



Source: National Baseball Hall of Fame Library

In the Dust

One of the most popular writers of the 20th century was born, and died, in Manhattan. Kansas, and New York, that is, respectively.

Damon Runyon was born to a family of newspapermen. His grandfather was a printer, and his father was the editor of the town's paper. The Depression of 1882 bankrupted him, and the family moved to Pueblo, Colorado to start over. Damon dropped out of school after fourth grade, but that didn't stop him from finding work at a variety of Colorado papers, including the *Denver Daily News*, where he was sports editor in the first decade of the 20th century. William Randolph Hearst brought him to New York in 1910, to cover baseball (the Giants) and boxing, the two most popular sports in America, for his *New York American*.

Runyon became one of the most acclaimed journalists in the country, and set the standards for sports writing. To this day, he is the only person ever to be inducted into both the Baseball Hall of Fame and the Boxing Hall of Fame. But Runyon's enormous popularity, and his legacy to us, come not from his sports writing, but from his many short stories with colorful characters that captured the language, the cadence, the schemes of the marginalized, but mostly loveable, losers of Depression-era New York.

Runyon himself loved gambling, and that meant he spent much of his time at floating (illegal) dice games and at the horse track, where he found many of his characters: Nathan Detroit, Harry the Horse, Regret (modeled after his best friend, Otto Berman, the accountant to mobster Dutch Schultz), Nicely-Nicely Jones (whose "livelihood is the best he can, which is an occupation that is greatly overcrowded at all times along Broadway").

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Runyon's stories have very little plot; it was the wonderful music and lyrics by Frank Loesser that made *Guys & Dolls* a smash Broadway musical. A Runyon story is more about characters and their observations about human nature. But what memorable characters they are, and such funny, witty and poignant observations about life and its struggles that still resonate with us today.

This past quarter marked the tenth anniversary of the depths of the financial crisis. At the time, it seemed as if the very foundations of the world economic order were collapsing. The causes of that crisis are still debated, just as the reasons for the recovery since then are in dispute. Regardless of the explanations, the past ten years have been unusual in a number of respects.

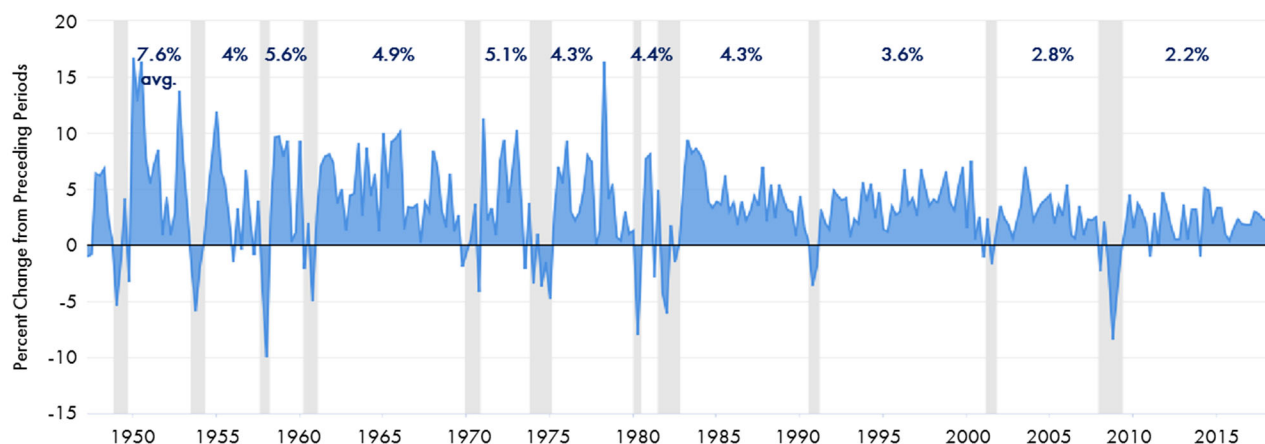
This economic recovery has been the weakest in recent history, barely registering 2% growth per annum (see Chart 1). At the same time, this will soon be the longest, uninterrupted expansion in at least 150 years.

At first, many doubted the recovery would take hold. Since then, its reversal has been predicted each year. All

manner of economic and geopolitical calamities has presented themselves, including, but not limited to, a Greece default that would bring down the eurozone, a trebling of central bank balance sheets in an unprecedented experiment in monetary policy, Russian military expansion, a surge in populist and nativist politicians around the globe, most importantly in the United States, Brexit, and many others crises. Investor confidence has swung up and down, but over the past year has fallen to its lowest on record (Chart 2, page 3).

