MORGIA
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Michael Morgia, CIMA®
Managing Director,
Partner

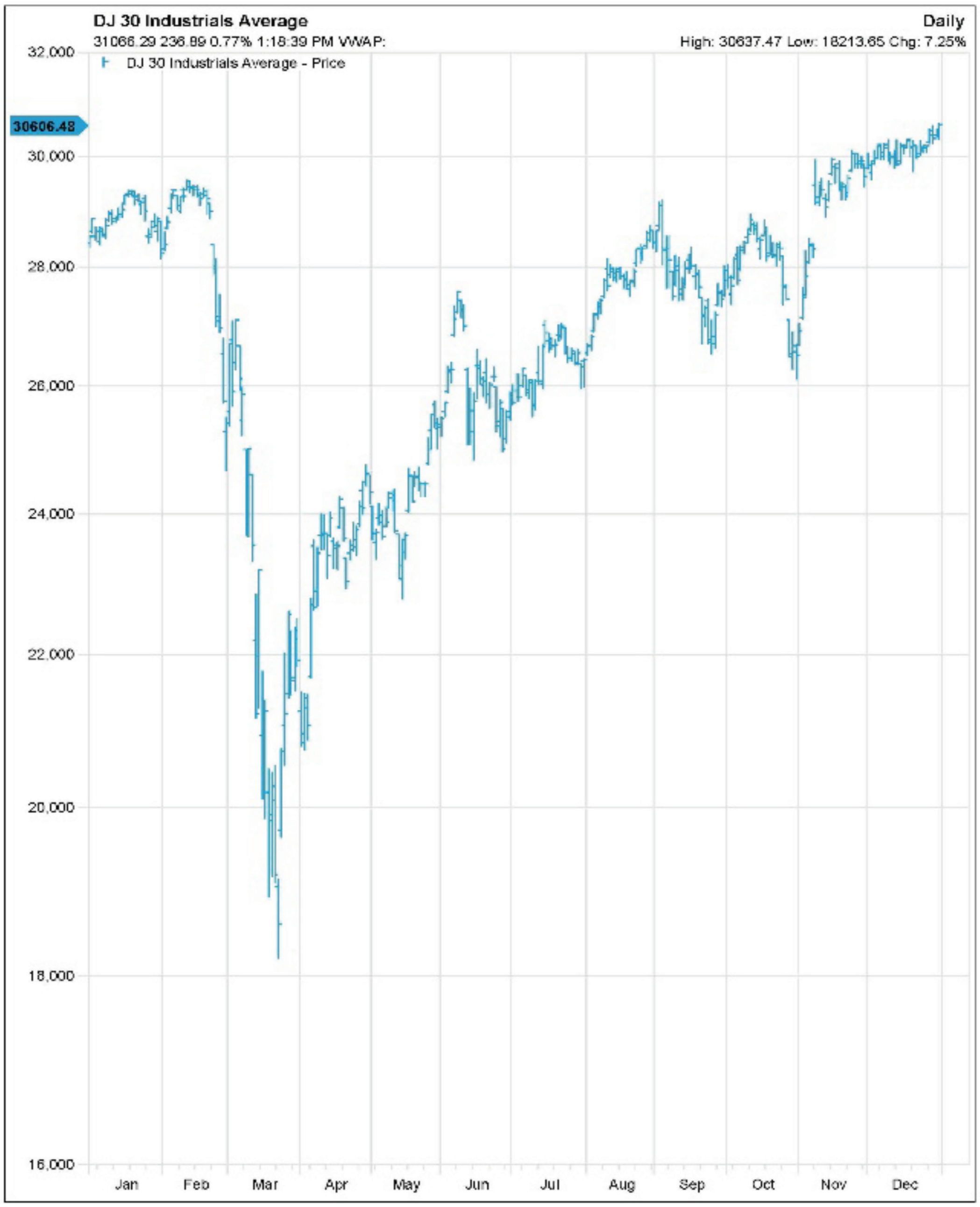
Don't Be in Any Rush?

During the darkest days of the COVID-19 Crash this past spring, Morgia Wealth Management seemed to be holding the line relatively well. We had started raising cash (selling stocks) right around the first of the year and by the time the stock market had fallen 17% or so, we had already moved almost half of our stock portfolios into cash and a little gold. So, as the stock market approached its eventual low point in late March, down 35% (and much worse for economically sensitive stocks), we were getting some positive feedback from clients. Well… maybe "positive" is the wrong descriptor. Let's just say we were getting about as much positive feedback as could be expected given that the stock market had dropped over one-third in value and the world was in the depths of the worst global pandemic in 100 years.

