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Who's Skinny Dipping?

There are very few ***good*** things that one can say about bear markets. Other than a few short-sellers, who bet against stocks, most investors dread these downdrafts. Investors and speculators alike become singularly focused on the obvious pain points: the stress, the unknown, the second-guessing, the regret, and of course, the dropping portfolio values. Nevertheless, when viewed from a distance, after some time has passed, a few major positives can be seen when it comes to crashing stocks. An obvious one *should* be the more attractive stock prices – although historically, most investors fail to capitalize on that. Everyone loves a good sale when it comes to consumer goods. Bargains and deals get us all excited for things like pork chops or Ford F-150s. For some reason however, "sale" prices in the stock market are seldom appreciated. Perhaps it's because investors feel more like the store owner that was forced to mark down their inventory, as opposed to the bargain hunting customers.

A less obvious benefit of market crashes is that they act as BS detectors. Bears (the animals) are well known for their amazing sense of smell, are they not? Similar to their namesake, bear markets have an uncanny ability to ferret out hucksters, charlatans, and bull$#!tters. Think back to the terrible stock market of 2008. I can vividly remember that Friday afternoon in December after the market closed when the news broke that Bernard Madoff had been running a Ponzi scheme. The stock market had been acting terribly throughout 2008, and by December investors started to pull their money out of different investments. In many cases this was forced selling to cover margin calls.

So, we can see that a harsh market downdraft acts as a purging mechanism – first of the foolish and then of the fraudulent. **Warren Buffett** once said about bear markets:

> ***"You don't know who's swimming naked until the tide goes out."***

Indeed. As the bond and stock market kept falling last year we kept waiting for something to break. That's what usually happens. In fact, some contend that bear markets don't end until something breaks. Then a new bull market can begin. It always reminds me of playing hide and seek as children. The seekers would start their search by yelling out "come out,

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come out, wherever you are!!" We know the problems are out there, lurking, waiting to implode. It's always just a matter of time. During the first stage of a market drop, it's usually foolishness and investment stupidity that is revealed. Who overpaid for certain popular investments? Who dramatically overpaid for garbage investments? We're going to find out. That's what bear markets do. We also know that the bad guys are quickly running out of places to hide.

In 2022 all manner of foolish behavior "came out" and was revealed to be what it was. It's hard to argue that's a bad thing. So what exactly did the bear market of 2022 reveal? Where do I start??

Let us begin with many of the huge, high profile, highly profitable, (but overpriced) technology giants that we have been warning about for a while now. They dropped considerably last year. A couple were down about 75% at their lows. This set up a few interesting bargains for us.

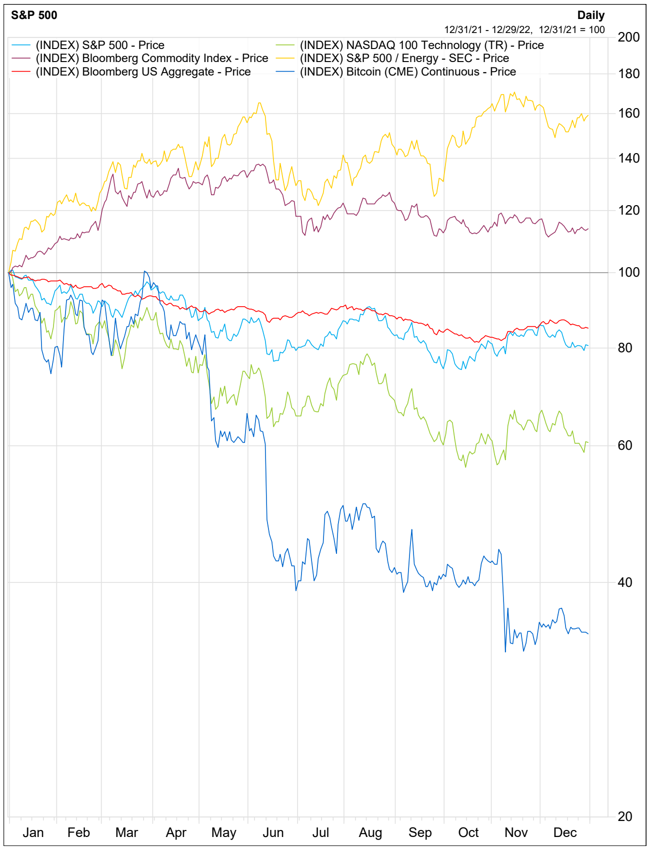
One of the hardest hit areas of the stock market was in the *new* technology space. These were the companies that have amazing ideas but are still unproven. We have been writing about this risk for a couple of years, so I won't belabor the point. I do feel compelled to utter the famous post-disaster phrase. "What were they thinking!?"

