POLARIS WEALTH ADVISORY GROUP

The Polaris Perspective

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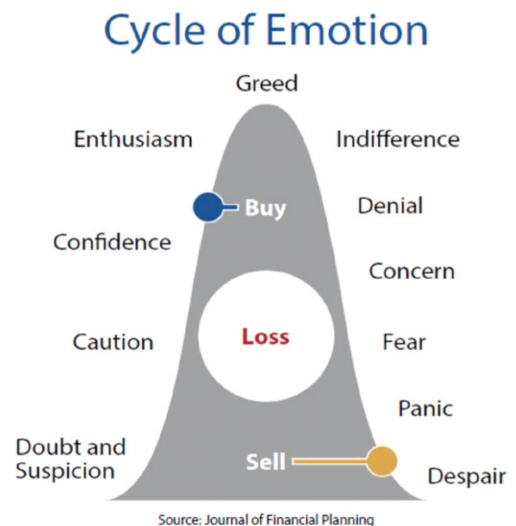
This is Not the Time to Go to Cash

MARCH 18, 2020

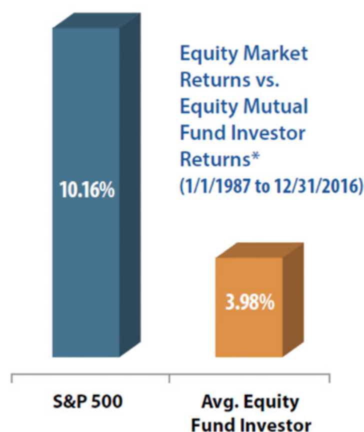
I have received several emails from clients asking the same question, "Should we go to cash?" Meaning, should they sell out of their entire portfolio and sit out what's happening in the market? While it is tempting to do so, the answer is, "Absolutely not." You would be falling prey to one of the oldest mistakes in investing – letting your emotions dictate your investment decisions. Don't get me wrong, it is scary. We are dealing with a pandemic, and the outcome is still completely unknown. What we are dealing with will hopefully be a once in a lifetime experience. While we have a few bruises, Polaris Greystone has so far avoided much of the downside and wealth destruction. We've done this by moving heavily into cash, but also into areas of the market that we feel will protect you and even make money during these tough times. I will go into more detail later in the piece.

The Emotional Investor

The emotional investor buys when they feel comfortable and sells when they are scared. The Journal of Financial Planning put together a great chart (to the right) called the "Cycle of Emotion". If I asked you to invest right now, you'd probably be doubtful that we could make money. As the markets stabilize and start to go up, you'd go from cautious to confident. This is when most investors feel comfortable investing. As their investment continues to rise, they become enthusiastic and perhaps a little greedy… until their investment starts to drop. At first, our emotional investor is indifferent to the losses they are experiencing. As the value of their investment continues to drop to what they originally bought it for, our investor's emotion shifts from indifference to denial. When their investment begins to lose money, they go from concerned to fearful to panicking… which makes them sell. They have bought high and sold low, which is not a great way to make money in the long run.



Source: Journal of Financial Planning



Source: Dalbar Inc. Quantitative Analysis of Investor Behavior

Dalbar, an investment research firm, took it a step further. They did a study on investor behavior and its impact on investment returns. They looked at equity mutual fund investors, who managed their money on their own, to see how their emotions impacted their portfolio's performance. The S&P 500 was up 10.16% over this 30-year study, while the average equity mutual fund investor got less than 4% return. This was completely due to the fact that most investors let their emotions dictate their buy and sell decisions.

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"I'm Scared!"

You have every reason to be scared. What we are all going through is unprecedented. Schools are closed, restaurants and bars are being closed, and grocery stores have empty shelves, as people have hoarded basic supplies. 6.7 million people in the San Francisco Bay Area have been ordered to "shelter in place" in an attempt to slow the spread of COVID-19. Rumors of other cities forcing "shelter in place" mandates will most likely come to fruition.

I wish that I could tell you with confidence that the worst is behind us. I think it is safe to expect the number of COVID-19 cases to exponentially grow as testing becomes more widely available. This will probably lead to more downside risk in the markets. So, given this statement, why would I recommend you not go entirely to cash?

