HIGHTOWER
AN UNOBSTRUCTED VIEW
THE MORGIA GROUP

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The Stock Market:

What goes up must come down
Spinnin' wheel got to go 'round
Talkin' 'bout your troubles it's a cryin' sin
Ride a painted pony let the spinnin' wheel spin

Spinning Wheel
by Blood, Sweat & Tears 1968

Ok so maybe the stock market is one of those rare things that does not have to obey the old Blood, Sweat & Tears rule. Allow me the liberty to rewrite the first line – from a stock manager's perspective:

What goes up (much faster than its underlying fundamental value), ~~must~~ is likely to come down (to a more logical price) - eventually.

Ok, so this wishy-washy, cover-my-backside type of writing does not lend itself to the pop song genre. It does, however, reflect the realities of the stock market. Prices that go up don't necessarily have to come down – at least not all the way – and at least not in our financial lifetimes. In fact, stocks tend to persist in their appreciation over time *as long as* their earnings and cash flow keep rising at a similar pace.

Over the past two hundred years, the US stock market is in what even the most ardent pessimist must admit is… an uptrend. Over that time there have been countless calamities both real and imagined. Prices stall and dip and crash and rebound. Yet the uptrend persists.

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So, this current market rise doesn't HAVE to reverse.

But…

When general market valuation measures, such as the current price-to-earnings ratio (P/E), get as high as they are at present, things get a bit dicey for longer-term returns. The bad news is that it usually means the subsequent 10-year returns turn out to be anemic. Anemic, as in about 1% to 3% annually.

The "good" news is that there is no correlation between high prices and *next* year's return. So, stocks will most likely get beat-up at some point – but just not necessarily tomorrow. Well that's comforting! The actual good news is that no one is forcing us to buy the expensive companies – we are perfectly free to shop for some bargains.

Back in the year 2000, the market's P/E was even higher than it is today. What followed was an extremely turbulent time-frame, replete with two separate 50% crashes and a market that went nowhere for 13 years. Back then however, it was not equally bleak everywhere on Wall Street. If you didn't get caught up in the overpriced technology and growth stocks and instead bought into some of the many reasonably priced value stocks, you would have actually made some money. Don't get me wrong, it still was no picnic, but the difference in outcomes between those who were price-sensitive versus those who were buying Anything.com was stark. We would counsel a similar discrimination for today's investors – choose your holdings wisely.

So what gives? Why all this current optimism?

Like we spoke of last year – lower corporate tax rates make companies worth intrinsically more. If stocks are worth the sum of all their future earnings, and taxes drop – well then, values go up. As shareholders/owners, we do not get to keep *all* of the profits that our companies earn. We must share those profits. Dear old Uncle Sam is our silent partner, taking 40ish% of everything that our companies make. Then he taxes us once again if we ever want to actually take any of that money out of the corporation and use it - but I digress.

Now that the corporate rate has been reduced to 21% (a bit below the world average), corporate shareholders will get to keep 79 cents on the dollar vs. 60 cents previously. That's a 32% increase to bottom line profits for some companies! Thus, the stock market *should* be valued higher than before this development. This is one reason the investing public is presently in a good mood.

Another major contributor to the stock market lovefest is the current governmental effort at cutting red tape. That is giving corporations some hope that they will get a small reprieve from some of the smothering bureaucracy that has been working its way deeper into the economy for many years.

Bureaucracy Corner:

Have you noticed the new protocol used in pharmaceutical ads on TV? In an apparent stroke of bureaucratic genius – the drug companies seem to have been forced to add a new disclaimer to the litany of reasons to never buy their product. They now all find it important to say:

"Do not take Fillintheblankocillin if you are allergic to Fillintheblankocillin."

Really? Did the FDA spend our tax dollars developing that one or did the drug companies come up with it on their own out of lawsuit fears?

What's more depressing? The wasted time and money used to develop and implement this new "safeguard" or the perception that the US populous needed clarification on the patently obvious?

So… less red tape means that corporations can start thinking longer-term. That can lead to more capital expenditures and general expansion which, in turn, means more hiring.

Yet another economic bright spot is the global business environment. We are in the midst of **synchronized global growth** – meaning that the world's major economies (The US, Europe, Japan and China) are all presently rising in unison. That has not happened to this degree in quite a while.[1]

But although economic growth is a long-term prerequisite for rising stock prices, it can often end up sowing the seeds of its own demise:

The economy expands → inflation picks up → interest rates rise → the money supply gets choked off and, finally → the economy contracts.

Spinnin' wheel got to go 'round

But as we constantly warn: Don't waste too much time trying to predict broad macro-economic conditions. Rather, focus your efforts on searching out one good investment idea at a time.

As the legendary investor Peter Lynch once warned:

"If you spend more than 13 minutes analyzing economic forecasts, you've wasted 10 minutes."

