# BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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## FINANCIAL MARKET OVERVIEW

The entire 30% stock market gain in 2019 evaporated in one month, between the last week of February, 2020 through the third week of March. The COVID-19 virus is a perfect example of the definition of a "black swan" event – something you've never seen, expected or predicted. Stocks suffered their worst quarter in 12 years.

The financial markets reacted swiftly with a powerful combination of selling by panic-stricken investors, traders, and advisors/analysts quickly realizing that there is, and will be, a sharp downturn in the economy. The Dow Jones Industrial Average plummeted more than 10,000 points or 35% during the last week in February through the third week of March and half of that decline occurred during the third week of March alone.

One week later on March 24th, the Dow Jones Industrial Average soared 11% in one day – the best one-day increase in **87 years**. During that same week, from Tuesday March 24$^{th}$ thru Thursday, March 26$^{th}$, the Dow Jones Industrial Average was up over 21% - the largest 3-day gain since October 8, 1931! How do we explain and rationalize witnessing the biggest daily declines and advances ever – all in the same month? We don't – it's not rational.

The overall U.S. stock market was down 20% during the first quarter, 2020 - the worst quarterly drop since 1987. Mid-size and small-company stocks suffered larger declines, ranging from -20% to -35%. The Information Technology sector was leader – meaning a smaller loss, followed by the Health-Care sector. The technology-heavy NASDAQ composite stock index was down only 14%. Energy, airlines and cruise ship companies suffered much larger declines – over 50% in one month.

Large-company stocks performed better (smaller loss) than mid and small-size companies and growth stocks outperformed value stocks. International stocks also declined significantly during the first quarter – down 23%. Emerging markets (smaller-country international stock indexes) were down 24%. Real estate also declined during the first quarter – down 24%. Water utility stocks were down about half as much (-12%) as the overall stock market.

Gold prices rose 3.6% during the first quarter. Fixed income or bond prices jumped 10% during the first quarter. Even though the interest rate on new 10-year U.S. Treasuries dropped to less than 1%, the value or price of bonds jumped. Interest paid a new 30-year maturity U.S. Treasury Bond is only **1.3%!** The logic for a 10% gain in bonds is simple: If you purchased fixed income bonds that were paying 2% or more just 3 months ago and now new bonds are

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paying half that rate (1%), the price or value of those bonds purchased earlier have increased. Investors are willing to pay more to purchase a bond that pays 2% versus 1% interest. An important discussion on this topic (fixed income or bonds) appears later in this newsletter under *Investment Outlook and Recommendations*.

The following chart displays sample returns of various asset categories during the first quarter of 2020 and year-to-date:

| **Year to Date 2020** | **1st Qtr. 2020** | **Index Return** (***includes dividends reinvested***) |
|---|---|---|
| **-23.20%** | **-23.20%** | **Dow Jones Industrial Average (^DJI)** |
| **-19.45%** | **-19.45%** | **Standard & Poor's 500 Index (^GSPC)** |
| **-20.82%** | **-20.82%** | **DJ U.S. Total Stock Market (VTI)** |
| **-14.11%** | **-14.11%** | **Large-company stock-Growth (IWF)** |
| **-26.71%** | **-26.71%** | **Large-company stock-Value (IWD)** |
| **-20.16%** | **-20.16%** | **Mid-Size Stocks – Growth (IWP)** |
| **-31.71%** | **-31.71%** | **Mid-Size Stocks – Value (IWS)** |
| **-26.01%** | **-26.01%** | **Small-company stock- Growth (IWO)** |
| **-35.83%** | **-35.83%** | **Small-company stock- Value (IWN)** |
| **-23.01%** | **-23.01%** | **International (EFA)** |
| **-23.94%** | **-23.94%** | **Emerging Markets (EEM)** |
| **-24.13%** | **-24.13%** | **Real Estate Investment Trusts (VNQ)** |
| | | *Fixed Income (includes appreciation)* |
| **+2.73%** | **+2.73%** | **Short-term U.S. Treasury (SHY)** |
| **+10.50%** | **+10.50%** | **Intermediate U.S. Treasury (IEF)** |
| | | *Alternative Investment Category* |
| **+3.60%** | **+3.60%** | **Gold (GLD)** |

**All returns calculated using adjusted historical quotes from finance.yahoo.com*

## FINANCIAL MARKET OUTLOOK

March 2020 was the most volatile month I have experienced over the past 33 years. By late February, the spread of the Covid-19 virus set off a wave of deadly fear, market volatility and significant losses in the U.S. and global stock markets. Three weeks later, stores, schools, restaurants, beaches, and parks were and are still closed. Sporting events and travel plans have been cancelled. Most Americans are temporarily out of work as personal/retail services, manufacturing and production facilities are closed.

