ECONOMIC & FINANCIAL MARKET UPDATE – June 2020

The Best of Times, The Worst of Times, A Recovery

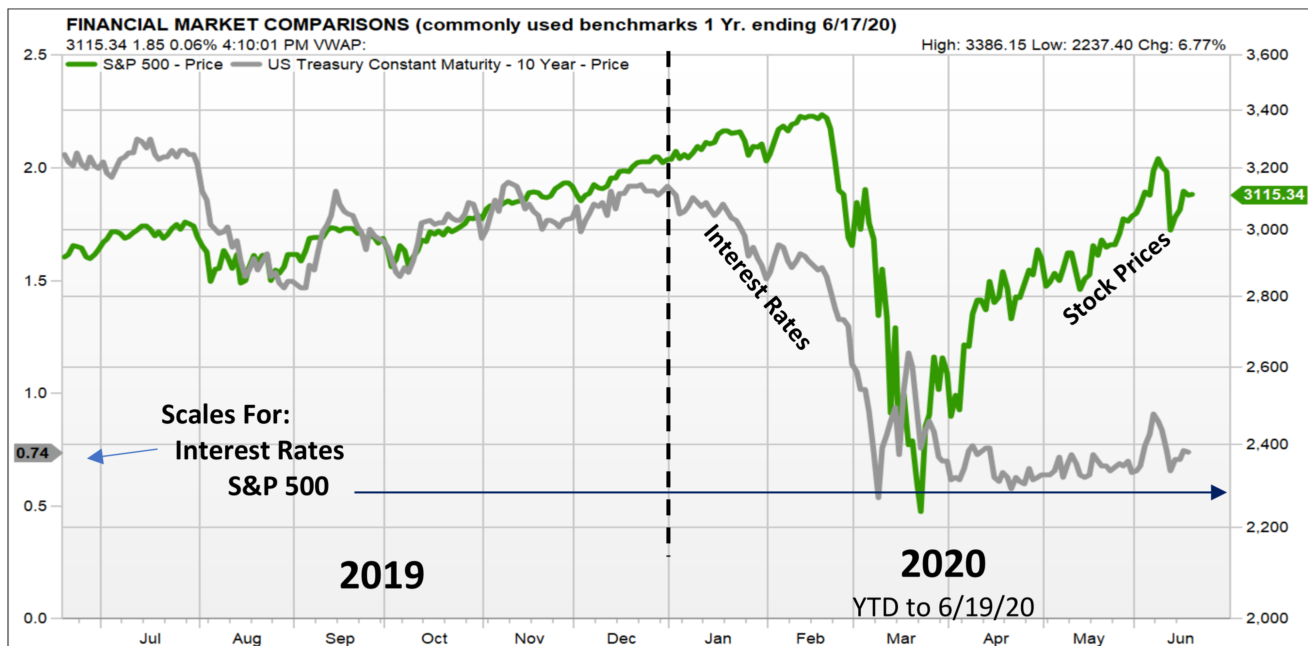
Reflections

It may sound a little trite, but the opening lines of Charles Dickens' epic novel, *A Tale of Two Cities*, seems apropos to describe the U.S financial markets and the economy during the first six months of 2020.

"It Was The Best of Times". As the new decade began, the U.S. economy was in the midst of the longest economic expansion in U.S. history (126 months)[i]. Data actually suggested that economic expansion was accelerating after the rather tepid growth of the previous year. In addition, the unemployment rate in the U.S. was at a 50-year low (3.50% as of 2/28/2020)[ii], corporate earnings were anticipated to grow meaningfully, inflation was benign, interest rates were near historic lows and the price of crude (a major expense item for consumers) was declining. The combination of these positive factors led enthusiastic investors to "push" each of the major domestic equity indexes e.g. the NASDAQ, the S&P 500, and the Dow Industrial Average to historic highs[iii] by the middle of February.

"It Was The Worst of Times". As the U.S. economy and financial markets were showing promise of another positive year, the coronavirus that had been plaguing China in late 2019 and early 2020, began to spread rapidly outside of China and quickly became a global pandemic. As rates of infection and deaths related to the virus accelerated in the U.S. (and elsewhere) in March, public health experts, the administration, and state and local officials called for business to shut down, citizens to shelter in place, and to avoid travel and contact with others if possible. Only business considered "critical to the economy and the health of others" remained open.

With business closed, unemployment quickly spiked to historically high levels, consumer spending (critical to U.S. GDP) contracted dramatically, estimates for corporate earnings plummeted, and fears of a significant U.S. recession and epidemic heightened. The result was a dramatic fall in stock prices and U.S. economic activity. The health of Americans took precedent – as it should.



