpetual prosperity from quantitative easing – In the aftermath of the Global Financial Crisis, the Fed engaged in quantitative easing, a program of purchasing bonds in the open market. The effect of the Fed's purchases was to (a) inject bank reserves into the financial system, (b) strengthen the demand for bonds, thereby bringing down long-term interest rates (which are unaffected by the Fed's normal open market operations related to short-term rates), and (c) with prospective returns on high-quality bonds brought down, reignite risk-bearing on the part of investors seeking higher returns, thereby causing the credit window to reopen. QE was a success in the U.S., and the economy recovered. Thus some people are now proposing that the Fed could engage in QE forever, with similarly positive results.

First, I think some part of the impact of QE may be psychological. In other words, QE stimulates the economy in part because people accept that QE is stimulative. If the Fed took exactly the same actions but did so without making an announcement, would the effect be the same? (I believe there's

a self-fulfilling, placebo-like component to many of the Fed's tactics.) In this regard, I think its first round of QE was more effective than its second, and its second round was more effective than its third. Accordingly, there could be a diminishing return from permanent QE, as the psychological effect abates.

And who knows exactly how QE works? Last week, at a conference I attended, a participant suggested that under Modern Monetary Theory (see more below), the Treasury could issue a potentially unlimited amount of debt, and if third-party buyers failed to take it up, the Fed could buy it under QE. Does this seem reasonable? If the Fed credits banks with reserves, the banks lend a multiple of those reserves, and the borrowers use the loan proceeds to make purchases or investments, does the process really inject money into the economy, or is it mostly a matter of bookkeeping? Or are they one and the same? Of course, this question is relevant to all nations with fiat currencies.

Quantitative easing is generally considered to have contributed to the past decade's low prospective investment returns, resultant risk-taking, asset inflation, and increasing wealth divide. As with any other prescription, shouldn't we worry about possible side effects like these?

Can government actions permanently raise the level of demand in an economy, or do they mostly accelerate future demand into the present? If the latter, can QE elevate GDP forever above what it otherwise would have been? I doubt it. But if it could, wouldn't that eventually cause what I call an "excess," leading to a recession?

Finally, when I hear people talk about the possibility that the Fed will prevent a recession, I wonder whether it's even desirable for it to have that goal. Per the above, are recessions really avoidable or merely postponable? And if the latter, is it better for them to occur naturally or be postponed unnaturally? **Might efforts to postpone them create undue faith in the power and intentions of the Fed, and thus a return of moral hazard? And if the Fed wards off a series of little recessions, mightn't that just mean that, when the ability to keep doing so reaches its limit, the one that finally arrives will be a doozy?**

Benign federal deficits – Over the years, some in government have pursued balanced federal budgets, or at least have paid their lip service. Democrats have generally been described as wanting to "tax and spend" in order to do more for citizens. But they've sometimes spent before they've taxed. Republicans, on the other hand, have positioned themselves as the party of fiscal restraint. It's often been their official position that there could be no increases in spending if not accompanied by corresponding increases in funding.

Regardless of the debate, federal budgets are rarely tendered on time or in balance these days. We've had deficits in 46 of the last 50 years (with the exception of 1998-2001), and in recent years they've risen as a percentage of GDP despite the prosperity we've been enjoying. Often there isn't even a pretense of interest in fighting deficits. Democrats have big spending ideas even in the absence of ways to fund them. And Republicans cut taxes but not always spending.

Both parties now seem to feel that the way to win elections is to simply ignore deficits. In the 1930s, John Maynard Keynes said that in periods when private economic activity isn't generating enough demand to create full employment, governments should spend more than they take in,

counting on deficit spending to stimulate demand. And then, during the resulting periods of growth, they should spend less than they take in, using the surplus to pay down the debt that was taken on to fund deficits. But departing from this, at the end of 2017, in the ninth year of a recovery, the Republicans enacted sweeping tax-rate cuts capable of ballooning the deficit.

A new entrant in this area is receiving a lot of attention: Modern Monetary Theory (“MMT”). One of its components is the belief that government deficits currently are too small, and in any event not a bad thing:

Tax revenues are not what finance the government’s expenditures, argues Stephanie Kelton, an economist at Stony Brook University and one of the most influential modern monetary theorists. What actually happens in a country that controls its own currency, she says, is that the government first decides what it’s going to spend. In the United States, Congress agrees on a budget. Then government agencies start handing out dollars to the public to pay for those tanks, earth movers and salaries. Afterward, it takes a portion back in the form of taxes. If the government takes back less than it gave out, there will be a deficit. . . .

