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CLIENT BULLETIN

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➤ *Amateur Psychologist*

There is a war going on in your brain right now. The combatants are your amygdala, which is a part of the brain that responds to danger, and your prefrontal cortex, the area of the brain responsible for long-term thinking and planning. For the past decade, the amygdala has been flat on its back on the canvas. In times of stress, however, the amygdala gets up off the mat and can temporarily gain the upper hand. This causes us to fall back on unproductive methods of decision-making in times of stress when too much information is thrown at us. According to Peter Sokol-Hessner, a cognitive neuroscientist at the University of Denver, stress “causes you to fall back on simpler methods of approaching your world. You have a decreased ability to use your previous experiences and knowledge to make smart choices in new settings.”

➤ *Preparation is Key*

We are certainly in a “new setting” to say the least, but the purpose of a disciplined financial and investment plan that is devised *before* unsettling times hit is to give your prefrontal cortex the weapon it needs - a longer-term perspective - to beat the amygdala back into submission. As you take more walks during the coming days and weeks, don’t forget to bring your prefrontal cortex along with you for some exercise.

➤ *Recession Watch*

Before the Coronavirus hit, I had a Client Bulletin article ready to go for this April edition about how long the current economic expansion has gone on and how to be prepared for an inevitable economic downturn, saying “Trying to forecast when the next economic downturn will hit is of course a fruitless exercise – “**when**” is not the operative question because no one can predict the future; “**how**” to be prepared in advance for the next phase of the economic cycle occurs is”.

➤ *It’s Here*

Well, much sooner than expected, the global economy is already in or heading into a recession thanks to the economic activity that has been postponed due to the virus. Just as the timing of going into a recession was unknowable, so is the timing on coming out - no one knows how deep it will go nor how long it will last. Regardless, the steps below which were applicable to being prepared for a recession are just as applicable now that a recession is upon us.

➤ *Be Prepared*

The best ways to prepare for an economic downturn (or behave **during** a downturn) sound remarkably simple and horribly old-fashioned, but guess what, they work. Here are some of those transcendent principles that apply whether you want to stay out of trouble or get out of trouble. If you take these steps, you can be a spectator during unpleasant economic times.

- ✓ Maintain liquidity with 3 to 6 months' worth of living expenses in cash/near-cash holdings
- ✓ Spend less than your income
- ✓ Use debt judiciously – today's ultra-low interest rates can mask excessive debt
- ✓ Maintain focus on long-term goals so you can prioritize short-term spending decisions
- ✓ Diversify your investments so you can be a buyer or seller of whichever asset class appears to be over or undervalued

➤ *Investment Implications – The Siren Song*

I think I know what you're thinking. "Since we know a recession is coming or already here as world GDP reports over the next few quarters come in somewhere between soft and downright ugly, why not just liquidate equity investments, wait on the sidelines until declines have abated and then jump back in?" The short answer is that it can't be done. There is no known method of getting out of the market and back in again opportunely to consistently achieve a return in excess of the index. The siren song of timing markets in the short term, which you would not be human if you didn't feel, inevitably results in missing out on a large portion of the long-term advance of equity holdings which are crucial to achieving long-term financial goals.

➤ *Getting Ahead*

A longer answer is that equity markets are a **leading** indicator of the economy by anywhere from 6–18 months. The declines in the equity markets over the past few weeks have already taken into account those upcoming GDP numbers and discounted them into current prices. That's how they work. Where equity markets go from here depends on what global earnings and GDP figures look like in 2021, 2022 and beyond as the clouds begin to break and the "post-virus" numbers come in. These are, of course, unknowable which brings us back to the only way to make rational decisions under uncertainty – having a pre-determined, disciplined plan and executing on it. I'm 99.99% sure that: a) the virus will ultimately be conquered; and b) the equity markets will resume their long-term ascent. No one knows when on either count. When they do, a re-balanced investment portfolio will prove profitable. In the words of Warren Buffet, "Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold." This too shall pass.

➤ *Leading the Way*

As it did in World War II, America can use its productivity and dynamic economy to be a leader in addressing this current crisis. Some US **states** have economies as big as **countries**: If **California** was a country, it would have the 5th largest GDP in the world. With a labor force of 19.5 million it generated more than \$3 trillion in output in 2019, exceeding India's 2.9 trillion, which was produced by a labor force of 519 million; **Texas** produced nearly \$1.9 trillion of output last year with a workforce of 14 million, just ahead of Brazil with a workforce of 106 million; **New York** had output of \$1.73 trillion in 2019, just ahead of Canada at \$1.7 trillion. Canada has 20.4 million workers, more than twice New York's 9.5 million. (source: www.fee.org)

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