



Red Scare

November 11, 1918 marked the end of the Great War, and Americans celebrated with parties and parades across the country. Hardly had the ticker-tape been swept from the streets when the national mood of exuberance and exultation turned quickly to suspicion and paranoia. Germany had been defeated, but a far greater threat to American prosperity and values loomed: Communism.

The year before, the Bolsheviks overthrew the Romanov dynasty, murdered the entire royal family, and seized control of Russia while espousing a universal ideology of world domination by uniting the workers of the world in revolt against capitalist economies and their bourgeois leaders and values. In January 1919, 35,000 shipyard workers went on strike in Seattle. In September of that year, Boston police walked off the job. A few weeks later, 275,000 steel workers struck in Pittsburgh and across the country. All three strikes ended when threatened with Federal troops.¹ None of the workers' demands were met. But it was widely assumed that Communists instigated, organized and controlled Seattle shipyard workers, the Boston police and

¹ Martial law was declared in Gary, Indiana on October 5, 1919, for example.

ANGELES INVESTMENT ADVISORS
429 SANTA MONICA BLVD, SUITE 650
SANTA MONICA, CA, 90401

PHONE: 310.393.6300
FAX: 310.393.6200

WWW.ANGELESINVESTMENTS.COM

Angeles

American steel workers in a coordinated plot to undermine the US economy and stir civil unrest. Communists were not behind these actions, but Americans thought otherwise.

In August 1919, Attorney General A. Mitchell Palmer created the General Intelligence Division of the Federal Bureau of Investigation, with J. Edgar Hoover as its head. It compiled dossiers on more than 200,000 Americans, arresting and deporting thousands of suspected Communists and radicals. On a single day, 2 January 1920, thousands of people were rounded up and arrested in 30 cities.² Palmer was pleased, but warned Americans that there were still 300,000 communists hiding in the country. Two-thirds of the states banned the display of the Communist flag, and the New York State legislature expelled five state assemblymen who had been elected as Socialists.

In May 1920, Felix Frankfurter, then a Harvard law professor,³ co-authored a report detailing the numerous violations of civil liberties in the hunt for subversives. It swayed public opinion, and politicians soon followed. The Red Scare was over almost as soon as

it had begun. The decade was set to become the Roaring Twenties, not the Red Twenties, as Americans turned their attention from Communism to Consumerism, luxuriating in their new-found wealth and new-fangled technologies.⁴

August 14, 1945 was V-J Day, marking the end of the Second World War, and Americans, again, celebrated victory over Germans (and Japan) with jubilation. Again, the euphoria was fleeting as the menace of Communism grew more ominous. President Truman issued Executive Order 9835⁵ in March 1947, requiring every federal employee to be examined for loyalty to the government. In 1948-49, the Soviets blockaded Berlin in order to force Allied occupation troops out and engulf the city fully into communist East Germany. In 1949, Communists won control of China, and the Soviet Union detonated an atomic bomb, ending the US monopoly on nuclear devices. The Soviets had spies inside the US atomic program that funneled critical documents that led to the Soviet bomb, notably Julius and Ethel Rosenberg, who were convicted in 1951 and executed two years later. In 1951, the US Supreme Court ruled, in *Dennis v. United States*, that the free speech of Communists could be restricted on the grounds that advocacy of the overthrow of government constituted a clear and present danger.⁶

Through Executive Order and Supreme Court rulings, the First Amendment rights of Americans were abridged as fears of Communist infiltration of American institutions swept the country. These fears were not wholly unjustified, as there were indeed Soviet spies at high levels of the US government.⁷ When Congress decided to conduct its own investigations, and to do so in public hearings, and to allow the American public to watch those hearings through the new medium of television, a Red Scare swept the nation, triggering a deep, penetrating fear that our

² Estimates range between 3,000 and 10,000 people were arrested that day.

³ Appointed by FDR to the US Supreme Court in 1939.

⁴ Automobiles, radio were among the newly available consumer products.

⁵ Known as the Loyalty Order.

