MORGIA
WEALTH MANAGEMENT
DISCIPLINED ◆ CAREFUL

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A Mulligan

Rarely do stock investors get the equivalent of the golfer's mulligan - a do over. But once in a while...

I have often joked that the best way to test a client's *actual* risk-tolerance level, would be to call them up, pretend that the stock market just crashed, and see how they react. You see, during calm stock market periods, clients might *think* and *say* that they can tolerate much greater downside than they actually *can* tolerate. That makes the normal method of assessing a client's risk profile pretty much worthless. The financial industry loves their check boxes. So, just pick one. Are you: *low risk, moderate risk,* or *aggressive*. That's all it takes. So simple. So useless. Not until a real problem or crisis hits will they actually know if they chose correctly. My "feigned" crash-test would work a whole lot better, as it would stimulate the proper emotional response and we could verify if the client's stated fortitude matched their true fortitude. But alas, that could very well lead to client heart issues and/or lawsuits – so we reluctantly decided against such a helpful exercise.

Lucky for us, the market created the next best thing: A real, but very temporary, steep loss on stocks. From last October 3rd until Christmas Eve, stocks dropped about 20%, promptly turned on a dime, and then climbed straight back up to the old highs by April and are currently sitting right around that level today. Such a rapid recovery is by no means the norm, as it usually takes a lot longer for the market to heal from such a hit. It seems to me that there is absolutely NO sense in wasting the resulting angst from that round-trip, and that we might as well get some kind of compensation or benefit for all of our mild pain and suffering. In actuality, we have been given a golden opportunity to actually *feel* whether or not we have set our risk tolerances correctly. Was our stock to bond to cash to gold ratio where it should have been?

How did you feel last Christmas Eve - besides festive? Specifically, how did you feel when stocks bottomed out after dropping 20%? Did you notice? Those December 31st statements were not bringing much holiday cheer.

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Were you thinking:

"$#!#, I should have trimmed some of my stock positions" and "What if this gets worse?" and "Oh no, not this again!".

Or were you just enjoying the thrill of it all, like a fun roller-coaster ride without a care in the world... Wheeeeeeee!

Hopefully you were somewhere in the middle - comfortable in the knowledge that you had set your stock exposure to the appropriate level for your unique financial situation.

Be honest! Where did you fall on that spectrum? Ok, now imagine that the drop had been twice as bad. That would come near (yet not quite match) the 2008 hit. Remember: How you act under market stress MUST be baked into your overall strategy! What good is even the hypothetical best of investment plans if you can't make it through the next downdraft without bailing out in fear somewhere near the bottom? Some otherwise valid investment methods must be dismissed, for this very reason.

This is why we emphasize risk-control, as our main, overarching strategy for clients. So, think back a few months and be thankful that you now have a rare opportunity at a do-over. If all went smoothly, and you did not lose any sleep, then leave well enough alone. Overwise give us a call and reposition your asset mix and targets to a lower volatility level.

For many investors, panic seemed close at hand 6 months ago - very close at hand. Then, as has been typical over the last few years, the Federal Reserve stepped in to save the day, with Chairman Powell stating that he would be in no hurry to raise interest rates.[1] Stock investors rejoiced, and we were back off to the races. Of course, we understand that these rapid up and down moves can be quite disconcerting. However, if you want to be a stock investor over your lifetime (and you should), you will need to decide just how you are going to deal with these occasional storms – ***before*** they actually strike.

