March 2020
Market Commentary

"Everyone has a plan... until they get punched in the face" – Mike Tyson

No truer words were ever spoken by "Iron" Mike Tyson, the former Heavy Weight Champion of the World. The punch in the face to the economy and financial markets has been delivered by none other than the term of 2020 – "Covid-19". In my 17-year career as a financial advisor I've never seen anything like this – a career that has seen SARS, MERS, H1N1, Swine Flu (Anyone else notice these are all starting in the same place?! – China). Never before have Govts. Mandated a shut down of commerce and daily life that have effectively caused a "Financial Heart Attack" to the global economy. The go-forward path has never been more uncertain – do we save the economy by trying to go back to work sooner, risking the possibility of a much higher death toll than we have at current?... or do we stay on lock down longer and risk a global depression like nothing seen since the 1930s, which eventually took a World War to get us back on a path of growth? These are difficult questions to answer and at a time when faith in our Govt. Leaders is not particularly high.

I will be the first one to admit I had no idea that a virus at the top of 2020 was going to be the pin that was removed from the grenade. However, I have written for AT LEAST the last 6 months that the global markets were complacent at best and over-valued at worst... a situation RIPE for some kind of shock to come along in 2020 to turn over the apple cart... and here we are. As Warren Buffet is prone to saying, "We find out who's swimming naked when the tide goes out". Let's review what we have done to try and either preserve capital or redistribute risk for our clients over the last year.

Gold

We added gold to our client portfolios between February and May of 2019. While stocks were the belle of the ball in 2019, Gold performed well last year – but more importantly it had generated positive returns here in 2020. We recently sold gold out of our client portfolios over the last two weeks – what?! why?! Mike are you an idiot?!... I guess we'll see! LOL – the thought process here, is that gold has done its job of preserving our client's capital and made them a profit at a time where stocks AND bonds are generally tanking. My concern is that if this crisis follows the patterns of the last crisis (2008), gold will hold up in price... until investors are forced to sell it, because that's what happens when you have a rolling liquidation in financial markets. My feeling is we may be a little early in punting our position, BUT it's clear to me that reinvesting our capital into equities is THE opportunity of the moment and I'd rather book a nice gain in our gold position and be sitting in cash ready to pounce on long term equity positions for our clients.

Content

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KOA WEALTH MANAGEMENT®

Commercial Real Estate

Via Private REIT portfolios from Blackstone and Starwood. While it remains to be seen how these i nvestment portfolios will hold up during this current recession (Oh yeah, we're in a recession... trust me). Thus far (At least through the end of February) both portfolios are positive in total returns YTD. Both portfolios are relatively defensive with a combination of investments in Apartments, Industrial to support eCommerce and Sale Lease Back properties – however they do have exposure to hotels (Less than 10% in both) and mortgage backed securities (Liquidity bucket for both). Thankfully, we believe we have teamed up with two of the most sophisticated Real Estate Managers in the business – it will be interesting to see how each manages this environment, but BOTH were building their portfolios with the mindset that a recession would hit at some point... so we'll see who put in place the better strategy! In the meantime, we are going to advise client to remove the Auto-Reinvest feature from each fund and have the monthly income pay to cash – why? Because we want MAX cash to either purchase equities as we move forward or to make sure we have liquidity for our clients should they need it for their daily lives.

Bond Allocations

I can't tell you how many times I've had other financial professionals in my office over the last year ask me about our bond allocations for clients and upon hearing that we had healthy positions in Treasury Bills (T-Bills), tell me I was an idiot (Pretty Much) for holding these securities when I could put that money into higher yielding funds or ETFs that they were peddling. Here's what I know – when Warren Buffet wants to keep his 128 billion in cash at Berkshire Hathaway safe while earning something, he owns T-Bills – period. In looking at the bond market over the last couple of years, frankly, investors were not being appropriately compensated for taking two kinds of risks 1) Duration Risk – meaning buying longer term bonds, usually the longer the bond has to maturity, the higher the rate of interest the borrower will pay the lender (Bond Holder)... however in recent times the "Delta" or difference between what you could get paid from owning a short term debt instrument vs. a long term debt instrument was too small to warrant owning longer term securities 2) Credit Risk – the "Spread" or excess return of owning bonds with "Credit Risk" vs. owning much safer US Govt. Issued debt was at all-time lows – meaning, you were having to take on MUCH more risk to try and grab the nickel bouncing around on the freeway – no thanks! Our T-Bill allocations now allow us the flexibility to come into the market and purchase opportunities in Credit OR Equities as we move forward... and as we've seen over the last month those opportunities are PLENTIFUL!