It appears that our time is up.

Those Who Fail to Plan…

Over the last 12 years, most of our updates have been focused on *investment* themes. And although the investment part of one's financial life is extremely important – there are other equally critical areas. At The Morgia Group, we recognize 14 separate areas of finance with which all individuals must contend. Over half of those areas are related to some form of planning. Planning itself is multifaceted and ranges from college education funding to retirement funding to estate planning tactics.

All of our 14 categories, by the way, fall within a certain over-arching structure that we have built into our process. That structure revolves around answering four financial questions of prime importance:

Where are you?
Where are you going?
How will you get there?
Why will you go that direction?

The last two questions apply to one's investments. The "how" question pertains to your investment strategy while the "why" question pertains to your investment philosophy - two things that all investors must understand deeply. Knowing *why* your investments are structured the way they are will help you maintain a steady course when extreme market gyrations draw out your emotions.

But like we said, today we want to spend our time on the planning aspects of finance. It is these aspects, which will help you answer the "where are you going" question.

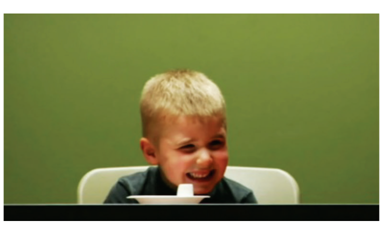
In truth, we like to phrase it a little differently. We ask our clients: Where do you *think you want to go?* Far too often, clients have not really thought it out properly. They have not framed the question correctly and thus their conclusion is a bit wishy-washy to say the least. Part of the reason that planning and goal setting works is that it puts you on a straight-line path. That, of course, can make all the difference. The sooner you dial-in your coordinates, the easier and more efficient your journey will be. Time and money will usually be saved since the straight-line is the shortest distance. Many investors simply meander around in the financial dark, wasting time because they were never precise as to where they were headed. For sure, they will end up somewhere, but where will it be?

With a clearly defined destination in mind, even if it turns out to be the *wrong* destination, at least you will have arrived in a timely manner! Better to figure out your financial mistakes quickly and with enough time to move on with a corrected course. We would humbly suggest that it would be far better still, to spend additional time up-front figuring out your *correct* goal right from the outset. Then, and only then, should you head off on your straight-line path.

Most of our clientele have done a fairly good job of saving and investing – of working hard and spending less than they earn. So do they really need to plan?

We will speak about that in detail a little later, but let's just say that planning is extremely important even for those individuals who are already financially successful. Why? Because the personality traits that lead to financial success are the same traits that will eventually create a different set of problems. Those personality traits stem from the likelihood that most of you reading this update, grew up as a "two-marshmallow child."

Two-Marshmallow Children:



Back in the 1960's, researchers at Stanford University led by psychologist Walter Mischel, conducted an experiment on delayed gratification. Young children were offered a choice – they could eat one marshmallow immediately or they could sit and wait until the researcher returned to the room with a second marshmallow and then the child could have both of them. I believe the wait time was around 15 minutes, which, to a five-year-old is the equivalent of a few days!

The results were that only about 1/3rd of the children held out long enough to receive the second marshmallow.

The amazing part of the experiment was only revealed many years later in a follow up study that showed that the delayed gratification children (the two-marshmallow kids) had markedly better life outcomes, such as higher SAT scores, better weight control, etc. Although I did not see it mentioned in the experiment summary, I am sure that the ability to delay gratification is also *highly* correlated with investment success. By definition, saving money **is** delaying the pleasure of consuming goods now, for the benefit of greater future consumption.

I am convinced that some of those two-marshmallow children (2Ms) from the original experiment eventually became Morgia Group clients. I can't prove this of course, as the names were never divulged. I guess we could serve some marshmallows in our conference room during client meetings as a test of sorts. However, it is probably unwise to needlessly drain our client's willpower. That could be bad for business!

So, having a 2M personality helped you and your portfolio get to where you are today. The problem is that those same traits might now be causing a problem.

The instant gratification crowd probably looks at the Stanford experiment and draws the conclusion that: It's dangerous to eat just one marshmallow!

Hint for 1-Marshmallow people: That is not the correct conclusion.

On the opposite end of the spectrum - our clients tend to take it to the other extreme. They have such a high ability to delay gratification that many of them now have a table overflowing with marshmallows! Go ahead… eat a few!

Hint for 1-Marshmallow people: Marshmallows are a metaphor for money and by "eat a few" we mean "spend a little."

What good is it for you to have enough willpower to save your money and invest it, if your heirs are simply going to blow it? There is a high probability that if you *go without* so to speak, that someone down the beneficiary-line will do the opposite and freely spend (blow) the money that you so carefully saved. Almost by definition, if your money ends up in the hands of someone frugal, they will simply pass more money on to the subsequent generations until finally, it reaches a spender and then …poof !

