Pittenger & Anderson, Inc.
REGISTERED INVESTMENT ADVISOR

P&A's Quarterly Letter

Q4 – January 10, 2019

Behold

Dear Friends and Clients,

If you don't think I know what I'm doing, here's some ammunition for your position. As recently as Thanksgiving, it looked like year-end wouldn't be a very busy time around P&A. Virtually all of our client RMDs were done, and there wasn't a whole lot of loss trading left to do. Most of our positions showed a gain and I could see the wood on my desk. Clients were building new homes and taking cruises and high-dollar vacations, most of which were successfully financed from portfolio gains. We were feeling pretty good about things. Then all hell broke loose in December.

People tell me they wouldn't have my job for all the tea in China. People used to tell my dad (Asst. Athletic Director at the University of Nebraska and Ticket Manager during the Devaney years) they wouldn't have his job for all the tea in China. I guess tea runs in the family. At any rate, the liquidity and earnings-driven 2018 equity markets turned into a political food fight and there was very little "Peace on Earth".

<u>So how do we people weather the storms?</u>

Are stocks and bonds fragile or durable, and how tough are the players? First of all, client reactions during the correction of October 2018-January 2019 have been minimal. A lot of this is born of the success we have enjoyed since the bear market of 2008. Face it, if you lived through all that, your patience should be at full reservoir. So far, the correction/crash/bear of 2018-19 has not earned a name. It was born of political parents and exacerbated by the same people creating trade issues… Perhaps a little more time is necessary to generate a name. The 2008 mess has several: the Financial Crisis, the Great Recession, the Big Short, the Panic of 2008, the Subprime Disaster…lots of monikers. Perhaps you can't love, loathe, or be afraid of something unless it has a name.

We had minimal unrealized losses on 11/01/18, and now they are easier to find…not large, but more prevalent. Part and parcel to this is our policy of encouraging people to spend money and keeping positions "fresh." This is a big subject, so if you want more chatter, pick any of the talking heads at P&A and we will run you through the logic. These assets provide the fuel for tax swaps that allow our clients to generate market losses at minimal cost. Most of you are familiar with the process. We sell ABC at a loss and buy XYZ in the same environment. The securities are similar but not financially identical. Eventually, the market finds traction and we have created a collection of losses that will live until summoned to your tax return. The first time a client watches this process they are quizzical. After a few round trips, they get the gist of things and warm up to the idea of paying nothing or less in capital gains taxes.

We want our portfolios to be agile, mobile, and hostile. Growth stocks have to be able to "go fast," while value stocks need time, and the unloved need to be recognized. I find myself wanting to name and categorize these pieces of the puzzle so that their conduct makes sense when we review and rebalance. Our portfolios represent shelter and remind me of tents. If not used properly, they will deliver mischief instead of success.

Gimme Shelter….

Apologies to Mick Jagger and Keith Richards.

We all know how houses and cinder block buildings work. I find tents and metal buildings much more interesting. Picture your investment accounts as a bivouac with orderly rows of small and large tents. The small tents are highly portable and sit on the ground. They are lightweight, supported by exterior bow frames, like pop tents. The camping industry classifies this group as “three-season” tents. The large tents are supported by poles that are secured to the ground by “guy” wires and canvas sidewalls. The guy wires are latched to tent stakes, creating tension from the center of the tent to multiple points outside it. The roofs and walls are made of canvas, or nylon, which also provides tension between the top of the poles and the top of the walls. The bigger tents are called “four-season,” since they are designed to withstand weather throughout the calendar. These tents are semi-permanent structures like a circus big top or a wedding tent. A metal building (Butler, Morton, Chief, etc.) isn’t much different than a four-season tent…it converts the tension generated by the roof and side walls into architectural strength.

Increasing the bow tension on a three-season tent won’t make it much stronger. They become a bit tougher when you add some stakes to secure them to the ground. So, if the wind comes up, your three-season model had better be secured or it will set sail and start to tumble on that bowed skeleton. Trouble is, it’s more portable than strong from the outset and probably not much of a tent to begin with. Three-season tents are designed to be used in nice weather. A four-season tent will handle a lot of weather as long as the aforementioned tension is maintained across the canvas and between the poles.

We would liken a three-season tent to a single sector mutual fund and the four-season model to a well-diversified, broad market portfolio. The lighter weight model will succeed from time to time, but the big top will be the best bet for long-term success.