Source: Factset Research Systems

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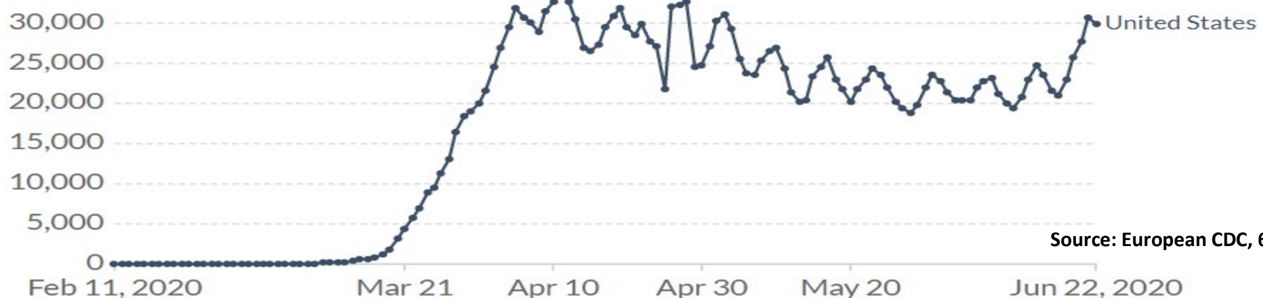
A Recovery. The reaction to the unprecedented rapid decline in the economy, the loss of twenty-two million jobs[iv] in eight weeks (March & April 2020), and the possible bankruptcy of many small and moderate size business, was also unprecedented. Unlike the Great Financial Recession (2008/09) when it took more than a year for Congress to pass legislation to help overcome that recession, this time it took less than a week for Congress to pass the largest ($2.3T+) relief package in U.S. history. That legislation, the CARES Act[v], provided one-time stimulus checks to individuals, enhanced and extended unemployment benefits, and loans and grants to businesses and municipalities.

In concert with the CARES ACT, and *critically important* to confidence in the progression and sustainability of economic recovery has been the action of the U.S. Fed, and other global central banks to engineer a program of massive fiscal stimulus. The Fed has cut the fed funds rates to near zero (0.25%)[vi]and expanded its balance sheet from four to seven ***trillion*** dollars (and counting) to keep interest rates low and money supply (M2) growing rapidly. The increase in money supply creates liquidity for the critical banking system and leads to increased consumption, borrowing and lending. As Fed Chairman Powell has stated, "the Fed is all in" on taking action to help the U.S. economy recover and is "not out of ammunition by a long shot".

While monetary stimulus is critical to a "comatose" economy, the most critical issue at the time was the virus itself and how effective control of its spread, and actions to cure infected citizens, would be. There could be no re-opening until citizens/consumers felt comfortable returning to some degree of "normality".

By late April/early May, the rate of growth of coronavirus cases began to stabilize and then decline. As a result, states, businesses, and the administration began to put policies and procedures in place for a gradual "re-opening". While there has been a recent up-tick in the rolling three-day average rate of growth in cases it appears to be more localized in states that re-opened more fully and quickly. Caution remains critical.

Daily New COVID-19 Cases – 3 day rolling average



Source: European CDC, 6/22/20

With the reopening of U.S. businesses and venues, has come evidence that U.S. and global economies are beginning to stabilize and gain positive momentum. The charts below display that positive momentum:

*Claims for unemployment benefits filed by unemployed individuals with state unemployment

2,008,000 4 Wk. moving avg.

Source: Evercore ISI

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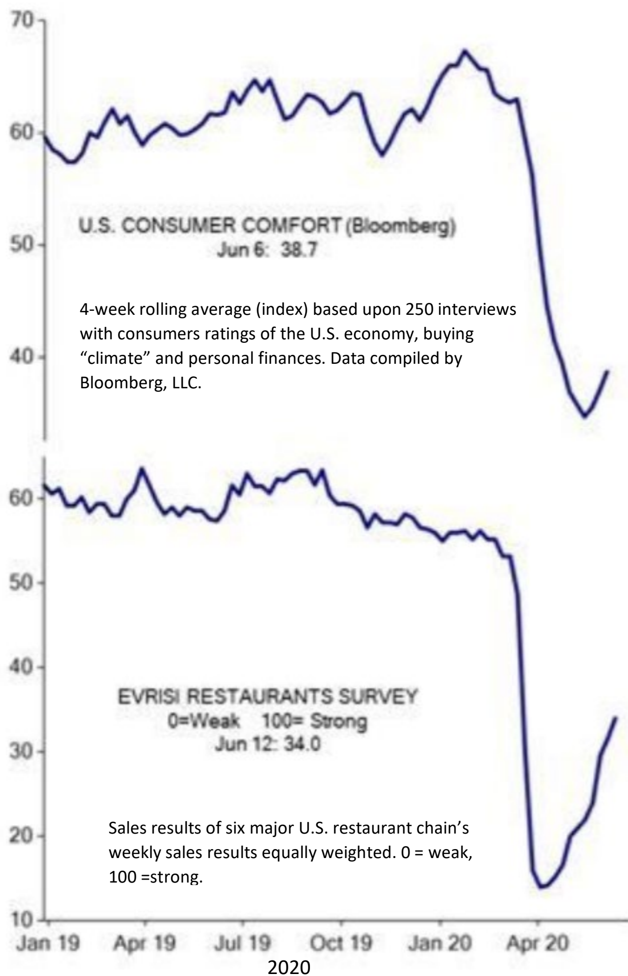