It's pretty bad when an entire area of the stock market is literally termed "profitless-tech." Mind you, it was called this BEFORE the stocks had fallen. The moniker itself is what a rational investor might call a clue. Anyone who cared to take a cursory look 12 months ago would have tread lightly (if at all) in this speculative environment. As you might imagine it was one of the worst places to invest in 2022. Many companies in this space are down 70%, 80%, or even 90%.

Recovering from such a hit is extremely difficult if not impossible. We stayed well clear of this area over the last year or two, but at these prices, who knows, we might start to take a peek for some buys. And then there were the cryptocurrencies. They were hit even worse. Bitcoin (the crypto blue chip) was "only" down 75% from recent highs. That was one of the least damaged coins. Many, if not most of the other coins (colloquially known as $#!T coins) were down much worse – many in the ~90% range.

Both profitless-tech and most of the cryptos were merely examples of greed and foolishness, not fraud. It seems bear markets start by sniffing out stupidity and then dine ravenously on those illogical investors for lunch. The resulting feeding frenzy can result in some very extensive collateral damage. Even some of the reasonably priced stocks fell.

Foolishness works both ways, however. Those investors who thought oil and gas could be easily replaced by wind and solar had been divesting from this sector throughout the last few years. Big mistake. It has been one of the only big winners this past year. See Chart 1. Energy stocks are the top gold line (up 50%), the technology heavy NASDAQ is green (down 40%), and Bitcoin is dark blue (down 65%). Each line is based at $100 as of January 1, 2022.



Factset Chart 1

Factset Chart 2

With all the extreme moves depicted in Chart 1 you may have failed to notice the drop in both the stock and bond markets. Chart 2 isolates those two.

You can see that it's been anything but a good year as both competed to see which would be worse. I can say from a historical perspective the bond market was far worse relative to its normal swings. In fact, from 1926 through 2022, it was the worst calendar year for bonds by a significant amount. On the stock side, there have only been six worse years, some by a lot. At Morgia Wealth Management (MWM), we were fortunate to have avoided the vast majority of this record-breaking bond drop for clients as well as side stepping some of the stock pain.

So, the bear has dealt harshly with most assets this past year, especially things that had been propped up by greed and hope and greater fools. Foolishness is one thing, but bear markets are just as good at sniffing out fraud. The 2022 drop was no different. Most of you have by now probably heard of Sam Bankman-Fried (aka SBF) and his crypto exchange company FTX. If you have not, think: The Bernie Madoff of cryptocurrency. Think: Madoff on steroids. Think: Billions of lost customer money.

In the Madoff case, most of the stolen money was eventually recovered over the course of many years. I have a hard time believing that the politicians who received millions of dollars of campaign donations from SBF will willingly return those funds. Even if they do, it would be a drop in the bucket compared to the lost billions of customer and investor money. Most of the billions of losses seem to have stemmed from FTX giving its sister corporation access to client funds to cover trading losses. Recovery won't be as likely this time. The crypto world is like the wild west devoid of most regulation. John Ray III, the corporate collapse specialist who was recently appointed to FTX's CEO position by the bankruptcy court, said that he has never seen something so bad. That's saying something, as Ray also took the lead role in the Enron case. His exact quote was:

> ***"Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here."***

FTX's cryptocurrency is down from $79.87 (less than a year and a half ago) to $1.24 recently. A 98.5% implosion. There were so many ways to lose money on the FTX fiasco. From depositors, to investors, to crypto holders, to creditors – all are feeling the pain.

We like to say that it's best not to have your money custodied (stored) with the same firm that is investing your money. And for God's sake, you should never have the auditor also be connected to the other two. Madoff had such an arrangement. Sam Bankman-Fried took it to another level. He was the custodian, the exchange, the investor, and the minter of the money of the realm – the FTX cryptocurrency.

Even some of the top investors in the venture capital community were snookered by Bankman-Fried and they are supposed to be the smartest people in the room.

We have two takeaways for you from this mess:

First (and foremost): Investors should focus on risk management! Remember it only takes one mistake of the catastrophic kind to wipe out a lifetime's worth of good investment decisions.

