Talbot Asset Management Random Report

32 South Main Street, Winter Garden, Florida 34787
407-877-2297 800-846-6467
www.talbotasset.com

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December 2020

Forty Years...

On January 5, 2021 I celebrate my 40th year in the investment business. I knew I wanted to be in the business when I was 15 years old. My high school economics teacher at Urbana High School in Urbana, Illinois, Mr. Dean, taught us about investing in the stock market. He had all of the kids in the class pool their money and we did research on what stock we wanted to buy. The class bought 5 shares of Dome Mines, a Canadian gold mining company. We paid $35 a share and sold it for $55 at the end of the semester. My love for the stock market began there. During my senior year of high school, I took some of the money I made working at McDonald's (at a whopping $1.65 an hour) and bought shares in Ponderosa (some of you will remember the steakhouse). I bought it because I ate lunch there ALMOST EVERY DAY. I bought it for six dollars a share. Unbeknown to me, the stock had gotten crushed because of an Australian beef famine and that's where they got most of their beef. Several months later, I sold it for $30 a share. Thinking I was a genius at this, I left for Southern Illinois University-Carbondale to begin a degree in Finance.

During my time at SIU-C I became President of my fraternity for two years (Tau Kappa Epsilon). As I was getting close to graduation, I knew I wanted to get into the world of stocks, yet I knew I was pretty young for someone to hire me into the field. The fraternity recruited me to go to work for the headquarters in Indianapolis where I travelled all over the United States and Canada as a consultant for the fraternity.

About the time I was ready to leave the fraternity staff and move on, E. F. Hutton was opening a new office in Carmel, Indiana. In the 1980's E. F. Hutton was one of the most prestigious firms on Wall Street. They were famous for their advertising with the slogan "When E.F. Hutton talks, people listen." I prepared the only resume I have ever written in my life and sent it to E.F. Hutton. I secured an interview with the local office and their manager Lou Jensen. I was 23 at the time and he was very apprehensive to hire me. However, he was also a fraternity guy (in a different fraternity) and was impressed with my credentials. I told him that this was my destiny and I would work 60-70 hours a week to be successful. He decided to give me a chance and hired me on January 5th, 1981. Upon receiving my licenses to become a "stockbroker", Lou came to me with one of his historic motivational speeches and said, "OK, now you have 12 months to find your clients or your fired."

As luck would have it, the day I started, Joe Granville, issued one of his famous market calls. Joe Granville wrote a market timing newsletter that everyone followed called the "Granville Market Letter." His stock market calls moved markets. As he got more famous, he became an investment seminar speaker complete with chimpanzees, dancing girls, and special effects that made it look like he walked on water. Thus, the day I started the market collapsed based on one of this famous calls.

As I started my 60-70-hour weeks, I gave tons of investment seminars called "Renewing Your CD"? In 1981, interest rates on money market funds were 21% and mortgage rates were 16%. Nobody wanted to own stocks except me. Who would want to own stocks when you could get a minimal risk return of 21%? I also wound up teaching several adult education investment classes and several of my students (or their kids) are still clients to this day.

Then August 1982 arrived. The Federal Reserve had raised rates to those earlier levels to fight inflation coming off of the Arab oil embargos of the late 1970's. In 1982, interest rates started to drop quickly and on August 13th of 1982, the market started to explode on the upside. I was trying to buy as much stock as I could with my limited clientele while the rest of the "old timers" in the office thought it was just another poor rally attempt similar to all the others they had seen since 1974. I hadn't experienced what they did so I bought stocks and this explosive rally continued until 1987.

Sometime around 1985, I was planning on a vacation to Nassau in the Bahamas. One of my investment heroes at that time was John Templeton, founder of the Templeton Funds. His office was located in Nassau. Mr. Templeton was considered one of the founders of international investing. In fact, Money magazine in 1999 named him the "greatest global stock picker of the century." During the Depression, he bought 100 shares of each NYSE listed company selling for under $1 and made a small fortune when the US exited World War II. He used these funds to start his mutual fund company and its flagship fund. I wrote Mr. Templeton a letter telling him he was my investment hero and would love to meet him or take him to lunch when I was visited Nassau.

A few weeks after sending my letter, I received a letter saying I had a 30-minute appointment scheduled. Arriving at his office was quite interesting as it was a very non-descript building with only two people working there (including his investment research head- Mark Holowesko). He didn't even have a quote machine in his office. He had no desire to get caught up in the day to day "noise" of Wall Street. He located his office in the Bahamas to be as far away from Wall Street as possible.

