

Preliminary Thoughts – The New World Order

March 24, 2020

by Bob Rodriguez

The following letter was sent by Bob Rodriguez to his friends and colleagues yesterday, as well as to Bob Huebscher. Bob Rodriguez has graciously allowed us to publish it.

Robert L. Rodriguez was the former portfolio manager of the small/mid-cap absolute-value strategy (including FPA Capital Fund, Inc.) and the absolute-fixed-income strategy (including FPA New Income, Inc.) and a former managing partner at FPA, a Los Angeles-based asset manager. He retired at the end of 2016, following more than 33 years of service.



He won many awards during his tenure. He was the only fund manager in the United States to win the Morningstar Manager of the Year award for both an equity and a fixed income fund and is tied with one other portfolio manager as having won the most awards. In 1994 Bob won for both FPA Capital and FPA New Income, and in 2001 and 2008 for FPA New Income.

The opinions expressed reflect Mr. Rodriguez' personal views only and not those of FPA.

Dear friends and colleagues,

Though the virus pandemic has been tumultuous, challenging and with little precedence, from a capital market perspective, this market collapse was quite predictable. Capital market excesses became pervasive in ways that were also unprecedented. Zombie companies, corporate operating strategies that elevated financial risk to extreme levels and consumers who also became highly leveraged were the accepted actions of the day. Prudence was an extremely rare virtue. Many times I expressed the opinion that I thought the various equity markets were at least 40-60% over valued. Recent events would tend to confirm my assessment.

Back in 2009, in my Morningstar speech, and then after I returned from my 2010 sabbatical, I argued that, if we did not get our economic house in order, we would experience a crisis of equal or greater magnitude than the 2008-2009 period and that this would take place after 2017. With the passage of the 2017 omnibus bill and the 2017 tax cut, along with a continuation of unsound and insane monetary policies, this speculative excess period was able to be extended. We knew there would be a pin that would prick this unbelievably speculative bubble but we just didn't know what it would be. Now we do.

Our economic and financial market systems were not prepared with appropriate "rainy day reserves" to withstand an exogenous shock. Balance sheets were stretched in all economic sectors. The shock to the US economy by the bombing of Pearl Harbor and the beginning of WW2 was more traumatic and of greater magnitude than what we are experiencing now and it would also last longer. However, after 12 years of Depression, the financial system was cleansed of speculative excesses that allowed for a financial re-leveraging of the economy to fight the war. After the carnage was over, the economy was able to grow out of an extreme leverage position. In contrast to then, this is not the case today, given that the economy is already extremely leveraged prior to the onset of the crisis. My worst fears have materialized.

Since 2013, I have been preparing for an economy of monumental excess, where debt and deficits do not appear to matter, along with Fed and other central bank monetary policies that totally distort the fundamental elements of the Capital Asset Pricing Model. With the events of the past three weeks, the perversion and conversion to a dystopian capital market and economic system is virtually complete.

As for me, with the yesterday's Fed announcement of unlimited QE and its "will buy or support almost anything," along with the pending passage of a \$2-2.5 trillion stimulus package, this is the end of the capital markets as we have known them. We have now entered unlimited QE and MMT where there is no escape. It is the Roach Motel all over again. In Chairman Bernanke's 2010 Washington Post op-ed, he argued that QE would lead to a virtuous economic cycle; therefore, the Fed would eventually be able to exit from its QE operations. I argued that once initiated, a reversal would be impossible. It would be like the Roach Motel, "You can check in, but you cannot check out."

With the initiation of the Fed's complete takeover and control of the US financial economy, there is now absolutely no accurate pricing discovery in the capital markets and we have entered a period of total manipulation. In light of this, the only markets I have an interest in are those where the heavy hand of government is not involved or only minimally involved. This leads me to rare commodities and collectibles. The public equity and debt markets are now nothing more than greater fool markets that are led by the greatest fools of all, the Fed and the Congress. US capital markets, RIP!

Despite my having avoided 100% of the market carnage and also being profitable, I have to shed a tear for the passing of a capital market that has benefitted the real and financial economy so well for decades. In 2008, when I wrote, "Crossing the Rubicon," I argued we had crossed over into a new economic order and system. Little did I know that within twelve short years this transformation would be virtually complete. We have entered into a far more dangerous environment where normal rules of analytics will likely not apply. When everything is essentially socialized as to risk, a return vs risk evaluation is essentially meaningless since the risk side of the equation has been truncated. Over a period of time which I cannot estimate yet, I will continue my preparation for a far different economic and financial environment. Capital deployment strategies will likely have to change from what has been the norm in the post WW2 environment. We are in a New World Order.

I hope I am wrong in my assessment, but I doubt it.

Good luck,

Bob

March 24, 2020