Second Quarter Report 2020

LUCIEN, STIRLING & GRAY ADVISORY GROUP℠

"Smart Decisions About Serious Money"

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A Message From The President

Thomas G. Twombly

I identify as a "grim optimist." I don't recall when I first heard that term used, but it instantly struck me as a perfect descriptor for my general approach to life.

Readers of these missives know that one of the investment principles I espouse is a hard-nosed faith, grounded in historical fact, that no matter how challenging things might be at any given point, they will eventually get better. Honestly, I don't believe one can make a successful long-term investor (in anything) out of someone who doesn't hew to that belief. Whether one is leading a business, raising a family, or diligently investing precious capital to fund a multi-decade retirement, if we're unable to retain that gritty faith through thick and thin, I think it's impossible to maintain the discipline necessary to keep doing the right things, or to retain the patience required to avoid doing the *wrong* things—especially during periods when those very principles themselves appear to be threatened.

Grim optimism is an especially important character trait to exercise in the present environment. The alternatives, either outright despair, or worse, brash overconfidence, are potential recipes for disaster; the first because of its debilitating mental health aspects and because it just doesn't square with the long arc of human history; the second because blithe overconfidence can result in the most debilitating and destructive setbacks of all.

Lately I've been rereading ***Good To Great[1]***, a book by Jim Collins that I bought shortly after it was published back in 2001. I've been struck recently by the brash assurance I've seen displayed by certain groups of people, whether it's neophyte day-traders eagerly buying shares of bankrupt companies on Robinhood, or outspoken politicians promising their constituents we'll have a COVID-19 vaccine by fall, and I wanted to revisit a lesson that has stuck with me since I first read it. Collins referred to it as "The Stockdale Paradox", a term he coined after extended interviews with Admiral Jim Stockdale, the "highest-ranking United States military officer in the 'Hanoi Hilton' prisoner of war camp during the Vietnam War."

Stockdale, as Collins wrote, was imprisoned from 1965-1973. He was brutally tortured over 20 times during that eight-year timeframe and suffered permanent impairment as a result. He eventually "became the first three-star officer in the history of the navy to wear both aviator wings and the Congressional Medal of Honor." He is credited with leading many of his fellow prisoners through what can only be imagined as hell on earth, where they lived with no rights, no release date, regular and brutal torture and no certainty they'd survive ever to see their families again. Sadly, plenty didn't. When Collins asked him *"who didn't make it out?"*

he replied *"Oh, that's easy…The optimists…they were the ones who said: 'we're going to be out by Christmas'…then they'd say 'we're going to be out by Easter'…and then Thanksgiving, and then it would be Christmas again…they died of a broken heart."*

To survive and eventually to thrive in adverse environments, Stockdale maintained, requires, ***"a very important lesson. You must never confuse faith that you will prevail in the end—which you can never afford to lose—with the discipline to confront the most brutal facts of your current reality, whatever they might be."***

People all over this country are feeling a massive sense of adversity now. We are going through a seismic shift, and we're all being challenged to deal with a reality full of volatility, uncertainty, complexity and ambiguity that offers no simple solutions and no guarantees. None of us can know for sure exactly how things will play out. In addition to a pandemic, we are groping our way through a highly volatile social, political and financial environment characterized by suspicion, deep mistrust and an angry and reflexive oppositional defiance towards "the other side." It's not the time for brash overconfidence. Neither, however, is it the time for despair. We should all be taking deliberate steps now to steel ourselves and to bolster our emotional resolve. Examples of grit, determination and eventual triumph help.

Twelve years ago, in the very early stages of what we would all eventually come to know as The Great Recession—a massive and terrifying economic collapse whose social and political after-effects still resonate today—I was inflicted with a devastating personal injury. Worse, it was completely intentional.

While playing soccer, the opposing goalkeeper "took me out" on purpose. He slid, cleats-up, at full bore—Ty Cobb style—into the knee of my right leg, which was planted firmly into the turf. My reality changed instantly. My tibia fractured vertically up into the joint. My anterior cruciate ligament (ACL) avulsed. My posterior cruciate ligament and medial collateral ligament were later described by my surgeon as 3+ tears—the worst they could be without being fully detached. There were four tears in my meniscus. After a five-hour surgery the following week, the prognosis was that I would never run again. I would probably never walk normally again. And I had a 90% probability of requiring a full artificial knee-replacement within five years. Those were especially brutal facts for me to face, but as I hit the ground after that vicious and illegal tackle, it was Stockdale's words I was thinking about first.

Simultaneously, from a corporate perspective, we were starting to face the worst financial collapse since the Great Depression. In the ensuing months, major equity markets fell -57% from peak to trough. The entire global banking system teetered under the weight of millions of fraudulent loans. Everyone's sense of well-being was at risk. Our clients were experiencing financial duress. Our own livelihoods and futures were gravely threatened. Bernie Madoff became a household name and a global pariah. You know the story. This fear and anxiety continued for years. The faith that we as a team, or I personally, could prevail in the end in the face of those fearsome realities was not an easy belief to muster.

