

THE END OF THE BEGINNING?

By: Henry Pizzutello, Chief Investment Officer

“Now this is not the end. It is not even the beginning of the end, but it is, perhaps, the end of the beginning.”

Winston Churchill spoke these words at a point when the tides of WWII started to turn for the Allies. His words have significant relevance to the financial markets today. With the recent explosive rally off of the bottom for markets, we are faced with the question of whether we are on the road to recovery or facing further declines. The Fed has put forth great fiscal stimulus force, as has the Federal government. We have made significant progress against COVID-19 and limited the collateral damage to the economy. Markets seem to have found a firmer footing, but there are still battles to be fought. We now know at some point that the economy will be nursed through to recovery, but we do not know the timing nor the shape of the recovery.

Even though the Fed actions have made it clear that the central bank is doing whatever it takes to keep solvent firms alive through the crisis, the stimulus is being issued through loans, not grants, albeit with generous terms. Within the next few years, they will end up back on the balance sheets of private institutions. This will ultimately place a larger burden on corporate finance and by default, affect corporate earnings. While this is an unavoidable consequence, we are going to be left with a more highly indebted economy. Growth will return, but could be painfully slow when it does. This may not augur well for investment returns going forward.

A recession is already a foregone conclusion, but there has been much discussion whether these conditions will lead to a depression. However, the Great Depression lasted for a decade, and even though current conditions look depression-like (i.e., an economy with a double-digit unemployment rate), given the policies (monetary, fiscal, trade, regulatory) that have been put in place in 2020, a downturn of that length is unlikely. Still, the near-term economic pain is likely not over yet, and the speed with which workers can return in the second quarter will likely determine the shape of the recovery.



This is a global recession that has been caused by forced shut-down, and so a return to employment could happen quickly if government orders change. However, the key questions to be answered are: how soon can those jobs be returned, and will there be enough residual demand to warrant a return to full pre-virus employment?

In just three weeks, 17 million people have applied for jobless benefits, and the number of unemployed people is clearly higher. That alone is 10 percent of our labor force. We have reached, in three weeks, a number that is higher than we got during the Great Recession in 2008. One of the critical factors will be how quickly government programs get money back into the system. As of this writing, the initial response has been frustrating and many businesses have not received money quickly enough. The longer it takes for the government effort, which has been enormous, to get to people, the more short-term problems become long-term problems.

While the recent rebound in equity markets indicates that the crisis phase has been dealt with, there remain significant hurdles to overcome before an “all clear” signal can be issued. If we are looking at the “alphabet soup” of recovery patterns (V, L, or W) that would signify the shape of market and economic recovery, the current data suggests that perhaps the best fit would be the hybrid of a W and square root $\sqrt{\quad}$, where growth recovers but at a slower pace.

LIVING IN A POST COVID WORLD

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While the news of viral transmission and infection rates has been positive recently, the post-COVID world is likely to look very different for many of us. One of the cornerstones of American values that has been the unfettered freedom that we enjoy as a society. This basic right has always been taken for granted, but the exceptional level of freedom that we have enjoyed is likely to be permanently changed. Our culture has always been tilted towards individual liberties over general security and safety and efforts to curtail those liberties have largely been met with resistance.

Crisis has a way of changing that. One can only look at how we use air travel to see the best representation of this. Before 9/11, it was relatively easy to show up last minute and still board a flight, even bringing liquids and food along. Today, the stringent airport screenings are now considered part of the overall travel experience. The current global health crisis has already changed the concept of freedom for those under “shelter in place” or quarantine, but as these restrictions are lifted, what are the implications for us as a society? This will largely be a personal choice as we move through the process of recovery, but the question of how much freedom people will be willing to sacrifice in the name of personal and public safety has vast implications both socially and financially.

From an investment perspective, the answers to these questions have tremendous importance. While everyone has different views on personal versus public safety (college students partying on Spring Break come to mind), it seems clear that there are going to be fundamental shifts in behavior. We may still have tremendous freedom of choice, but we are likely to use them in different ways. Most people can drive less than 10 minutes to see any number of movies, and an equal number of restaurants. Are those choices now going to be replaced by take-out and watching at home?