The mood was very somber, as you might remember, and the consensus opinion was almost unanimous and went something like this: "Good job on defense, but DON'T be in any rush to buy back." That sentiment was not just being expressed by clients, however. Investment professionals (ourselves included) were very pessimistic as well. It seemed like everyone believed there was just no way that the stock market was going to recover back to its old high anytime soon. That kind of straight down drop followed by sharp reversal all the way back to the starting point is something called a "V" shaped recovery. It just isn't what normally happens. Yes, many pundits were saying that the stock market might bounce off the low, wherever that might happen to be, and rise back up a bit. But if you were expecting things to recover quickly, you were dreaming. There were even many market forecasters fretting that a 50% (or more) drop was highly possible.

I can vividly remember a client conversation that took place very close to the low point on March 23rd. The client thought that the bottom was still a long way down and asked me not to reinvest all the cash I had raised on his behalf in his portfolio. I sympathized with him but said that if he wanted to adopt that strategy, we would have to move that cash to a separate account. My rationale was that our normal defensive strategy must always be ready to return to offense at a moment's notice. I too was in no mood to be thinking about offense (buying), but I've done this long enough to remember that when you least want to buy is usually the time when you should buy. Furthermore, we work hard to take the guesswork out of when to get defensive or aggressive by sticking with our indicators and the facts, not our emotion or hunches.

I have also learned that it is much too psychologically difficult for investors, including myself, to move instantly from defense back to offense (or vice versa for that matter). So, we usually start by moving a third or half of the amount that we ultimately want to move. If that first toe-dip into the water comes back with all digits still attached - we can then invest more. We don't even need to wait very long. We have found that this partial step usually helps to clear an investor's mind and makes it much easier to act.



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Thankfully we used this disciplined strategy instead of our feelings and emotions, because that *highly unlikely* "V" shaped recovery of the stock market is exactly what ended up happening.

How was such a rapid recovery possible one might wonder? It was, in large part, thanks to the stocks of the giant technology companies that actually prospered throughout the COVID-19 crisis. Nominated for *best supporting role in an economic pandemic*, was none other than The Federal Reserve, who "printed" $4 trillion dollars of new "paper." In our update from six months ago, we wrote about how this kind of printing can elevate the value of many assets. The supply of dollars goes way up, and the price of those dollars goes way down (which is the same thing as saying the price of everything else goes up).

Another, more recent, positive development has been the broadening out of the stocks that are participating in the upwards move. After November's successful vaccine news from multiple pharmaceutical companies, many economically sensitive stocks (the value stocks) had a very big and very fast jump. We believe that this is quite a healthy development. It is much better for a rising stock market when the driving force behind the move is fueled by many different companies from many different industries.

The Cobra Effect

Like all investors throughout the world, we were quite pleased that the Fed came riding to the rescue this year. They sprayed cash anywhere and everywhere, eventually saving the economy, the stock and bond markets, and ultimately the "day." Three cheers for the Fed – right? Well... yes and no. We can't seem to shake the nagging suspicion that there could be many possible unintended consequences to creating $4 trillion dollars out of thin air. Don't get us wrong, we fully agree that if citizens are forced to stop working and the economy is dead stopped, the government needs to help that citizenry and those companies affected by their mandates. We would feel a whole lot better about it, however, if our government had not been running budget deficits for the last 40 years.

There have been many anecdotal cases of small businesses having trouble finding people willing to work. It seems likely that some of the free cash that was doled-out has acted as a disincentive. Otherwise normal, employable people have started to grow accustomed to "money for nothing" as the old song goes. Furthermore, many of the newly enabled stay-at-home crowd have started to find other pastimes – some of which fall squarely into the "vice" category. Even some endeavors that would normally be constructive, such as working on one's investment portfolio, can easily be altered into something not so productive - altered into something that we investment professionals might label as *speculation*. From there it's just a tiny further step that can turn that speculation into full-fledged *gambling*. And when we see the stock market being used as a casino – we start to worry.

It is often the harbinger of financial pain, usually for the speculators, but many times for the entire market. This current gambling is remarkable. It comes mere months after an all-out stock market panic where nearly everything on Wall Street was crashing and burning.

