Third Quarter Report 2020

LUCIEN, STIRLING & GRAY ADVISORY GROUP℠

"Smart Decisions About Serious Money"

Meet our Team

Thomas Twombly
President

Mark Ward, CFP®, ChFC®
VP, Operations and Chairman, IPC

Chris Vasquez
Advisor Associate

Raymond Krisanda
Bookkeeper

Daisy Lopez
Staff Accountant

Shelby Holt
Client Services Specialist

Diane Hunley
Receptionist

Donna Geery
Goddess of Files

Contact Us

512-458-2517

info@lsggroup.com

www.lsggroup.com

7800 N Mopac Expressway
Suite 340
Austin, Texas 78759

A Message From The President

Thomas G. Twombly

Greetings, I hope this finds you well.

As I write this on Halloween, much of our country is in a state of deep anxiety. In addition to the long, drawn-out disruption to all our lives from the confounded sickness that consumes so much of our attention, we're facing social, financial and economic uncertainty that will surely continue for quite some time. Many of us are also experiencing a prolonged, painful separation from family, friends, and trusted colleagues that is entirely unnatural and unnerving for the human species. We *need* close contact with others to function normally, and we're not getting it. It's taking a heavy toll.

Everywhere around us we can *feel* the loosening of social bonds we've always relied upon. In some cases, they're breaking altogether after a great many years of trusting in their strength. As if that weren't enough, in a couple of short days we're facing an election – and the anger, hatred and vitriol that has become so normalized in recent years is reaching fever pitch, threatening to shatter even more of those bonds. The tension is palpable. None of us can escape it.

Anxiety is a part of life. Most of us have learned to deal with it as a normal component of our daily routine. But in periods of heightened anxiety like this one, it threatens to distort our decision-making. Under intense pressure, the human central nervous system is programmed to stimulate our adrenal system, triggering the release of catecholamines like adrenaline and noradrenaline, which provoke our "fight or flight" response. This physiological trigger exists for the sole purpose of focusing our minds on the immediate sense of danger, compelling us to take urgent, explosive action. It's hard-wired into our DNA over millions of years, and it's a powerful force. Think about it for a minute, we are *not* descended from ancient ancestors who were slow in their reaction time to predators and threats.

In the modern world, though, this ancient and critical survival tool can be horribly destructive to long-range strategic plans if left unchecked. The "tunnel vision" we're prone to–where we can literally experience our peripheral vision closing down when we're under threat–can result in a failure to recognize the full range of consequences to our actions. Overwrought, we're prone to leap before we look.

Resisting that urge takes discipline, and a determined effort to focus your vision and drive, figuratively speaking, with an eye towards the point *in the far distance* where the lines on either side of the highway converge, and not to get overly fixated on the little dots screaming past you just outside the driver's side window.

In our emailed letter to clients on March 20th, a Friday that ultimately proved to be just one trading day shy of the gut-wrenching Monday marking the ultimate bottom of the historic -34%, 33-day plunge in the S&P 500 earlier this year, I wrote about *how* to think, instead of what to think. I also highlighted the ancient wisdom reflected in the written Chinese word for "crisis"–that alongside danger there is always *opportunity* if you can just see it. I advocated for training our eyes on the long view on the other side of this crisis, while also taking deliberate action to address any immediate vulnerabilities. The circumstances today are different, but the exact same guiding principles apply. If you're interested, I'd encourage you to revisit that letter. You can find it at: lsggroup.com/our-response/.

We cannot ever know what the economy and the markets are going to do next. The short-to-intermediate term course of both has always been unknowable; it's just that in times like these, that reality is brought into much sharper focus. That realization makes us feel anxious.

On the other hand, if we can keep our eyes high and scan the far horizon, we can have a surprisingly good idea of what they will ultimately do, in concept if not in the specific. And it's for those ultimate outcomes, *years and decades from now*, that serious people are deliberately investing. Be one of those people.

