MORGIA
WEALTH MANAGEMENT
DISCIPLINED ◆ CAREFUL

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OUCH!

Six months ago, in our last Update, we lead with a lyric from a 1970 Grateful Dead song: *...when life looks like easy street there is danger at your door.*

Sorry about that!

In hindsight, perhaps Sinatra's "Fly Me to the Moon" would have been a more pleasant prediction for stocks. Unfortunately, we were not "feeling" that one and had to call it as we saw it. With too many stocks sporting what we considered to be lofty prices, and with somewhat of a feeding frenzy in the technology stocks, it reminded us an awful lot like late 1999, before the popping of the dot-com bubble. We hasten to add, however, that the current environment is NOT as extreme as it was back then.

Back in July we also outlined our strategy regarding these worries:

... we have been trimming back portions of some of our growth holdings. Certain prices have become just too high to ignore – even for companies of high caliber.

In the first 45 days of this correction, growth stocks had fallen 8% **more** than value stocks. Amazingly however, growth is *still* ahead of value for the full year (and *way* ahead for the past decade!). Although being cautious and avoiding the high-priced stocks has helped a lot recently, it has, ironically, penalized portfolios a bit for the full year. From last January until about August the best game in town seemed to be stocks with lofty price-to-earnings ratios (expensive). Stocks like Amazon and Netflix come to mind. They have not fared well as of late however – yet are *still* quite expensive even after their recent drops of 30% and 40% respectively.

Is this recent growth-stock bruising the start of a major shift away from growth and towards value stocks? Many investors have been waiting a long time for such a shift, but it usually coincides with a much stronger global economy and a Fed that is not raising interest rates. We shall see.

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As bad as the broad markets have done during this recent drop, there have been some truly brutalized areas. We already mentioned that a few of the previous darlings in the growth-stock space have been hit hard. Some of the semiconductor stocks as well as other technology component makers have seen their shares cut in half from their recent highs. Even a good number of the value stocks have been punished, in spite of being much "cheaper" to start with. Case in point would be General Electric shares which have fallen 55%, down to $7.50 recently.

And if it seems bad here, rest assured it has been much worse in foreign stock markets across the globe. Ok, so Hungarian and Brazilian stocks are still positive for the year, but that's about it!

So, what to do now?

First of all, remember that we always maintain a bit of a defensive mind-set and posture, by avoiding high-priced, debt-laden, and low cash-flow companies. Furthermore, we have been advising clients for the last 12 months that it would be wise to bring their stock percentages back down to their targets – if not a bit lower. After the last few years, the stock portion of most investor's portfolios have been drifting higher due to the up-swing in the market.

Then, in addition to that advice, in August we shifted from overages in technology and cyclical companies into more conservative sectors like consumer staples, utilities, and healthcare, which has helped. In mid-October, we went into extra-defensive mode, holding more cash than normal (17-20%) in our stock accounts. Lastly, as we were finishing up this letter, we have actually moved into major-defensive mode, like we did back in 2008, 2011, and 2015, now holding between 30 and 40% extra cash as well as a position in gold.

Being defensive in a bear (down) market makes it much easier to go bargain shopping as stock prices drop. As hard as it was to go through the 2008 financial crisis, it produced some of the best buying opportunities that I have seen during my entire 30-plus year career. The investors that were too aggressive going into that crash took such a beating, that they had no available capital to buy into those bargains as they developed.

Investing is always a balancing act. Over the long-run, it has been a very good idea to be a stock investor. Nevertheless it has also paid-off during so called "bear" markets to play tighter defense. Permanent loss of capital is, and has always been, our major concern. *Everything* else takes a back seat to that. Notwithstanding this caution, temporary downdrafts come with the territory for *all* investors. If you try *too hard* to avoid *any* loss, you will likely "avoid" much of the gains as well - at least in our experience.

Presently we find ourselves concerned with the possibility of a global recession happening sometime in the next year or two. At this point at least, the US economy is much stronger than the rest of the world, but it has been a long time since we have had an economic retrenchment. With Fed Chairman Powell raising interest rates, as well as tightening monetary conditions in other ways, the odds have increased that the global economy could stall.

With this in mind, we will be exercising caution. As always, we will be careful.

On the other hand, after some of the recent smash-ups, there are many interesting bargains developing. We are actually quite tempted to be buyers in some cases. In the relatively mild recession of 2001 when the growth stocks were hammered (that's a technical financial term), many value stocks actually fared rather well and there were decent profits to be made despite the economy. Not so in 2008. In that year's recession the only place to hide was in cash and US government bonds. One never knows which flavor of recession will be next, nor how exactly stocks will react.

We don't attempt to predict the market's exact direction since we don't believe *anyone* can do that very well. We DO, however, always try to **respect the trend** to some degree. A *continually* falling stock price or stock market needs no prediction, merely open eyes and open minds. You may not want to *believe* that your favorite stock is heading down – but as it continues to do so, missing the "signs" is usually a matter of willful blindness as opposed to actual blindness. This *selective vision* works the other way as well. Over the years we have witnessed many overly-cautious investors, who were always too nervous to invest. They were always so afraid of the next bear market that they missed some remarkable bargains and stellar long-term gains. They could never seem to entertain the optimist's view of the world.