Second: Never trust your money to someone who dresses like a middle school student in Phys-Ed class, while on stage with former heads of state.

Tony Blair, Bill Clinton, and Sam Bankman-Fried on stage at the Crypto Bahamas conference May 2022

So something broke.

Does this mean the bear market could be nearing an end? Well, it helps that most of the speculative money has been washed away in this market storm. That's a good start, but that doesn't mean that all is healed yet. It seems recently that every time the market tries to catch its footing, Fed Chairman Powell opens his mouth and scares away all the optimists. He continuously reiterates that he won't stop raising interest rates until he sees that inflation has been truly tamed.

We worry that might take a while. The stock market is usually six months ahead of the economy (that's a generalization) and usually moves ahead of the news. Some economists are saying that the economy should bottom this coming spring. That opens up the possibility that we may have already passed the worst of the stock storm and that the bottom might have already been found. When Powell finally does stop raising rates, it will likely generate one heck of a rally. We shall see.

Quarter-Decade Check In:

It may seem hard to believe, but this past summer marked the end of the first quarter of the current decade. As you may remember, for the past 50-plus years, we have tried to predict the "big mistake" for each decade (and then obviously tried to avoid that mistake). In July of 2020 we made the call that "paper" would be the big mistake of the 2020s. Paper as in fiat currency or paper money. Our belief was that real things and hard goods would be better than cash, bonds, and perhaps even stocks. We worried loudly that the boogie man, inflation, would finally arrive back on the scene after 40 years of hiding. So far, with the massive worldwide spike in prices catching many investors and politicians off-guard, we seem to be correct. Most of the decade lies ahead of us however, so it is too early to congratulate ourselves just yet. Furthermore, predicting a calamity is not the same thing as capitalizing on that calamity, or at least avoiding the pain caused by that calamity. We've got some more work to do!

July 2020 MORGIA™ WEALTH MANAGEMENT

We think the "Big Mistake" of the 2020s will be paper money.

The implications could be very broad and very deep. We have not witnessed dollar erosion or real inflation for many years, and it seems so unlikely today with the world stuck in an induced economic coma. But there is so much debt building up throughout our country and in the world and in the state capitals and in the corporations and student loans and auto loans and credit card debt, that we feel the piper will finally need to be paid. Investors have been fretting about this for far too long. And being *early* on an investment prediction is indistinguishable from being *wrong*. So, we have waited a very long time to make the call. Until now.

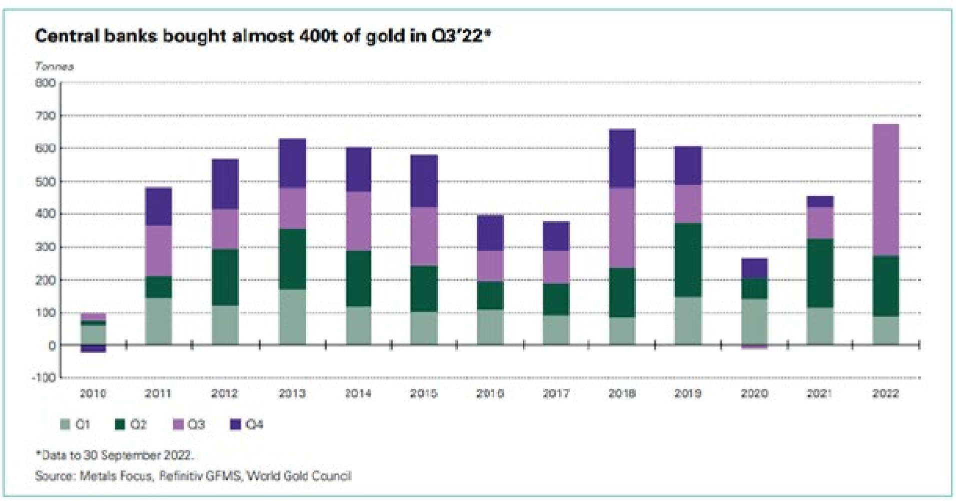
The main problem with paper asset values, has *always* been that they eventually yield to the politician's propensity to buy their way into office/power by giving away other people's money.

So what have we been doing to prepare client portfolios for such a prediction? How do we protect client capital? How do we grow portfolio values?