Ms. Kelton . . . points out that every dollar the government spends translates into a dollar of income for someone else. So a deficit in the public sector simultaneously produces a surplus outside the government. . . . (*The New York Times*, April 7, 2019)

Thus, according to MMT, deficits are benign – not a sign of profligacy – and merely an indication that the government has put more money into the economy than it has taken out in taxes. MMT is modern in that it has moved past the old-fashioned concept of balancing spending and revenues, opening the door for bigger deficits.

Does Ms. Kelton think deficits don’t matter? No, the *Times* article goes on:

Of course they matter, she said. . . . They can be too big, especially if they are not used to increase the nation’s productive capacity, or if there is a shortage of labor, raw materials and factories.

In this connection, we should note that Ms. Kelton served as an economic adviser to Bernie Sanders in 2016. Thus it may be reasonable to suspect that MMT is largely a rationale for governments to give away more free stuff, expanding their deficits. **Sometimes it can be hard to separate economic opinions from political leanings.**

This relaxed view of deficits reminds me of a hypothetical consumer who has a credit card with no credit limit. He can spend whatever he wants without having to worry about paying off the balance. In theory, this could work (although it’s challenging to figure out what’s in it for the card issuer). But at a minimum it doesn’t allow for unforeseen developments. **I believe here, as elsewhere, the workings of economics are too uncertain for a perpetual motion machine like MMT to be relied upon. In other words, Modern Monetary Theory is just that: a theory. What if it’s wrong?**

. . . when the University of Chicago’s Booth School of Business asked top scholars about a couple of [MMT’s] claims, they split between the 28 percent who disagreed and the 72 percent who strongly disagreed. (ibid.)

Disregarded national debt – I recall a heated debate when I was young over whether it’s okay for nations to permanently be in debt. More recently, any such doubt has been forgotten, and almost all nations are debtors. The main issue became whether there can be a level of debt that’s too high. But now, thanks to MMT, there’s a belief that there’s no such thing.

Continuing from the *Times*’s description of Modern Monetary Theory:

“The national debt is nothing more than a historical record of all of the dollars that were spent into the economy and not taxed back, and are currently being saved in the form of Treasury securities,” Ms. Kelton said.

In other words, national debt is just a sign of all the government has accomplished.

While I can’t prove that Modern Monetary Theory is off the beam, I also can’t see making it the economic law of the land. Does it have a weakness? I think there may be one hidden in the middle of the long quote above, regarding **“a country that controls its own currency.”** I don’t know exactly what Ms. Kelton meant by this phrase, but it might be a reference to a country that can print as much money as it wants without having to worry about its currency depreciating, and thus one that is always able to issue and refinance debt without limits.

Today the U.S. dollar is the world’s reserve currency, and there aren’t any obvious candidates to replace it. Further, the U.S. benefits from an unlimited appetite for its debt, since it’s the safest of any major sovereign. For these reasons, expanding the national debt isn’t a problem. And like the cardholder described above, since there’s no limit to its credit, the U.S. can add the interest that accrues to the unpaid balance.

What happens if these conditions change? Could a tipping point be reached at which there’s so much debt that people question the U.S.’s creditworthiness and ability to repay its borrowings? In that case, the demanded interest rate would rise, meaning the debt and interest mightn’t be repayable without massive money printing that would result in debasement of the dollar. Thus, could there come a day when it takes unacceptably more purchasing power to pay off U.S. debt denominated in dollars that have depreciated?

I put these questions to my friend Randy Kroszner, former member of the Fed’s Board of Governors and Deputy Dean at the University of Chicago’s Booth School of Business. Here’s his response:

I think the last three decades for Japan and the last decade for the U.S. have shown (and continue to be showing) that countries with credible institutions can “get away with” higher debt levels without a raid by bond vigilantes than most had once thought. That said, it leaves the country vulnerable to a change in sentiment, exactly as you describe. “Getting away with it” for too long erodes the credibility of the institutions over time.

Again, MMT might work, and vastly expanded national debt might prove viable or even advantageous. But I wouldn’t bet the ranch on it.

Economic strength without inflation – For the last 60 years, there has been widespread (albeit not universal) acceptance of the so-called Phillips curve, which posits an inverse relationship between the rate of unemployment and the rate of inflation. In other words, as unemployment falls and the labor market tightens, workers gain bargaining power and employers have to compete for a declining number of available workers. This results in rising wages, which translates into increasing inflation.

The U.S. has seen unusually little unemployment during the Trump presidency, and today it's at a 50-year low. Nevertheless, there hasn't been much wage inflation until very recently, and there still isn't much general inflation.