As you already know, and as you'll see from the Investment Commentary that follows, this pandemic has done tremendous destruction to many parts of our economy, to many industries, to many companies and to many individuals. Without a doubt, we are witnessing a tragedy unfold for a great many people.

What it has not done, however, is to stop resilient, adaptable entrepreneurs from figuring out ways to address new opportunities, to fill the voids that have been created in this disruption, and to see what nobody else has ever seen before. It has not stopped, as Clifford Leaf, Editor in Chief of Fortune Magazine said in his October 2020 Foreword, "*innovation, or ingenuity, or the catalytic sense of optimism that so many problem-solvers bring to their day jobs. What the pandemic hasn't done is to stop creative, ambitious business leaders from figuring out ways to fix what's broken…*"

For all of its faults, and there are many, democratic capitalism is the only economic system ever created that allows individuals to invest their hard-earned money, on a very broad scale, into the indefatigable human desire to *be* more, to *do* something unique, and to create something lasting. That, too, is an incredibly powerful force–and it's sustainable for a much longer time.

Don't lose sight of that. And please call us if you'd like to discuss your personal situation.

Thank you again for your confidence and trust.

Thomas G. Twombly
President

Investment Commentary

As we look out over the economic and investment environment as we enter the fourth quarter of 2020, we're struck by just how conflicted the traditional indicators of a so-called "healthy economy" are. We're also struck by how different the overall conditions are to anything any of us has ever experienced. We don't have a mental map for this terrain (and neither does anyone else, for that matter) because it's impossible to compare it, in any cohesive way, to any experience we've had before.

There is no question in anybody's mind that we've experienced a sharp economic downturn. We're in a recession that to this point has knocked about -10.1% off our GDP. And yet the U.S. stock market closed out the month of September at a level of 3,363–a barely-noticeable 23 points shy of the record high of 3,386 it had set in mid-February, just before this downturn began. 22 million people lost their jobs in the United States in the first few months of this crisis. Only 11.2 million of those jobs have been regained to this point, and an additional 4.5 million people have left the job market entirely. Yet household net worth In the United States just set another all-time record. According the Department of Housing and Urban Development, 17% of FHA-insured mortgages throughout the country were delinquent in July. In New York City, that figure was 27.2%. And yet according to estimates from J.P. Morgan, household debt service ratios (the percentage of overall household income required to cover payments on outstanding debt) dropped to a new low of 9.4%–far lower than the record high of 13.2% set in the final quarter of 2007, and by far the lowest this ratio has ever been since 1980.

This Dickensian "best-of-times, worst-of-times" environment is evident in the performance of the various sectors and industries that make up the index of the largest companies in the United States, too. The stocks of Energy companies have plunged by -48% so far this year, while On-line Retailers have soared by +60%. Airline stocks have dropped by -46% while Home Improvement companies have risen by +33%. Hotels, Restaurants and Cruise Lines have declined by -45% while Information Technology companies have jumped by +29%. And Retail Real Estate Investment Trusts have slid by -41%, while Grocery suppliers have sprouted by +20%–to name just a few of the more obvious contrasts.

Year over year economic activity has shown similar diversions, indicating vastly different behaviors within the overall populace. After an initial -35% decline in the first quarter of the year, new mortgage applications have now risen by +22% compared to last year, reflecting a robust and growing demand for single-family housing in an environment supported by historically low interest rates and perhaps driven by people leaving inner cities and moving to the suburbs or the countryside. Overall consumer debit/credit transactions also plunged by -37% in the early stages of the shut-down. But they have since rebounded to a level that's now a mere 4% below that of 2019. On the other hand, traveler traffic as measured by the Transportation Security Administration, which fell by a massive -96% in the March and April period, has experienced an extremely anemic rebound and currently sits a full -70% below the level of last year. The vast disparity between those people, companies and industries who have done well in this economic environment, and those who have not, has led many to describe it, understandably, as a "K-shaped" recovery–with the upper arm on the incline, and the lower arm on the decline.

