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Investment Advisors LLC

The Lost Decade?

I don't think so…

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Ten years ago we read headlines like "The ten stocks which will change the world," followed by dreamy visions of Cisco and Intel reaching for the stars. It was a new world of magical multiples and instant fortunes! We all know that plan ended in tears, and now we look back and survey the rubble and wax poetic about the dismal world we live in. As always, the past (recent past) is present and future in the eyes of the punditry.

And as always, in this letter we will eschew a mere regurgitation of facts and figures, and we will not mortgage our credibility with some silly forecast. There are lots of people more than willing to do both (CNBC, anyone?). We will try to share some perspective and hopefully say something useful and thought-provoking.

The first, smaller point, is that this past decade was not lost. Not even in terms of the markets. For one thing, while the S&P 500 lost money, international and emerging markets stocks have done well. In fact, emerging markets have emerged! The world really has changed, as it always does. Hundreds of millions of formerly poor (very, very poor) people are working and moving into the "middle class." Historical, monumental and indeed wonderful change. How can we call such a decade lost?

Even in the crassest, most self-interested terms, intelligent, disciplined investors were well-diversified and made money last decade. Perhaps less than usual, but they did OK. Aside from maintaining their international equity allocations (instead of chasing the almighty S&P 500 in 1999, remember that?), they maintained their bond exposures. In almost every year of this decade we were told that rates were bound to go up, get out of bonds. And it never happened; bonds did fine, and outperformed not only cash, but equities!

The second point, the Big One, is that past does not equal future. This stuff is highly unpredictable; stop trying to guess at it. Simple to understand, very difficult to practice, but the most important thing an investor needs to know.

Schumpeter

Joseph Schumpeter (1883-1950), like many great minds, was born on February 8, spent time at Harvard where he was unappreciated, and being of mathematical bent and independent mind was no fan of Keynesianism. He grew up in Austria, and fled to the US when the Nazis came to power.

Three related themes he championed as the drivers of the world economy were:

1. **Entrepreneurship**
2. **Innovation**
3. **Creative Destruction**

You can see why the statists at Harvard didn't care for him. In his view, clearly borne out by the economic history of the world since his death, entrepreneurs innovate, create new companies, new jobs, new ways of doing business and accomplishing many things. Thus the world is not benefitting by government management of the economy or regulation of large businesses to ensure "fair" or even "perfect" competition; it is benefiting from new companies and all that they do. And what they do inevitably involves what he termed "creative destruction." The old companies get destroyed, jobs are lost, there are winners and losers, there is pain. Not what a bureaucracy likes to see--so disorderly, so upsetting to constituencies, you know. It just won't do.

I mention this, not merely because he was so good, so important, and so overlooked, but because one plainly sees this process playing out in the world today. We now have unemployment over 10%, and many of those jobs are not coming back. Recovery in the job market is slower than in the past because we are seeing companies and industries destroyed or at least completely reshaped. The auto companies provide one graphic example.

Our point is that the news is not all bad. It is painful for the people directly affected, but may turn out to be great for the economy, great for the markets, and great for you, the investor. The doom and gloom in the press may be exactly the wrong picture to focus on. Focus on the growth, the new companies, the opportunities. In fact, we have come to understand that we can't even forecast where the main sources of new employment will be over the next ten years, it is so complicated and happens so fast!

At this point, I pass the baton to John Bussel, a principal of Hewins Financial Advisors, LLC and member of our Investment Committee. John has some interesting thoughts about where we stood 10 years ago and what the future looked like then.

A look back and some lessons learned

John Bussel, Principal and Member of the Hewins Investment Committee

It is important to appreciate where the markets and market psychology have come from over the course of the last ten years. Imagine the thinking back in December 1999. People were so high on equity returns – it must have been better than Woodstock! Think how good the economic fundamentals were – the economy grew at an annualized rate of 5.8% in the fourth quarter of 1999 and unemployment was around 4%. Stock market returns had run in excess of twice the historical rate for five years. If someone had proclaimed that bonds would outperform stocks for the next ten years starting in 1999, he might have been locked up – imagine such an INSANE claim. Even though there was historical precedence for bonds to beat stocks for ten year periods, it was so far removed from anyone's memory or experience it was essentially considered impossible by investment pros and the public alike. But stock market valuations were so beyond prior historical peaks that things must have been different. The world must have changed—there was a new normal! Sound familiar? So it turns out the 4th quarter of 1999/1st quarter of 2000 was the greatest selling opportunity of our lifetimes.

Here we are ten years later. Equity returns in the US have been abysmal, and the economic fundamentals, while improving, seem very vulnerable to falling apart again. But from an investing point of view, the downside risk is much less today than it was ten years ago. Ten years ago people were taking on mind boggling risks – they just did not have any clue they were doing so. They really did not appreciate that they were taking a massive bet on valuations staying sky high and the economy never again going through a down cycle. Sounds ridiculous now, but it really happened.

Now the perceived wisdom is that a sustainable, vigorous and extended economic and market recovery is an impossibility. In this kind of environment the downside risk/upside potential is very, very compelling if an investor is truly looking out 10 years. While counterintuitive, investing when the macros are poor but valuations are at least reasonable is much better than the inverse. At worst the macros stay poor, but at best they surely and steadily improve. Bottom line is that it makes more sense to buy and hold stocks when unemployment is at 10% and showing some signs of improvement than when unemployment is at 5%. Interesting, isn't it?

Now maybe the stock market corrects 10%, 15% or more in 2010. Nobody knows, although there is no shortage of people willing to guess. But even as many believe that our current policy makers are leading us to a replay of the 1970's – there will still be great opportunities in the decade ahead given the values that exist today. An interesting factoid: Warren Buffett turned 40 years old in 1970. That same year he became chairman of Berkshire Hathaway, whose shares he had started accumulating five years earlier for under $15/share. By the end of 1979, the shares were worth $1,310, and he had a net worth of $620 million. So in spite of the war in Vietnam, two failed presidencies, high energy prices, stubbornly high inflation and a terrible bear market in 1974 – he was able to take advantage of the malaise and make a tremendous fortune not by investing in bonds or gold or real estate but equities.

Wrapping up – it's a new decade, the 2010's

So as we look at the next decade, we should acknowledge that despite the prevalent pessimism and solid reasons for doubt, we may have already seen the worst of it – things might actually be getting better and perhaps we are just at the beginning. We will certainly have to review all this in December 2019. Stay tuned.

Sincerely,

Roger C. Hewins III
President

John Bussel
Principal, Consultant

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