Despite weak economic growth, unending geopolitical crises and poor investor sentiment, returns to investors have been spectacular. Japanese stocks, in the face of no real economic growth in a generation, are up 150% in the past decade (about 10% p.a.), European stocks and US high yield bonds have gained 200% (11.5% p.a.). Leaving all others in the dust has been the performance of US equities, with a cumulative gain of nearly 400% (17% p.a.). In the past ten years, US equities have more than doubled the return of non-US markets (Chart 3, page 3).

Chart 1 Real Gross Domestic Product



Source: Source: Bureau of Economic Analysis
Shaded areas indicate U.S. recessions
myf.red/g/nDo

Chart 2 State Street Investor Confidence Index, March 2009 - March 2019



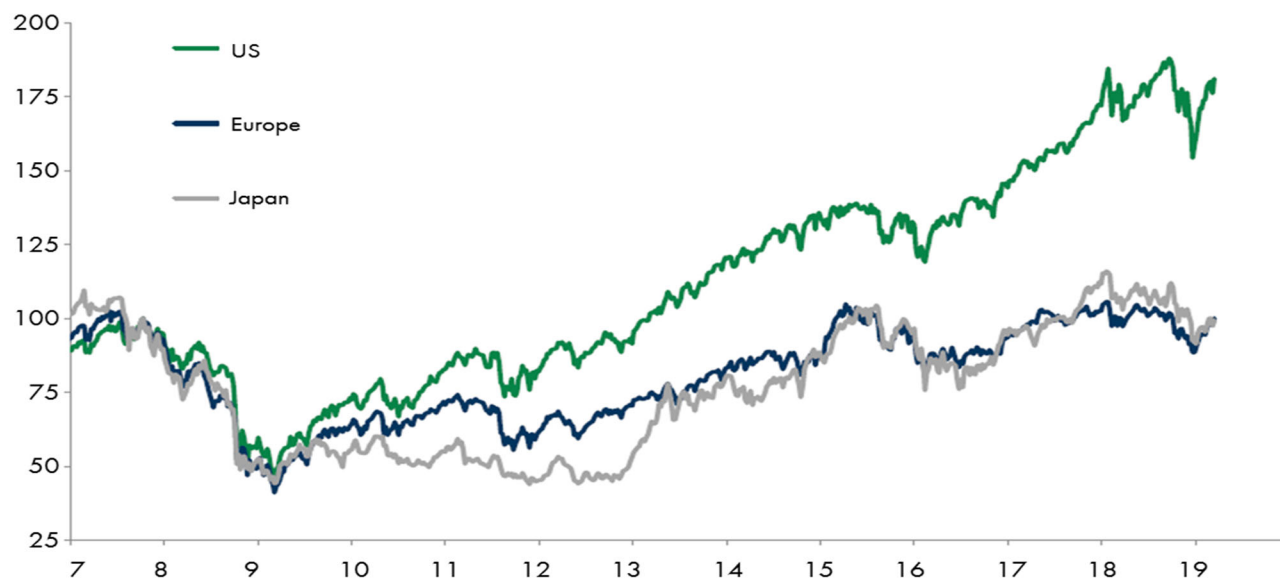
SSICCONF Index (State Street Investor Confidence Index) Line Chart Monthly 31MA

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Chart 3

US, Europe, Japan Equities, Price Performance, Local Currency, 100 = Last Cycle Peak Oct. 2007



Source: Goldman Sachs

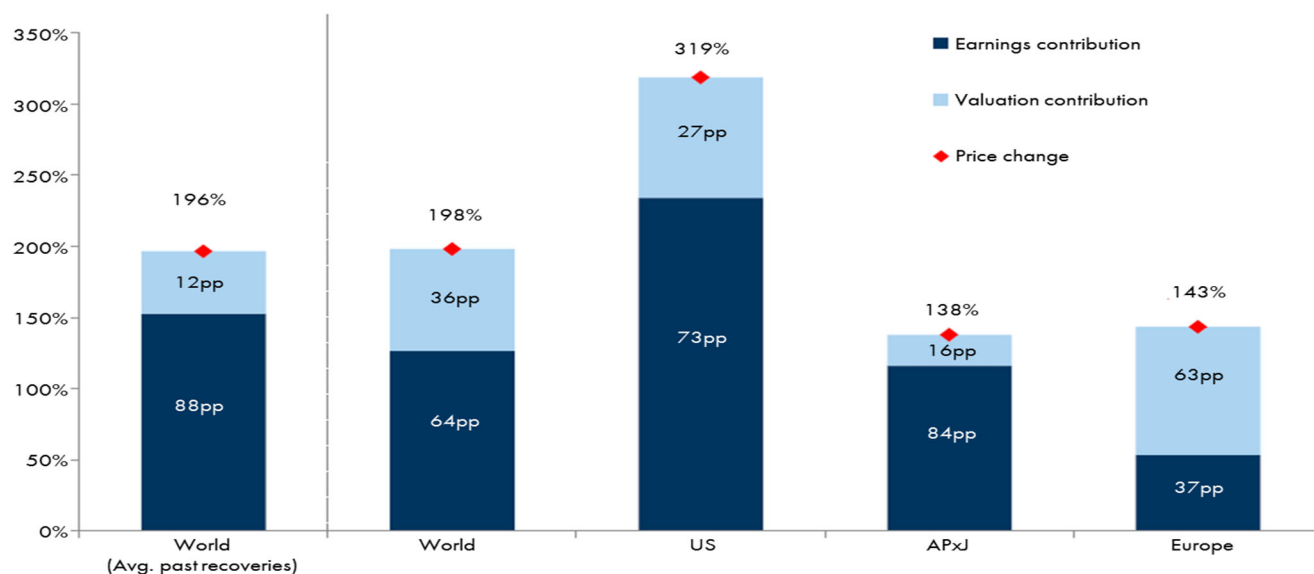
This strong performance by US equities has not been ephemeral, but driven primarily by earnings and margins growth. In contrast, the gains in European equities have come more from re-rating than from earnings (Chart 4). Earnings per share have compounded at a 6% annualized rate in the US versus just 1% in Europe.