The United States now leads the world in Covid-19 cases. Nearly everyone is now taking this virus seriously. Few experts predict this pandemic war can be won quickly and even if everything goes well, a fast-economic recovery is unlikely. Unemployment is rising at a staggering pace and some bankruptcies are likely. But remember this: The financial markets are anticipatory and react quickly. When you are listening to the news or reading the newspaper about how the economic recovery is underway *sometime in the future*, then you are too late to reinvest.

Investors need to understand that the state of the U.S. and the world's ***economy*** is the biggest factor affecting the long-term direction of the financial markets. The economic slowdown that began in early March will continue until Americans go back to work, businesses are open and students return to class. This waiting period could be weeks away or several months. No one knows the answer at this time. However, the consequences of an economic slowdown and unemployment are already in the numbers! That's why the U.S stock market lost over 35% in one month.

The financial markets are anticipatory and UNEXPECTED CHANGES to normal/consensus expectations are what causes violent moves up and down. Likewise, the financial markets will react months ahead from when the actual GDP numbers are published and confirm a turnaround has occurred. A recovery will come – but no one can tell you the exact date.

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Expect continued volatility in the stock market – this "black swan" event is not over until we make some progress and positive events are disclosed. The best examples of events or positive news are: containment of the virus, progress towards a cure or vaccine, businesses and employees are allowed back to work, schools in session, fans allowed to attend sporting events and other large-group gatherings, etc. The probability of this scenario is very likely in our opinion.

WHEN will the events above arrive and how fast will the financial markets respond? **NO ONE KNOWS THE ANSWER**, but the probability of moving in that direction is higher than most people FEEL at this time. If you must insist on an estimated date, then our answer is the beginning of Summer and containment within several weeks to a few months.

The financial markets will respond much faster with any progress (real or imagined) and the advance will occur before you will respond. More likely than not, the stock market advance will not be slow and measured, rather it will likely be sudden and significant.

Prepare for more volatility over the next few months, but don't forget about the other side of the coin – opportunity. If the drastic measures we have experienced (social distancing) are working and we get this right, it could be the opportunity of a lifetime. If you are a long-term investor, it is a good time to invest in stocks. It is not important to try to time the bottom of this panic-selling period. You simply buy (perhaps multiple equal amounts over the next 6 months) when prices are reasonable and do so with the expectation to hold for years to come. The alternative safe route? You can buy guaranteed 10-year maturity U.S. Treasury Notes bonds paying less than 1% interest or certificates of deposit paying a similar interest rate.

## INVESTMENT OUTLOOK AND RECOMMENDATIONS

Expect first quarter GDP (Gross Domestic Product) to be slightly negative due to the shutdown of businesses in early March, 2020 and the exact figures won't be calculated and disseminated until over a month from now. Even worse, the second quarter GDP (beginning April 1st and ending June 30, 2020) will likely be awful and won't be calculated and disseminated until mid-summer!

If you wait for the "awful GDP numbers" to be announced in summer and defer making investment decisions until the GDP numbers rebound, – it's too late. The stock market has already reacted and dropped by over 30%. By the time the actual figures are calculated and released in the press, it's old news and we may see only a day or two of panic reaction by day-traders.

We sold *international stocks* in client accounts across the board in late February, and reduced other stock positions for conservative clients and for those who have strong aversions to volatility. The proceeds from sale and large cash positions will be reinvested. The timing is unknown, <u>but it will likely occur within weeks to months.</u>

***<u>Our focus will be:</u>*** The best choice is buying broad market indexes. Why? Simple analogy. When water is emptied from a pool, all of the water (stocks) level goes down, and when the pool is refilled, the whole water level (stocks) go up. Specific stock selection isn't necessary to participate in the advance. That said, there are also strong companies now and in the future such as Amazon, Apple, water companies and others

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that can be purchased now or very soon.

In addition, there are some real lifetime POTENTIAL bargains for those who have higher-than-average risk tolerance and the patience to wait for it. Banks and Energy stocks are down over **50%**. Airlines and cruise companies are down over **65%**. There are many other examples as well.

Some clients have called suggesting additional funds could be invested in businesses and companies that are benefiting from the new "social distancing" way of life such as delivery companies, video conferencing, Netflix and many others. If you believe the current way of life is going to be normal, then I would agree. If not, no. Prices have already moved up on these stocks and the current restricted way-of-life must continue for these share prices to hold or advance higher.