Do you think that Fed Chairman Jay Powell had these outcomes on his Christmas wish list when he "created" the new money? A lax workforce? Reliance on free money? A gambling problem? No, those were probably not his intended consequences. The government's goal was to get the funds into the hands of the many people that *really* needed help. Free money, however, hardly *ever* behaves and can never be relied upon to get to its intended targets. The research is very clear on this. "Found" money does not get treated with the same respect as the money that came from one's hard labor. Just ask the lottery winners; just ask the trust-fund babies.

There is an old story about British controlled India back in the late 1800s that goes as follows: [1] There was a major problem with cobras infesting the capital city of Delhi (and we worry about mice!). The British government, in their infinite bureaucratic wisdom, came up with a simple and effective plan. They started paying people for every dead cobra that was turned into the authorities. At first this plan worked brilliantly and the city's cobra population dropped markedly. Then something unexpected happened – go figure. People, the clever and industrious beings they are, made a simple calculation – more live cobras equals more potential dead cobras equals more money. The Brits hadn't thought deep enough into their "fix" to realize that if you pay people to bring you dead snakes, they could, conceivably, start to farm those snakes in order to increase the amount of money they can make.

As the dead cobra carcasses started coming out of the woodwork and the government payment coffers started to dwindle, the British eventually caught on to this little game and quickly shut it down. The snake farmers suddenly found themselves in need of a new career. They also found themselves with numerous deadly reptiles that they did not need anymore (I hate it when that happens). What to do with all those excess cobras ... what to do? Perhaps just release them back out into the wild? That sounded like the only logical idea to the new entrepreneurs. The problem was that the "wild" in this case meant simply letting them loose into the city. Hence, Delhi's new population of cobras menacing the city dwellers soon rose to *triple* the number that it was prior to the implementation of the so called "solution."

Getting back to 2020: We have witnessed many so called "solutions" to our pandemic-related health and economic problems. The linchpins of these global plans have been the lockdowns (full and partial) and the subsequent payments of freshly minted money to the populous. Sure, we may argue over degrees. For example, on the medical side - do we really need to wear a mask while driving alone in a car? On the financial side - did the recently passed COVID relief bill really need to send stimulus checks to people who hadn't lost their jobs? Irrespective of differences in the details, I think most of us would agree with the overall goals of restricting the viral spread and financially helping those that were hardest hit. Still, we run a very real risk of inadvertently exacerbating some of our long-standing problems as well as creating a fresh batch of new ones. The U.S. already suffers from a massive, multi-decade debt binge, so spending a lot more money than we are currently earning might not be the best idea. It's also probably not wise to accustom the populous to receiving money for *not* working.

Also, our nation's increasing reliance on government is worrisome. With all its faults and problems, capitalism is still one of the best forms of democracy ever invented. Whereas we vote for politicians once every two or four years, we vote for corporate products and services every second of every day. If we don't like the way McDonald's makes a hamburger, we instantly vote with our wallet by going to Wendy's. The implication is that capitalism puts a large amount of power into the hands of the people. Corporations *must* provide us with what we want and at a reasonable expense or they will quickly go out of business. Of course, monopolies can develop and totally defeat the purpose of capitalism. Lately some observers have accused the big tech giants of having become monopolies. This very well may be the case, but the technology space always has plenty of competition laying in the weeds, looking to disrupt any and all corporate incumbents. Stop to think about who the technology leaders were 20 years ago (if you can even remember) and you will realize that the top names don't stay on top for very long in a competitive marketplace. The current tech darlings have been the best performers in our portfolios over the last ten years and it will be interesting to see if there will be a push to break them up.

It could easily be argued that *government* is perhaps the biggest monopoly of them all. Unlike most corporations accused of having too much power, the government did not become a monopoly by providing the best products or services. It got there because it does not allow other entities to compete. And it has an army…so there's that. If we don't like the way a certain bureaucratic arm of the government operates, say for instance the DMV or the IRS, well too bad! We do not have any other choice. There are no other options. There is no escape.

Take the case of California, with its own extra layers of increasing tax and regulatory burden. There seems to be quite an exodus of many wealthy individuals and businesses over the past few years.[2] In a tweet from last May, tech visionary Elon Musk (one of the world's richest people) explains his own departure:


Elon Musk @elonmusk · May 9

Frankly, this is the final straw. Tesla will now move its HQ and future programs to Texas/Nevada immediately. If we even retain Fremont manufacturing activity at all, it will be dependen on how Tesla is treated in the future. Tesla is the last carmaker left in CA.