There are reasons why the relationship underlying the Phillips curve as defined above might be different from what it was in the past:

- Since the U.S. labor force participation rate (percentage of adults who are either employed or looking for work) is at its lowest level in more than 40 years, it might be more meaningful to look at the non-employment rate (the percentage of adults who aren't working) rather than the unemployment rate (the percentage of adults looking for work who aren't working). By the former measure, the labor market isn't so tight.
- Inflation might be structurally lower now and in the future than it was in the past, altering its relationship to conditions in the labor market. Automation, the shift of manufacturing to low-cost countries and the prevalence of free/cheap stuff in the digital age might help explain today's unusually low rate of inflation. For examples of the third of these, think about recent trends in the price of photographs, cellphone calls, messages (texts and emails versus telegrams and faxes) and books.
- On the other hand, the cheapening of things like those listed just above could halt, and a more traditional relationship between inflation and unemployment could resume.

Excessive inflation creates a number of serious economic and social problems, typically requiring central banks to raise interest rates to cool it off, with the effect of dampening economic growth and job creation. Likewise, rising inflation can cause investors to demand higher interest rates on bonds and loans to compensate for the risk of losing purchasing power. This can make it harder for borrowers to service their debt, causing defaults to rise and discouraging investors from taking risk and providing financing. (On the other hand, there's a level of inflation that's desired such that, among other things, workers will see wage growth, and the U.S. can repay outstanding debt with dollars representing a reduced amount of purchasing power. Today that desired rate is about 2%, and policymakers worry about the fact that it hasn't materialized despite the low unemployment rate.)

Rising inflation could be seen as a potential contributor to the end of the recovery. So far it hasn't shown up despite the tightness of the labor market. Has the Phillips curve relationship been revoked for good, or is inflation in the offing? Who knows?

The word I use to describe inflation is “mysterious.” It's rarely clear how it gets started, and in the 1970s and early '80s, when it reached the mid-teens in the U.S., no one could figure out how to stop it until after Paul Volcker became Fed chair. It's mysterious why there's so little inflation today, and whether there'll be inflation in the future. But I'm not confident that it'll still be below 2% a few years from now.

Persistently low interest rates – “Lower for longer” has been another rallying cry of the bull market. If interest rates remain low, economic growth is encouraged, defaults are scarce, risk-taking is encouraged and financing is easy. So far – against the odds – the strength of the U.S. economy hasn’t caused interest rates to rise.

The Fed has raised interest rates nine times since the end of 2015, taking the short-term fed funds rate from roughly zero to 2¼-2½%, and in late 2018 it said it would go further. But in January, in response to fears of economic weakness that arose in 4Q2018, the Fed reversed course and declared that there would be no more increases for now. Whereas the yield on the 10-year Treasury note hitting 3¼% early last October coincided with (and probably contributed to) the start of the stock market’s fourth-quarter swoon, the promise of low rates has played a big part in the rally this year.

In mid-2007, in a real economy that felt to me a lot like this one, the fed funds rate and the yield on the 10-year Treasury note both were around 5¼%. Today, with the fed funds rate and 10-year Treasury yield below 2½% instead, the Fed describes interest rates as “neutral”: neither low enough to be stimulative nor high enough to be restrictive. (I considered the 2007 rates to be neutral – how can that be true of rates at both levels?)

Will the Fed leave rates low? Can it do so if inflation strengthens? Will it leave rates so low that there’s little room to reduce them in the future should stimulus be needed? If deficits and debt grow faster than GDP, won’t that put upward pressure on interest rates? Or if the Fed cuts rates, as many people now consider likely, will the markets be cheered by the stimulus, or will they fall in response to the economic concerns at which the rate cuts are directed?

Certainly no one can say.

Equanimity regarding the inverted yield curve – Something else we’ve heard a lot about over the last couple of years is how risky it is when the yield curve inverts.

The yield curve is usually upward-sloping, meaning lenders demand higher interest rates when they lend for longer periods as compensation for the increased uncertainty (especially with regard to possible declines in the purchasing power of the currency between the time the loan is made and when it’s repaid). But sometimes, long-term rates fall below short-term rates, and the curve is said to be “inverted.” The curve has been unusually flat in recent months, and today it’s actually inverted.

Because most periods of inversion have been associated with recessions, the condition is considered worrisome. In that regard, the *Financial Times* noted on June 1 that “the [yield curve] has ‘inverted’ before every US recession in 50 years.” (Note, however, that this is different from saying every inversion has been followed by a recession.) What people should be focusing on isn’t the usual coincidence of inversions and recessions, but rather the reason for this particular inversion.

Understanding the latter might allow observers to sense whether a recession is implied and avoid a “false positive.”

