THOUGHTS FOR THE WEEK

BEGINNING OF KNOWING

February 23, 2024

A Chinese proverb states, “To say you don’t know is the beginning of knowing.” However, in a chaotic, fast moving, random world, people crave certainty. They want answers. And there is a strong temptation to provide answers – with certainty – even when said answer carries the weight of uncertain probabilities. This delusional certainty – often a joint delusion amongst all involved parties – can lead to consequential decision errors. When faced with questions involving a high degree of variables, many of them random, it’s often better to start with, “I don’t know.”

“I don’t know” is not a cop-out. It’s an acknowledgment that there are too many factors at play to make decisions with certainty. Howard Marks of Oaktree, an investment firm, is fond of saying, “We encourage our teams to make forecasts about the economy, interest rates, etc…but it’s not OK to bet on those forecasts.” A forecast helps gauge probabilities and forces the forecaster to think through variable paths. But there is a wide gulf between a forecast and “knowing” – “I place a 65% probability on short term interest rates being 4% by year-end,” is a lot different than, “short term interest rates will be at 4% by year-end.”

A non-investment related example, a few years back I suffered a bout of what turned out to be sciatic nerve pain, stemming from a long-term spinal disc problem (itself stemming from, most likely, years of abuse from skiing). I went to see a doctor, and his original diagnosis was a strained piriformis muscle. Not, “It might be you piriformis muscle, but we’ll do an CT scan to further investigate.” No, it was, “It’s your piriformis muscle.” And off to PT I went, with a prescription for muscle relaxers in hand. But it wasn’t the piriformis muscle. And after two weeks of PT, and a worsening condition, I went back to the doctor, who then sent me to an orthopedist. Being a joint doctor, his diagnosis was, “Hip problem.” Now, I tend to have confidence in professional opinions, so deferred to the doctor, and took a series of steroid injections and more PT. But a few more weeks later, still in pain, I was back in the orthopedist’s office. Finally, a CT scan was ordered. It wasn’t my piriformis muscle. I didn’t have a hip problem. What I had was a herniated disc, pressuring my spine, and sending pain down my leg. The “certainty” of the doctors cost me roughly a month of delayed treatment for the real problem. “I don’t know,” followed by investigative testing, would in hindsight have been the proper path.

The client / advisor relationship often faces the challenge of questions appropriately met by “I don’t know.” When you’re paying an advisor meaningful dollars, answers with certainty, on the surface, are a reasonable expectation. The problem – the economy and markets are not fixed systems with consistent cause and effect and a static range of probabilistic outcomes (like, for example, the range of outcomes in the card game, blackjack). Rather, the economy and markets are complex, random, dynamic systems, inputting trillions of variables that continuously shift. Further, the actions of participants changes the dynamics in real time, an effect George Soros, noted investor, refers to as reflexivity. We’ve used this analogy before, it’s as if you’re rock climbing, and where you decide to place your feet on the rock wall then changes the shape of the wall itself.

To navigate in this dynamic environment, probabilistic thinking has to be employed. What (hopefully) improves over time, as a professional, is your odds making skills. But probabilistic thinking contains a degree of "I don't know," and sometimes that degree is high. If you ask, "Is a US treasury bond a solid credit," we can answer yes, with an extremely high conviction in the probability we're right. Call it "almost" certain. But if you ask, "What do you think the market will do this year," we will answer, "I don't know," because that is the right answer. It's not giving you a false sense of security, nor is it incentivizing us to bet your capital on mis-calibrated odds. Instead, it forces a reckoning of the inherent uncertainty any investor faces, and consequently incentivizes us to look for ways to reduce risk, primarily through diversification of holdings.

Watch financial news sometime (surprising, because we never encourage this), and pay attention to the guests. A few are humble, and plainly acknowledge the uncertainty they face. But many speak with "authority" - the "market will do x this year"; "interest rates will finish the year at y." Then ask, "How do they know this?" And "Do they acknowledge their limitations?" Most do not, and as they appear authoritative, listeners can mistake these guesses for certainty.

As a team, we bring a lot of skills to bear. Sadly, fortune telling is not one of them. We believe our odds making skills are highly calibrated, but we don't mistake that for certainty. And we're not afraid to say, "I don't know." After all, it's the beginning of knowing.

Mike, Cate, Scott, Willis, Suzy, Oscar and Wes

Private Wealth Advisors
Mike Burbank, CIMA®, CFP® | Managing Director
Scott Hafeli, **CFA** | Executive Director
Willis Davis, **CFA** | Senior Vice President
-
Cate Rachford | Senior Vice President, Group Director
Suzy Shin | Wealth Management Associate
Oscar Castillo | Portfolio Associate
Wes Cai | Wealth Management Analyst

Morgan Stanley Private Wealth Management | The Burbank Group
555 California Street, 14th Floor | San Francisco, CA 94104
Phone: +1 415 576 3134

To unsubscribe from the email list, please contact Wes Cai at Wes.Cai@morganstanleypwm.com.

Mike Burbank's Awards:
2017-2022 **Barron's Top 1,200 Financial Advisors: State-by-State** (formerly referred to as Barron's Top 1,000 Financial Advisors: State-by-State)
Source: Barrons.com (Awarded 2017-2022). Data compiled by Barron's based on 12-month period concluding in Sept of the year prior to the issuance of the award.

2013-2020 **Financial Times 400 Top Financial Advisors**
Source: ft.com. Data compiled by the Financial Times based the following time periods:
Awarded 2013-2020; data 12/31/12 - 6/30/19

2019-2020 & 2022 **Forbes Best-In- State Wealth Advisors**

Source: Forbes.com (Awarded 2019-2020 & 2022). Data compiled by SHOOK Research LLC based 12-month time period concluding in June of year prior to the issuance of the award.
Awards Disclosures

Please note that the URL(s) or hyperlink(s) in this material is not to a Morgan Stanley Smith Barney LLC website. It was created, operated, and maintained by a different entity. Morgan Stanley Smith Barney LLC is not implying an affiliation, sponsorship, endorsement with/of the third party or that any monitoring is being done by Morgan Stanley of any information contained within the linked site; nor do we guarantee its accuracy or completeness. Morgan Stanley is not responsible for the information contained on the third-party web site or the use of or inability to use such site.

The information and data contained in this piece are from sources considered reliable, but their accuracy and completeness are not guaranteed.

This illustration in this piece is hypothetical and shown for illustrative purposes only. The illustration is not intended to predict the returns of any particular investment, which will fluctuate with market conditions. Actual results may differ from those depicted in the illustration. The Burbank Hafeli Group at Morgan Stanley Private Wealth Management is focused on serving the investment and financial planning needs of the founders of food, beverage, and consumer products companies and private equity and investment banking professionals.

Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors or Private Wealth Advisors do not provide tax or legal advice. Clients should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trust and estate planning and other legal matters.

Asset allocation, diversification and rebalancing do not assure a profit or protect against loss. There may be a potential tax implication with a rebalancing strategy. Please consult your tax advisor before implementing such a strategy.

The views expressed herein are those of the author and do not necessarily reflect the views of Morgan Stanley Wealth Management or its affiliates. All opinions are subject to change without notice. Neither the information provided, nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results.

This material does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The strategies and/or investments discussed in this material may not be appropriate for all investors. Morgan Stanley Wealth Management recommends that investors independently evaluate particular investments and strategies and encourages investors to seek the advice of a Financial Advisor. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives.

Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low-price levels.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives, and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer.

Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Morgan Stanley Private Wealth Management, a division of Morgan Stanley Smith Barney LLC. Member SIPC.

CRC 6416453 dtd 02/23/2024