We have always attempted to be extremely disciplined with our strategy, yet, we were very careful to incorporate open-mindedness and flexibility into our methods. Our current tactics reflect this thinking. So, even though we are currently being quite defensive, we will be ready at a moment's notice to reverse course - to pounce on arising bargains, once this storm blows over.

Let us close this section with some words of encouragement from Warren Buffet earlier this year:

When major declines occur, however, they offer extraordinary opportunities to those who are not handicapped by debt. That's the time to heed these lines from Kipling's [poem] "If":

> *"If you can keep your head when all about you are losing theirs . . .*
> *If you can wait and not be tired by waiting . . .*
> *If you can think – and not make thoughts your aim . . .*
> *If you can trust yourself when all men doubt you...*
> *Yours is the Earth and everything that's in it."* [1]

Introducing Morgia Wealth Management:

Spoiler alert: We have changed our name and have a new "tag line." Ok, I guess you probably already noticed as much from page one.

Why mess with a good thing? What was wrong with our old name "The Morgia Group?"

Well for starters, we never actually *chose* the word "group," rather it was our only *option* at our previous firm. Also the term “group” is not very descriptive. For those that don’t know us, we could just as well be a group of dentists (although I’m sure our dentist clients would beg to differ).

After our 50th Anniversary, we decided we needed something better for the next half-century - a rebranding if you will. But what should it be? The “Morgia” part was sort of essential (at least in my opinion!). The rest of our name needed to be much more descriptive of the services that we strive to deliver. There are innumerable tasks and services that we perform each day, but in short, one could say that we manage our clients’ financial affairs. For individuals, we try to be their personal finance department. From financial planning to asset allocation to investment management, we try to cover it all. For our corporate, pension, and bank clients, we do our best to assist and advise their executives with all of their financial matters.

Basically, we *manage* our clients’ *wealth*.

So, there it was… Morgia Wealth Management.

The Tag Line:

It is surprisingly difficult to sum up your life’s work in a slogan. The more we tried to do it, the harder it became. We deliberated on what actually makes a difference? What makes us different? What is the foundation of our investment philosophy and our process?

After enlisting the help of a few clients, we eventually realized that it really came down to two adjectives; disciplined and careful. Being disciplined is extremely important if you hope to survive the investment world for any modest length of time. And we guess 50 years is a decent amount of survival time. So *that* adjective was a comfortable fit.

“Careful” is not a word one typically hears in the investment industry, however, it resonated strongly with us. It fits perfectly with our philosophy and exemplifies what we try to bring to the table for our clients. It really IS at the core of everything we believe.

So, **“Disciplined. Careful.”** it was!

Recently, while perusing famed bond investor Howard Marks’ latest market letter, we knew we had picked the right descriptors. In his September memo to his clients, as he was warning about the current dangers of certain overpriced stocks and bonds, we came across these lines:

That’s what Warren Buffett had in mind when he said “It’s only when the tide goes out that you learn who has been swimming naked.” Skillful, ***disciplined, careful*** *[investors] are likely to get through the next recession and credit crunch. Less skilled managers may not.*

[**emphasis** mine]

Let’s dig a bit deeper, into these two descriptors and why they matter so much to us.

Disciplined:

"A disciplined mind leads to happiness, and an undisciplined mind leads to suffering."

Dalai Lama XIV

To even begin investing you will first need the discipline to work hard and earn money. No small task. Then you will need the discipline to spend *less* than you make. Then more discipline will be required to patiently do all the homework and research required to hone in on a financial strategy that you can follow over the long-term.

You would be wise to read **everything** related to the most financially successful individuals and the strategies that they employed. Add in as much financial history as possible. What worked in the past? What failed in the past? Why?

Formulate your strategy, your tactics, your game plan and your contingencies. In the financial world, the various investment strategies are also called "disciplines" for good reason. They take stick-to-itnessive.

Now… once you have settled on your well thought-out and time-tested strategy, you will need discipline to stay on course. When all manner of events try to pull you off track, you will need to persist.

Tough times will try to **scare** you off course… you must stay disciplined.

Good times will try to **tempt** you off course… you must stay disciplined.

Long times may start to **bore** you off course… you must stay disciplined.

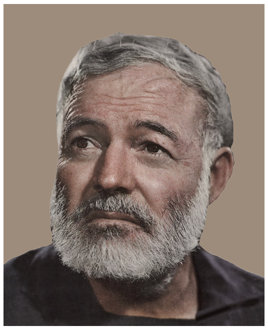
Trying to keep up with the Joneses may **pressure** you off course…you must stay disciplined.

Family "needs" will **nudge** you off course…you must stay disciplined.

Life itself will constantly conspire to knock you off your financial path. Only the disciplined investors will make it through. Discipline is what allows you to persist over time so that you can tap into the long-term compounding that eventually turns money into wealth.