⁶ The opinion was 6-2, written by Chief Justice Fred Vinson, with dissents from Hugo Black and William O. Douglas. Felix Frankfurter wrote a separate, concurring opinion. However, the Court diluted the *Dennis* decision in the 1957 *Yates v. United States*, allowing advocacy of overthrowing the government as an abstract doctrine. In 1969, *Brandenburg v. Ohio*, effectively overturned *Dennis*, ruling that advocacy of overthrowing the government was protected free speech unless it was to incite "imminent lawless action."

⁷ The Venona Project was a US counterintelligence program begun in 1943 and carried out through 1980. Files were declassified in 1995, with intercepted messages showing that senior US officials were spies for the Soviet Union, including Harry Dexter White at the Treasury Department, Alger Hiss and Lawrence Duggan at the State Department.

Chart 1 S&P 500 Index and State Street Investor Confidence Index, 1999-2019



Source: Bloomberg

way of life was under assault by an enemy we could see, the Soviet Union, and an enemy that was invisible in our midst, and could be any one among us.

Fear is a fundamental emotion, based often on very real threats, and thus an appropriate response to imminent dangers. But fear also has a way of expanding, extending disproportionately to hinder or halt rational discussion or analysis. At the height of the Red Scare of the 1950s, one man spoke up and confronted the monster that had been unleashed. The Communist threat remained for the duration of the Cold War, but the paranoia abated when the spontaneous heart-felt plea of a most unassuming and mild-mannered man helped Americans realize that the hunt for communists had come at the cost of the very values we sought to protect.

The past decade for investors has been characterized by two notable, counterintuitive facts: the US stock market has risen 250% in its

longest rally in history, and investor confidence is near record lows (Chart 1—the decline in investor confidence has been particularly steep in the past five years). Last month’s poll of money managers by *Barron’s* reported just 27% were bullish, the lowest reading in over 20 years.⁸ So, what is behind this long bull market? And, why have investors been so cautious?

The answer to the first question has two parts. First, the starting point matters. Ten years ago, the world was taking tentative steps to recover from a global financial crisis. Asset prices were still very depressed, well below (40-50% or more) prior highs. Secondly, through a combination of luck and policy,⁹ the economic expansion has been sustained, for 125 consecutive months, and counting, now the longest in US history. Solid, albeit modest, economic growth underpins this bull market.

⁸ <https://www.barrons.com/articles/barrons-big-money-poll-why-wall-street-is-scared-of-washington-51572045878>.

⁹ Probably in that order.

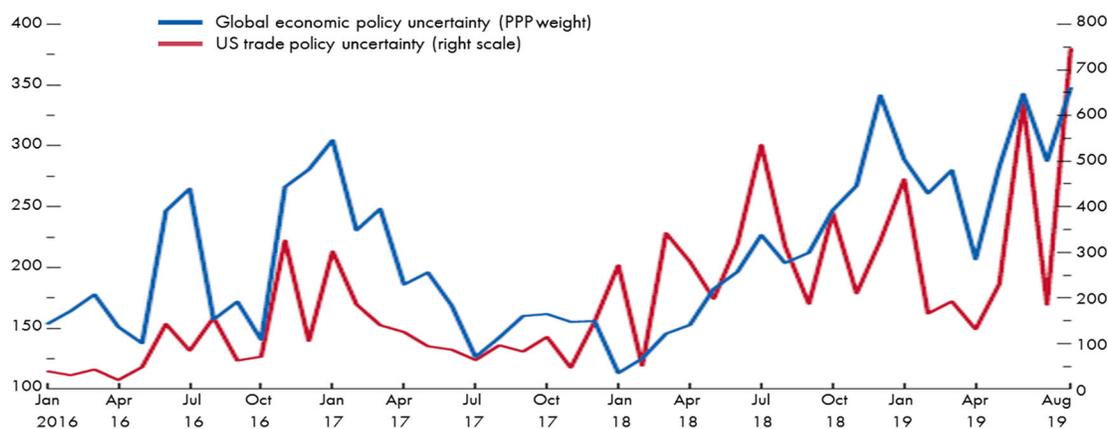
Angeles

Investors' lack of confidence is more complicated to explain. Uncertainty over economic and trade policies is rising (Chart 2). The imposition of tariffs by the US on all its major trading partners, including Canada, Mexico, China, the EU, etc., without clear articulation of US

objectives, no doubt contributes to this uncertainty. Geopolitical risks are seen as rising, too, contributing to heightened uncertainty (Chart 3).