12.7K 19.4K 60K

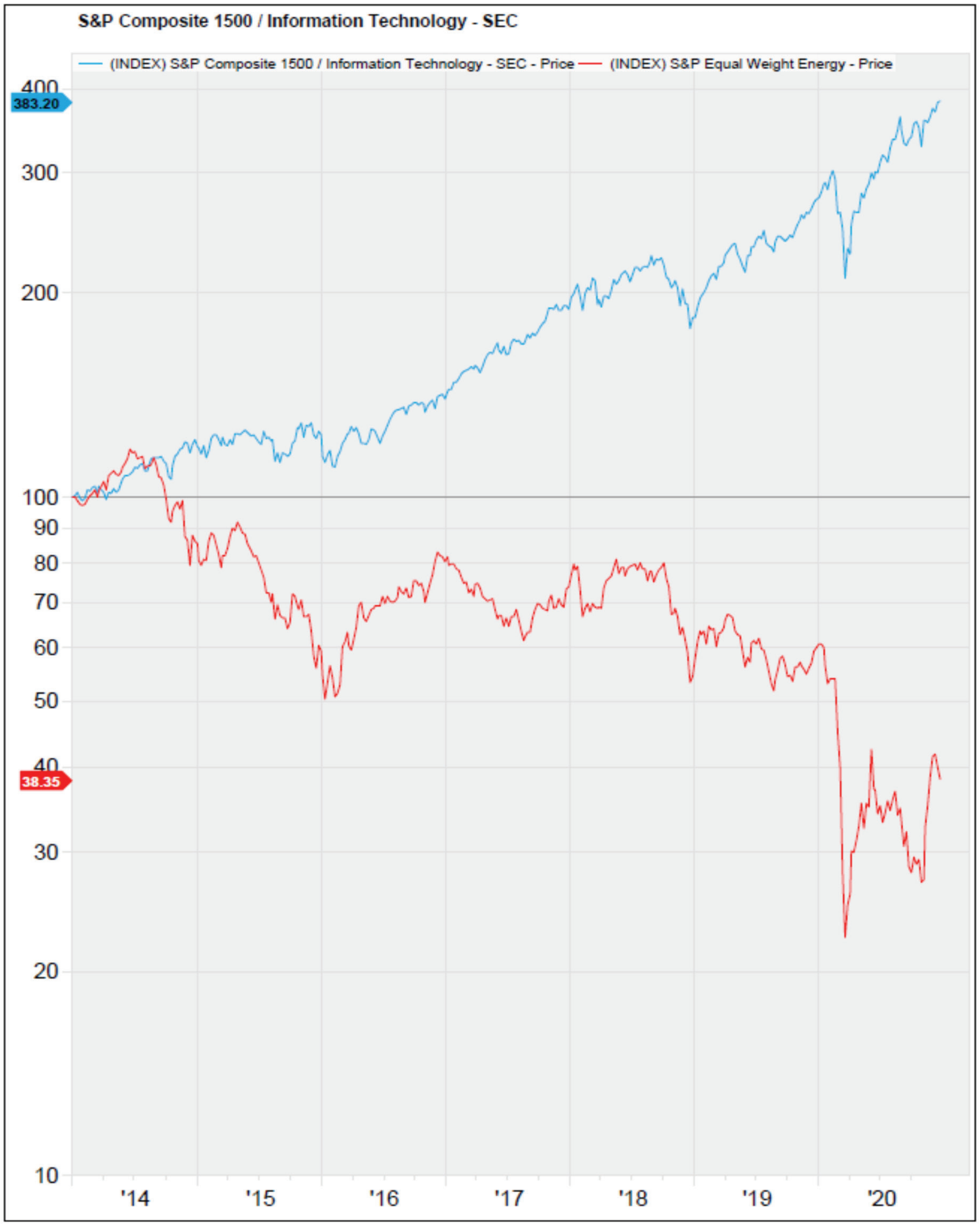
Some California legislators, not wanting to take such economic impacts lying down, have proposed an "exit tax" that would be levied for a full ten years on certain individuals ***after*** they move out. Maybe the old Eagles song *Hotel California* had it right when they said: *"You can check out anytime you like, but you can never leave."*

The more that we run our economic matters through the federal or state governments, the less "stuff" we should expect to receive. We should expect lessening quality, quantity, timeliness, and choice. Take the restaurant industry as a counterexample. The only job security for a restaurant owner is her own wits and hustle. She must fight it out every day with no guarantees, in a constant, high level competition with other establishments, as well as online choices. She must provide her customers with something of *better* value such that they willingly trade their money for her services.

Why is all this important to investors?