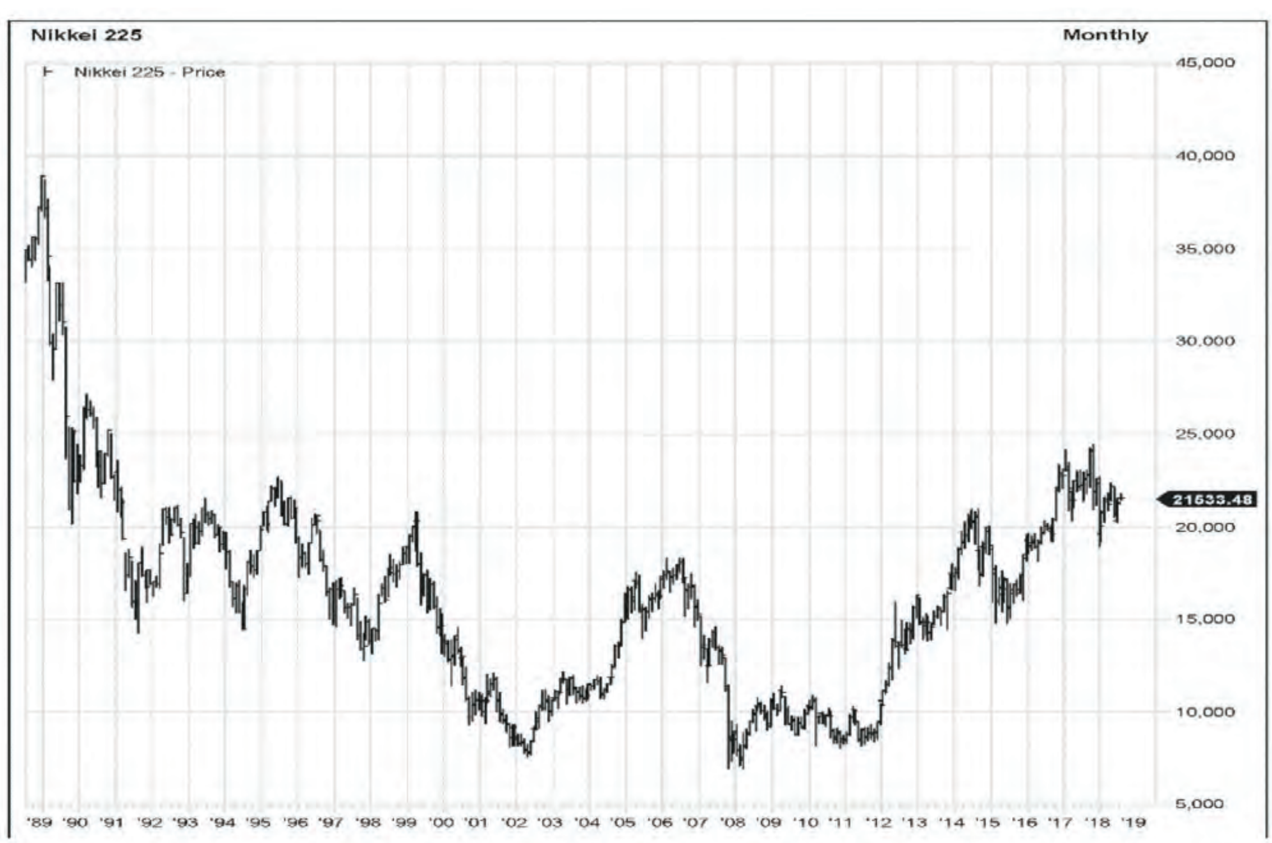
Step one is to get your stock allocation in the proper proportion. But, even if you do that, we still believe that there are times when you *should* step aside to some degree; sell down some of your stock holdings and wait in cash for the storm to pass. We have used this tactic for over 50 years.

But what about the long-run?? Aren't we supposed to just buy and hold over the long-run?

Well... yes and no.

Yes, in the sense that long-term participation in the stock market has paid off quite handsomely over most historical timeframes. And yes, the magic of compounding that we so often speak about, necessitates a long lead time. BUT… Not all markets are the same. Twice in my lifetime, there have been long stretches of time (think a decade and a half) where the stock market flatlined. And what about the 1929 crash, where it took 25 years to get back to even. Or worse, the 36-year stretch from 1906 until 1942 when stocks ended right where they started. Let us suppose that 36 years from today, the stock market is still at today's price or lower. Now further imagine that at such a time, we call you up (assuming phones still exist) and implore you to relax, have some more patience, and think longer-term. How well would that go over? Hmmm?

I could even give you worse examples by going back to the 1800's when the US stock market was capped for *60* years! Or more recently, if we look overseas at Japan, whose stock market is about half the price today as it was 30 years ago in 1989.



