We have been working closely with our clients as we navigate this economic downturn. For long term investors, it is essential to cut through emotion and take advantage of attractive pricing in the market. If you have any questions in how to effectively manage your finances and investments through a recessionary period, please reach out to us for a free consultation.

April 7, 2020

Hold on to the following quote from our Federal Reserve Chairman expressing their commitment to financially support the U.S. economy. Draw it close and let it assuage any fears you have:

> "*When it comes to this lending, we're not going to run out of ammunition*."
>
> \- Jay Powell, Federal Reserve Chairman

<u>Overview</u>

In this letter, we will talk about the unbelievable scenario we are living in. Despite the anxiety and fog of bad news, there is a way for smart investors to weather this. We did it in the 2008 recession and we did it in the 2001 tech bust. Smart investors set aside their emotions and look to the future. Is it easy or without pain? No. But the results on the back end of this should be worth it.

The next 3 months will be very ugly so be prepared for lots of bad news. Case counts in the U.S. will rise dramatically before they top out and decline. The market is waiting for U.S. cases to top out. Once they do, investors will look at the overseas countries that are further along in corona land. If those countries have their new case count under control, our market can expect a relief rally.

Corporate earnings for first quarter 2020 will be announced starting in two weeks. The commentary from management will be negative, of course. Usually, management gives guidance for the year to come. This time they will probably skip that as they want to avoid getting sued for incorrectly predicting the future. Then, when we get to July, we will have corporate earnings announcements yet again. They will be abysmal, but that will be expected so it probably won't matter. By then, we will all hopefully be emotionally (some of us physically) immune to the coronavirus.

Over the next 8 months, there will be surprises that no one has anticipated, hence, the market will continue to bounce around. We do know that stocks are cheap now. We also know that markets tend to turn up 3 months or more before the economy does.

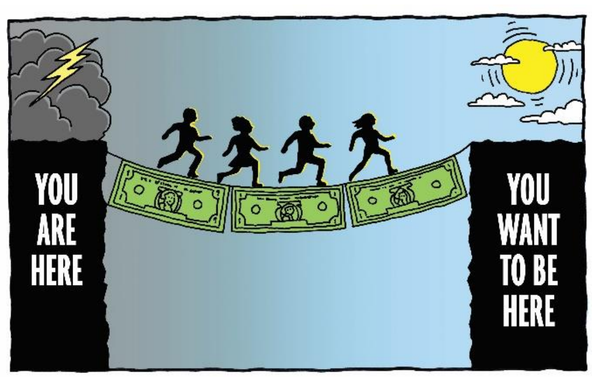
How long will it take for the case count in the U.S. to get under control? It took South Korea only 3 weeks to slow the growth of the virus. They used testing, contact tracing, and social distancing measures. The most optimistic projections for the U.S. are 4-6 weeks for the U.S. to flatten the curve although there will continue to be hotspots across our vast country.

Government Support for the Economy

When economic and financial markets are stressed, there are two entities that can act to support the economy and hopefully lessen the turmoil. The Federal Reserve (through Monetary stimulus) and Congress (through Fiscal stimulus) are these two groups. We witnessed this back in 2008 and we are seeing this to a new degree and pace today. In March, both the Federal Reserve and Congress stepped up to the plate to give citizens, corporations, and financial markets money to carry them over the economic chasm created by COVID-19. The magnitude of their actions is truly stunning and unprecedented. The money being made available is large enough to offset quite a bit of economic damage from COVID-19.

Fiscal Stimulus

Looking at the fiscal side of stimulus, Congress has passed three different stimulus bills that put money in the hands of consumers, companies and local municipalities. The third measure, labeled the CARES Act, provides $2 trillion in stimulus and is the largest economic stimulus in American history amounting to 9.5% of U.S. GDP. Here are the benefactors of the recent fiscal measures.



Big Business

Big business stimulus is primarily there to support industries and sectors that are hardest hit by the virus. The biggest recipient are passenger airlines who are expected to get $50 billion. Boeing will get loans and loan guarantees of $17.8 billion.

Small Business

The Small Business Administration (SBA) has been given $350 billion to provide loans of up to $10 million to qualifying businesses. This program benefits the 30.2 million small businesses in the U.S. who employ 47.5% of all non-governmental U.S. employees. The program is called the Paycheck Protection Program. These loans are directly tied to paying rent, utilities and most importantly…keeping employees on the payroll.

Individuals/ Families

The program for individual workers and families has three major parts:

(1) a “bonus” for taxpayers, and
(2) increased unemployment benefits for the unemployed, and
(3) giving unemployment to freelancers, part-time workers, and independent contractors who previously were not included in unemployment.