Source: Evercore ISI (3 charts)

With mounting evidence that the economy was recovering and returning to at least some level of "normality", but certainly not without concerns, the S&P 500, and other major equity indexes, have rebounded strongly from their March lows. After falling to a low[vii] on March 23rd the S&P 500 has risen by more than 38% and now is off just -4.12% (not including dividends) year-to-date through 6/19/2020. The NASDAQ is positive by +10.85% and the Dow is off by -8.61% as of the same date.

Our economic/financial market outlook, when considering the next twelve to eighteen months, remains optimistic but not foolishly positive. The recent trends of declining Unemployment Claims (folks returning to work), rebounding vehicle and overall retail sales, improving Consumer Comfort (sentiment), historically high Household Net Worth, very low inflation and historically low interest rates support that opinion. If correct in our analysis of the effect of these trends on the economy, improving corporate profits (the engine that drives stock prices) combined with low interest rates and inflation should provide for positive returns over the time-frame discussed.

While optimistic when considering the next twelve to eighteen months we remain focused on issues that could alter that perspective. Those major concerns include: 1. the possibility of a second *significant* wave of corona virus cases; 2. ongoing U.S./China tensions; 3. surprisingly higher bank loan loses; and 4. the uncertainties created by a pending general election. Any meaningful change in these or other major domestic or geopolitical factors can shake one's confidence temporarily or alter their position. However, as all investors have been reminded during these challenging times, it is important ***not*** to "invest in headlines".

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Portfolio Strategy

Our current strategy remains in place and has been further solidified by actions that we have observed in the financial markets. During the past two years, as opportunities have presented themselves, we have been opportunistic by moderately reducing and then increasing equity exposure several times and we will continue to do so. However, our primary actions will be to maintain our investment philosophy and disciplines and focus on longer-term results, avoid reacting to short-term "noise", to maintain a well-diversified/balanced portfolio and to always be aware of need for cash flow, liquidity, and desire to avoid extreme volatility. Obviously, endeavoring to optimize capital growth in a tax-efficient manner is paramount as well.

As we have indicated previously, equity portfolios emphasize the Health Care, Technology, Consumer Discretionary and Industrial sectors that are so important to domestic and global economic growth, and where innovation that improves people's lives and grows capital is at the forefront. As we build equity portfolios to provide for future capital growth our concentration is always on the quality of the companies invested in. Our purchase disciplines require a history and expectation of superior rates of revenue, earnings, and dividend growth, as well as above average measures of profitability, return on equity and prudent use of debt.

With respect to fixed-income (bond) investments, with interest rates, even at very long maturity terms, historically low, we will keep bond portfolio maturities short and in high quality issues until rates begin to rise again. Probably not in the foreseeable future.

Thank you very much for the opportunity to serve you. We highly value our relationship with you and would appreciate any questions, comments or critique' that you would like to share with us. We are also looking forward to the return to more normal times so that we can meet personally again.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio.

Diversification and asset allocation do not protect against market risk. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield.

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[i] National Bureau of Economic Research, 6/2009 to 2/28/2020

[ii] Bureau of Labor Statistics 12/31/1969 to 2/28/2020

[iii] FactSet Research Systems; NASDAQ 2/19/2020 @ 9838.37; S&P 500 2/19/2020 @ 3393.52 and Dow Jones Industrial Average 2/13/2020 @ 29535.31

[iv] Bureau of Labor Statistics, May 2020

[v] U.S. Department of Treasury, 3/27/2020

[vi] United States Federal Reserve, 3/16/2020 0.00% to 0.25% Federal Funds Rate range

[vii] S&P close on 3/23/20 was 2237.40