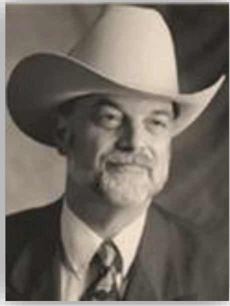

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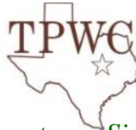

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

(254) 947-1111
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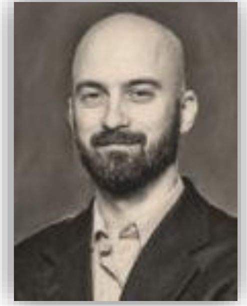

jeff@tpwc.com

jake@tpwc.com

March 31, 2020

TPWC Market and Economic Update – Special Edition

The Markets

The first quarter of 2020 ended today and there were several ways of looking at it in the stock market. The S&P 500 Stock Index (SPX) closed today at 2,584.59, down 20% for the quarter marking the worst three months since 2008. On the other hand, the SPX is also down 23.7% from its top on February 18 but up 15.5% from its recent bottom on March 23. We sort of prefer to look at it as a decline that is barely a bear market (pun intended) as it is only 3.7% below the bear market cut-off of a 20% decline. As to whether the 15.5% gain in the last week or so marks the beginning of a new bull market, only time will tell. The SPX did drop about 1.6% on this the last day of the quarter but in light of the massive moves it has made in the last month that decline seemed almost placid.

What we can tell so far is that it was the big, highly leveraged, institutional investors, mostly hedge funds, that led the rush for the doors while the average investor seems to have kept his or her head in this pandemic and media storm. We suspect that when the dust settles there are going to be a bunch of hedge fund managers crying in their metaphorical beer. At least one major hedge fund, EJF Capital, has suspended investor redemptions for at least 90 days.

As is usual, some of the most intense selling was near the bottom of the market. Those who sold when the market was down about 35% are already having second thoughts. Once corporate earnings for the first quarter start being reported and CEOs hold conference calls to discuss what they see for the future, we will see if we have a bottom or just a bear market bounce. Based on the continued buying spree we are seeing from corporate insiders; we are cautiously optimistic. It is important to remember that the stock market is a future-pricing mechanism. Its level is a collective opinion of where corporate earnings will be a year from now.

The ten-year U.S. Treasury note yield continued its decline to close out the quarter at 0.677% but even that previously unthinkably low yield gave us a positive slope to the yield curve as the 90-day T-Bill was yielding an even lower 0.130%. That low 90-day yield is a distinct improvement over the 0% it recorded at the end of last week. Oil, or more specifically, West Texas Intermediate crude (WTI) continued its slide into oblivion. It closed out on Tuesday just over $20 per barrel after having dipped down to about $19.50 on Monday, an 18-year low. Texas may feel the hit as the layoffs have already started in the oil patch and in the supporting industries, many of which are centered in Houston. The major oil companies like Exxon-Mobile and BP, already sinking before the pandemic and the Saudi-Russian price war, are trading at 50% to 60% losses from just a few years ago.

The Economy

Moody's Analytics, the firm that probably most accurately got the read on the "great recession" a decade ago, is now estimating that we are already in a recession. They are forecasting that the U.S. economy shrank at an annualized rate of 2.5% in the first quarter and will contract an astonishing 18.3% rate in the second quarter. For the calendar year 2020, Moody's is forecasting the U.S. GDP will shrink 2.2%, the largest annual decline since 1948. Notably, to get from two quarters of a negative 2.5% and negative 18.3% back to only a 2.2% annual decline takes a massive growth spurt in the second half of the year. If it happens, it will likely be rather back loaded with most of it coming toward the end of the year, after the second wave of the pandemic hits in the fall. They are also predicting an unemployment rate averaging around 8.7% in the second quarter.

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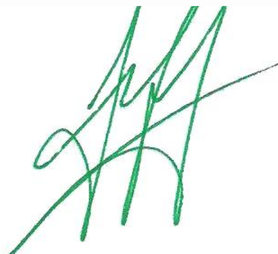
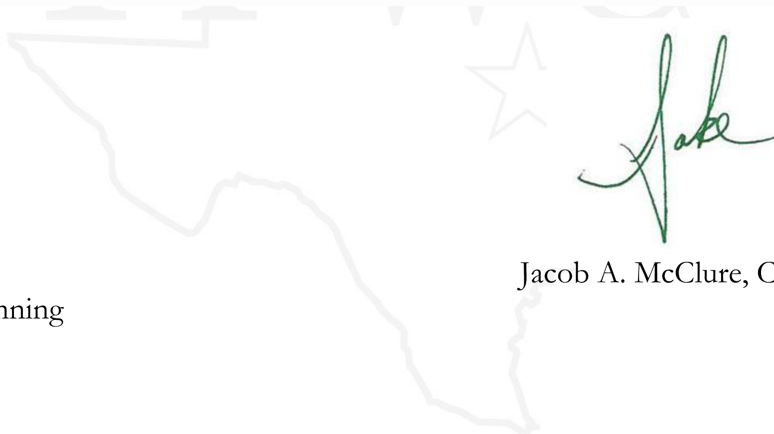
How this crisis shapes up in the future depends on a lot of factors. If we base our estimates on what happened in 1918, staying mostly shut down longer results in a quicker and more robust recovery. Cities like St. Louis that took the biggest steps and the biggest economic hits up front and stayed locked down longer. recovered quicker than those that took less drastic and shorter measures. What we see as the best estimates suggest that it will be July or August before the infection rate declines enough to start significantly relaxing restrictions. The infection cycle will vary from place to place. New York City may see the infection rate peak in mid to late April with the peak in daily deaths following about two weeks behind, but other places where the infection arrived later or are less concentrated will likely see the infection and death rates peak as much as several months later.

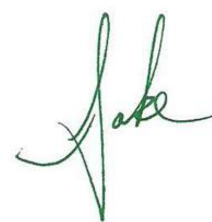
There is a glimmer of hope though. Johnson and Johnson announced that not only do they have what they believe is an effective vaccine, but they are retooling to get ready to mass produce it and should have it ready and in sufficient quantity to distribute across the country by early next year. Given that they made a similar bet on an Ebola vaccine and it proved to be effective we may be in sight of the end of this crisis. Nine or ten months is a long time to wait for the all-clear siren to sound, but if it works out, it will be the equivalent of a bone fide miracle. The vaccine is already in clinical testing and we can only hope and pray that it proves both safe and effective.

A year from now we could well be in the opening months of a new age. One of the few things we are reasonably certain of is that this crisis will change a lot of things in our society and our economy and that those changes will be for the better. Meanwhile, be patient, don't give up hope, and wash your hands.

Until next time, we remain at your service. Don't hesitate to reach out to us with your questions, concerns, thoughts and observations.







Jeffrey W. McClure CFP®
M.S. Personal Financial Planning

Jacob A. McClure, CIMA®

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