It is important because the more government runs the show, from an economic sense as well as a monetary sense (money printing), the more we will need to worry about things like productivity, quality, shortages, and inflation.

Over the past decade or so, investment capital from around the world has been concentrating to a major extent into the United States, and a lot of this concentration has been into U.S. tech stocks in particular. It can be seen in the major price rises of these stocks as well as the dollar itself. It has come at the expense of most of the other sectors of our economy and at the expense of most of the other countries of the world. The chart below is one stark example of the price effects of this concentration over the last 7 years. It shows the growth of $100 dollars invested in U.S. technology stocks vs $100



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dollars invested in U.S. energy stocks. The end-result is an unbelievable **ten-fold** difference in ending dollars!

If the U.S. continues its trend of continuous money printing, borrowing, and ever greater governmental control of the economy, one could make the case that there might be better investment opportunities elsewhere. If foreign investors come to that same conclusion, the virtuous cycle of an increasing U.S. dollar attracting money into increasing U.S. stock prices (mostly technology stocks) could very well reverse. Many macroeconomic thinkers that currently have our ear believe that we are entering a decade where foreign markets, foreign currencies, and commodities could be the outperformers. We can see the logic in their arguments and have made quite a few portfolio moves in that direction over the past nine months. We have added more international stocks to our portfolios than we have in a long time. However, we will never count our country out. It's highly likely the U.S. will continue to be one of the world's best innovators of new technologies, medicines, and businesses.

Currently on the national front, we imagine there is lot of pent-up demand from U.S. consumers that were stuck at home for too long. Combine that demand with the latest $900 billion in stimulus money, as well as a possible massive governmental infrastructure plan for 2021, and the U.S. economy could have an impressive recovery from the COVID induced recession. The stock market is already anticipating as much. The likelihood of an infrastructure bill, combined with the bargain stock prices in the industrial stocks, was enough to get us to buy into that sector over the past months. We can only hope, however, that any economic recovery is not overshadowed by the nation's *longer-term* economic problems. We feel those problems might have been exacerbated by all the aforementioned governmental "solutions."

If you happen to notice an unexplained increase in the number of "cobras" slithering around your town - you will now know the reason.

So this notion that you can just sort of send checks out to everybody and things will be fine, is not true - obviously. Some people have this absurd view that the economy is like some magic horn of plenty – like, it just makes stuff. There is a magic horn of plenty and the goods and services, they just come from this magic horn of plenty... Now let me just break it to the fools out there - if you don't make stuff - there's no stuff.

We've become detached from reality. You can't just legislate money and solve these things. If you don't make stuff - there is no stuff, obviously. It will run out at stores... the machine just grinds to halt.

-Elon Musk

They pretend to pay us, we pretend to work.

-A Russian saying from the days of communism

Giant Sprinkles

From an investor's standpoint, one of the more important unintended consequences of all the recent money printing has got to be the major up-tick in stock speculation. This often happens when the Fed cranks up the printing press. Their intent was to get money into the hands of consumers so that they can do what consumers do... consume. All that purchasing would, of course, help businesses increase their bottom lines and help the economy work its way back to even. What could go wrong with a plan like that?

Well, for starters, the citizenry may not buy the kind of things you want them to buy. You would probably prefer them to do something productive with the money - like putting food on their tables or keeping employees on the payroll. But who's to say they won't go and do something foolish with their newly gotten loot – like gamble it away? Not to worry you say, casino traffic was way down last year, even after the closures were reversed. Ah, but don't forget that this is the Zoom economy now - *everything* can be done from home and from your cell phone. A lot of young investors and first-time investors are starting to treat the market as some sort of online casino. Some of this speculation is enabled by the ease at which investors can now "play" the market using phone apps. This increased gambling pushes the price of many speculative stocks into the stratosphere. Yes, some of the new technology companies are doing amazing things, but are they suddenly worth five or ten *times* what they were 12 months ago, pre-COVID? The odds makers would say probably not.

This kind of action is nothing new. We see it when markets or sectors of the market are getting closer to their tops. It doesn't mean we need to sell or get defensive right away, but it acts as a warning of sorts. We need to keep our eyes open and be prepared to move. There have been many times over past decades when the animal spirits, as they say, have been released. Some major trend develops, it picks up steam, and then investors extrapolate that move out to infinity. We have seen it with Japanese stocks, biotech stocks, technology stocks, energy stocks, etc. Most of the time it ends in disappointment.