Japanese Stock Market "Nikkei 225" 1989 to 2019 *Source: FactSet*

You get the point. We don't feel like waiting around multiple decades should stocks decide to misbehave in a major way. With somewhat of a trader's mindset (I said *somewhat*), we may be able to mitigate that type of stagnation and actually profit. That would not work with a strict buy-and-hold mentality. In my Japanese example above, there were many fantastic intermediate term (think 3-4 year) upswings over the last 30 years, in spite of the overall stagnation. **By the way**, we are NOT predicting this type of market. But should one arise, we need a pre-determined plan – one that doesn't start with "I hope…".

Historically, during major stock market drops, it doesn't help much trying to pick the right *type* of stock to buy. It is usually much better to step aside temporarily and wait it out.
But what if you bought cheap stocks? – it didn't matter you still got beat up.
But what if you bought very low debt stocks? – it didn't matter.
But what about stocks of companies that sold necessities, like food? - you still got hurt.
But what about conservative utility stocks? - nice try, but no, you still suffered.

For this reason, we have a practice of raising cash in our stock accounts from time to time for defensive purposes. With this cash, should stocks fall, we will have the opportunity to pick up some real bargains. **However**, correctly deciding when to do this "cash raising" is anything but easy and the exercise is fraught with problems. But there it is… if you stay fully invested through disaster type markets, your portfolio will suffer… a lot.

You might ask: But if we get nervous, why not just sell everything and wait on the sideline until the storm passes? Good question. The simple answer is that we don't think anyone is that smart (ourselves included).

Any investor who wishes to use the "sometimes-defensive-by-selling-down-stocks-and-holding-more-cash" strategy, must also contend with what we call the **train and the station problem.**

Even if you pick the perfect time to sell… you need to figure out when to buy back in. That's no small task! If you are sitting at the train station and the train is **leaving** you must board it at some point, or it will head off without you. A few years ago, we had a client who decided that he did not like the way stocks were acting and decided to hold back on the new investment he was making – to leave his money in cash temporarily until the world situation clarified itself. My question to him was simply:

"How far from the station will you let the train go before you decide to jump on? Will you let the market go up 20% before you decide that you were wrong to wait?"

"Oh no…" he said "Definitely not that far"

"Pick a number" I said.

"If the stock market goes up 5% from here, you call me, and I will put that money to work and admit defeat" he laughed.

Don't get me wrong – we *never* pressure clients to invest, but I knew he wanted to buy, and that he was just trying to get the timing right. I just felt compelled to warn him about human nature. Once an investor anchors their mind on the current price, they have a hard time buying at a higher price later. I have been there and done that myself. Sure enough, the market jumped 5% over the following two months and I called him back. No surprise, he said:

"Ahh! I should have just gone ahead a few months ago. Now the market is even higher! Let's just wait a little bit longer and see if it comes back down to where we started."

You can see where this is going. The market *never* came back down to that level and that money is still sitting in cash. The train has totally left the station and the market is now more than 100% higher after multiple *years*! This is why *any* attempt at defensive cash-raising strategies **must** be accompanied by two things. The first is the ability to quickly admit when you are wrong; carefully choose that point ahead of time. The second is the ability to accept paying a higher price when you *are* wrong. If you can't stomach both, then don't try this at home.

The Monster Under the Bed:

Losing money, even temporarily, is high on the list of stressful situations. Our friends and family in the military and law enforcement must deal with the greatest of stressors – immediate threat to life. The second worst stress comes from family health issues. Third place, undoubtably goes to financial distress. Also, money problems tend to bleed over into other areas of life, having ill effects on one's health, marriage, and family matters.

Ever since the Great Recession of 2008, we have noticed that many, if not most, investors who lived through that turmoil have yet to rid themselves of its effects. A sort of post financial crisis stress syndrome seems to be afoot. This is not new. Think back to some of the stories of your older relatives who lived through the Great Depression. An entire generation swore-off stock investing for life and resigned themselves to pinching pennies instead. They ventured only as far as their local bank's FDIC insured accounts to "invest" their money. And their idea of diversification was a mixture of savings, checking, and cash in hand.