Towards that end, these are some of the trends that we will be watching:

Globalization vs Populism

The tidal wave of populism that started with the election of President Trump 2016 has gathered momentum. Given the global repercussions of the virus onset in China, it is likely that a return to domestic production will become a major priority in some industries, especially in the areas of health care and pharmaceuticals. China may be especially affected. During the trade war last year, many companies began to change their supply chains away from China. If a company didn't start thinking about the need to diversify their supply chains last year during the trade war, they are likely to start thinking about doing so now.

The European Union may be similarly affected. The example of Brexit may be a blueprint for more dissent among European countries. The recent crisis has highlighted differences between the “have's and have nots,” most specifically represented by Italy and Germany. The virus response in each country underscored their differences, and the economic fallout post-recovery phase will be a template for the rest of Europe.

The Return of Big Government

Ronald Reagan famously said that the 10 scariest words to an American were “we are the government and we are here to help”. Despite the desire of the current Administration to reduce government intervention into the lives of citizens, the recent stimulus packages have inserted government into the lives of people and business in a larger sense than ever.



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In fact, the battle against the coronavirus already has made government—federal, state and local—far more visible and palatable to Americans than ever.

The longer a general shutdown persists, the longer government intervention will be needed, and the more private enterprise will be dependent upon subsidy. We are seeing the critical role that “big government” plays in our lives and our health. We are also seeing the consequences of decades of disinvestment in public infrastructure and dismissal of scientific expertise. The election in November will have a lot to say about whether this trend may continue.

Higher Education

The trend toward higher education and the value of a college degree as a pre-requisite for success may be changing. With the decline of industry and the rise of a service-based economy, many parents and students alike believed they had no choice but to pay for high priced private colleges to get an edge in the new world. This crisis has shown that unanticipated outside events can affect everyone across the board, white and blue collar workers alike. As students have increased their personal debt burden and the cost of college has skyrocketed (correlating almost exactly with the rise of government funded education loans), the entry in the job market has not kept pace. Given the changes that are likely to occur going forward, and the fact that technology companies generally require specific skill sets, it is likely that a significant percentage of students will eschew college for more technically based training. This trend had been identified pre-virus, and will likely accelerate. The top colleges in the U.S. will likely continue to thrive and charge top dollar, but the tuition inflation for many lower tier schools may be coming to an end.

Religion

In times when individuals have little control over their situations, religion has always been a comfort. All faiths have dealt with the challenge of keeping faith alive under the adverse conditions of war or persecution, but the current situation has affected all religions at the same time. The desire to look for answers in religion in a time of crisis has been amplified globally.



Religion in the climate of quarantine will be different than in the past, but will also challenge previous conceptions of worship and likely increase participation, especially for those who have no means to attend local congregations.

Work and Social Environment

The practices that have already been put into place during the quarantine period will most likely exist in some form after this is over. Bureaucracy is beginning to be replaced by online efficiency. Not everything can become virtual, of course, but there are many instances where changes have been made that have increased productivity. Medicare allowing billing for telemedicine was a long-overdue change. The resistance by teachers' unions to allowing partial home-schooling or online learning for K-12 kids has been swept away by necessity. And while not every job can be done remotely, many companies and people are finding out that there is not that great a difference between working efficiently at home and commuting to an office environment. Once businesses sort out their work options, it will be harder to deny employees those options. In other words, it turns out, an awful lot of meetings (and doctors' appointments and classes) really could have been done through email.

In the same way life changed after 9/11, life will change after COVID-19. While we still hold out some hope for a V-shaped recovery later in the year, it would appear that a U-shaped recovery is the most likely outcome and perhaps the best one for which we can hope. However, beyond the short-term, it is likely that we will ultimately use resources more efficiently in the future.