Whether or not this recovery broadens out and continues in the near term, however, is highly dependent on at least two factors that are subject to a great deal of ambiguity at this point. One of those factors is progress against the disease that has triggered this pandemic. The other is a continuation of the fiscal stimulus that has provided so much economic support in the interim.

Unfortunately, the prospects for the latter are hampered by bitter political divisions and an upcoming election in which neither party is willing to give ground. And the reality is that even if our political leaders were eventually to reach such an agreement, there will likely be a high price to be paid in the long run–whether that's higher tax rates, lower entitlement spending, greater risk of inflation, rising interest rates, a declining U.S. dollar, or a combination of all of these, and more.

And as to the former, while the outlook apparently is promising for a medical solution in the long run–with 11 potential vaccines in stage-three trials right now–even under an optimistic scenario it will surely take a great deal longer to administer a final version to a broad percentage of the global population. The key in the short-term, therefore, is the anticipated behavior of individuals, and whether we will see healthy behavior within the broad population that will help to quell the spread of the disease this fall. Unfortunately, current trends suggest perhaps we haven't accepted that reality, or the importance of curbing our individual impulses in favor of principled, broad-scale discipline.

Facing this environment, and with U.S. equity market valuations now back near historically high levels after the sharp plunge and equally sharp rebound we've witnessed, it's hard to regard this as a time to be assertively adding to U.S. stock holdings. At the same time, with record high levels of cash currently held by many individuals and institutions alike, but with interest rates on cash holdings at close to zero; yields on 10-year Treasury bonds at .69% and 30-year Treasury bonds at 1.46%, but with inflation currently running at 1.73%; neither does it seem wise to maintain a strong overweight allocation to cash and high-grade bonds–especially for long-term investment portfolios.

If we were to see an unexpected increase in inflation, or a sudden weakening in the U.S. dollar that might indicate a decreasing trust among foreign investors in U.S. assets and foreign lenders to our government, we could see a substantial exodus of assets from fixed-income holdings. Since the bond market as a whole is many, many times the size of the equity market, such a broad-scale reallocation would lead to a great deal of volatility in all assets classes in the short-term, but perhaps also a lot of long-term buying pressure in equities as a whole, and particularly in those with large non-U.S. revenue streams.

Investing is never about absolute choices. It's always about comparative choices–where one tries to weigh the potential risks and rewards of one asset class against the potential risks and rewards of others in an effort to construct a disciplined, patient, long-term portfolio designed to meet your needs, and comprised of a full range of thoughtfully-allocated holdings–because one *never* knows for sure.

Having carefully made this circuit, we find ourselves coming back more confidently to where we started, with slightly elevated cash levels in most of our allocations, fixed-income holdings more heavily weighted to shorter-term, high-quality positions, and with longer term holdings still stalwartly invested in broadly-diversified equity holdings, a not insubstantial portion of which is in great businesses either domiciled or focused outside the United States.

General Market Results

	2nd Quarter	YTD	One Year	Three Year	Five Year	Ten Year
Barclays Agg Bond	0.62	6.79	6.98	5.24	4.18	3.64
S&P 500	8.93	5.57	15.15	12.28	14.15	13.74
DJI	8.22	-0.91	5.70	9.98	14.02	12.69
S&P 400	4.77	-8.62	-2.16	2.90	8.11	10.49
Russell 2000	4.93	-8.69	0.39	1.77	8.00	9.85
NASDAQ	11.24	25.33	40.96	21.05	20.63	18.12
MSCI EAFE	4.80	-7.09	0.49	0.62	5.26	4.62
MSCI EM	9.56	-1.16	10.54	2.42	8.97	2.50

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7800 N Mopac Expy Suite 340 | Austin, Texas 78759
Phone: 512-458-2517 | Fax: 512-458-3120
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