So, planning is *especially* important for our 2Ms. Hard work and frugality fosters a respect, understanding, and appreciation of the effort needed to earn and grow wealth. Time at work is time you are *NOT* out spending your money. The result: A lot of accumulated cash flow. Then it gets invested. Then time passes. Then repeat. The result is accumulated *wealth*.

There are two main risks with this positive development. The first, we will call "working for free" and the second we will term "incubating idiots." I will explain each in turn:

Working for Free:

At some point as you work, earn, save and invest you will reach a point where you will *most likely* have all the money you will actually need to maintain your living expenses for the rest of your life. You won't realize it, as no one will bang a gong, but you will have reached that point nevertheless. Any more work that you do from this point forward will be for money that *you* will never spend. It will technically be a waste of your time.

Caveat #1: If you are working for free **but** you:

1. Love your job
2. Are accumulating additional wealth for your family
3. Are accumulating additional wealth for charitable purposes
4. All of the above

Well then, by all means keep going.

A fulfilling career has been shown to be highly correlated with good health. Just make sure you didn't inadvertently leave another personal passion or engaging hobby on your life's backburner.

Caveat #2: Notice we said - ***you will most likely have*** all the money you will actually need. The world of finance deals in probabilities, never certainties. We are big believers in planning for potentially tougher economic times, and *good* planning must accommodate such possibilities.

Incubating Idiots:

We know, we know… that sounds a bit harsh. But over the years we have come to witness this occurrence a few times and felt it needed a label as caustic as the ramifications that can result. Besides, it sounds way more interesting than something like: unintentionally enabling counterproductive financial behavior. Wouldn't you agree?

The idiot incubator is formed with the money an individual uses in order to insulate and shelter another family member from the real world of financial consequences. It is built with equal parts of good intentions and money. Oh… and the money never has any strings attached as that might gum up the works of the incubator.

As the delayed-gratification individual (the 2M) naturally accumulates greater amounts of wealth, it becomes easier and easier to *throw* some of that money towards the financial problems of various family members. Although reluctant to spend too much on themselves, these savers have little problem playing the role of financial rescue worker, swooping in as needed to "save" others.

If you do that however, you are effectively paying good money to "protect" your children or grandchildren from some of the best lessons of the real world. Well… Junior really tried hard and his boss just doesn't appreciate him so I want to buy him a brand new truck.

The sad part is, if we do this, we are literally spending money in order to damage the character of the loved one we are trying to help. It's far cheaper to be the "bad guy" and let them work themselves out of their own predicament. That financial inaction must be accompanied however, by a greater time commitment on your part. You will have to spend some added hours counseling and coaching the offending family members on the proper way to get themselves back on their financial feet. If they listen to you, great, then they save themselves some pain. What if they don't listen? We would contend that it is far better to let them suffer the financial consequences in order that they internalize the lesson. Tough love as they say. If they eventually inherit some of your wealth – you will have increased the likelihood that they will use that wealth responsibly.

By the way, many times the idiot incubator can get fired up for lesser financial sins. For instance, let's say you are paying for your grandchild's college tuition to some extent – might it not be a better lesson to have that financial help contingent on an adequate GPA? *That* life-lesson might actually be more valuable than the college course for which you are helping to pay.

So, do *your* math (or let us do it for you). Understand exactly where you want to go. Calculate, as best you can, how much income you need to live on. See what your current assets and savings will eventually produce. Then you can make an educated decision as to your spending levels. If you don't make that decision there will be unintended consequences. There will be some individuals that are going to enjoy spending your money. We would contend that **you** should be one of those individuals.

In our last Update we included an interview with Tony on his 50th year in this business – thank you for all the kind words regarding that chat. We thought we would once again utilize the interview format for a conversion with our resident planner PJ Banazek.

PJ started his career in the accounting profession and has been a CPA since 1992. He is also a Certified Financial Planner and the combination of those two achievements are rare in our profession, but are a significant resource for our clients. 2018 will mark 30 years of work in the fields of finance and accounting for PJ, the last 17 as a partner of ours here at The Morgia Group. In the following Q&A, I will ask PJ a few questions that we as financial advisors seem to get quite often regarding financial planning.

Here is our chat:

Question: The whole planning thing seems a bit daunting – where does one begin?

PJ: It can be very intimidating if you let it be. But as I tell most people, start by keeping it as simple as possible. One of the biggest reasons a client has trouble getting the planning process moving is they have trouble coming up with their spending plan. It might simply be that they do not really keep track of where they spend their money. Or they don't want to think about it for a multitude of reasons. I try to get them to approach it differently when we are doing an initial plan by encouraging them to think about it simply in terms of their current paycheck. How much money do you get in your paycheck? Let's multiply that number by the number of times you get paid in a year, and then subtract any items that will be gone when you retire, such as a mortgage. If that is your spending level today, you will likely spend at least that much when you are initially retired!