During the depths of the Covid crisis we took some decent positions in what we would call "real" asset plays. We purchased mining stocks and energy stocks along with commodity funds that own oil, gas, corn, wheat, nickel, and other raw goods. We also started moving more funds from cash and bonds into gold and silver. So far gold has been fine, holding up in value better than most assets but not making any major move up. Ironically with all the global worry over energy supplies and war, as well as a possible world recession, foreign investors have been **purchasing** U.S. dollars as a safety trade. This has pushed currencies like the Yen, Pound, and Euro down substantially (~20%) over the past 12 months. Gold has been quite a profitable investment for most of the world's citizens *other* than Americans. However, we still think it's a good idea to own some. The global central banks agree.

The third quarter of 2022 ending September 30th saw a dramatic increase in the amount of gold purchased by these entities. The chart below (courtesy of our friends at Macro Intelligence 2) shows the annual purchases of physical gold bullion over the last 12 years. Each bar represents a year and is divided into the four quarters of each year. Notice that the third quarter 2022 has seen a record amount of buying by a wide margin (the pink portion of the last bar). Even without the fourth quarter tallied in yet, 2022 has seen the most gold purchased by central banks in a long time.

Central Banks are on track for their biggest-ever net accumulation this year.



Our next moves:

Financial forecasting is difficult at best. There are no sure things. Nevertheless, there are a few economic matters that are easier to predict. One of the best bets you can possibly make, is the following: Politicians will do *whatever* they can to avoid making difficult financial decisions.

So, if we think that inflation has a high likelihood of being a nagging problem for the rest of the decade (and we do), we can probably predict the politicians' course of action. It's called **the path of least resistance**. We can comfortably postulate that once the interest rate increases by the Federal Reserve start to impact the economy (and the voters), the politicians will start to sweat. They will put a lot of pressure on Fed Chairman Powell to **stop** raising interest rates – to stop the pain. They will push him to start printing money once again or lower rates. That, in turn, will give the inflation monster a chance to regroup and return to harass us.

We can probably also anticipate that corporations will be blamed for the price increases (evil entities that they are). Maybe something like a windfall profit tax will be proposed for the energy companies. Funny… I don't remember any windfall loss rebates proposed during the last five or six years during the oil bust. Price caps might even be suggested.

What should we do?

We should anticipate higher prices and shortages. That's what usually happens when the government tries to "manage" inflation and "control" the economy. Just ask a Venezuelan. This type of government "help" would only strengthen our thesis that real goods will outperform i.e. hold or buy the energy stocks and hold or buy commodities of all sorts. We should also be prepared to buy more stocks in general at some point. If we believe that the Fed must eventually stop raising rates, the market could have a sharp rise on that news.

Important Caveats: High prices are the cure for high prices. At some point, inflation itself could cause a global slowdown – and thus *lower prices*. So investment timing will be important on the inflation investments such as energy and mining stocks as well as commodities. We have a sense that these investments may need to be stopped and restarted a few times over the next few years. As the Fed raises rates the economy will naturally slow – and that can temporarily harm economically sensitive companies such as these.

Reality always has a way of showing up once politicians run out of other peoples' savings. Thus, ***reality*** is going to be a major part of our theme of emphasizing "real" over paper assets for the next five years or so. Unlike the last few years where people were investing in dreams (remember profitless-tech stocks?), we believe the world is rapidly shifting to more tangible and substantive solutions and companies that solve real current problems. For example: Germany's decade long obsession with solar and wind energy construction projects, at the expense of natural gas and nuclear, ran into a brick wall called reality. Converting too early and too heavily into less efficient means of energy production and then outsourcing the procurement of that country's *actual* energy needs to Russia was **un**realistic. Some might even say it was "idiotisch" (I will assume that your German is good enough to translate that).

We believe that the word "unrealistic" is going to be synonymous with the word "painful" for the foreseeable investment future. Germany is now paying for their fantasy. There's talk that citizens may need to burn coal or wood this winter due to massive shortages of gas. We would contend that burning coal to heat your German cottage is not all that green! If the Russians win the war, that will not be good for European oil and gas supplies. If Russia loses the war, it could even be worse for supplies!