As we sat down on the couch for our conversation, I asked him what his advice would be for someone 27 years old if I wanted to become independently wealthy. He immediately responded that he would do what his wife and him did for the first 20 years they were married. <u>They saved 50 cents of every dollar they made</u>. I said, "That's incredible". He said, "Yes, but you would be amazed at how fast money compounds when you are saving at that rate.

He was also still managing the flagship fund at that time. He was about 75 years of age at that time. I asked him, "How long are you still going to manage money before retiring?" Again, without hesitation, he told me about his buddies here in the Bahamas. He said he has his fishing buddies that come into the office and tell him about the fish they caught and how it made them happy. He said he has some golfing buddies that will come into the office and tell him about the golf score they had and how it makes them happy. Then he said, "<u>the thing that makes me happy is finding that one stock that makes 60,000 people happy.</u>" I knew right then that I would probably never retire from this business.

During the period of 1982-1987, I met a lot of interesting people and went to several training programs with E.F. Hutton. In one of the many sessions I asked an 87-year-old "stock jockey" what he would advise me. He said, "always buy quality, you can't live with junk." I will never forget those words and remember it in almost everything I buy (not just stocks). He helped mold my investment philosophies where I knew most of my clients were not necessarily wanting speculative returns but consistent returns over time. This was much easier to do back in the 1980's when you could have bond portfolios returning ten percent (compared to one percent now).

Two years rolled around and I had the offer to move to a regional firm called Prescott, Ball and Turben, which was owned by Kemper Insurance. I moved in July of 1987. Over the course of the prior five years, institutions had created a unique trading tool they named "portfolio insurance." During the creation of these innovative financial instruments, you could trade the stocks in the SP500 in New York and trade the commodity futures of the SP 500 in Chicago. They figured out that if you bought the SP500 stocks in New York and sell short the SP 500 futures in Chicago, you could lock in a riskless rate of return playing the price discrepancies between two markets on the exact same thing.

On October 19th, 1987, TVs in Indianapolis were glued to the Radisson Hotel where a fighter jet had crashed while trying to land at the Indianapolis Airport. The market started to decline and by noon, the market was down about 10% causing these trading programs to widen their risk-free rate of return potential. By midafternoon, these programs of "portfolio insurance" were causing the markets to collapse. By the closing bell, the market was down <u>22% on the day</u>!

The next day, the market opened down again and the computer programs kicked in. Around 10:30 am, they turned off the computers abilities to trade risk free between the two markets. Future studies showed that if they hadn't done that, they could have driven the markets down to almost zero. About 10:30-11:00 am an incredibly large institution came in with an enormous order to buy stocks and the market rallied substantially. Some people theorized it could have been the U.S. Government but no one could ever verify which large order essentially pulled the stock market back from the abyss.

After the 1987 crash, a relatively new tool evolved called "stock options." These instruments allowed you to invest in stocks with very limited amounts of money. This attracted a lot of younger investors because you could essentially speculate on the movements of stocks. Prescott, Ball and Turben decided to send me to an advanced options class at the Chicago Board Options Exchange in Chicago where I had the chance to be on the floor when they all started yelling orders at each other. As part of the education, they told you in class that "95% of the people who buy options lose money." Thus, my preference for selling options began where I sell options to the people wanting to buy them. There are investment trade offs with these strategies called "covered call writing" but it's a moderately bullish strategy of providing some income while lowering downside risk.

In 1991, upon moving to Florida, I decided to start my investment practice, Talbot Asset Management, while contracting as an independent advisor with Raymond James Financial Services. Raymond James was known for investment research for small and medium size companies and I naturally migrated to them. By this time, I had clients all over the United States and the move to Raymond James went smoothly.

The markets in the nineties were quite good. However, investment speculation started to explode. There is a BIG difference between speculating and investing. Usually if people want to speculate, they should just go to Las Vegas where you can get free drinks while you speculate. Investing is tough where even John Templeton would tell you successful investors are good investors if they are right 60-70% of the time. The people speculating would buy "penny stocks" where speculative companies were traded at less than a dollar a share. In some cases, pennies a share. This was illustrated by the movie, "The Wolf of Wall Street." A good portion of that movie was accurate. Cab drivers would give you stock tips. Guys sitting next to you in a bar would tell you about the 10,000 shares they just bought at 2 cents a share. I kept remembering, "buy quality, you can't live with junk." I never got pulled into this and eventually everything blew up and created the next investment bubble – the Dot.com era and Y2K.

