When the Unexpected Leads to the Unexpected

Norm Macdonald gave one of my all-time favorite stand-up bits a few years ago during the David Letterman farewell tour.

Norm lays out the idea that he's not really scared of Iran or North Korea when it comes to geopolitics. The only country that worries him is Germany:

I don't know if you guys are history buffs or not but...in the early part of the century Germany decided to go to war. And who did they decide to go to war with?

THE WORLD.

That had never been tried before.

So you figure that would take about five seconds for the world to win but no, it was actually close.

This doesn't do Norm's delivery justice so here's the clip (skip ahead to the 4 minute, 30-second mark):

When you think about it in these terms, it does seem preposterous. People of the early-20th century were used to war and conflict but nothing at the scale of the first World War. No one had any idea what to expect.

Most people were worried about their families, friends, and the outcome of the war, but the economic and market implications were also completely up in the air when fighting broke out.

Frederick Allen Lewis discusses the uncertainty surrounding business activity and the stock market in his excellent book, The Lords of Creation: The History of America's One Percent:

When the armies began to march in Europe at the end of July, *1914, the first effect upon the American economy was a stroke of almost complete financial paralysis. The New York Stock Exchange was closed at once, to remain closed for months; if it had not been, the rush of European investors to convert their American securities into money against the unpredictable emergencies of war financing would have knocked prices down to the bottom, undermined bank loans, and imperiled the whole financial structure.*

American businesses were worried the Europeans wouldn't be able to pay their bills. Governments fretted about foreign trade disruptions. Commodities prices fell so drastically that there was a campaign to get as many Americans as possible to buy a bale of cotton to save business in the South.

Then in the summer of 1915, something unexpected happened -- the economy took off like a rocket.

It turned out the war wasn't going to be a crutch to the U.S. economy, but a boon. Allies across the sea needed to buy materials, supplies, and food in bulk from the U.S. because many of their supply routes had been compromised. Business boomed, wages increased, prices rose, credit expanded (thanks to the recent creation of the Federal Reserve), profits rose, and farmers enjoyed some of the best times they'd ever known.

The stock market also joined the party. After falling more than 30% in the lead up to the war, when it reopened, stocks went crazy. The Dow was up almost 90% in 1915, which remains the highest calendar year return on record. From the start of the war in 1914 until it ended in late 1918, the Dow was up close to 9% a year.

How many investors do you think predicted stocks to rise at an average clip throughout a WORLD WAR?

When the war ended in 1918, economists agreed the good times finally had to come to an end. Governments were awash in debt, millions of soldiers were unemployed, and all of the huge war-time contracts that had propped up many businesses came to an end.

But a funny thing happened -- the economy kept right on chugging along as the boom continued for a solid two more years unabated. The inevitable collapse did come at the tail end of 1920, leading to a depression in 1921, but this furious economic expansion lasted much longer than anyone could have imagined. No one could have possibly predicted these outcomes at the time.

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There are things that happen in this world on a regular basis that are totally unexpected -- natural disasters, accidents, terrorism, disease, tragedy, market crashes, geopolitical events and so on. There are certain things you can never really plan for in terms of when, how, and why they'll happen.

Yet I'm constantly amazed at people's ability to be completely blindsided by an unexpected event, but then have the audacity to assume they know exactly how things will turn out after that unexpected event occurs. It's almost as if we presume that a period of certainty will surely follow a period of uncertainty.

This is never the case.

In recent years investors have been inundated with things like unprecedented interest rate policies from central banks, negative interest rates on government bond yields, changing regulations, new

Fed chairs, a new president, the European debt crisis, government shutdowns, falling rates, rising rates, and everything else that impacts markets and the economy.

"Unprecedented" is a word that's been used a lot since the financial crisis began. It's a good idea to have an open mind when the unexpected happens on a regular basis.

Predicting the future is always difficult but even if I gave you the future headlines it still might not help you as an investor or handicapper because you have no idea how people will react to the news.

Understand that there are no blueprints for certain geopolitical events or market environments. These things don't exist in a vacuum.

The unexpected often leads to the unexpected.

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If you'd like to learn more about WWI I can't recommend the 5-part Hardcore History podcast on the topic enough:
Blueprint for Armageddon

Now here's what I've been reading lately:

- Rebalancing with Shannon's dream (Personal Finance Engineer)
- Jerry Seinfeld's closed-door policy (Cal Newport)
- Here's how the fund industry works now (Reformed Broker)
- The human condition (Humble Dollar)
- The 20th anniversary of Can't Hardly Wait (The Ringer)
- What do clients want? (Irrelevant Investor)
- Why do investors focus on the wrong things? (Behavioural Investor)
- Advice that sticks (TEBI)
- 20 things I learned while I was in North Korea (Wait But Why)