Of course, there are stretches where the US underperforms the rest of the world materially. Between 2002 and mid-2008, for example, US stocks trailed non-US by more than 1000 basis points annually (3.5% versus 13.7% p.a.). For most of the post-WW2 era, the relative performance of US and non-US equities oscillated, but this past decade has seen the longest and largest period of US outperformance since World War Two, when the economies of much of the world (outside the US) were destroyed (Chart 5, page 5).

This relative outperformance by the US may just be simply part of the long-term cycle, admittedly longer and in greater magnitude than in the past. But there are good reasons why Europe has become marginalized in the global economy, which is driven, and dominated, by the US and Asia.

There are virtually no leading technology companies based in Europe, and innovation is weak. For example, Europe accounts for about 5% of worldwide patent applications, compared to 25% from the US and 40% from China. Europe spends around 2% of its GDP on research and development versus about 3% in the US. Venture capital investment represents more than 0.6% of GDP in the US, 0.5% of GDP in China, and only 0.1% in Europe. There are valid reasons why the US and Asia have left Europe in the dust, and little prospect that it will close the gap will close.

Chart 4 Regional Equity Market Performance by Contribution, March 2009—March 2019



Source: Goldman Sachs
World average past recoveries since the 1970s using US equity cycles from trough to 10 years onward

Damon Runyon did not get to meet the greatest athlete of the 20th century, but he would have liked him. He was born on a Virginia farm in the middle of the night of 30 March 1970, “as perfect a (specimen) as I have ever delivered,” said the farm’s manager. His mother came from an impressive line, but his father, Bold Ruler, was near-royalty: selected Horse of the Year in 1957.

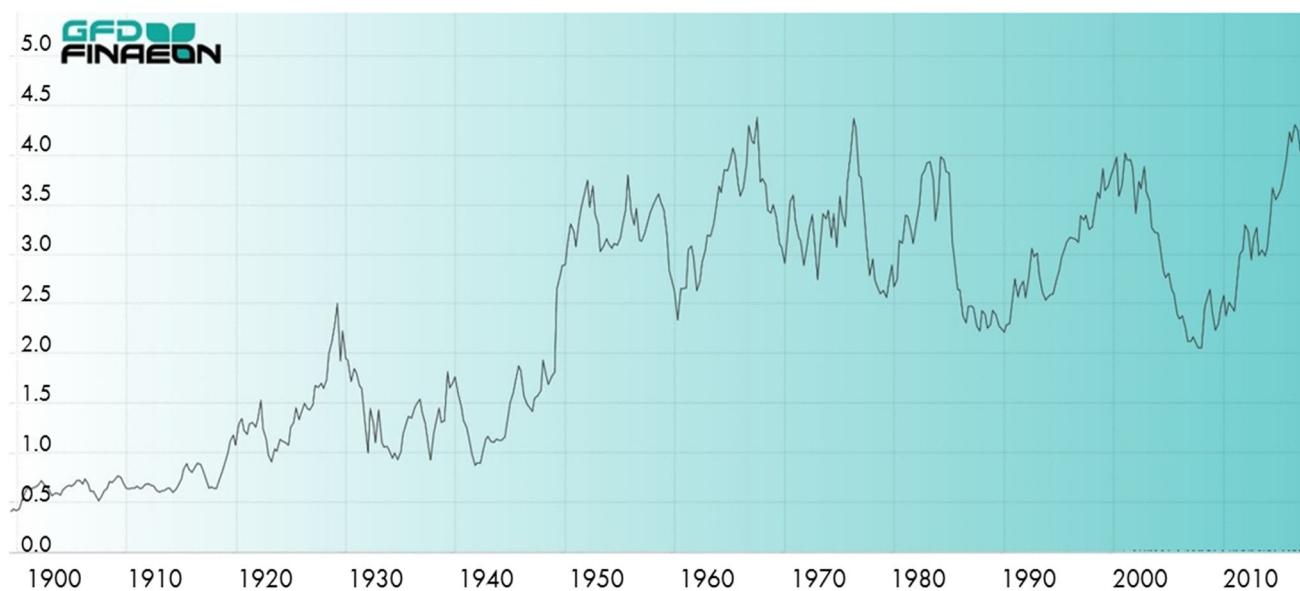
Rather than charge a stud fee, the owner of Bold Ruler, Ogden Phipps of the famous Claiborne Farms of Kentucky, entered into a foal-sharing agreement. They agreed that Penny Chenery would send the Phipps two mares in 1968 and two in 1969. The winner of the coin toss would get first pick of the foals produced in 1969, the loser would get first pick in 1970. Phipps won the coin toss, and in 1969 took delivery of a filly he named The Bride. She never won a race in her career. Penny Chenery took the consolation prize the following year: a colt she would name Secretariat.

