

He allowed himself to be swayed by his conviction that human beings are not born once and for all on the day their mothers give birth to them, but that life obliges them over and over again to give birth to themselves.

Gabriel García Márquez
Love in the Time of Cholera

The virus: To state the obvious, we are in the midst of an unprecedented global health crisis wrought by the COVID-19 pandemic. Since the virus is new to humans, we have no existing immunity. Since the virus is easily transmitted, it has spread rapidly through a globalized world. We do not, in my mind, have solid statistics on serious illness rates or death rates, but if you have seen reports from hospitals around the globe and here in the U.S., you likely understand the need for “flattening the curve” to allow our health care system to effectively respond. The ultimate duration and intensity of the event are still unknown. The human toll continues to build.

First and foremost, our thoughts are with all those directly impacted by the virus and we wish them and their families and communities the best of health. And our thanks go out to health care providers, to social safety net providers, to non-profit staff and volunteers, to grocery store workers and delivery drivers and the many, many others that continue to help provide and maintain the necessities of life and infrastructure of our economy.

Economic impact: With no established vaccines or cures and insufficient testing capacity, we are trying to stem the transmission of the virus by limiting social interaction. Inevitably, the success of limiting interactions has led to massive business and employment disruptions. The scale of the total economic disruption is unlike any other we have seen in our lifetimes. The combination of the speed, the magnitude and the self-imposed nature of this economic disruption is truly unique. The rise in unemployment claims is already so large that it dwarfs any other historical rate of change, including during the Great Depression. We will not have the data to fully understand the drop in economic activity for some time, but it is clear that we are already in a recession.

Government responses: There have been massive responses from governments at every level. While the debates and finger-pointing about the timing and nature of responses have already begun, there is no other event that I know of that has had this overall level of response with this amount impact in such a short period of time, ever. Along with the shut-down of “non-essential” businesses in the majority of states, the largest responses at the national level include:

1) The Federal Reserve (the Fed), in response to the sudden surge in demand for cash and the accompanying dislocations in the bond/credit markets, lowered the Fed Funds overnight interest rate to 0% and ramped up a variety of liquidity programs that it had first used in the Great Recession of 2008-2009. Then it launched unlimited quantitative easing. From its press release on March 23rd: “*The Federal Open Market Committee (FOMC) will purchase Treasury securities and agency mortgage-backed securities **in the amounts needed** to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy.*” Beyond Treasury and mortgage-backed securities, the Fed is also addressing liquidity constraints in the commercial paper market, the corporate bond market (including junk bonds!), the municipal bond market and the US dollar market. In March alone, the Fed’s balance sheet increased by over \$1.4 trillion dollars.

2) To help fill the hole in the economy from the “stay at home” policies, the President signed into law The Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, on March 27th. The total package of relief measures is estimated to cost more than \$2.2 trillion and is the largest emergency spending bill ever enacted by Congress. For reference, \$2.2 trillion is about 10% of the size of the pre-coronavirus U.S. economy. The spending package spreads the funds throughout the economy, including checks to individuals, forgivable loans to small businesses and non-profits, expanded unemployment benefits, money for hospitals, health care and food support, money to states and territories, support for impacted industries, and money to backstop various of the Fed’s loan programs. And there is likely more to come.

The Stock Market: Not to be left out of the list of historical firsts, the U.S. stock market, as represented by the S&P 500, dropped a bit over (-33%) in the shortest amount of time ever during the 1st quarter. It reached an all-time closing high of 3386 on February 19th and it dropped to its 2020 low on March 23rd at 2237. For the full 1st quarter, the total return of the S&P 500 was a negative (-19.6%).

While the speed of the stock market collapse was fast, the fact that stocks finished the quarter slightly above where they closed in 2018 is not surprising. As I have noted in these letters many times in the last few years, the U.S. stock market has generally been trading at historically high valuation levels. If I had not heard the news about the spread of COVID-19, I would say that the stock market just had a needed correction.

The estimated historical average annual stock market return, as measured by the S&P 500 from 1926 - 2019, is close to 10% with dividends included. Of course, over short periods of time, the returns on the stock market have varied widely. For example, in 2008, the S&P 500 lost (-37%), while in 2009 it gained +26.46%. Historically, the risk of an investor losing money in the stock market goes down dramatically as the time of ownership is extended. At Peak, we believe the optimal time-horizon to invest in the stock market is 10 years or longer.

Along with time (and investment discipline), the one factor that I have found to have the highest correlation to an investor's future success in the stock market is the starting valuation level. That is, when an investor starts investing in a stock market with a high, or expensive, valuation level, the probability of earning the historical average annual return of 10% over the next 10 years is low. If an investor starts from a neutral valuation level, the probability of earning the average annual return over the next 10 years is roughly even, or 50/50. And, if an investor starts from a low, or "cheap," valuation level, the probability of earning the historical average annual return (or more) is high.

At the lows of the last two bear markets, in 2002 and 2009, the stock market reached a cheap valuation level. At the end of March, I viewed the stock market to be at a neutral valuation level.

What's next?: We will get this health care crisis under control. We will work through the recession and, eventually, get the economy back to "normal." In the meantime, the potential economic scenarios vary widely. Some of the key elements that will impact the length and depth of the recession and the trajectory of the recovery include: the timing of broad availability of testing for determining who has the virus and who has had the virus; the timing and success of moving out of stay at home mode; the timing and effectiveness of COVID-19 treatments; the effectiveness of the federal government's support for the economy; the number of and size of bankruptcies; and, looking outside the U.S., the overall success of the global economy. In the end, it's hard to believe that economic activity is going to get back to its pre-virus level until we have a widely distributed vaccine.

At Peak, we are here to help our clients work through this event. We are committed to helping our clients build and maintain financial security. We are committed to managing client portfolios to help meet ongoing cash flow needs. We are here to facilitate all financial planning needs. Our goal is to help all our clients come out of this event even better positioned for the future.

Finally, one tax planning area that we would like to highlight during this time of economic disruption is philanthropic giving. We are available to discuss possible charitable strategies through the use of donor advised funds, appreciated stock giving, qualified charitable distributions (QCDs are available for clients with an IRA who are at least 70 ½ years old), and a new \$300 per taxpayer (\$600 for married filing jointly) above-the-line deduction for cash donations if taking the standard deduction. Less money paid in taxes = more money to give.

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We appreciate your business and we continue to work hard to earn the trust that you have placed in us. Please let us know if you have a friend or family member that could use our assistance.

John McCorvie, CFA