The internet was starting to explode at that point in the late 1990's. Between 1990 and 1997, the percentage of households owning computers increased from 15% to 35%. Every new internet stock had the suffix .com in its name. During this time, companies were able to become publicly traded stocks with just a dot com in their name. People sold high quality stocks to buy companies like Pets.com or CDnow.com (online retailers of compact disks) or Cyberian Outpost which was one of the first successful online shopping websites. It made a controversial ad campaign in the Super Bowl where they shot fake gerbils out of a cannon. In fact, 20% of the 2000 Super Bowl ads were purchased by Dot.com companies. There were hundreds of examples of these companies where most went out of business.
On March 13, 2000, the Dot.com market crashed and it took the Nasdaq which included the dot.com related stocks and other technology companies almost 20 years to get back to the level it

was on March 13, 2000.

Mixed in with the Dot.com bubble was the year 2000 problem. This was known as Y2K. Computer programs were designed for the four-digit years beginning with 19. People believed that when the computer programs rolled over to the year 2000, computer crashes would occur all over the world. They believed planes would fall from the sky and power grids would come down. John House, United States Deputy Secretary of Defense even said, "the Y2K problem is the electric equivalent of the EL Nino and there will be nasty surprises around the globe." People liquidated portfolios for fear their brokerage statements would show a zero balance. When January 1, 2000 finally arrived, only minor problems occurred. No planes fell from the sky and life went on.

After Y2K and the Dot.com bubble, we then went through a pretty prosperous time with interest rates dropping and the stock markets doing well. This low interest rate environment helped cause the Great Recession of 2008-2009. The government (which in my opinion, always seems to help create problems) wanted to expand the number of people living in residential homes. They lowered the underwriting requirements to where anyone with a pulse could get a mortgage on a home with little to nothing down. In fact, I knew a housekeeper at Disney who owned 4 homes with very little cash outlay. Home prices exploded due to the demand. People were buying homes and trying to "flip" them as fast as they could. I had a feeling the market was topping when a developer on Lake Apopka, here in Central Florida, was developing lakefront lots claiming you could get to the ocean via various canals. This was promoted as a high-end development financed by SunTrust Bank where you could buy the lots with zero down and finance the rest. They even gave you helicopter rides to fly over your lot. Never mind the other issues that Lake Apopka was essentially a "dead lake" from agricultural run offs from the 1940's (it's actually better now) and that the lake at it's deepest point is only six feet. Have fun getting to the coast from there, although it is doable!

Under the surface, there was a huge smoking gun developing. Banks would create these mortgages and then sell them to mortgage pools. This was outlined in the movie, "The Big Short," which was also primarily a true story. This process of selling mortgages went great until the government issued an accounting regulation called "marked to the market." This meant that you had to mark on your books the value of your assets whatever the market value was. Well… if a mortgage wasn't traded according to the government's new rule, it had no value because there was no market. Banks capital ratios plummeted. Money locked up all over the place. In fact, we were probably 24-48 hours from not being able to access cash from ATM machines (a little-known fact). This event caused the real estate market to plummet and prices all over the country collapsed. Bank regulators had to relax the "mark to the market" rule or multiple banks would have collapsed. The relaxing of this rule occurred in March of 2009 and we have been essentially in a bull market ever since.

2020 the Year of the Bat

Just when I thought I had seen it all after 39 years in the business, obviously I had not seen it all. This year included global economic shutdowns, global population "lockdowns," historic market declines followed by historic market increases. "Stay at home" stocks exploded to the upside while hotels, casinos, restaurants, cruises and theme park stocks got crushed.

At one point, I would listen to a conference call of various companies and each one would say "we have no idea what our revenues or earnings are going to be." How are you supposed to invest in various companies when the companies don't even know what they are looking at? I admit, I had too much cash built up because I have always had a philosophy of "when in doubt, raise cash." There is less than 3% of the advisors in this business that have more experience than I do and if I had no idea which direction things were going, then I'm not sticking my clients' necks out too far. In fact, another investment rule, when you have major down moves like we saw in March and April, buy the highest quality companies you can as those stocks will recover faster when the smoke clears.

So how did we get here and where do we go from here? We all realize the coronavirus originated in China from a level 4 biological lab. It's still to be determined whether it was intentionally released or accidentally leaked from this lab. Originally it was promoted as being released from a "wet market" in Wuhan from a bat. The incredible thing of 2020 is that one of U.S. quarters for 2020 commemorates the National Park of American Samoa where one of the sacred animals on the island is a BAT and the bat is on the reverse side of one of the 2020 quarters! One of those quarters is attached to this newsletter but I would not spend it as it will most likely have some collectible value someday!