You Don't Sell Now

The S&P 500 is down 29% from its peak, and over 25% for the year (see below). Please keep in mind that the S&P 500 is a weighted average. If you looked at all 500 stocks in the S&P 500, they are down 33% from their February 19th highs. The equal weighted S&P 500 index is below levels seen in 2018. In fact, they are now priced at levels not seen since spring of 2016.

S&P 500 Index - Down 29% from its Peak

Source: PGFG and Standard and Poor's.

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Volatility is at record highs. Two days ago, the VIX (the volatility index) closed at 82.7, the highest closing reading ever. Today it spiked intraday to 85. We have not seen this kind of volatility since October 23, 2008, when the VIX hit 96. That was when the banking industry was teetering on the edge of a financial cliff, Lehman Brothers went bankrupt, and the Treasury Department forced the healthy banks to buy out the ones that were about to go belly up. There have only been two other trading days (both in October 2008) that the VIX has traded higher. Spikes like these are typically found close to the lows in the markets.

Volatility is at Record Highs

Source: PGFG and Standard and Poor's.

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We have you well-positioned for this volatility. For example, the S&P 500 was down about 5.2% today. Our Rising Dividend Stock portfolio and our Socially Responsible portfolio were both down approximately 1.2%. The All-Country World Index (ACWI) was down just over 6%. Our Global Growth strategy was down only 1.1%. If you look below, you can see how well we've defended our portfolios against loss during these tumultuous times.

Today's Performance

	Rising Dividend Growth & Income	Rising Dividend Growth	Global Growth	Socially Responsible	Focused	Concentrated
PGFG	**-1.62%**	**-1.90%**	**-1.12%**	**-1.21%**	**-2.06%**	**-1.64%**
Benchmark	-4.55%	-5.18%	-6.01%	-5.18%	-6.80%	-6.80%

Month-to-Date Performance

	Rising Dividend Growth & Income	Rising Dividend Growth	Global Growth	Socially Responsible	Focused	Concentrated
PGFG	**-4.68%**	**-4.99%**	**-8.59%**	**-4.54%**	**-10.17%**	**-7.36%**
Benchmark	-15.26%	-23.09%	-23.19%	-23.09%	-24.38%	-24.38%

From Market Peak

	Rising Dividend Growth & Income	Rising Dividend Growth	Global Growth	Socially Responsible	Focused	Concentrated
PGFG	**-11.75%**	**-15.34%**	**-18.68%**	**-14.87%**	**-22.60%**	**-18.91%**
Benchmark	-21.79%	-33.09%	-32.40%	-33.09%	-34.62%	-34.62%

Source: PGFG. The performance listed is using proxy accounts. Proxy account values as of March 18, 2020. All performance is reconciled at month end.

As a reminder, the Rising Dividend Growth & Income benchmark is 60% S&P 500, 40% Bloomberg Barclay's Aggregate Bond Index (AGG); the Rising Dividend Growth and the Socially Responsible strategies are benchmarked to the S&P 500 TR Index; the Global Growth strategy benchmark is the All-World Country Index (ACWI); the Focused & Concentrated strategies have the same benchmark, the Russell 1000 Value Index.

All of our tactical ETF strategies did significantly better than their benchmarks today, as you can see from the chart below.

Today's Performance

	All-Equity	Growth	Moderate	Conservative
PGFG	**-2.83%**	**-2.54%**	**-2.28%**	**-2.18%**
Benchmark	-6.10%	-5.41%	-4.96%	-4.50%

Source: PGFG.

For clarity, the "All Equity" ETF strategy benchmark is 100% ACWI; the "Growth" ETF strategy benchmark is 70% ACWI, 30% AGG; the "Moderate" ETF strategy benchmark is 50% ACWI, 50% AGG; the "Conservative" ETF strategy benchmark is 30% ACWI, 70% AGG.

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How Are We Managing Your Portfolio???