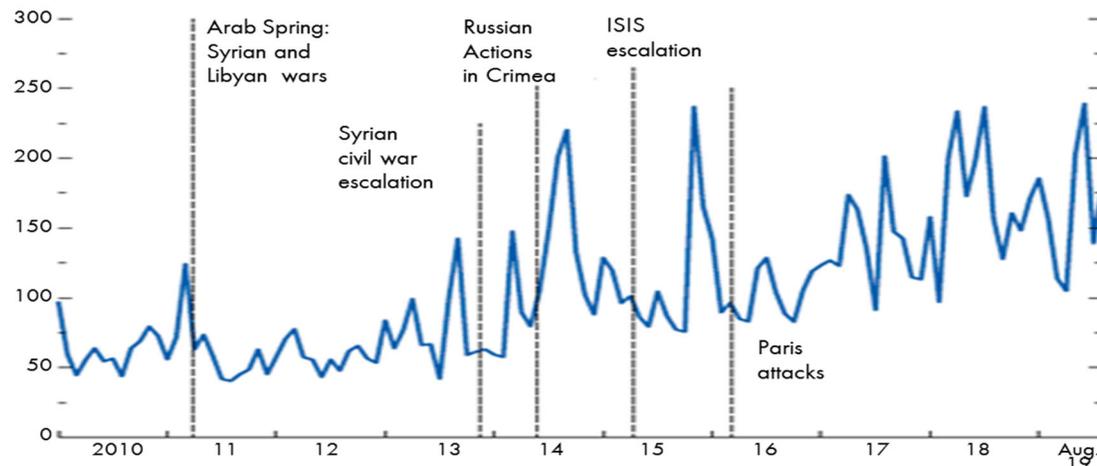
Investors have acted on these fears by raising cash allocations to the highest levels outside of a market

Chart 2 Economic and Trade Policy Uncertainty, 2016-2019



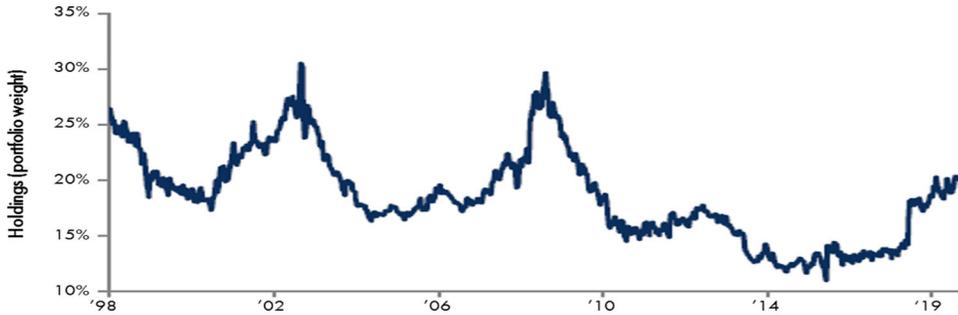
Courtesy: IMF World Economic Outlook, October 2019

Chart 3 Geopolitical Risk Index, 2010-2019



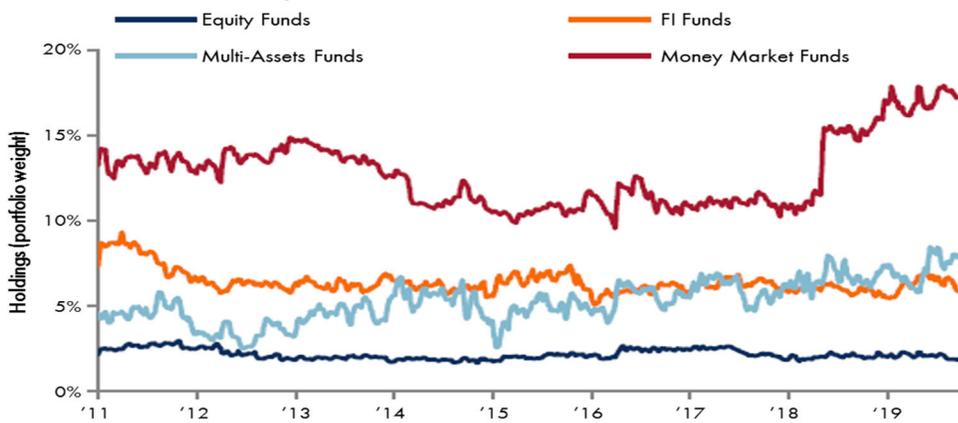
Courtesy: IMF World Economic Outlook, October 2019