Truth be told, pretty much the entire western world has been disincentivizing investments into real energy and real resources for many years now. Like we have said before, there can be no electric vehicles without mining for copper and lithium. If someone doesn't drill for oil, the world will coldly grind to a standstill. The insufficient investment in energy infrastructure and lack of capital spending simply means a stunted supply, probably for five years even if the West took immediate corrective measures. At Morgia Wealth Management, we saw this as an opportunity to invest in the energy producers and the miners, which we have been doing for the past few years. I suspect we will be involved in this area for quite some time – perhaps not continuously, but rather opportunistically. On a brighter note, a European re-build of a more realistic energy infrastructure could be economically beneficial and eventually help lower inflation.

> ***One of the sexy ideas of green tech is that we could finally break the geographical links of oil geopolitics that we all know and we all hate - where we have to deal with Venezuela and Iran and Iraq and Russia. It's agonizing, it's painful, it's expensive, it's dangerous. But if you want to do the green transition at scale you then need Canada and Mexico and Peru and Bolivia and Ecuador and Chile and Argentina and Brazil and Australia and Indonesia and Malaysia and India and Pakistan and Turkey and Mongolia … and Kazakhstan and China and Nigeria and Congo and South Africa and Gabon and yes… still Russia.***
>
> ***If you really, really want to do the green transition with the technology we have today then you have to love carbon and you have to love dictatorships.***
>
> ***-Geopolitical analyst and author Peter Zeihan [1]***

Other reality-based themes on our radar are the risks of an underpopulated world and a potential global monetary and economic schism between the West and the East. China and Russia do not like the U.S. dollar's monopoly power as a reserve currency and are doing their best to undermine that. Cold wars and hot wars are disruptive to supply chains and are always very inflationary.

Problems on the demographic front will probably start becoming a real issue over the next decade. China's population, in particular, looks extremely top heavy. Their economy could suffer in the long run without enough young citizens to support the bulge in the elderly population. Japan, Europe, and Russia are not much better.

Why is this an issue? The economies and stock markets of countries with a robust population of 20 to 30-year-olds tend to grow a lot faster than more "aged" nations. 60-year-olds just don't spend as much. They tend to batten down their wallets at a time when their major life purchases are behind them. The early-bird dinner specials at 4:00 pm just don't generate that much economic excitement.

In the West, the United States, with its cadre of millennials and healthy immigration statistics, is probably better positioned demographically. We also have ample energy and agricultural resources. If we use our brains (not a given), the U.S. economy, and thus the U.S. stock market, could continue to perform competitively. Perhaps some of the best demographics are in the emerging market (EM) countries. We have started taking positions in some EM stocks over the last year and a half. So far … eh. Longer term, however, we like the math.

In a recent talk, macro advisor and investor Raoul Pal painted an interesting decade long case for EM. One point he articulated stood out. He considered a country like Saudi Arabia with very low-cost energy and amazing capital resources. It runs budget surpluses and has a sovereign wealth fund projected to be worth $1 trillion within two years.[2] This surplus fund stands in sharp contrast to the national ***debt*** of the U.S. which just recently passed the $31 trillion mark! Now, further imagine the Saudis partnering with India, whose population is vast, well-educated, and well-balanced, with many more youth than elderly. This could be one powerful combination among many in the developing world. We think it might make a lot of sense in the next decade to invest outside the U.S.

Caveat: There are many unique types of risk with foreign investing, so we won't be going overboard here.

Another investment area that investors must re-strategize is the bond market. It's going to have to be tactical now. We don't believe investors should just buy and hold bonds anymore. When interest rates were 12% in the early 1980's you could do that. *Today*, if you buy longer-term bonds, you might not want to hold them to maturity. That might not be the safest strategy. Presently it looks like Powell's Fed might be successful in their effort to slow economic activity enough to match the shortages in labor and goods. If successful, that will eventually lower the longer-term rates and boost bond prices. In the long run, however, there are many factors that could keep inflation running hotter than in previous decades – not the best environment for bonds. We will need to be nimble here for the foreseeable future.

The other major risk for bond investors is default…people don't always pay you back…

The General Store:

Over the years, clients have become familiar with our distaste for indebtedness. Whether it is personal debt or corporate debt, we have always advised against excess borrowing and against investing in companies with high levels of debt. There are many sound reasons and mathematical rationale for this approach to personal finance and investing. A cursory gaze at financial history will illuminate countless debt induced crises. During the inevitable economic downturns that hit every few years, a high debt load becomes a major problem for heavy borrowers. But remember, every **debt** is also someone else's **asset**. A problem for the former is a major problem for the latter. Lenders or investors in highly indebted companies are just as financially exposed as the borrowers, sometimes more.