About 75% of Americans who filed a 2018 or 2019 tax return will receive a direct payment of $1,200 for single filers, $2,400 for joint filers, plus $500 per child. The amount will be reduced or eliminated for those with higher incomes. For individuals filing taxes as single, the reduced amount begins at an adjusted gross income (AGI) of $75,000 per year and is completely phased out at $99,000. For joint filers, the reduced amount begins at $150,000 and payment is eliminated at $198,000. There has been criticism of the timing of when checks will be received.

We want to emphasize the meat of the bill is the expanded unemployment support. These provisions make the numbers work for a majority of unemployed Americans and benefits go through July 31 of this year. The good news is that for at least half of the unemployed workforce, the new benefits will completely replace their working income through July 31. Let’s look at the numbers for a median income worker in Texas who takes unemployment. Let’s just stay conservative and assume this worker hasn’t received the “bonus” one-time payout.

The median wage for workers in the U.S. is about $936 a week or $48,672 per year. Using the Texas unemployment tables, a median income wage worker would receive normal unemployment check of $487 per week for 26 weeks or 6 months. Under the new CARES act, each unemployed person will receive an additional $600 a week on top of normal unemployment through July 31.

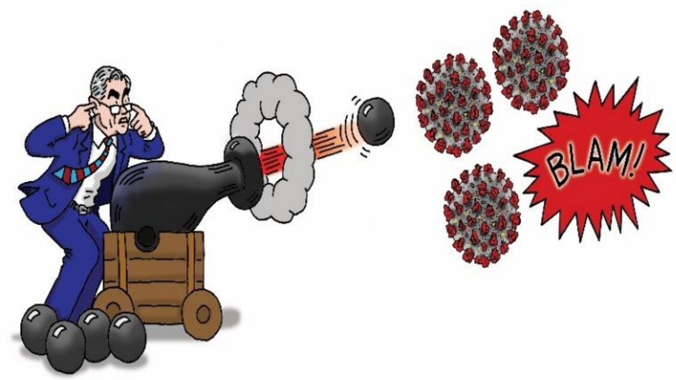
Coronavirus Weekly Unemployment through July 31, 2020		
	Per Week Payment	**Notes**
Normal Texas Median Wage Unemployment	$487	26 weeks guaranteed
CARES Act Unemployment	$600	Guaranteed through July 31, 2020
TOTAL Unemployment	**$1,087**	

In the Coronavirus unemployment scenario, this worker would make $151 more than what they were making while working. Note that we based this on the median worker wage in the U.S.

Since we are using the median, one-half of workers make less than our hypothetical worker. Because the $600 payments and the one-time bonus are fixed amounts not indexed to income, workers in the bottom one-half of the labor pool will have more money to spend than they did when working. Since consumer spending is more than two-thirds of the U.S. GDP, economic recovery will depend on spending.

When the CARES Act $600 payment stops on July 31, we believe that the government will be forced to provide additional unemployment benefits if the virus is still forcing the shutdown of the U.S. Unfortunately, it will take 2-3 weeks to get these funds into the hands of workers. In the meantime, the unemployed will probably be living on credit cards.

Monetary Stimulus



The Federal Reserve is on record that they will pour as much liquidity into the economy as necessary. While this can take many forms, there are two primary tools in use. First, the Fed lowered the benchmark short-term interest rate which will make it cheaper for consumers and companies to borrow. Second, the Fed has begun buying debt securities (bonds) in the open market. This bond-buying program has no set purchasing schedule, no upper limit, and no end date. This is astounding. The program includes purchases of corporate bonds, Treasuries, municipal bonds, and conforming mortgage loans. By purchasing bonds and lowering interest rates, they are both, directly and indirectly, injecting capital into the markets. This reduces volatility and should give both business and consumers more confidence to continue business as normal.

Conclusion

Every day there are buyers and sellers in the market. Some days there are more buyers than sellers and the market is up. Other days there are more sellers than buyers and the market ends down. Each buyer or seller has his/her reasons for selling. Right now, the primary reason is fear. Fear is not a strategy.

We aren't going to try to "call the bottom". Market bottoms are processes over time, not moments in time. We will take investment opportunities as the market presents them and invest in the areas where the economy shows demand. We use software tools that show us where the demand is in the stock market. The most likely areas now are data center products, communication gear, medical devices and supplies, and general business software. We recently raised cash in portfolios by selling specific companies that would not recover as quickly as the broader economy and we will reinvest this cash in better positioned companies.

We agree with Warren Buffett who has said: *"For 240 years it's been a terrible mistake to bet against America, and now is no time to start."*

The Fed and Congress have stepped up to the plate to support the American consumer in this recession. While this is probably not the last stimulus bill that is needed, they are all willing now, more than ever, to limit the downside in this scenario.

Sincerely,

Leslie J. Lammers, CFA
President and Co-Chief Investment Officer

John A. Hanson, CFA
Co-Chief Investment Officer

Enclosures

[1] Sources: *Bank Credit Analyst, Morningstar, Economy.com, Barron's, Standard and Poor's, Lowry Research, Stock Trader's Almanac, Wall Street Journal*