Use them every day, and both types of tents will need maintenance: spliced bows, new turnbuckles, replacement guy wires, re-set stakes, and patched canvas. The comparison to a portfolio should be coming into focus.

Picture the S&P 500 as a four-season tent with 11 poles. Each pole shelters one of the major sectors of the index. As the sectors grow, the tent needs to maintain enough tension to lift the roof, stretch the walls, and convert that energy into architectural strength. Each sector is responsible for creating its share of load-bearing energy. Without it, the portfolio (tent) will start to fail. When tensions go slack, the canvas starts to flap in the breeze, and the inhabitants get nervous about the viability of their structure.

Planes, Trains, Automobiles (& Boats)…

Most pundits claim technology as their favorite sector; after all, that’s where the growth lives. I am a fan, but I really enjoy tracking retail and transportation. The latter will be a good fit for the focus of this section.

Airplanes respond to four forces of nature: gravity, lift, thrust, and drag. Any plane will be stationary when gravity equals lift and when thrust equals drag. When a plane is sitting on its wheels, gravity is greater than lift and the plane is vulnerable. During takeoff, the plane gains strength from interior as well as exterior pressures. Once airborne, the weight of the plane and cargo is spread across the wings as well as the hull. Airplanes gain strength when you use them and do best at full throttle.

Trains, bicycles, and anything that travels on asphalt will benefit from the gyroscopic action of their spinning wheels. That "look ma, no hands!" maneuver is almost impossible on a bike at rest. However, at cruise speeds, all of the above are comfortable to ride and will naturally track a course. If they don't go faster, there will be no reason to buy them because last year's product will be just as good. Ditto this stuff for automobiles.

Boats are a lot like planes; they respond to the same gravity, lift (floatation), thrust, and drag scenarios. They are at their worst while sitting still. For the most part, an airplane can be trusted to stay put while resting on its tricycle gear. Boats, on the other hand, need to be tied to something…a mooring or a dock, for example. But boats seem to enjoy banging into these moorings, docks, and other boats, so they can beat themselves up while sitting still. Boats just don't play well together and, regardless of where you put them, they want to be somewhere else.

When the weather comes up, boats need to move out to sea; cargo, hull, and crew are safer that way. If you have a business that employs boats, you will eventually become a boat buyer. After you have bought your first boat, it's just a matter of time until you will need to buy your second. The transportation sector is constantly in need of new resources; that's how they add tension (strength) to their sector.

Turn, Turn, Turn…

Using similar examples of tension across the other S&P 500 sectors, you can see how the investment portfolio "big top" comes together, and more importantly, stays strong.

You've heard us say before that markets move from weak hands to strong hands, meaning when there is indiscriminate selling and big drops, the "owners" of stocks step in while the "renters" of stocks get out. The same is true at the sector level. One sector comes into favor as another falls out. This sector rotation is ongoing, cyclical, and can be secular. Tech and Biotech are classic examples of sectors that tend to have higher growth rates than, say, Utilities or Telecom. These latter two tend to pay higher dividends and experience less volatility over time. Consumer Staples tend to get attention when the economy is softening, while Consumer Discretionary needs economic strength. (Americans shop in good times and bad, but more so in the former.) On and on this goes, down through the remaining sectors.

In the mid-60s, The Byrds sang about everything having a season, a time to be born, and a time to die; a time to plant, and a time to reap. The same is true in the investment world. The above paragraph paints the picture that certain sectors are in planting mode while others are in reaping mode. At a granular level, companies are born, and companies die. Markets experience tension from a variety of sources, and this impacts sectors and companies in different ways. Holding a stock portfolio of best in breed companies and relying on them to do what they're supposed to do results in the lines being tight and the structure sound.

On our scale of affection for stocks (Like, Really Like, Love), we're still in the Like camp. Volatility is more likely to continue than abate in 2019, but we've been through this before. Don't let the large point moves in the Dow Industrials throw you off. In percentage terms, these moves aren't as big as they seem. That 1,058-point jump the day after Christmas was the largest single day point gainer, but it didn't crack the Top 20 for largest percentage gainers in the Dow's 122-year history.

Reach out if you'd like to discuss your account or financial plan. We'll continue to work behind the scenes to help you facilitate that new home, boat, trip, or charitable gift.

On behalf of the P&A team,

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