Prudent Planning during a Downturn

By: Robert Borden, CFP®, EA, Chief Compliance Officer



The recent market and economic downturn related to the outbreak of the novel Coronavirus (COVID-19) certainly presents its own set of challenges, but it also provides opportunities to take advantage of both lower stock prices and lower interest rates through prudent financial planning. As US Treasury yields have plummeted over the last month, mortgage rates have tumbled as well, at one point touching all-time lows. Whether or not you are a good candidate for a refinance depends on the current rate and structure of your existing mortgage. Also noteworthy is the fact that rates on any floating rate loan, secured or unsecured, have tumbled as the prime rate has declined from 5.5% a year ago to 3.25% currently. Additionally, the recent decline in the stock market provides a great opportunity to make contributions to tax advantaged accounts such as 529 Plans or Roth IRAs. Prudent budgeting and expense management are always important, but their importance is magnified during periods such as this. Beyond lowering personal expenses and taking advantage of low interest rates, the recently passed \$2.2 trillion Coronavirus Aid, Relief & Economic Security Act (CARES) Act provides relief this year on a variety of fronts.

Setting Your Budget In 2020

This is a great opportunity to reduce spending throughout the remainder of the year. In some years you will spend more, perhaps due to an extravagant vacation for a special occasion, major home renovations, or a classic car that you've wanted forever. Other years may be lighter years where you don't have any major expenses and spend more time at home than anything else. This is a good time to evaluate spending for the remainder of 2020. If you have major expenses planned this year, ask yourself if they are necessary or if they can wait. Effective budgeting is always important but becomes even more so during economic and market downturns.

Refinancing Your Home Mortgage

Take advantage of lower interest rates that have accompanied the decline in stock prices through refinancing a high interest rate mortgage. You may be a good candidate for refinancing if you have a 30-year fixed rate mortgage at 4.5% or above or if you have a 15-year mortgage with a rate above 4%. You may

also want to lock in today's low rates if you have an adjustable rate mortgage (ARM) that will adjust within the next few years. A cash out refinance makes sense under certain circumstances to pay off higher interest debt or for planned home remodeling. All of this should be considered under the lens of what makes sense from a long-term planning perspective.

Contributions to Tax-Advantaged Accounts

While the S&P 500 has rebounded off March 23rd lows, the index is still down over 13% year-to-date (as of 4/10/20) presenting an opportunity to make contributions to 529 Plans and Roth IRAs where future earnings grow tax-free. If your 2020 adjusted gross income is expected to be below \$196,000 (married filing jointly) or below \$124,000 (single) this is a great time to make a standard contribution to your Roth IRA. Even if your income is above these levels you may be eligible to make a backdoor Roth contribution. 529 Plans and even Health Savings (HSA) Accounts also grow tax-free and you can contribute up to the permissible limits. Note that the 2020 tax filing deadline has been extended to July 15 and therefore the 2019 contribution for plans that would normally have a deadline of April 15 has also been extended.

The CARES Act and Executive Action

The \$2.2 trillion CARES Act signed by President Trump on March 27, as well as executive action taken by the President on March 13, provides several notable benefits. To put the size and scope of the recently passed Act into context, the 2009 economic stimulus was approximately one third the size of the CARES Act or just over \$800 billion. The CARES Act is expansive but key elements of the Act and recent executive action are:

- \$500 billion in assistance to businesses, states, and municipalities in addition to a \$349 billion loan program for small businesses known as the Paycheck Protection Program (PPP).
- Waiver of Required Minimum Distributions (RMDs) for 2020 for traditional IRAs, avoiding unneeded tax payments for clients not reliant on their RMD and presenting a special opportunity for Roth conversions this year. Note that the waiver does not apply to beneficiary IRA required distributions.
- \$1,200 to Americans making \$75,000 or less (\$150,000 for joint returns and \$112,500 for single & head of household) and \$500 for each child
- Extension of the tax filing and tax payment deadline to July 15. If you have not yet paid your tax bill, it is prudent to wait until closer to the deadline to do so.
- Granting of wide latitude to the Treasury Secretary in making additional loans and loan guarantees to states, municipalities and certain businesses.