Equity Allocations

Over the number of months, I have communicated to clients that we have focused on two things with our equity exposure 1) High quality companies with great balance sheets 2) A more conservative allocation than the indexes, with higher weighting in Consumer Staples and an almost 25% weighting to Healthcare – a completely out-of-consensus view in light of the fear around a Bernie Sanders candidacy for President. In good times or bad, companies with strong balance sheets are preferred – why? Because they have the financial flexibility to take advantage of opportunities when they are plentiful and to make sure the company survives in times of economic stress without having to dilute their shareholders (Issue new common stock at depressed prices). Our portfolio includes companies with fortress balance sheets like – Apple, Google, Facebook, Berkshire Hathaway, Johnson & Johnson, Amazon, Visa, Alibaba, Disney. These companies will not only survive the current malaise but are probably going to pick up more global market share on the backside of this calamity as their competitors don't make it out the other side. In the short-term stocks are correlating to one – meaning when they go down, they all go down, to differing amounts, but make no mistake the great and poor companies alike get punished. However, as we move forward and volatility start to calm down, investors are going to pick through the wreckage. Given that this is a healthcare crisis that has morphed quickly into an economic crisis... might the solution we seek come from the healthcare industry... and might a lot more money be invested/spent in that area as we move forward... wait what was the largest allocation in our equity portfolio? Healthcare – as Dad says, "Sometimes it's good to be smart, sometimes it's good to be lucky – I like to be both!".

Final thoughts

In times of chaos we must look to be opportunistic, and in times of plenty we must remember to be skeptical. 2019 was a year of skepticism for me as I didn't buy the large rise in global equities on the back of zero earnings growth from companies (Overall) and continued slowing growth from the global economy. Strategists and economists told us we were going to bottom out with the decline of growth at the end of 2019 and we would see an inflection point in Q1 of 2020 with an increase in growth… boy were they wrong… as often they are! My concern was that if we hit any kind of disappointment in that inflection of growth that markets were way ahead of their skis and set up potentially for a large fall… and here we are. NOW is the time to be to be opportunistic – and the opportunities reside in Credit in the bond market where we have plenty of room to add more credit risk as we move through 2020 and work towards an eventual return in the economy and especially in the equity market. Within equities, we are focused on two areas 1) The highest quality companies that will make the most money on the back end of this – think tech companies exposed to cloud & electronic payments, the surviving retailers and the healthcare diagnostic companies… these are the names who will win the MOST on the backside of this recession 2) What I call the "Road Kill Bucket" – companies the market thinks may go out of business… but don't – what I learned from the financial crisis is THIS is where you can make the most money if you're right, but this is the deep end of the pool – I'm looking for companies in the financial, energy and healthcare REIT (Think Senior Housing) space that are under heavy assault at current in the stock market… if these companies can manage through the storm, investors stand the ability to make multiples on their investments as we recover in the years to come. As dad would say (Yes, he's like walking fortune cookie), "A crisis is only worth something if you learn from it" – the 2008 crisis which was unpleasant to go through was INCREDIBLY instructive for me. It taught me the mechanics of how markets work, what to own (IE. Individual Stocks vs. Indexes), what to avoid and more importantly gave me a road map of how this will play out (Market mechanics are generally the same regardless of causality). For the time being I think the bottom in the global stock markets is still ahead of us (I know our investors were hoping I would tell them last Monday 3/23/20 was it – sorry). If we follow the pattern from 2008 – we just had peak volatility this past week (VIX index over 80 slightly breached the highs hit in October of 2008) . You get peak volatility when you have max uncertainty – as we did in October of 2008. Many of my colleagues in 2008 thought October was the bottom and pushed their remaining cash into equities at that time. What they found out was they lost almost half their capital over the next 6 months as they market didn't bottom until March of 2009. At current we know the recession will be deep – the question now is how wide? I think the eventual stock market bottom is 3-6 months in front of us and from lower levels than where we sit now. With that being said, we are not fire selling our securities and hunkering down with cash, canned goods and a gun for the next 6 months. We are keeping our investment plan and long-term holdings – BUT I have sourced an elevated amount of cash from the portfolios (Opportunistically!) so that as the next 3-6 months play-out I can make opportunistic investments on your behalf (If you can send us cash… please do). If I plant these seeds correctly, I am confident that a couple of years from now we will have a bountiful harvest! The last thing I want our investors to remember is – that as US citizens we are incredibly lucky – we live in a country with one of the most effective capitalist systems the world has ever seen. Is it perfect? Clearly not, but would you prefer the economy of Europe? Japan? China? – No thanks – we practice economic Darwinism… and it's BRUTAL – BUT if you look at 2008, we came out of that crisis stronger than any nation in the world over the last 10 years… and I believe when we recover from this crisis the same thing will happen again! Keep the faith – be proud to be an American and THANK YOU for being a client of Koa – we plan to make your decision to work with us look like a very smart one!!!

PS. No time to discuss what I think comes next… but tune in for my comments on what I think could be the longer term (3-5 years from now) repercussions of what will come out of the actions being taken to fight the current war (Yes, we are already thinking about what comes next… that's what you pay us for!)

Michael Souza,
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