Somehow, we dug deep and found it. We didn't give up as a team. And our clients certainly didn't give up on us. In fact, four years later we took deliberate inventory and we found that more than 97% of the treasured folks who had been on our client list in June of 2007 remained loyal clients in June of 2012. Our firm grew stronger for the experience, and many of you are still valued clients to this very day.

I didn't give up personally either. I couldn't *afford* to lose faith. I was fortunate to have a brilliant surgeon, let there be no doubt. I was also blessed to have a tough, demanding and deeply committed physical therapist whom I fondly nicknamed "The Princess of Pain." The odds were hard against us, but with their help I resolved immediately to give my recovery every last ounce of commitment possible.

Twelve years later, I can run. I walk quite normally too. I ride a bike hard and I hike long distances over rugged terrain as often as I can get out in the wilderness. I have climbed Mt. Wheeler, the

[1]*Good to Great, Copyright 2001 by Jim Collins (pages 83-85) HarperCollins Publishers Inc.*

highest peak in New Mexico at 13,161 feet above sea level, *twice* since then. I still have all my original parts (plus three titanium screws in my right tibia) and the only knee that occasionally hurts is the left one.

So, keep the faith! In my experience, grim optimism works. We will get through this together too.

Thank you again for your confidence and trust.

Thomas G. Twombly
President

Investment Commentary

There is one big lesson to be drawn from everything we've experienced during the first half of 2020. That's the conclusion that the short to intermediate term direction of both financial markets and the economy are completely, utterly unknowable. Predictability, certainly in the short run, is an illusion.

This shouldn't come as a surprise. It's a belief we've shared for years and it's why we stress careful preparation, a devout long-range view and broad asset class diversification in the management of investment decisions over the siren's songs of short-term timing and selection. But every so often the entire investing world gets an especially stark reminder of the futility of relying on (or even paying attention to) the myriad short-term economic prognostications to which we're subjected every day.

With one after another occurrence that has legitimately qualified as "unprecedented," the last two quarters have provided a great illustration of the pithy wisdom behind the quote from John Kenneth Galbraith, the famous economist and one-time UT professor, who said: "the only function of economic forecasting is to make astrology look respectable."

On February 19, a short month and a half into the year and on the heels of a very strong performance for calendar year 2019, the Standard & Poor's 500 Stock Index reached an all-time high of 3,386. Then, with nary an apparent cloud on the economic horizon at that point, over the course of the next 16 weeks we were treated to what can justifiably be described as the wildest and most mind-blowing ride in history. Nobody predicted it, and none of us now should feel any assurance that it is over yet. It's both humbling and disconcerting on one hand, and galvanizing of our philosophy on the other.

In just 16 days, seized by the terrifying specter of a global contagion that seemed to come out of nowhere and spread like wildfire, the index of the 500 largest and most powerful businesses in the United States suddenly plunged from that all-time record high to a bear market, defined as -20%, in the shortest such transition period in history. The speed and breadth of that drop alone was breathtaking, but it wasn't over. By Monday March 23, a short 17 days after that, and a mere 33 days from the original peak, the index closed at 2237, a full -34% lower than it had been barely a month prior. This too was an unprecedented occurrence in the history of U.S. financial markets.

The response, from individuals, businesses and governments alike, was also unprecedented. On March 27th the CARES Act was signed into law, creating a $2.3 Trillion-dollar stimulus package that dwarfed the economic stimulus of the Great Recession of 2009 by a factor of more than 300%. Alongside that, according to Federal Reserve data, between January of 2020 and July of 2020, total deposits at commercial banks increased from $13.26 Trillion to $15.6 Trillion, as individuals and businesses stockpiled cash at a rate that was triple any other previous six-month period on record—ever.

And equity markets proceeded to experience their most explosive rebound in history. Who could have known?

This is why we will continue to structure investment policy around the following things: understanding our clients most precious and longest-term goals, and then aligning their investment portfolios, and the various asset mixes they contain, with consistent behavioral coaching and a firm grasp of the full arc of human history and the long-term persistence of progress. For all the evident faults and frustrations with that approach, and for all the patience, discipline and tolerance for ambiguity that requires, there's no other intelligent way to go about it.

General Market Results

	2nd Quarter	YTD	One Year	Three Year	Five Year	Ten Year
Barclays Agg Bond	2.90	6.14	8.74	5.32	4.30	3.82
S&P 500	20.54	-3.08	7.51	10.73	10.73	13.99
DJI	18.51	-8.43	-0.54	9.08	10.62	12.99
S&P 400	24.07	-12.78	-6.70	2.39	5.22	11.34
Russell 2000	25.42	-12.98	-6.63	2.01	4.29	10.50
NASDAQ	30.95	12.67	26.94	19.14	16.36	18.25
MSCI EAFE	14.88	-11.34	-5.13	0.81	2.05	5.73
MSCI EM	18.08	-9.78	-3.39	1.90	2.86	3.27

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