Our generation was much more fortunate (so far), as the 2008 financial crisis was stopped from becoming a full-blown depression by fast acting, cash printing, central bankers. But the emotional damage was done by that point and many investors will carry the effects with them for the rest of their investment life, like it or not. Subsequent to that crash, investors now seem to live with a mild, but persistent unease and paranoia when it comes to their view of the stock market. *Once bitten*, as they say. It's hard to shake the feeling that something is amiss, that some financial calamity could spring to life at any moment – that there is a monster under the bed! Perhaps even one bigger and meaner than in 2008. This condition manifests as a general worry that something bad lies in-wait to gobble up your hard-earned, and hard-saved money. I admit, once in a while, I too find myself peaking over my financial shoulder.

Truth be told however, we actually don't think there is a monster under the bed.

We think there are a whole *bunch* of them! And probably a few more in the closet as well. The real question is just how long they stay dormant. But this is nothing new for investors. The market must A L W A Y S contend with these monsters. Stocks have made it through two World Wars, oil embargos, political turmoil, and even "great" depressions (one in the 1800s, one in the 1930s). So, don't overly despair (mild despair is always better). Furthermore, and ironically, the market is usually much safer when there are large herds of worriers roaming throughout the investment landscape, such as we have now. There is even an old saying about it: *The market climbs a wall of worry.* This simply means that if no one is worried, all the potential stock buyers will have already bought, leaving only sellers.

The rising stock market also begs some questions: Why isn't the market falling? Why are we hitting new highs? Perhaps it's because the economy, despite some rumblings, is doing pretty well. Perhaps falling interest rates will give stocks a further push like they often do. Wall Street has a couple more sayings: *Don't fight the tape* and *Don't fight the Fed*. Today's worries are fighting both.

Alright, enough of all that positivity, here are some of the monsters we see currently sleeping under your bed; under *all* of our beds:

The world debt load.
The perpetual budget deficit.
The "free" stuff era.
Student loan debt.
The financial inequality gap widening.
Automation of many jobs.
Underfunded pension liabilities.
Falling interest rates seem to be forecasting a big economic slowdown.
Economically sensitive stocks are looking like dead canaries in a coal mine.
Take your pick.

Again, these kinds of problems are nothing new and the stock market has dealt with their ilk for its entire history. Oh, and it has climbed straight through in spite of them. Ok… so maybe not straight through but through nonetheless. So, what do we do? Firstly, as we spoke about above, raising cash when stock prices start to break down is our first go-to tactic. The beauty of that strategy is that it doesn't matter *why* a stock price is breaking down (falling), it just matters that it IS breaking down. Next, perhaps we should contend with only the monsters that might be awakening; deal with problems that have a higher likelihood of striking sooner, as opposed to wasting time on every *possible* problem.

At Morgia Wealth Management, we have a 50-year tradition of trying to predict the "Big Mistake" for each decade (the awakening monsters). Almost fourteen years ago, in January of 2006, (a couple years before the financial crisis hit) we wrote:

…we are leaning towards a prediction that certain housing prices could win the distinction of being the "big mistake" of the 2000s … many buyers are only purchasing in order to "flip" or sell out quickly, and hopefully at a higher price to the next buyer. That's also known as the "Greater Fool Theory."

We followed that up one year later in 2007 (one year prior to the financial crisis), with a worry on excessive risk-taking in general:

Nowadays, investors seem to be shunning conservative companies and embracing risk – risky companies, risky emerging markets, and risky bonds … Why… The only reason I can think of is that the investing public has determined that risk is not a factor. I think they are wrong.

Then came the 2008 crash and the higher risk-taking investors had their come-to-Jesus moment. Where once there was euphoria, there was now panic. Those investors who were caught flat footed learned a costly lesson, but it was the *wrong* lesson that they learned. They *thought* they had learned that stocks are dangerous, and that you need to be paranoid for the rest of your investment career. What they *should have* learned was that if you buy overvalued things, there is a strong likelihood that you will suffer! Oh… they also *should have* learned that if you buy overvalued things with borrowed money, you will suffer exponentially.

But that suffering, and paranoia set up the perfect environment for this past decade's wonderful bull market. Many were too shell shocked to fully participate however.