The explanation for inversions isn’t always clear, since interest rates (like inflation) can be mysterious. Today I would say the inversion of the curve may be due to the fact that the Fed has brought short rates up at the same time that (a) there’s a surplus of capital for investment at the long end of the yield curve, putting downward pressure on rates there, and (b) there’s less reliance on

capital investment in the information age, so less demand for long-term debt capital. One more thing that may be bringing down long-term yields is an increase in general worry among investors, and thus a flight to the safety of Treasuries. When demand for bonds rises, sellers are able to require buyers to pay higher prices, which translate into lower yields.

I don't fully understand why an inverted yield curve should be a negative, but its fans swear that it is. I merely can't prove that it's not. One possible ramification is the threat to bank profitability: an inverted yield curve takes away banks' ability to make money simply by borrowing short to lend long.

Profitless success – Historically, companies have been considered valuable primarily because they produce profits – if not immediately, then at least they were expected to do so in the foreseeable future. Then the view arose in the tech-media-telecom bubble of the late 1990s that companies could be great (and valuable) even in the absence of profits for years to come. Today, profitless companies are back in vogue and sometimes valued in the tens of billions of dollars.

Tech and venture investors have made a lot of money over the last ten years. Thus there's great interest in tech companies (including ones like Uber and Lyft that are applying technology to enable new business models) and willingness to pay high prices today for the possibility of profits far down the road. **There's nothing wrong with this, as long as the possibility is real, not over-rated and not over-priced.** The issue for me is that in a period when profitless-ness isn't an impediment to investor affection – when projected tech-company profitability commencing years from now is valued as highly as, or higher than, the current profits of more mundane firms – investing in these companies can be a big mistake.

Today there are a lot of investors who weren't around to see the 2000 bursting of the TMT bubble, in which large numbers of Internet and e-commerce companies were given the benefit of the doubt, only to end up worthless. Venture capital funds showed triple-digit annual returns in the late 1990s, but the ones started around 2000 performed very poorly (and people began to ask me if venture capital was a legitimate asset class).

Today, some tech and venture investments have again produced great results, and the doubts seem to be gone. **In investing, however, the truth usually lies somewhere between the extremes of infinite value and worthlessness.** Investor sentiment seems to be closer to the positive end of the pendulum's arc these days, but it's unlikely to stay there in perpetuity.

Growth investing preeminence forever – Since future-oriented “growth investing” has been so successful for so long, and has so seriously trounced “value investing,” people are asking me whether this will ever end. In particular, value investing is being likened to the out-of-favor “cigar-butt” school of investing, in which people buy assets regardless of their quality just because they're low-priced. Critics of value investing argue that, since the technological leadership that's often associated with growth stocks is so essential for success in today's world, old-economy companies lacking it are unlikely to be top performers in the future.

My answer is simple: low price is very different from good value, and those who pursue low price above all else can easily fall into “value traps.” And certainly it's true that old-economy companies

are less likely to be the fast growers of the future or benefit as much from the “moats” that protected them in the past.

It may also be true that given the ease today of searching the universe of securities, it may be harder than it used to be to find “value” companies with current assets or earning power that are broadly unrecognized and thus underpriced. Since the best returns come from buying things whose merits others aren’t aware of, it’s certainly possible that easy, widespread access to data is making it harder for value investors to excel.

On the other hand, companies that do have better technology, better earnings prospects and the ability to be disrupters rather than disrupted still aren’t worth infinity. Thus it’s possible for them to become overpriced and dangerous as investments, even as they succeed as businesses (this was often the case with the Nifty-Fifty in 1968-73). And I continue to believe that eventually, after the modern winners have been lauded (and bid up) to excess, there will come a time when companies lacking the same advantages will be so relatively cheap that they can represent better investments (see value versus growth in 2000-02).

Understandably, the stocks of companies with bright futures are likely to be outperformers in times of economic growth and optimism, when investors are happy to pay up for potential. But stocks of companies with tangible value in the here-and-now are likely to hold up better in less positive times because (a) they’ve previously been disrespected and valued lower and (b) the rationale underlying their prices is less a matter of conjecture and faith. Thus a swing in favor of value may have to await a period in which the “champions” lose some of their luster, perhaps in a market correction (see 4Q2018). But it’ll come.

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What do all the theories propounded above have in common? That’s easy: they’re optimistic. Each one provides an explanation of why things should go well in the future, in ways that didn’t always go well in the past.

In recent years, the U.S. has simultaneously experienced economic growth, low inflation, expanding deficits and debt, low interest rates and rising financial markets. **It’s important to recognize that these things are essentially incompatible. They generally haven’t co-existed historically, and it’s not prudent to assume they will do so in the future.**

Many of the beliefs discussed above suggest we’re in a so-called “Goldilocks” environment: one that’s not too hot and not too cold.

