Client's Corner

It Isn't the Known Unknowns That Get You

DONALD RUMSFELD'S CAREER IN PUBLIC SERVICE WAS SO LONG that he remains both the youngest and the second-oldest person ever to have served as U.S. secretary of defense (1975–77 under Gerald Ford, 2001–06 under George W. Bush).

Mr. Rumsfeld's operating hypothesis was that in a job like that, one was always going to be dealing with unknowns. But, he said, the unknown breaks down into two categories: known unknowns and unknown unknowns. And it isn't the known unknowns that get you.

(The mother of all known unknowns was Y2K. You may remember that, as the millennium approached, a problem in the coding of the world's computer systems threatened to render them inoperable at midnight on December 31st, 1999. Your financial advisor may regale you with stories of people seeking desperately to convert their savings and investments into physical cash, for fear that the records of them would disappear. After a year or more of international alarm, feverish preparations and programming corrections—and the expenditure of some $300 billion worldwide—at midnight on New Year's Eve, the computers rolled over without incident. This particular unknown had proven…just too well known.)

In 2020, investors have been faced with both a known unknown—the presidential election—and an unknown unknown—the COVID-19 pandemic. Once again, we discovered (or more accurately rediscovered) the wisdom in Mr. Rumsfeld's dictum that it isn't the known unknown that gets you.

I've been an investment professional of one sort or another through 14 presidential elections, beginning with Nixon vs. Humphrey in 1968. It is our great quadrennial known unknown. And every time, the adherents of both candidates forecast the end of our national life if the other guy wins.

But I may tell you that I've never before encountered so many investors passionately desirous of getting out of the equity market before an election, fearing that the success of one candidate or the other would plunge our nation into chaos. In the next breath, many of these same people said they planned to get back in the market after the election—in effect fleeing their core long-term investments to avoid volatility they themselves thought would be of short duration. You may infer from this conundrum—as I did—that there wasn't a lot of rationality being practiced here.

(For the record, the S&P 500 closed on the Monday before Election Day 1968 at 103. It closed this election eve at 3,310. After a while, that experience has the effect of predisposing one to shrug off elections. But I digress.)

Politically, this year's election turned out to be chock full of irony. The incumbent president appears at this writing to have lost—but his party did quite well down the rest of the ticket, through Congress and the statehouses. The challenger won a large popular majority—but his party fared significantly less well. I think it safe to say that this outcome was forecast by exactly nobody. (Granted, the runoffs for two U.S. Senate seats in Georgia will have some bearing on the ultimate outcome. In that sense, January 5 is our new national known unknown.)

For investors, though, this election served up a hearty helping of same old, same old. To wit: if you got out of the market around the trough of its perfectly predictable pre-election sinking spell—S&P 3,270 on Friday, October 30—you very quickly got thoroughly skunked. Two Fridays later, on November 13, the Index closed at a new all-time high: 3,585, up about 10%. And another known unknown bites the dust.

Meanwhile, the pandemic rolls on, gaining momentum as the weather gets colder and people move indoors. Societally, it was and remains the great unknown unknown of 2020, and on into next year. Yet at the heart of the matter, there's a wonderfully known unknown: the vaccine. (Indeed, vaccines.)

We don't know when an effective vaccine will be ready. We don't know how long after that it will take to reach meaningful swaths of the population, starting with its most endangered stratum, the elderly infirm. Until it does, we don't know to what extent affected cities and states will lock down, nor with what deleterious economic consequences.

Thus, as they did in the run-up to the election—indeed, as they did when the pandemic first struck with full force and the S&P 500 fell 34% in 33 days—investors have a choice today. Fearing another lockdown-driven economic downturn, they can throw off their long-term plans and portfolios, and retreat to the sidelines "until the dust settles." We have seen—not once but twice in this phenomenally instructive year—how dreadfully (and quickly!) this "strategy" fails.

The other choice—the one that has served investors exceptionally well (and quickly!) throughout a most stressful year—was and is to just ride it out. I have every confidence that your financial advisor is continuing to counsel this course of action to long-term, goal-focused, planning-driven investors.

"Follow the science," we are told. Well, so be it. For the science tells us that, even as the virus may currently be winning the battle, the vaccine must ultimately win the war. And you won't want to be sitting in cash when it does.

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