President Trump had taken a hard line against China. It's no secret they didn't like him. He was derailing their "one belt, one road" initiative where everything revolved around China and essentially, we were second tier compared to them. Multiple factories had started to leave China and several were returning to the U.S. If you cut off the money to China, you cut off the funding for their goals of world domination. That's why you see the Chinese almost taking victory laps over the election. And it's why they had no problem in not telling the world about the virus. They're waging economic warfare against us.

Initially the world was told to shutdown and stop the spread. The Federal government took control of various parts of the Covid response while states took over other parts of it. Unfortunately, all of it became political as opposed to realistically looking at the data. Having daily reports of cases made no sense as all it did was create panic! Scientists became politicians and politicians became scientists.

The good news is vaccines are on the way and should be available for everyone by May of 2021. The interesting thing is that the hospital board I serve on has gotten data that by the end of December, herd immunity (meaning you already got it) could be approaching 80% so the vaccine is coming a day late and a dollar short. However, things should be getting back to some sort of normalcy soon, either way.

With good news on the horizon as the world returns to normal, equities should perform well. In fact, with the amount of money that has been printed, those dollars will most likely flow to stocks, real estate or gold but would be very bad for bonds. Thus, I believe, stocks should continue to do well. Unfortunately, it's still too early to determine which stocks will outperform.

One piece I feel is probable, is that international stocks (which have gone nowhere for probably ten years) may finally start to perform. In fact, I think they could start to outperform. I believe the U.S. dollar will gradually decline over the next few years. There is no <u>incentive</u> for our government to cut the deficit so they will continue to flood the market with dollars. In this environment, international stocks should do well.

I also believe that interest rates will start to rise making bonds a very risky investment. The last few offerings that the government made to sell bonds have gone terrible. Maybe people don't want to earn 1 ½% annually for 30 years. <u>DUH</u>…

THANK YOU...

I would like to thank all of my clients who have been with me over the years. Some are still with me from the early adult education days. I want to thank my loyal assistant and office manager, Nancy Shelly, who has been with me almost 25 years. I realize most of you would rather talk to her than me anyway. I also hope that most of you have talked to Sam Giufre, my assistant portfolio manager, who also happens to be Nancy's son. He helps me do research and also helps me manage accounts. He has proved to be quite an asset to Talbot Asset Management. I have known Sam since he was 5 years old and I'm thankful to have him on our team. Thank you, E.F. Hutton, for giving me my start to this 40-year journey and thank you to Raymond James for allowing me to create my own independent office of Talbot Asset Management. I look forward to continue helping each of our clients reach their financial goals!

Notes from Nancy...

New government regulations have required us to have at least an annual review of your account(s) to discuss whether your objectives, income needs, etc. have changed so that Rod is aware of these changes and can structure the account accordingly. I will be reaching out via email or telephone over the next few weeks to set up a time for us to go through this review. We can also do it via Zoom if you prefer to "meet with Rod face to face!"

If you have recently moved, dropped your home phone number, got a new cell number, retired, changed jobs, had a significant change in income, need to update your beneficiary(s) on your IRA account due to marital status changes or maybe you won the lottery, you'll want to call me so I can update your account information!

As I mentioned in the last Talbot Asset Management Random Report, no longer referred to as Quarterly Report, this year the Coronavirus Aid, Relief and Economic Security (CARES) Act has waived the required minimum deduction (RMD) for your IRA, SEP IRA, SIMPLE IRA or retirement plan account. Individuals, including beneficiaries, will not be required to take their 2020 required minimum distributions (RMDs) from their IRAs. This RMD waiver would also apply to individuals who turned 70½ in 2019 but did not take their RMD before January 1, 2020. You can still take the distribution, if you'd like but it's not required and there will be no penalty for not taking it in 2020. We would suggest you consult your tax advisor on whether you want to take a distribution this year or defer the tax liability to next year.

The National Park of American Samoa quarter is the first in 2020 and 51st overall in the America the Beautiful Quarters Program.

Located some 2,600 miles southwest of Hawaii, the National Park of American Samoa is one of the most remote national parks. It includes sections of three islands—Tutuila, Ta'ū, and Ofu. Almost all of the land area of these volcanic islands—from the mountaintops to the coast—is tropical rainforest. It totals 13,500 acres, of which 4,000 are under water.

The reverse (tails) design depicts a Samoan fruit bat mother hanging in a tree with her pup. The image evokes the remarkable care and energy this species puts into its offspring. The design is intended to promote awareness of the species' threatened status because of habitat loss and commercial hunting. The National Park of American Samoa is the only national park the Samoan fruit bat calls home.