- Economic growth won’t be so strong that it brings on excessively high inflation, or so weak that it ends in recession.
- Inflation won’t be so low that the economy stagnates, or so high that it leads to burdensome increases in the cost of living and requires contractionary interest-rate increases to cool it off.

I’ve seen times in the past when people believed such an ideal state would continue in perpetuity, but it has never worked out that way. Maybe it will this time – no one can prove it won’t until it doesn’t

– but certainly broad acceptance of such a proposition indicates that optimism prevails in the current investment environment.

We keep an eye out for the widespread belief that “this time it’s different” because we want to know if markets are being lifted by bullishness, optimism, risk tolerance and low levels of skepticism. **Everything else being equal, these things result in asset prices that are high relative to intrinsic values, and their presence exposes us to the risk that they’ll abate, taking asset prices down with them.**

In [*On the Couch*](#) (February 2016) I said:

That’s one of the crazy things: in the real world, things generally fluctuate between “pretty good” and “not so hot.” But in the world of investing, perception often swings from “flawless” to “hopeless.” The pendulum careens from one extreme to the other, spending almost no time at “the happy medium” and rather little in the range of reasonableness.

Widespread attaching of “the four words” to bullish propositions suggests that the environment is being perceived as flawless. When and if that swings to hopeless, the result is pain for investors.

Of course, no one can prove that the nine propositions discussed above won’t hold. Economics and markets aren’t governed by immutable laws like the physical sciences, and there’s no schematic diagram that shows how they work. Thus, I want as usual to make it explicit that these are the musings of someone who (a) isn’t an economist and (b) doesn’t claim to know exactly how economic and monetary mechanisms function. **But who does?**

Now, sometimes things really are different, as Templeton said. (And in areas like technology and digital business models, I’d bet things will be different more than the 20% of the time Templeton cited.) Certainly the world today is very different from that of the past. As I’ve written before, 40 years ago it felt like the world was a stable place that was subject only to limited change in areas like scientific progress, fads and politics. Today the idea of an unchanging world is out the window: things change every minute, and anyone who doesn’t keep up with the changes is fated to miss out. Technological prowess can be essential for success, and every company or industry that lacks it is susceptible to being disrupted by those who possess it.

I readily admit that, at my stage in life, I may not fully grasp the forces that will determine the future. At times like this, when tech stocks are in the middle of a great run, I’m reminded of a classic book from my youth, *The Money Game* (1967). In it, the pseudonymous Adam Smith introduced the Great Winfield, a veteran broker who, despite the limitations associated with having reached middle age, was minting money in the new tech stocks. When asked about the source of his success, he introduced Smith to his traders:

“My boy,” said the Great Winfield over the phone, “Our trouble is that we are too old for this market. The best players in this kind of a market have not passed their twenty-ninth birthdays.”

. . . “My solution to the current market,” the Great Winfield said. “Kids. This is a kids’ market. This is Billy the Kid, Johnny the Kid, and Sheldon the Kid.”

. . . “See? See?” said the Great Winfield. “The flow of the seasons! Life begins again! It’s marvelous! It’s like having a son! My boys! My kids!”

Of course, veteran that he was, the Great Winfield knew the truth. Thus he went on:

. . . “The strength of my kids is that they are too young to remember anything bad, and they are making so much money they feel invincible,” said the Great Winfield. “Now you know and I know that one day the orchestra will stop playing and the wind will rattle through the broken window panes . . .”

[Emphasis added]

To close, I’ll return to a concept I consider indispensable for anyone hoping to succeed at investing – the three stages of a bull market:

- the first, when only a few forward-looking people begin to believe things will get better,
- the second, when most investors realize improvement is actually underway, and
- the third, when everyone concludes that things can only get better forever.

Clearly the few who buy in the first stage – when optimism is scarce and thus asset prices are low – can access great bargains. But those who buy in the last stage – out of a belief that the news will always be good – can be making a big mistake. **The nine propositions reviewed above all represent variations on “things can only get better forever.” If they’re the ideas guiding investors today, that should be considered worrisome.**

The best investments often are made in times of fear and desperation. That’s rarely possible when investors are willing to blithely dismiss the limitations of the past with the words “this time it’s different.” I would remind those investors of a quote usually attributed to Mark Twain: “History doesn’t repeat itself, but it does rhyme.” **Of course it’s important that investors keep up with current developments and those that will shape the future. But it’s also essential that they not completely unlearn the lessons of the past.**

June 12, 2019

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