Quite a few years ago the Morgia family had to contend with just such an ordeal. It was a little bit before my time so I cannot say how I would have handled the issue. The story of the event did make a lasting impression on me about the safety, or lack thereof, of liabilities and debt.

Almost a century ago, back in 1932, during the Great Depression and long before Morgia Wealth Management, my immigrant great-grandfather Cataldo Morgia ran a general store with his wife Ida and their children. They sold many items including fresh produce from their neighborhood garden. The business was called Morgia Health Management. Ok… I just made that last part up, but it would have been such a good name! Alas, it was merely called the Morgia's General Store and it served the local Italian community in the "Flats" of Watertown, New York.

Times were tough, depressions always are. It was customary back then for the shopping "regulars" to run tabs and then settle-up at the end of each week. As the economy got progressively worse more and more of these tabs went unclosed. Embarrassed by their inability to make good on their debt obligations, customers started avoiding the store.

Having your customers go missing is one thing but these were also friends of the Morgia family. It got so bad that eventually Cataldo's eldest son (my grandfather Silverio) took him aside one morning and pitched an idea. As business strategies go, it probably wasn't one that will ever

Cataldo Morgia – source:
Morgia Family Personal Archives

be taught in business school – but it was the right move. My grandfather said to his father something to the effect of: This is not worth losing all our friends. Everyone is too embarrassed to show their face at the store. Even out on the street everyone is avoiding eye contact with us. No one has any money to pay us back. The money is already effectively lost - let's not lose our friends as well. When Cataldo asked what his son had in mind, he outlined his idea.

The next day they made a big show in the neighborhood by taking the box of receipts, dropping a box of matches into the container and then lighting the whole thing on fire. A few of the neighbors came out to investigate the smell of smoke and asked; "What's going on?!" Of course, in the Flats it probably sounded more like "Che diavolo sta succedendo!?" If you understand Italian, I apologize for slipping in a swear word, but I'm pretty sure that's how the question would have been asked. My great grandfather explained that all the tabs were officially closed and the records were all destroyed. Who owed what? Who knew and who cared?

Word spread through the neighborhood pretty quickly (Italians are not really known for holding back on news and gossip) and the next few days saw a return of the store patrons. Everyone got a do-over. Of course, this was not an easy thing to do financially for the Morgia family, but there wasn't really another option.

The moral of the story is that, one way or another, you will not collect that which cannot be paid.

How does this apply to our nation's paper assets – both the U.S. dollars and Treasury bonds? A few different ways. For starters, like in the above story, reality is reality. If the total interest and principal payments on the growing U.S. national debt obligations truly can't be made, it would be best for us to quickly realize that fact. "Can't" might be the wrong word, but I'm not so sure. My confidence in the word "won't" however, is fairly strong.

Secondarily, it's much more palatable to forgive the debt obligations of your friends and neighbors, especially when you can see that they are under duress and are in true need. The U.S. debt holders will not be so keen on forgiving the U.S. government from its obligations. Treasury bonds are also a critical part of the functioning of the global financial system. Any hint of a problem will not go well.

Consider the words of economist Herbert Stein in 1986. While speaking on U.S. federal debt, he said something profoundly simple and true:

> ***If something can't go on forever, it will stop.***

But that was almost 40 years ago and the debt bomb hasn't exploded yet, you might say. This is true, but the exponential nature of the debt growth, combined with our seemingly never-ending budget deficits have us thinking that something must give relatively soon. Soon enough, at least, to adjust our investment thinking a tad bit.

Your Uncle Sam:

I thought it might be instructive to convert our nation's finances into to a hypothetical family budget to help conceptualize the problem in familiar terms. It's easier to wrap our brains around thousands of dollars vs the trillions that our government works with. Let's say our hypothetical household is that of your Uncle Sam. Sam and his American family.

Sam's financial overview

Annual Income:	+$48,000
Annual Spending:	-$61,000

Annual Deficit Spending:	-$13,000
(Sam just borrows this difference every year)	
Mortgage Loan:	$314,519
Interest Payments:	$4,864
Interest Rate:	1.5% currently
(but rates are rising fast)	
Average Term:	5 years
Net Worth:	-$20,000
(Total Assets Minus Total Liabilities)	
For Hypothetical/Illustrative Purposes Only	

Sam's got issues! His family loves to spend money and they have little fiscal discipline. Who are we kidding – they have NO fiscal discipline. Your uncle has a lot of family members. None of the American family wants to take a cut in their allowance. In fact, Sam lets them all vote every two years, on whether to increase or decrease what he gives them. Guess how they vote?