In summation: You must find the correct path for you, and then stay on that path for a very long time, despite the countless daily obstacles that will get in your way.

Be Disciplined!



Careful:

"No, that is the great fallacy: the wisdom of old men. They do not grow wise. They grow careful."

Ernest Hemingway, A Farewell to Arms

The world is a dangerous place! Many in our generation have forgotten this.

Dig out your history books, flip open to any random page. You will find one major problem after another – it's just the way of the world: The Great Depression, World War II, Vietnam, natural disasters, the list goes on.

The Great Depression shaped the personality of an entire generation. Prior to the 1929 market disaster, all caution had been thrown to the wind for almost a decade. The rare few investors that were careful in the 1920's were then in a position to make a fortune post-crash when stocks were trading at .10¢ on the dollar. But those individuals were the rare exceptions. After that downdraft, of course, investors finally learned their lesson about being careful… for about five years… at which time they bought back into a big up-swing and then got pummeled all over again.

And then there was the "go-go" stock craze of the '60's, the "nifty-fifty" stocks in the '70's, the biotech boom in '91 followed by the dot-com bubble ten years later. That was right before the real estate bust and the financial crisis of 2008. And I'm only counting the major screw ups!

Recently we could look to the Bitcoin craze that culminated about one year ago. From $20,000 last December, it fell 70% to $6,000 in February, jostled around a bit until mid-November then fell *another* 50% in a couple weeks.

Notice a pattern?

The careless and the clueless are not long for this world - and their money is not long for this financial world. Those that didn't get carried away on the upside of these manias, survived the subsequent downdrafts and then pressed on to new highs each time. Those that got "caught up" in the euphoria, did not live to fight another day.

The financial markets lay traps of many kinds. They always have. Investors must study these pitfalls and devise strategies to stay away from them. Unfortunately, most people are not even aware of the existence of these traps until one springs shut and clamps down on their financial leg, so to speak. Countless bubbles have attracted far too many people. Unfortunately, foolishness can endure for quite a few *years* in some cases, until it eventually ends up luring in more and more unsuspecting speculators (who, of course, think they are investing). The unwitting "investors" arrive just in time to get their "assets" handed to them.

The math of "careful:"

Compounding is an impressive force of nature, but it cuts both ways. Upside compounding can be amazing over long time-frames. Suppose your portfolio returned 80% over a few years' time. I image you would be pleasantly surprised and quite happy. Yes, your purchasing power would increase nicely and you could buy many more *things* (not to mention extra *stuff*). Would it be life changing? That much is doubtful, but it *would* be rather nice of course. What **would** be life changing is if your portfolio ***lost*** 80%. Reflecting on this simple yet stark example, investors should quickly realize that a gain and a loss of equal magnitude are anything *but* "equal."

An 80% gain can be mathematically erased by a 44% loss (trust me, I just used my calculator). An 80% loss however takes a gain of 400% to get back to even. It hardly seems fair! This is why "careful" matters.

In addition to the math seeming unfair, the human brain is wired to feel losses much more than gains. The scientific consensus says that, psychologically speaking, people "feel" a loss about a 2.3 times more than a comparable gain.[2] A 2010 study actually demonstrated that **retirees** have a *ten*-fold greater emotional reaction to losses versus gains.[3]

But what does being "careful" actually entail? Well…there are literally dozens of different risk *types* in the financial world, let alone specific risks. You need a plan to deal with each and every one of them. From allocation risk to inflation risk to liquidity risk to credit risk, the list could fill a page or two.

And just when you think you have insulated yourself from investment risks, other financial risks can arise. These usually stem from a lack of **planning**. For instance: The economy takes a bad turn and you didn't realize your debt load would be so hard to service. Or maybe you have been spending more than was prudent given your portfolio size – did you even do the calculations to check? Alternatively, let's say that times were very good and your spending was well under your means. Your estate then built up quite nicely over the years, but your **will** was not carefully constructed. Fast forward a few more years and now your granddaughter's ex-husband is spending your money (oops). We preach to our clients constantly about the need to get all of their financial affairs in order; to cover all the bases when it comes to prudently managing their risk profile.

But here is a secret we have learned over the past 50 years: You will NOT avoid all trouble. You will NOT make it through your financial life and your investment journey unscathed (there will be plenty of scathing over the years).

But with **"careful"** as your touchstone, those inevitable problems will be containable and ultimately conquerable. Then the *good* times and the bull markets will take care of the rest.

Be Careful!

As always, please call or email with any questions and/or comments. On behalf of Tony, P.J. and the rest of Morgia Wealth Management, thank you for your continued confidence.

Sincerely,
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Morgia Wealth Management

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Back Row: Frank Murphy, Katrina Thompson, Mike Morgia, Heather Clement, Tony Morgia, Andrea Fiorentino, Anthony Surber
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1. Berkshire Hathaway Inc., 2017 Annual Report, Feb 23, 2018.
2.
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