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FINANCIAL MANAGEMENT, INC.

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2020 – First Quarter Review

Covid – 19 Induced Shutdown

Around the middle of the first quarter, most of us were feeling good about the economy, the status of our investment portfolio, and the prospect of good things to come. Then life as we knew it changed almost over-night. A pandemic so severe that health systems in population centers became overwhelmed and human tragedy became too familiar. A partial economic shutdown became necessary in order to affect a war of social distancing on this not so pernicious virus.

Financially speaking, the stock market went from record highs to a bear market in record time (2/19 to 3/23) with a 100% stock portfolio with 20% invested in international down 33.07%. Simultaneously, unprecedented fiscal and monetary stimulus was enacted and put in place in record time. With the aid of initial data showing that social distancing was “flattening the curve”, another record – twelve trading days (by 4/8/20) to a bull run of 22%.

Through the end of the 1st quarter, a 100% stock portfolio with 20% invested in international was down 22.38% with dividends reinvested. Intermediate term bonds were up 3.3% (Barclay’s Aggregate Bond Index) and short-term bonds were up 1.37% (S&P Short Term Bond – Gov’t/Corporate Index).

The severity of trading activity caused market disruptions (dealers unwilling to play their role and limited buyers) in many corners of the bond market. Through experience gained during the financial crisis, the Federal Reserve has opened a handful of facilities and has become the dealer to keep bond trading open and markets properly functioning. We are seeing a gradual recovery in portions of the bond market that had become clogged (municipals, short term corporate, ultra-short-term corporate, and high yield).

Estimates of the impact on GDP in the second quarter range from a decline of between 10% and 50%. Using last year’s GDP of about $21.4 trillion, a 40% decline in GDP in the second quarter would amount to a $2.14 trillion reduction in GDP. Interestingly, the CARES Act fiscal package passed by Congress and signed by President Trump on 3/27/20 amounts to $2.1 trillion. Congress estimates that more will be needed to get through this partial economic shutdown.

This shutdown is creating a significant crevasse in our economy. Accurately estimating its depth will be equal to the difficulty estimating the impact upon corporate sales and earnings. Records will likely be set for quarterly reduction(s) in GDP and unemployment. The CARES ACT $2.1 trillion package is designed to help fill the crevasse created by the partial shutdown of our economy. This fiscal spending is not the same as gross domestic product. It is difficult to believe that it will comprehensively replace lost sales, earnings, and personal income.

The Federal Reserve last week announced an expansion to nine different programs it has unveiled to support lending to states and businesses. These programs amount to $2.3 billion in additional lending at very favorable terms.

Most client inquiries we have received revolve around seeking an entry point with new money and/or the rebalancing of bond holdings into this dented stock market. This will be the focus of the remainder of this quarterly review. Warning: This discussion sounds a lot like an attempt to time the market.

- We can make a case that the recent run-up in the market is not realistic, given the economic data and corporate data to come is going to be very bad. What is the worst case likely to be? We will come back to this question.
- We can also make a case for the market healing and not retracing losses based upon the fact that the market is forward looking. We know Q1 was impacted by the virus happenings in March and the Federal

government and Federal Reserve are coming to the rescue with huge fiscal and monetary support. We know that Q2 will be impacted to a greater extent than Q1. But, if the fiscal and monetary stimulus gets us through the intentional economic stoppage, and the market looks ahead 6 months, then the market can overlook the present situation.

Parts of the bond market have been slow to recover from the trauma of early March trading. This leads us to believe that the "nerves" are not yet calmed despite the stock market runup over the last two weeks. We tend to believe there will be another draw down in the stock market prior to a "U" shaped recovery in the economy. Therefore, we are tending towards a patient approach to new cash and/or rebalancing out of bonds to stocks.

Note we have left out a discussion of the need for either a vaccine, treatment, or both, and a way to monitor for the virus and movements of those who are later found to have the virus. All of these solutions are in development. The quality of these solutions will likely determine the pace of our economic and securities market recovery.

Worst case scenario: Using the Great Depression for comparison purposes. From the end of 1928 through 1933, the economy shrunk by 34.8% as measured by GDP. The Great Depression dragged on for a long time as its cause was misdiagnosed (inflation was suspected when in reality there was a monetary shortage). Over this period, stocks declined 72%. In the worst year, stocks were down 47.5%. Contrast to the present situation: We have a planned economic partial shutdown and massive fiscal and monetary assistance in place with more coming. The Federal Reserve has recent experience going beyond typical monetary action in dealing with keeping securities markets functioning and has been very quick to respond to this situation. Therefore, we tend to think that the worst-case scenario is a retrenchment to lows experienced in mid-March or slightly beyond to a 35% to 40% decline before a recovery ensues with the anticipation of the gradual reopening of the economy.

Best case scenario: It is happening now with a gradual recovery in the stock market.

Either road will be bumpy, volatile. But we will win the battle over the virus and recover.

The hangover from additional government, corporate, and personal debt will be a concern for another day.

Please feel free to contact us with any questions, or if you would like to schedule a virtual face to face or phone meeting.

Thank you,

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