Chart 4 Cash as a Percentage of Portfolios 1998-2019



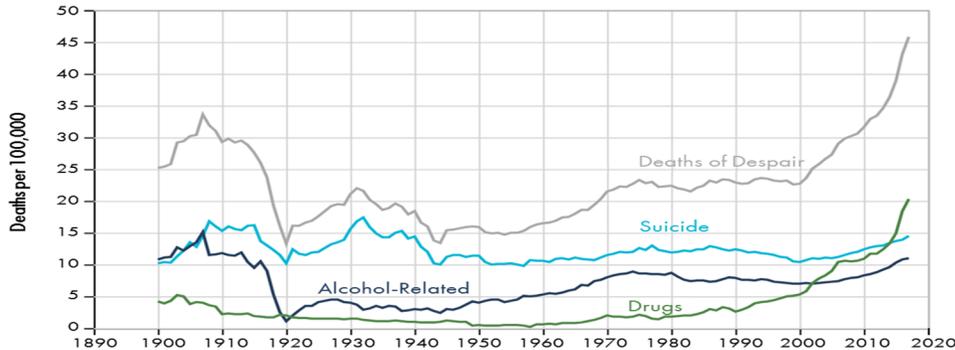
Source: State Street Global Markets

Chart 5 Investor Flows by Fund Type As a Percentage of Portfolios, 2011-2019



Source: State Street Global Markets

Chart 6 Deaths of Despair and Its Components 1900-2017



Source: Social Capital Project analyses of DCD data:

[https://www.jec.senate.gov/public/index.cfm/republicans/2019/9/long-term-trends-in-deaths-of-despair.](https://www.jec.senate.gov/public/index.cfm/republicans/2019/9/long-term-trends-in-deaths-of-despair)

crash (Chart 4). Especially over the past two years, marginal funds have flowed primarily into cash (Chart 5).

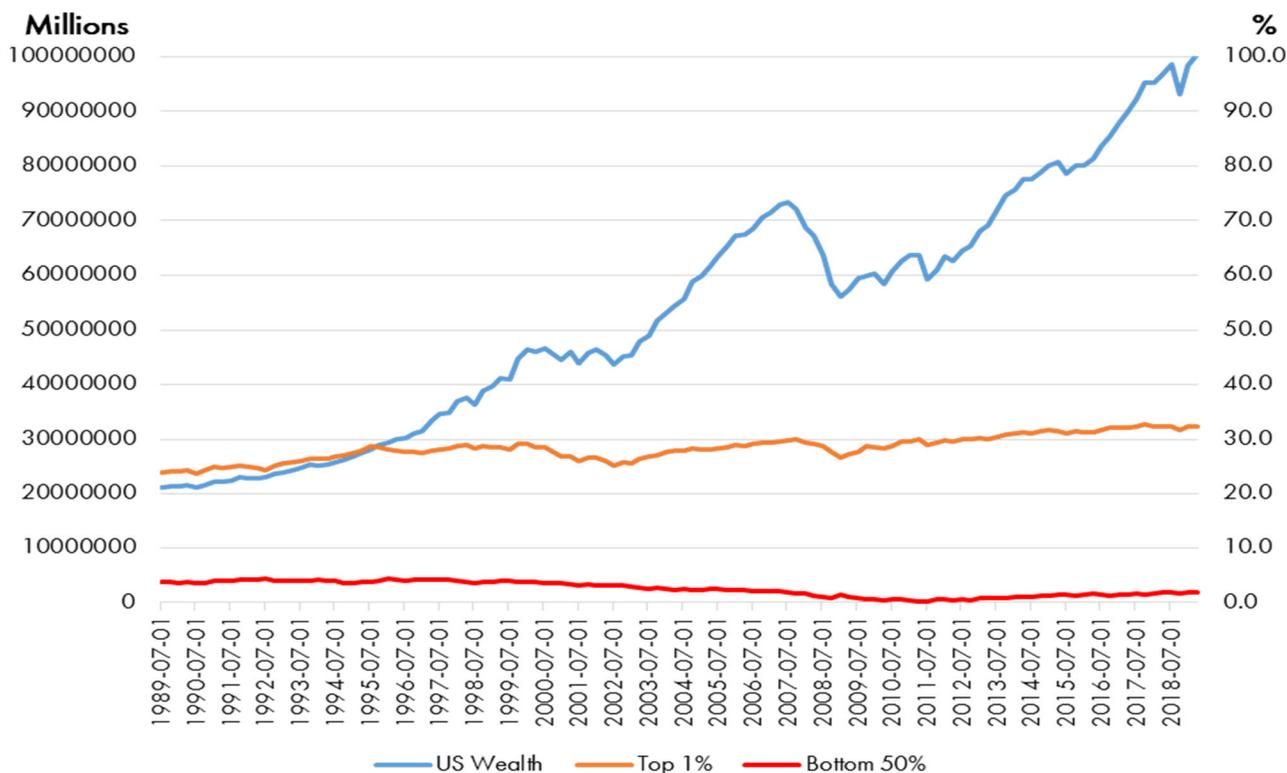
We are in the longest economic expansion in US history, and the longest bull market in US history, yet investor confidence is low and cash positions are high and rising. It's not that there is nothing for investors to worry about; there's plenty. But that's always true. The depth of investor caution is out of proportion to economic realities, so there must be something else going on.