*Fixed Income – Bonds:* I will be reminding readers / clients about this topic every quarter. Sometime in the future, our country will return to work, schools, etc. The Federal Reserve has pushed interest rates down to levels not seen since the Great Depression – the current interest rate on a 30-year *home loan* is below 3%. The interest earned on a 30-year U.S. Treasury is only 1.3%. Someday, interest rates will increase back to the normal range – say 5%-7% on mortgages and 5%-8% on 30-year Treasury Bonds. When (not if) interest rates do begin to rise, the most conservative part of a client' investment account – fixed income or bonds, is going to lose value. And conservative investors will be confused – how can I lose money on guaranteed fixed income (bonds). How much will the loss be? For 15 to 30-year maturity bonds, you can expect the price or value of your bond or bond mutual fund to fall 10% for every 1% increase in interest rates. For shorter-term bonds or bond mutual funds, about 3%-5%. In either case, the drop in value will exceed the interest income. The primary way to avoid a loss is to keep your bond maturities SHORT. Six-month to 2-year maturities would be the suggested range – keep in mind, the interest income will be 1% or less. There are other ways to battle rising interest rates and we will be discussing the methods later in our newsletters.

## CURRENT ACTIONS IMPLEMENTED TO COMBAT COVID-19

**Federal Reserve and Congress:**

The Federal Reserve acted with unprecedented speed to prevent extreme panic in the financial and lending markets. The Fed cut short-term lending rates to a stunning ¼%. In addition, the Fed purchased bonds (flooding the market with cash) called "quantitative easing." The Fed's decision to back-up money market funds in order to maintain their $1 per share value helps to prevent a financial crisis. The Fed also made dollars available to foreign central banks so cash can get to where it is needed.

Second, Congress finally acted and did something useful to help the country rather than talk endlessly about it. Congress passed the Cares Act to provide funding to help the hardest hit industries and families through the next two months.

For individuals, the Care Act does provide some financial assistance and income tax breaks. Some of those assistance items are discussed below that will benefit most people.

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**Direct Payments:**

The act provides an economic impact payment to many taxpayers of $1,200 for individuals and $2,400 for taxpayers filing jointly. In addition, taxpayers with children will receive $500 for each child. The payment starts to phase out at an adjusted gross income (AGI) of $75,000 for singles, $112,500 for heads of household, and $150,000 for taxpayers filing joint returns. It phases out entirely at $99,000 for single taxpayers with no children and $198,000 for taxpayers filing jointly with no children. If you have children, you will still receive $500 per child. You do not need to do anything to claim your payment. The IRS will calculate the amount of the payment, if any, based on your 2019 federal income tax return, or the 2018 tax return if you have not yet filed your 2019 return. If you qualify, the IRS will send the payment directly to you. Taxpayers receiving payments do not have to pay income tax on that income.

**Expanded Unemployment Benefits:**

Self-employed workers and independent contractors can now apply for unemployment along with people in positions that would typically qualify them for the benefits. These benefits are available for weeks of unemployment, partial employment, or inability to work caused by COVID-19 beginning on or after January 27th, 2020 and ending on or before December 31st, 2020. There is no waiting period and the CARES Act allows for an additional $600 per week over regular unemployment assistance levels.

**2020 Required Minimum Distributions:**

The CARES Act gives you a one year waiver of required minimum distributions (RMDs) from Individual Retirement Accounts (IRAs) and tax-qualified plans, including 403(b) plans and governmental 457(b) plans for the calendar year 2020.

It's too early to state with conviction whether or not The Cares Act and the Federal Reserve stimulus package is enough to support our economy while most of America is out of work and maintaining seclusion. But, since March 24th the financial markets have recovered over one-half of the decline that started in late February. For now, the hope that economic damage can be contained – even if we don't know whether/when the virus can be contained - seems to be working. Stated another way, it's just a matter of time (could be weeks, months or years) until both will be contained and the panic selling of stocks from late February through mid-March will be just a memory just as Friday, October 19th 1987 will always be remembered.

## LOOKING FORWARD

We are experiencing unusual, uncomfortable and downright scary events due to the COVID-19 virus. The path and timing toward recovery is uncertain. – but it will arrive. Stay safe and continue protecting yourself as recommended. We will get through this challenging series of events.

During challenging times, crisis, and uncertainty, take a moment to reflect and look for small and good things in life. For me, I have witnessed something occurring daily over the past four weeks that I haven't seen for decades. Parents, children, pets, and neighbors are all walking and riding bikes throughout the neighborhood. Everyone is voluntarily keeping 6 feet or more distance from one another, but there are smiles, people saying "hello",

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laughter, and actual communication. Neighbors are asking one another if they need anything. Only occasionally do I see someone walking head down looking at their cell phone. What a delightful ray of light during challenging times.

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