From the moment he was born, he was considered a remarkable physical specimen: large, powerful, perfectly proportioned. Small differences in length and bone angles can translate into large differences in performance, and it would become clear later that this horse was exceptional.

His debut race as a two-year old, on July 4th, 1972 at Aqueduct in New York, was inauspicious. He was bumped hard out of the gate and nearly fell, and finished out of the money. Fear of being bumped and falling stayed in his memory, and for the rest of his career he started each race in the back of the pack, away from the other horses.

The 1973 Kentucky Derby attracted the largest crowd in racing history, over 134,000 people. Secretariat was in the outside post position. At the start, he immediately cut over to the rail, and hung back in last place, as usual. But he ran each quarter-mile turn faster than the last, meaning he was accelerating throughout the race. He won the Derby by 2 ½ lengths, the first to run it in under two

Chart 5 US Equities versus European Equities, 1900-2018



Source: Global Financial Data

minutes. No horse has ever posted, before or since, a faster time at Churchill Downs.

The Preakness Stakes two weeks later was a repeat of the Derby. Secretariat started in last place, again, and won, again, by 2 ½ lengths, setting a new Preakness record.

The nation had not had a Triple Crown winner since Citation in 1948, and the hype was now building. *Time*, *Newsweek* and *Sports Illustrated* all put Secretariat on their covers that week, and the Belmont Stakes, televised on CBS, would draw an audience share of 52%. The country was riveted by this extraordinary athlete and the hope of seeing a Triple Crown winner, but few could anticipate what they were to witness that warm June day in New York.

The Belmont is a long race, 1 ½ miles. This is why winning the Triple Crown is so difficult. The Derby and the Preakness are about 20% shorter, favoring sprinters, but the Belmont requires both speed and stamina. Some horses have one trait, very few have both.

In this small field, only five horses were entered, Secretariat burst out of the gate, moved to the rail, and never looked back. He also never faltered. As the others tired, he extended his lead. He won by a record 31 lengths, shattering the margin of victory in any Triple Crown race before or since.¹ His time of 2:24 was not only a track record, it remains the fastest 1 ½ miles ever run on dirt. His top speed was calculated at 49 mph, the fastest ever recorded.

Secretariat's performance may not have been pre-ordained, but it was also not random. He was big and powerful, but so are others. Physically, there were two aspects of him that stood out, one visible, one not. Secretariat's stride angle, the maximum



length between the front and rear legs, was 110 degrees. Contrast that with Man O' War, considered the other great horse of the 20th century, who had a stride angle of just 83 degrees. By reference, a cheetah, the fastest land animal, has a stride angle of 125 degrees. Secretariat simply covered more ground with each stride than any horse in history. Secondly, was his heart. Not only in the sentimental sense, as everyone who knew him loved his sweet personality, but physically as well. Following his death, it was estimated that his heart weighed ten kilos; the average horse's heart weighs less than four. Secretariat was not just a great physical specimen, he was the greatest.

It is tempting, and understandable, for investors to look at the longest economic expansion since the Civil War and anticipate its end. Or the lagging performance of a market and expect it will catch up. Valuations matter, but trends persist while the forces that set them in motion remain in place. Success requires balancing all these forces, and a high dose of humility about being able to predict

¹ Watch the race here: <https://www.youtube.com/watch?v=V18ui3Rtjz4>.

the future. As Sam the Gonoph² observed, "I long ago come to the conclusion that all life is 6-to-5 against."

The final word, though, goes to Damon Runyon. Paraphrasing Ecclesiastes (9:11), Runyon wrote: "The race is not always to the swift, nor the battle to the strong, but that's how the smart money bets." Now, there's a tip.

² Runyonesque slang for a pickpocket.



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