We think that there will be continued high volatility, and we think that there is some additional downside to this market. To reiterate, we feel that we are well-positioned to mitigate much of this downside risk. We are sitting on significant cash in all of our strategies. Our equity investments are in defensive segments of the market or are strategically positioned for this pandemic.

As you can see from the chart below, we have taken extreme measures to protect your portfolio. The Rising Dividend Growth and Income Strategy can have as much as 80% equity exposure if risk seems low. We are 30% equity. Beta, in layman's terms, is how much your portfolio should go up or down when the markets move. If the S&P 500 dropped 10%, this strategy should be 1.6%.

Current Allocation and Risk Exposure

	Rising Dividend Growth & Income	Rising Dividend Growth	Global Growth	Socially Responsible	Focused	Concentrated
Stock	30.00%	45.00%	48.00%	48.00%	85.00%	99.00%
Bond	34.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Cash	36.00%	55.00%	52.00%	52.00%	15.00%	1.00%
Beta	0.16	0.27	0.46	0.38	0.63	0.66

Source: PGFG.

Below you will see what our Tactical ETF strategies' current allocations are, how much cash we are sitting on, and what a typical allocation would be in normal markets. As you can see, we have moved into a very defensive stance.

Current Tactical ETF Allocation

	All-Equity	Growth	Moderate	Conservative
Stock	44.00%	35.00%	26.00%	19.00%
Bond	0.00%	20.00%	40.00%	58.00%
Cash	66.00%	45.00%	34.00%	23.00%

Typical Tactical ETF Allocation

	All-Equity	Growth	Moderate	Conservative
Stock	99.00%	79.00%	50.00%	30.00%
Bond	0.00%	29.00%	49.00%	69.00%
Cash	1.00%	1.00%	1.00%	1.00%

Source: PGFG.

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Our equity strategies are primarily invested in Consumer Staples, Communication Services, Health Care, and Real Estate.

Consumer Staples – These are companies that sell basic goods that you need to have to live. You are going to wash yourself and your clothes. You are going to eat. These are examples of consumer staples. We hold a significant weighting of consumer staples companies in our portfolios. We hold companies like Clorox, Campbell's Soup, Costco, Flowers Foods (sells baked goods), Hormel Foods (sells food products under 50 brand names), Kimberly-Clark (largest toilet paper manufacturer), Kroger (the grocery store chain), and Walmart. All of these companies' products are in demand based upon what is going on in our society right now.

Communication Services – These are companies surround telecommunications and technology names. For example, our dividend paying strategies hold AT&T. People are still going to use their phones. The non-dividend-paying strategies own Netflix, Electronic Arts (online gaming), and Activision (online gaming).

Health Care – This includes biotech companies, health care providers, medical equipment companies, and insurers. This is a tricky area of the market to invest in, but it can be a profitable one if you know what you are doing. Our three most widely held positions are Johnson & Johnson, Quest Diagnostic, and Thermo Fisher. Most of you probably know the Johnson & Johnson name. They are a large company that provides consumer goods, pharmaceuticals, and medical devices. Quest Diagnostic is one of only two labs (outside of the CDC) allowed to test for the coronavirus at the moment. Thermo Fisher is the company making all of the tests. We also own TeleDoc in our non-dividend strategies. TeleDoc allows you to see a doctor virtually (preventing you from exposing yourself to coronavirus just to see a doctor).

Real Estate – Pretty straight forward, but it can be a tricky area depending on what type of real estate you own. We have one holding, American Tower Corporation. It owns cell phone towers, specializing in 5G towers. Again, people are going to use their phones.

While we have definitely experienced some losses, we've avoided some horrific areas of the stock market. If you have investments away from Polaris Greystone, we would highly suggest you avoid stocks in the following segments of the market: travel and leisure, oil, banks, and consumer discretionary companies, to name a few.