If he tried to balance his budget, he would need to cut his household spending by 21% or $13k. That would be difficult, so instead Sam just borrows more money every year to make up the difference. Sam has another problem. The rate on his debt is aberrantly low today – it's normally much higher. Sam never likes to borrow long-term. Sure, that would be smart when rates are low. But Sam is a short-term thinker. He thinks that borrowing long-term would be a little more expensive and he needs every penny he can find. He borrows for 5 years on average, and his interest payment rate floats. He prays that rates stay low. It's a wonderful plan. But rates happen to be floating up right now – a lot! Sorry Sam.

To be truthful, Sam couldn't even pay his bills recently when rates were at record lows. As the rate naturally climbs to 5% (the current going rate), Sam's interest payment would go from $4,864 up to $15,700 per year.

Ouch!

That's an extra $11k per year in expenses! But his family already needs to borrow $13k extra every year without the higher interest payments. Oh well. Looks like his family now will need to start borrowing $24k every single year. Or Sam could just cut the family expenses by 33%. Haha, that's fresh! Sam never cuts his spending. His family would pitch a fit, and Sam never could take his children's tantrums! The situation is bleak.

But breathe easy folks, all is not lost. Sam has an ace up his sleeve. Your dear old uncle has a counterfeiting machine in his home basement. He can simply print more money to repay some of his debts. A little (or a lot of) this "new" paper mixed in with the existing stuff each year and the problem is solved right? Everybody knows the machine is down there in the cellar, but no one wants to talk about it. Everyone accepts the newly printed money regardless, so why make a fuss?

The above analogy IS the U.S. situation… with a lot more zeros added to the end of each number. Who exactly is enabling this for our country? Who keeps allowing the nation to spend more than we make and borrow/print the difference? The answer is that whoever holds the currency and holds the bonds of America are the enablers. There are many entities and individuals who are doing this. We ALL are doing it to some degree.

U.S. government bonds are owned by most investors and foreign nations. And all of us have cash and short-term funds based in dollars. As we mentioned earlier, some of the traditional holders of the debt and the U.S. currency have spent the last few years converting their paper-based currency into more tangible items, like gold. China and Russia stand out as two sovereign nations that have sold a massive amount of dollars and U.S. bonds to buy gold bullion.

Right now, the U.S. dollar is holding up well versus other global paper currencies – but not so well against *real* things such as oil and food. The United States has a printing problem. When we need more funds, we just push a button and create more money. That sounds a bit like counterfeiting, and some economists have half-joked that's precisely what is going on! So, the nation will most likely never *technically* default – but constantly diluting the dollar's value is not much different. You paid for a slice of American apple pie but when the waitress serves it up you are shocked to find out that the slice is more of a sliver. What's up with this slice, you ask? Sorry, this is the current slice size at Uncle Sam's Pie Parlor.

Our dollar bills are undergoing a similar diminution. The size is the same, but the buying power is dramatically "thinner." We've talked about this over-printing ad nauseam over the past few years, but it begs the question: How does the investment world look and operate under such a scenario? We would contend that people act very differently under an inflationary environment - an environment where other people are stealing your money. The bad news is that theft (of any sort) tends to cause MORE inflation and induce a downward spiral. When you combine theft and conflict, inflation and shortages will be tough to shake. The next decade seems likely to be chock-full of strife. Cold, warm, and hot wars seem probable.

The Dollar During Conflict:

The history of the dollar's value is one of dropping roughly in half during war-time and then returning to "normal." In the past, the gold standard kept the dollar somewhat moored to a stable value.

Source: http://www.sovereignman.com/kit/index.html
Information through 2005

It's a bit hard to tell, but the starting point is at $1 in 1775. Over the years, wars would break out, the dollar would drop to half value (high inflation). Peace would eventually be restored and the value would find its way back to its old level ($1). However, after two back-to-back world wars followed by the cold war and finally the abandoning of the gold standard in the 1970s, the dollar has never recovered. That was all she wrote.

Corruption and economic mismanagement also produce high inflation.