A few of our younger clients have called recently to have conversations about the latest hot stock that is "sure" (in their minds at least) to be headed up 100-fold. Worse, some of them want to throw diversification out the window and concentrate all their funds into a very narrow group of stocks - the ones that rose the most "yesterday." They want to gamble.

I can't seem to shake the vision of a child sitting down for a dinner of his own choosing - then choosing a plate full of ice cream sprinkles for his main course. No ice cream even, just the sprinkles! Or perhaps just one **giant** sprinkle sitting alone on a plate.

Of course, we rational adults would try to tell the child that they should have just a few *small* sprinkles *modestly* scattered on a *moderate* scoop of ice cream. More importantly, we would all tell them that they first need to eat a well-balanced meal. Of course, that meal should include a healthy portion of vegetables. Have some broccoli first – yum!

Nowadays, financial professionals are working overtime advising some of their more aggressively minded clients to use sound investment principles and strategies. They are recommending techniques such as "diversification" and "buying higher-quality investments" and "thinking long-term" and "limiting your exposure towards speculative stocks."

Those clients only hear "eat your broccoli!"

Before we admonish these (mostly) younger traders, we might better ask ourselves if we are not doing the same thing, albeit to a lesser degree. Technically speaking, the overall stock market seems to be in a speculative mood of late. Take the S&P 500, for instance. The top five companies in the index are all the giant technology stocks – the prices of which no one would call cheap. That doesn't sound like diversification to me. The technique of diversification is a very powerful risk mitigator. It has been called the only free lunch in finance, due to its protective properties combined with the fact that, if done properly, it won't "cost" you anything. It theoretically won't lower your potential returns. But alas, it's way more fun to be totally concentrated in whatever happens to be in vogue at the moment.

Don't get me wrong – we *like* this kind of speculation. It does a few things for us. First of all it pushes up the price of some of our stockholdings to overly elevated levels. It's then up to us, if and when, to say "thank you, goodbye" (sell). Rampant speculation also focuses investor's attention away from a lot of potentially valuable bargains. Again, it's then up to us when to capitalize on the discrepancies.

There is what we would call a *proper* way to speculate. I witnessed this "proper way" many years ago watching the strategy of self-made, elderly, female client of mine. She would buy *most* of the interesting startup companies that were making the news at the time. The trick was that she only invested a relatively small dollar amount into each one – perhaps 0.2% of her net worth. That way she could purchase 20 or 30 of these “sprinkles” at a time and then wait to see what happened. All she needed was to have one big winner out of ten purchases and that more than made up for any losers. Even if none of them worked it didn’t really matter, since she only had about 5% of her net worth tied up in these speculations. There was a lot of merit to her strategy. As soon as she heard about an interesting technology or biotech breakthrough, she would take her small position. It satisfied her sweet tooth, per say, and kept her disciplined. Many times, an investor will procrastinate on something they want to buy. Then the stock goes up, drives them crazy, and eventually ends up enticing them to buy-in for a lot more than if they had moved when they had the initial idea.

The beauty of stocks, in general, is that their returns are asymmetric. Your maximum loss on a given stock investment is “only” 100% or (1x your investment). The upside, however, has no such cap, and there is nothing that says a stock can’t rise 10x or 100x your principal. That usually takes many years to develop and there is a certain amount of luck involved. Never-the-less, *those* are just the type of odds that a gambler can only dream about. Of course, investors should never be gamblers, so the trick for investors is to avail themselves to this asymmetric effect without risking too much. Buy a few of these speculative positions. “Sprinkle” a few into your portfolio, moderately of course, and with a smarter, deeper strategy. Do your research, then use a stop-loss philosophy to control damage. Perhaps most importantly, use portion control and diversify.

Easy on the sprinkles and eat your broccoli first!

You know you are diversified if you always have something to complain about

- Source Unknown

Important Reminder: At the end of the year you may have noticed some increased short-term trades. This is due to the fact that we make proactive tax maneuvers before the calendar year ends. For instance, if there is an unrealized loss on the books in a stock that we like for the long run, we still might decide to sell that position temporarily. We would book that loss in order to give our clients a write off, then we would buy it back after 30 days (per the IRS rule).

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Sincerely,
Michael Morgia, CIMA®
Managing Director, Partner
Morgia Wealth Management

Tony Morgia
Managing Director, Partner

P.J. Banazek, CFP®
Managing Director, Partner

Footnote:
1. The Cobra Effect, Raol Paul and Larry McDonald, 8/24/2020, Realvision.com
2. Will Top Companies Follow Elon Musk's Lead and Flee California for Unregulated States? Scott Reeves, 12/22/2020