The broader context is the high levels of anxiety, conflict and dissatisfaction we see throughout the world. Deaths of despair, from suicide and drug and alcohol abuse, are at record levels in the US (Chart 6).

Despite enjoying the highest standards of living in human history, political dissatisfaction is rising, pushing electorates into opposing, and irreconcilable, camps, and electing leaders who fuel further polarization.

Inequality is certainly an important aspect of this growing dissatisfaction. Aggregate

Chart 7 US Wealth, Share of Total Net Worth Held by Top 1% and Bottom 50%, 1989-2019



Source: Federal Reserve System. US Wealth (LHS, in millions of dollars), Top 1% and Bottom 50% (RHS, as percentage of total net worth).

wealth is at record levels, but the share of that wealth to the top 1% has risen from 23.9% to 32.4% over the past 30 years, while that of the bottom 50% has fallen from 3.7% to 1.9% (Chart 7).

We are clearly better off in absolute terms than at any time in human history, but relative inequality matters deeply to humans. We saw this a year ago in France, when a 7.6 cents per litre tax on diesel fuel sparked the *gilets jaunes* movement that shut down the economy. We see the same phenomenon today

in Chile, the wealthiest country in Latin America by per capita income, where a rise in subway fares from \$1.12 to \$1.16 last month exploded in riots by more than a million people who see the nation's wealth accruing to the elites and not to the masses.¹⁰ Emmanuel Macron and Sebastián Piñera are political centrists, but they are also among the elites, and unless they address the inequality underlying these protests, they risk being replaced by the repressive populists that have ascended to power in other disaffected electorates.

¹⁰ Out of a total population of 18 million. The fare hike was reversed, but protests continue.



Elias Kazantzoglou was born in Turkey to a Greek family of rug merchants. His family moved to New York when he was four years old, and Elias worked his way through college washing dishes in restaurants. Eschewing the rug business, he decided to pursue acting, studying at Yale and at Julliard and with the famed acting coach Lee Strasburg. Elias turned to directing plays in New York, to wide

acclaim, before moving to Hollywood in 1945 to direct his first film, *A Tree Grows in Brooklyn*. Two years later, he directed *Gentleman's Agreement*, starring Gregory Peck, a film that tackled anti-Semitism, and won an Academy Award for directing. In 1949, his movie *Pinky* addressed racism in America, receiving 3 Academy Award nominations. *Panic in the Streets*, the following year, won 2 Academy

Angeles



Awards, and *A Streetcar Named Desire*, in 1951, won four Oscars. Then, in 1954, he made one of the greatest films of all-time, *On the Waterfront*, which took home 8 Academy Awards, including Best Director.

