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OBSERVATIONS ON THE MARKET

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There are few events that can capture a news headline faster than a virus that could potentially spread into a global pandemic. It is now being estimated that the impact to global GDP may reach $1 trillion. Certainly, a big number, however, the global economy now stands at almost $90 trillion. From 2017 to 2018, global GDP grew by $5 trillion. It is best to always keep these events in perspective, which is what the media never does. Nobody knows the ultimate outcome, but this is one of the few times that there is unanimous support by every government to try and stop its spread. In the past it has never been a good strategy to bail out of the markets from these threats. The world is fighting a common problem. It doesn't mean that there will not be some financial pain and casualties.

Some of the independent oil produces may not survive the threat. The oil sector was already suffering before coronavirus from a weak natural gas market and limited access to the debt markets. Now, some companies are facing 20% or higher interest rates which effectively shuts them out of the bond markets. The energy sector of the S&P 500 is now less than 5% of the total market capitalization. This sector doesn't get much attention anymore, and an oil and gas company going bankrupt is almost perceived as; they deserve it. The financially strong survivors will benefit. Warren Buffett, the guy who is supposed to be smarter than the rest of us, loaned $10 billion to Occidental Petroleum last year. His latest annual report shows that oil is not the only place he has invested.

The Berkshire Hathaway annual report was released on Saturday. The letter to shareholders is always worth reading, since the guy (Buffett) has made more money from investing than virtually anyone else. This year his commentary focuses on the basics. He usually always gives an illustration about the power of compounding, and does again, and gives his usual discussion about Berkshire's portfolio of businesses and stock holdings. He does make a prediction: "What we can say is that if something close to current rates should prevail over the coming decades and if corporate tax rates also remain near the low level businesses now enjoy, it is almost certain that equities will *over time* perform far better than long-term, fixed-rate debt investments." The Berkshire Hathaway stock portfolio is valued at $248 billion as of 12/31/19. He has skin in the game. Some simple assumptions show why the odds are in his favor that he will be right.

The current yield on the 10-year Treasury note is 1.37%. Let us assume we are investing $100, so we earn $1.37 each year for 10 years. With the benefit of compounding, our $100 grows to $114.58. The S&P 500 has a current dividend yield of 1.75%. However, for each of the last eight decades, the dividend has grown by a remarkable steady 6% average in every decade back to 1940. If it does again, our $1.75 dividend ends the decade at $3.13. With the magic of compounding, our $100 turns into $124.45. Without any growth in stock prices, stocks win by a wide margin. Every one of Berkshire Hathaway's top ten holdings is a dividend payer. He is just relying on simple math.

The virus could disrupt the global economy in the short run. However, those previous eight decades contain several challenging events that were arguably much worse. It is just hard to bet against 6% dividend growth, and the hard part is always: When do you get back in?