Lines in the Sand

Investment tactics during the Covid-19 issue.

March 12, 2020

As you know we have been sending out emails recently regarding the present situation with the Covid-19 virus and the stock market turbulence. The following is a more detailed explanation of the defensive tactics and maneuvers that we have been deploying for your portfolios.

The markets are plagued by uncertainty – nobody knows the extent of the Covid-19 threat, tests are in short-supply and the plan to mitigate the virus's spread isn't clear. Financial markets and the economy are showing that they can and will react to this uncertainty and threat.

Stock investors are very concerned that the economic slowdown caused by global consumers restricting their traveling and reducing their discretionary spending could be enough to push the world economy into recession. Recessions bring many risks to corporations – especially cyclical companies and companies with higher debt loads.

Our investment approach has been Disciplined and Careful. We respect the power of herd mentality in the markets. After being in this business for over 50 years, we know that crashes are part of the rhythm of the market. Investors tend to be emotional in the heat of the moment, but we have our disciplined and defensive plans set in advance. We feel the most intelligent way to proceed in uncertain and volatile markets is by employing the follow risk control tactics:

Asset Allocation

For years, we have focused our discussion with you on your asset allocation (the mix of stocks, bonds, cash, and precious metals). Based on those conversations, it is **already** set to an appropriate level for your personal situation and risk tolerance. It is times like these that asset allocation is so important. Our conversations about the potential downside scenario are for times like this so you understand and can better tolerate the typical market drops that will happen. Cash, bonds, and gold can be valuable offsets when stocks are dropping.

Strong Companies with Quality Earnings

We focus on companies with strong cash generating businesses and lower debt levels. This helps them better weather the inevitable economic downturns that arise.

Bonds

Investors often question why bonds are an important part of portfolios, especially when historical gains trail equity gains. In volatile markets when equities are under significant pressure, bonds become a more stable and attractive investment. These positions in your portfolio help offset losses and protect capital.

Precious Metals

We have been buying gold and silver for the last two years as a hedge. If things were to get worse, the demand for gold could rise further as it is considered a safe-haven asset. So far during this crisis it has been one of the few assets that have been rising in price. Gold has also been known to rise when other assets like stocks, bonds and cash are losing value. Potential gains in this precious metal could offset potential losses elsewhere. Precious metals play an important role in your portfolio and have helped blunt the impact of the downturn. In some of our funds, precious metals are 8% of assets. We watch this closely because when equity markets recover, gold may drop in value.

Cash

For our retiree clients, we usually hold between 6 to 12 months-worth of spending money in cash. This is in addition to the cash normally held based on your asset allocation and our current level of defense.

Our cash discipline is driven by a tactic that we call "Lines in the Sand." In our evaluation of the market, we set certain price points, long before problems start. When the market falls below those points, we sell some stocks to raise cash. The first of those points was triggered 2 weeks ago – and we have been raising cash in all stock portfolios since then. Some of our portfolios are holding 30 – 40% cash. This cash position insulates a portion of the portfolio against further market downturns and enables us to move back into the market quickly when we feel the time is right.

Once we reach our maximum cash levels (this differs depending on the type of portfolio), we then will exercise patience and ride out the storm.

Legendary investor Warren Buffett has said many times to "Be fearful when others are greedy and greedy when others are fearful." So, as the market falls, we start putting together a wish list of stocks we would like to buy when the market stabilizes and turns around. This is where our cash position is beneficial.

Discipline

We are patient, we don't let emotion drive our decisions and seldom buy as prices are still falling. We prefer to let the herd exhaust its selling stampede before we start our purchasing. We won't try to catch the bottom price. We will wait and knowingly pay a higher price in order to have a little more clarity. By the time a "lot" of clarity develops, however, prices would most likely be expensive again. This becomes a balancing act.

Sometimes our "lines in the sand" strategy will not work – meaning we might start to raise cash and then the market could turn on a dime and climb back up rapidly. For this reason, we set points for buying back in as well – otherwise we run the risk that the stock market "train" could leave the station without us (we would then have sold low and bought high).

Path Forward

Remembering back to the Great Recession of 2008 – it was both a nerve-racking time to be an investor AND the best time to buy quality stocks at extreme bargain prices. In fact, many of our best investments came from buys during that time.

We don't want to panic and we don't you to panic either. We will stick to our plan and continue to ramp up our defenses should the downdraft persist. We also will need to be watchful to redeploy capital (buy back in) should the nervousness abate - but we are in no rush to do that just yet. We know these are trying times and we welcome your calls and visits to talk with us about the markets, your portfolio and your situation.

We will keep you informed.   Stay disciplined, stay careful.

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