Elias solidified in place as one of the greatest film directors in movie history. He cast unknown actors and made them stars, from Marlon Brando and Karl Malden, Eva Marie Saint and James Dean, to Warren Beatty and Natalie Wood. His films dealt with racism and corruption, and he insisted on casting Zero Mostel in *Panic in the Streets*, the only work Mostel could find as he was blacklisted in Hollywood due to his past Communist ties.

The Hollywood blacklist came out of hearings of the House Un-American Activities Committee (HUAC). Studio heads, writers, producers, actors were all pressured to name names of colleagues suspected of having Communist ties. Many did not, pleaded their Fifth Amendment rights, and saw their careers end. But when Elias Kazantzoglou, who had shortened his name to Elia Kazan, was called by HUAC to testify in

April 1952, his past work promoting social causes gave hope to many that he would refuse, and his stature in the industry would cause Congress to drop their search for Communist infiltration in the movie business. The most powerful director in Hollywood had an opportunity to defend his principles and the First Amendment rights of many of his colleagues.

But Kazan was torn. He believed strongly in social justice, but he also fervently despised Communism. He had joined the Party in 1934, and left disillusioned in 1936 when he saw how the ideology suppressed individual expression. He saw the Soviet Union for what it was, a repressive dictatorship, and had no interest in defending it or anyone associated with it. And so, before the television cameras, and to the great dismay of many of his friends, Kazan named eight people that had been members of the Communist Party with him in 1934, names that HUAC had already known were members.

Following the 1952 elections, Republicans took control of the Senate, and appointed Joe McCarthy of Wisconsin as chairman of its

Government Operations committee, and its permanent subcommittee on Investigations. McCarthy selected Roy Cohn as chief counsel to the subcommittee, and a young lawyer named Robert F. Kennedy as assistant counsel. McCarthy had been agitating about Communists in the US government since 1950, and chose his new perch to ferret out Communists in the Army Signal Corps. John G. Adams was the Army's counsel, and Adams appointed an unknown Boston attorney, Joseph N. Welch, special counsel.

McCarthy was unable to prove that any Communists were working in the Army's Signal Corps, but persisted in his investigation anyway, convinced he just had to dig further. The Army had had enough of McCarthy, and publicly accused him of seeking favorable treatment for a Senate staff member, G. David Schine, a close friend of Roy Cohn, who had recently been drafted into the Army.

McCarthy responded to the charge of seeking favors with purported copies of FBI documents with names of subversives in the Army. J. Edgar Hoover testified that these were copies of documents that did not exist in FBI files, but McCarthy was unbowed. On the 30th day of the Army-McCarthy hearings, as they came to be known, which were being broadcast live on television across the country, Joseph Welch challenged Cohn and McCarthy to present their alleged list of 130 subversives in defense plants "before the sun goes down" today. McCarthy responded that Welch should start with his own law firm,¹¹ and a lawyer named Fred Fish-



er, who had once belonged to the National Lawyers Guild, a group that had been sympathetic to the Communist Party.

Joseph Welch was born in Iowa in 1890, attended Grinnell College and then Harvard Law School, and for the next 30 years practiced law in Boston. Befitting a man of his background, he was plain-spoken and mild-mannered, a gentleman in every sense of the word. He sat through McCarthy's rants and Cohn's attacks for thirty days, but McCarthy's public denouncement of Welch's young associate, Fred Fisher, was a step too far for him. With cameras rolling, he said to McCarthy, "Until this moment, Senator, I think I have never really gauged your cruelty or your recklessness. Fred Fisher is a young man... starting what looks like a brilliant career with

¹¹ Hale and Dorr, a venerable Boston firm.

Angeles

us....Little did I dream you could be so reckless and so cruel as to do an injury to that lad....If it were in my power to forgive you for your reckless cruelty I would do so. I like to think I am a gentleman, but your forgiveness will have to come from someone other than me."