Five years ago, we tried to sum up the implications of this "overly-pessimistic" attitude that was (and still is) overhanging Wall Street. In our July 2014 Update we wrote:

…we thought it would be wise to start looking for any sign of … the next Big Mistake…

That's just the problem today. It seems much harder to spot potential dangers, as markets seem so relatively peaceful. Which got us thinking: ...Normalcy may be the new oddity. And "no surprises" could wind up being the next surprise.

And so, it was. We now sit a mere six months away from this decade's end point; six months away from our prediction turning out to be correct. So please, no one make any sudden financial moves! Why did we think that worrying about big mistakes might just be the big mistake over the last ten years? The wall of worry, that is why. This has been the most un-loved bull market of my lifetime. And that usually means that it's not over just yet. Don't forget that the last two major bull markets went about 20 years each, albeit with some rough patches along the way.

Regrettably, it is highly improbable that the upcoming new decade will pass without a few monster sightings. We *will* have a "big mistake" prediction for the 2020's. It's a little early for us to make that call, but we are currently watching something that has our undivided attention. It's a bit less grandiose than the items on our monster list, but almost as dangerous, at least from an investor's standpoint.

In the never-ending battle for stock market domination, the growth-stock vs value-stock situation is getting interesting. Growth stocks are on an unprecedented 13-year run, and it's getting a little too easy to make money in that space. "Easy" is not a term typical of the stock market. So, when we spot something that appears to be a no-brainer, alarm bells start ringing. Too often it is merely sucker-bait in disguise.

Our main worry with this growth-stock field day is that the prices of a handful of these darlings are hitting some very high levels, at the exact same time that investors are headed towards them like moths to a flame. They are also abandoning most other types of stocks, from foreign shares to all kinds of value stocks. There are presently some true bargains to be found. Normally we would be salivating (all right, we *are* salivating) viewing so many bargains. It's just that IF the growth stocks end up taking a decent sized hit and the tide shifts back to value – there will be a lot of disaffected investors. These investors, if spooked, could possibly cause an overall market to drop if they rush for the exits simultaneously.

Back on August 11, 2006, at the very **dawn** of this epic growth run, you couldn't **give** these same stocks away. To shine a light on the stark contrast between today's feeding frenzy and that year's repulsion, we offer our words from July 2006, exactly one month before this growth stock boom began.

But over the last few years an interesting thing has happened. There has been a mass exodus of investors from the large, high quality growth stocks... We find ourselves moving a bit in the other direction. We are trimming some of the value stocks, and buying some of the out-of-fashion large growth stocks and blue chips...

If in a few years these moves work out, I'm sure we will see the crowd heading back to growth stocks. That will be our cue to sell.

So. Now we have our cue. But Mom! I don't want to leave the party!

It is extremely difficult to start backing away from the investments that did the best for you over the past 10 years or so. It's equally hard to imagine a different environment with different winners and different losers. The human brain likes to anchor on present conditions and extrapolate current trends out to infinity. It does NOT like change.

Who knows, maybe it will be different this time. Maybe growth stocks will shine brighter for the rest of our investment lifetime. Anything is possible, and perhaps we can explore why some are forecasting just such an occurrence in a future update.

But…it has been often said, perhaps most famously by the great investor Sir John Templeton, that the four most expensive words in the English language are:

This time it's different.

Sir John Templeton

Introducing "Share the Wealth"

Some of you have asked us for more communication in between our Semi-Annual Updates. **Share the Wealth** is our attempt to offer some insight as to what is currently capturing our attention. Every few months we will record a conversation on topics du jour. We have also produced a handful of educational videos called Morgia 101. These will live on our website **morgiawm.com**. If you want us to email you these videos as they come out, just let us know. Lastly, please feel free to check us out on some of our additional platforms:

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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,

Michael Morgia, CIMA®
Managing Director, Partner

Tony Morgia
Managing Director, Partner

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

Back Row: Frank Murphy, Katrina Thompson, Mike Morgia, Heather Clement, Tony Morgia, Andrea Fiorentino, Anthony Surber
Front Row: Nico Morgia, PJ Banazek, Joe Cosmo, Shane Simser, Zachary Buskey

1. CNBC, January 4, 2019, Fed Chief Powell gave the markets the message they wanted, Patti Domm.