Take Zimbabwe. Over a decade ago, after twenty years of poor governmental management and rampant money printing the Zim dollar was destroyed. At one point it was losing 50% of its purchasing power every 24 hours! A client of mine who did volunteer work each year in that country told me a story of the local workers who, after receiving their paychecks, had to rush to the bus stop to go to the bank before the currency dropped so much that they couldn't afford the return bus fare! This is theft of labor. This is a country's leaders giving away money that is not theirs! It is a story that is all too familiar.

People act differently under an inflationary regime because people act differently when theft is prevalent.

During a recent CNBC interview, Walmart's CEO said that if the rising pace of shoplifting doesn't change, prices will go up and stores will be closed.[3] That's called inflation and shortage and it comes with little theft (shoplifting) and big theft (money printing). As it becomes more and more obvious to the average citizen that the government is taking their money, behaviors will start to change – and not in a good way. People could start to go into self-preservation mode. Why bother saving? Wouldn't it be better to spend your money fast on real goods and real assets before your paper money erodes, like the Zimbabwe bus fare? As the government runs into trouble with their tax receipts, they might resort to villainizing those with assets (more than they already do). Perhaps politicians will start calling for a tax on assets again, like they did a few years ago?

What would be a logical citizen's response? Stop buying assets and buy more consumables (stop thinking long term and just blow the money before it gets confiscated through inflation or taxation). At some point, productive workers simply cut back, stop working, or retire early - what's the point if your labor will be stolen? The U.S. needs to be **very** careful how we handle this issue over the next decade. I'm sure we will eventually fix our problems but understanding **how** we might fix them will inform **how** we should invest.

In our role as fiduciaries, attempting to protect and grow client portfolios, we will need to keep a close eye on these developments, staying both flexible and nimble. The traditional 60/40 stock/bond portfolio might not be so optimal anymore. Our foray into "**real**" investments like commodities and gold over the past few years might have more room to run in this type of environment. As the tech sector has been the hardest hit so far, we will be on the watch to deploy some of our sidelined cash into this area. Productivity and innovation will be our country's best path out of our inflationary woes, so there should be some very good opportunities in the technology stocks at some point.

We also believe that it will be imperative to focus on our long-standing thesis that it is most prudent to buy stocks of companies with very strong balance sheets. Low debt and strong free-cash generation are characteristics that typically shine in a weakening economy. These are characteristics on which we always focus, so we won't need to change our methods here, although we may want to place more emphasis on this than usual. Companies with products that are less economically sensitive will also be favored.

Lastly:

As difficult as market crashes can be, these are precisely the times when some truly great bargains can arise. The majority of the best investments we have made over our entire careers have come when stocks were unloved. I can't quite say that we enjoy these times, but the "math" sure looks a lot more attractive at these price levels. We will continue to hunt for great companies at cheap prices – it should be a lot easier than this time last year!

I will leave you with my favorite recent (sarcastic) quote from U.S. Congressman Al Lawson Jr, while he spoke in front of the Financial Services Committee and Fed Chairman Powell back in March of 2022.

> ***" One of the benefits of inflation is that you can live in a more expensive neighborhood without moving."***

Feel free to **check out our video library** on our website (**morgiawm.com**) or our YouTube channel or follow Morgia Wealth Management on LinkedIn. As always, please call or email with any questions and/or comments. On behalf of Tony, P.J. and the rest of Morgia Wealth Management, thank you for your continued confidence.

Sincerely,

Michael Morgia, CIMA®
Managing Director, Partner

Tony Morgia
Managing Director, Partner

P.J. Banazek, CFP®
Managing Director, Partner

The Morgia Team

Seated (left to right):
John Johnson, Nico Morgia, Katrina Thompson, Shane Simser, Zachary Buskey, and Joseph Cosmo.

Standing: (left to right):
Heather Clement, Frank Murphy, Tony Morgia, Kiersten Guthro, Michael Morgia, PJ Banazek, and Andrea Fiorentino.

Missing from the photo:
Will McCanney

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1. Callen, Bryan Show. 12/14/22. The End of the World with Peter Zeihan / Episode #14 (At 10:00 min mark) https://www.youtube.com/watch?v=aHUoMmKDLUI

2. https://www.reuters.com/world/middle-east/saudi-arabias-wealth-fund-sets-up-investment-firms-five-mideast-countries-2022-10-26/ Saudi Arabia's wealth fund sets up investment firms in five Mideast countries 10/26/22 Reuters

3. https://www.cnbc.com/2022/12/06/walmart-ceo-says-shoplifting-could-lead-to-price-jumps-store-closures.html