McCarthy ignored Welch's rebuke and renewed his attack on Fisher. Welch, with rising emotion, interrupted: "Senator, may we not drop this? We know he belonged to the Lawyers Guild ... Let us not assassinate this lad further, Senator. You've done enough. Have you no sense of decency, sir? At long last, have you left no sense of decency?"

McCarthy started on Fisher again, and Welch cut him off angrily: "Mr. McCarthy, I will not discuss this further with you. You have sat within six feet of me and could have asked me about Fred Fisher. You have seen fit to bring it out. And if there is a God in Heaven it will do neither you nor your cause any good. I will not discuss it further." Welch then stood up and walked out of the hearings to spontaneous, thunderous applause. For the millions watching on television, it was a riveting, real-life drama, and it exposed, in a way that no other could have done, the depth of depravity Senator McCarthy had stooped in his search for Communists in the US Army.

That month, President Eisenhower decreed that no one in the Executive branch would cooperate with McCarthy's subcommittee. By the end of the year, the entire Senate voted to censure him. Within three years, McCarthy would be dead of alcoholism at the age of 49.

Objectivity is elusive. Unemployment is at 50-year lows, wealth is at all-time highs. These are seemingly objective facts. But it's also true that large segments of the population are dissatisfied, struggling, and especially resentful that however much the pie grows, the vast proportion of that



prosperity accrues to the few. These are also objective facts. Markets are at all-time highs, investor confidence is near record lows. Facts, too.

None of this is contradictory, as much as it may appear so. Some facts are objective, but facts are often experienced in multiple ways by different people, and their experiences may be equally valid.

It could be said that Joseph McCarthy self-destructed, and perhaps that was inevitable. But it was the impassioned plea for decency, not from the brilliant lawyer he was, but from the civil and gracious man Joseph Welch was, that exposed McCarthy's viciousness and vindictiveness and brought an end to the nightmare known as McCarthyism.

Elia Kazan, too, confronted an ethical challenge. He was told by his boss, Spyros Skouras, head of Twentieth Century Fox, that he would have to give the committee names of communists if he wanted to continue to work. Kazan justified his testimony on the grounds that

the names he mentioned were already known, and that he wanted no part in defending an ideology he despised. We can understand his logic, while also recognizing that Kazan missed an opportunity to uphold a higher ideal.

Before his testimony, the Broadway producer Kermit Bloomgarden met with Kazan, who told him he had been called to testify. Bloomgarden told Kazan to follow his conscience, and Kazan told him he had to think of his kids. Bloomgarden responded, "This too shall pass, and then you'll be an informer in the eyes of your kids; think of that."

James Baldwin wrote, "Not everything that is faced can be changed, but nothing can be changed until it is faced."¹² We are all obligated to confront both the facts and our fears: to assess, to understand, and to act, according to our best judgment and conscience. Elia Kazan struggled with the facts and his fears, while Joseph Welch showed us how we can confront both with decency and honor.

¹² As Much Truth as One Can Bear.



Michael A. Rosen

Principal & Chief Investment Officer

November 2019

Please follow the Angeles Insights by Michael Rosen at <https://www.angelesinvestments.com/insights/home>

CONNECT WITH US



LinkedIn



Twitter



Facebook

Founded in 2001, Angeles Investment Advisors LLC is a global investment management firm serving select institutions and high net worth families and individuals.

This report is not an offer to sell or solicitation to buy any security. This is intended for the general information of the clients of Angeles Investment Advisors. It does not consider the investment objectives, financial situation or needs of individual investors. Before acting on any advice or recommendation in this material, a client must consider its suitability and seek professional advice, if necessary. The material contained herein is based on information we believe to be reliable, but we do not represent that it is accurate, and it should not be relied on as such. Opinions expressed are our current opinions as of the date written only, and may change without notification. We, along with any affiliates, officers, directors or employees, may, from time to time, have positions, long or short, in, and buy and sell, any securities or derivatives mentioned herein. No part of this material may be copied or duplicated in any form by any means and may not be redistributed without the consent of Angeles Investment Advisors, LLC.

If you would like to receive a copy of our Form ADV Part 2A free of charge, please email Steve Smetana, Chief Compliance Officer, at ssmetana@angelesinvestments.com, or call 310.393.6300.