It can be a bit harder for a business owner who may have an income that fluctuates significantly, but the same concept of keeping it simple to start is the best way to get moving. Once a simple plan is built, it is easy to refine it and modify it as time goes on. Over the years I have done a number of plans for clients that started out this way. Over time these clients have used that first plan to refine their goals and build a very successful financial life for themselves.

The other area that is often overlooked by clients is the concept of imagining what their retirement life will look like - the dream so to speak. What does your bucket list look like? Have you even stopped to think about that? Is it travel, a new hobby, visiting the kids and grandkids, winter in Florida, hiking the mountain ranges of the US, or mastering the art of cooking? If we don't think about what we really want to do when we finally have the time and money to do it, we won't be ready mentally to get started. It may also mean we did not plan for it financially.

For many people this concept is very hard to get their arms wrapped around. The same skill set they have developed over the years building successful careers and businesses can be applied to plan their retirement. Setting goals, planning for these goals, then executing the plan.

Question: What are some of the other benefits of preparing a financial plan?

PJ: I think our clients that are willing to go through the financial planning process are also the same clients that fully utilize all the services that we can offer. Most of our clients initially come to work with us because they want to invest money in the financial markets, and that of course is a very important part of what we do. However, Tony, Mike and I have a tremendous amount of experience that can be very valuable separate from the management of money.

We have helped clients better understand their estate plans, explained the value of trusts to protect against long-term care needs, analyzed business buyouts and opportunities, evaluated the necessity and value of life insurance policies – on and on. I don't want to say we have seen it all over the years – but we have certainly seen a lot. For many of our clients, these are issues that arose during the process of planning. That process starts a dialog that goes well beyond the basics of investing. Through that process of engagement with clients, we learn a lot about what is important to them, in both a financial sense as well as their big-picture goals. Many times we end up drawing out those goals as most clients have rarely thought it all the way through. We like to say that we ask the right questions. Our hope is that through this interaction our clients get a chance to see firsthand the knowledge and experience we have built up over 50 years – and then take advantage of that knowledge for their own benefit.

One other area where I think planning has helped our clients is that it makes them think about their overall goals *before* making a choice that can have a long-term impact on their financial well-being. We are all presented periodically with so-called "opportunities" to make that investment that is "guaranteed" to succeed in the sales pitch. Our clients that are more engaged in planning services tend to be the ones that will ask our opinion *prior* to making one of those "investments" so that they can make the most informed decision. We find that the clients we are most frequently helping to untangle a bad investment decision are those that are *less* engaged in our process and therefore did not fully evaluate that "sure-fire investment" idea prior to making it! Trust me, it's far easier to avoid these traps in the first place than to escape from them after you are stuck.

Question: So you mean to say – let you look before I leap?

PJ: Yes. Bounce any of those ideas off us first and we will crunch the numbers for you. If we think the idea is a poor choice, we will be frank about it. If it looks like it actually **is** a great deal, we might just invest alongside you.

Question: What about estate planning?

PJ: With the new tax law there was a significant change to estate taxes at the federal level. Under the new law, a married couple today can have an estate worth over $20 million before paying *any* federal estate tax. However, I still firmly believe that estate planning is extremely important even if you will never have to pay the federal estate tax.

First, while this overhaul of the federal tax system is the first major overhaul since 1986, the estate tax rules have changed a lot! In 2001 the limit was $675,000. By 2009 it was $3.5 million. In 2010 there was **no** estate tax. NY Yankee owner George Steinbrenner shrewdly picked the "right" year to pass away saving his estate $600 million in taxes.[2] In 2011 the federal government set the level at $5 million, but that law was only valid for 2 years, before finally being made "permanent" a few years later…. Until 2018!

I give you this history to remind you that the estate tax is a political hot potato and is subject to change. Equally important is that many states do not automatically change their laws as quickly as the Federal government and there are often differences in the rules.

Some of the estate planning topics our clients wish to address are not tax related at all. Some worry about an inheritance that can be squandered. They may have a child that is financially irresponsible, or a child that has special needs. There are many factors separate from taxes that a client needs to consider when doing their estate plan.

Just like any other area of financial planning, the most important thing is to have an open discussion about your concerns and gather all of the information you need to make informed decisions.

Thanks PJ.

"If you don't know where you are going,
you'll end up someplace else."
— Yogi Berra

As always, please do not hesitate to call or email with any questions or comments. On behalf of Tony, PJ and the rest of The Morgia Group, thank you for your continued confidence.

Sincerely,

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