Travel and Leisure – Avoiding travel and leisure companies is a no brainer, given the COVID-19 pandemic. Airlines, hotels, cruise lines, online travel agencies, and entertainment companies are down substantially. United Airlines, for example, was a $90 stock in mid-January. It is now $21.38 per share. Hilton Hotels was at $112 a month ago. It is now trading at $48.22. Marriot has fared no better. It has dropped from $150 to $63 per share. Royal Caribbean Cruise Lines has dropped from $135 to $22 a share. Carnival Cruise Lines has gone from $52 to $9 a share. It's been an absolute bloodbath for these companies. At some point, however, we will want to buy some of these companies again. People will travel again. They will need a place to stay while they are gone. But for now, these companies should be out of your portfolio.

Oil – We suggest you avoid all oil companies, as oil has set record low prices due to the Saudi / Russian oil price fight. Both countries are increasing their output to their maximum level in an attempt to hurt the other one financially. U.S. oil companies have been caught in the crossfire. A significant percentage of our oil production comes from fracking oil shale. This is a dirty and costly process. It costs them about $40 a barrel to pull oil out of the ground using this technique. It costs Russia about $20 to produce a barrel of oil, whereas it only cost the Saudis about $10 a barrel. West Texas Intermediate (WTI) oil traded as low as $20.08 today, closing at $22.33. WTI was at $60 a barrel at the beginning of the year, and $47 at the beginning of the month. U.S. oil companies will shut their doors if prices remain this low for very long.

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Banks – We have suggested avoiding most of the banks for several reasons.

1) In a flat yield curve, lending becomes less profitable. The Fed lowered rates down to 0% on Sunday (after an emergency meeting). Yields are historically very flat, although the yield curve has steepened over the past couple of days. Nonetheless, banks make less money in zero interest rate environments.
2) Most banks have an asset management arm to them. With the markets down 30% off their highs, they will not be making as much money.
3) Many banks have lent money to the oil industry. There is fear that the oil companies will not be able to pay back their debt.
4) With everything going on in our country, we will most likely go into a recession and unemployment will rise. This increases the likelihood of defaults for home loans, credit cards, car loans, and student loans. The impact has been swift. Citibank has dropped from $82 to $36 a share. JPMorgan Chase has gone from $140 to $83. Bank of America from $35 to $20, Wells Fargo from $54 to $28. Goldman Sachs has dropped from $250 to $140. Again, there will be some amazing buying opportunities in this space… just not yet.

Consumer Discretionary – We suggest avoiding consumer discretionary companies. As I just discussed, we are most likely already in a recession. Anxiety is high, and when people are scared, they stop spending their money. Consumer discretionary companies are companies you "choose" to buy from rather than "need" to buy from. Do you go on a buying spree at Nordstrom or Macy's if you are fearful that you might lose your job? Are you going to buy a new home? Or a new car? These are all discretionary choices. As fear levels go up, wallets close. Avoid this area of the market until things calm down. There will be some great buying opportunities in this space too, eventually.

What Should You Do From Here?

I know that this will sound a bit crass, but… do nothing. Let us do our job. You hired us because you were confident that we could do a better job managing your money than you could on your own. As you have read, we have a strong, well thought-out portfolio that should weather this storm successfully. There might be more downside in this market, but it doesn't mean that you have to suffer the same percentage downside.

The markets will settle down. Investors will soon become callous to the day-to-day news about COVID-19, just as they became callous about terrorism. Did you know that one of our army bases in Iraq came under rocket attack on March 11th? The attack killed three Americans and wounded 12. We have become callous to these types of attacks because we've been dealing with it for two decades.

When the markets do settle down, there will be the buying opportunity of a lifetime. If you go 100% into cash, you likely won't feel comfortable buying these opportunities (go back and read the beginning of this educational piece). There are several Wall Street strategists saying they believe the S&P 500 will finish significantly higher than where we are today. Goldman Sachs' strategist, for example, thinks the S&P 500 will end the year at 3,200. That's a 33% return from where we are now. If you knew that the markets were going to go up 33% by the end of the year, would you invest?

Our strategy will be to remain in our defensive stance, for now. We are hopeful that we can make some money with our current holdings. When the opportunity arises, we will shift from our defensive names and snap up some fantastic companies with amazing upside as they recover.

As always, I welcome your questions and comments.

Sincerely,

Jeffrey J. Powell
Managing Partner & Chief Investment Officer

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