THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update – Special Edition

The Markets

The S&P 500 Stock Index (SPX), our preferred stock market indicator, advanced another 1.2% since Friday to close at 3080.82. The Index is down only 4.64% year-to-date and is up 12.26% from a year ago. It is still down 9.02% from its record high in February but up 37.70% from its March bottom.

The 10-year U.S. Treasury yield seemed to conclude that the end of May marked a turnaround as it rose 5.56% in two days to close at 0.684%, still amazingly low, but much higher than it was in mid-April. West Texas Intermediate crude oil (WTI) followed suit, rising 4.27% to finish the day at $36.90.

Looking at the markets, one could wonder if there really is or was any form of economic distress in the United States. As happens occasionally in history, the economy is definitely taking a beating, but on Wall Street, the forward-looking stock market is convinced that the worst is behind us and happy days are here again. There is actually a good rationale to that difference. Quite a lot of analysts have looked at the "multiplier effect" on GDP of past stimulus programs and concluded that it is at least 1:1, meaning that once the immediate crisis is over we should see about one dollar of extra GDP growth for every dollar the stimulus programs pumped into the economy.

Another factor missing from the market over the past several days has been any reaction to the protests, riots, looting and the backlash to those actions. While socially, all those are very significant events, the markets are driven mainly by the prospects of higher or lower corporate earnings in the future. The reality of the situation is that the large corporations represented in the stock indexes are not likely to be hurt by the demonstrations or the reaction to them.

That additional GDP growth, the reasoning goes, will kick the American economy back to where it was in 2019 sometime in late 2021. The stock market recovery we have seen is not justified by simply getting back to zero, where we were a year ago, but by investors making bets on the winners and losers in the market. The reasoning is that the winners will wind up with the extra profits forfeited by the losers. That is why the tech-heavy NASDAQ market is within a whisker of an all-time high, up 27.65% from a year ago and over 7% so far this year. Despite or perhaps because of all that optimism, we suggest keeping your guard up. The NASDAQ has been known to get ahead of itself on overly optimistic assumptions only to come crashing down as reality was different from its assumptions.

The Economy

The Congressional Budget Office (CBO) came out with a report today suggesting it will take nearly ten years for the U.S. economy to recover to the level it would have reached had there been no coronavirus. Remember though that in the year 2000, that same CBO reported that a serious threat to the U.S. financial system was coming as the U.S. would pay off its national debt in about 20 years resulting in a scarcity of Treasury securities. The CBO is good at projecting current conditions into the indefinite future, but not so good at recognizing the changes that come as a result of political mood swings and technological innovation.

Moody's Analytics commented that the "worst of the catastrophic blow to the global economy…is over." The end of May likely marked the bottom for the gross economic hit we are to experience. That comment is based on there being no "second wave" of large-scale infection as social distancing breaks down and that there is a second wave of

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fiscal stimulus from Congress and it is not vetoed by the President. Presuming that two-part variable goes right, Moody's believes the U.S. GDP will recover to 2019 levels by the beginning of 2022 and go on to new heights from there. The problem with both forecasts is that we won't know the extent of the damage until the storm is over, and even then, it will take a year or more as companies that survived the blow but were weakened continue to collapse.

Remember too, that Moody's scenario relies on two events, that we do not have a large-scale reignition of the viral contagion, and that we get a second round of fiscal stimulus. Failure in either or both of those could push the recovery out by as much as another year.

The practical lessons to learn from the overload of economic forecasts is to hold to a reasonable, well-diversified, long-term course and make no big bets. It is also critical to avoid taking action from some form of desperation or fear. In the Wall Street Journal, Morningstar, and other publications, we are reading of retirees who lost 80% or more of their retirement funds after investing in exotic "alternative investments" such as collateralized notes. Some of those financial products, commonly sold by "financial advisors," with the names of well-known investment banks on the cover, offered annual yields as high as 13% for up to ten years. They were also advertised as a "low-risk" investment. It turns out the high yields were generated by the investment company borrowing as much as three times the original invested capital and thereby "leveraging" the returns. Common underlying assets included income-producing real estate, pipelines, and other oil related items. When the income from the leveraged real estate and oil-related items collapsed, so did the value of the investments and those losses were multiplied by the leveraged amount. Then, the big-name investment bank that had issued the investment products exercised its right to buy the investors out, sometimes at mere cents on the dollar.

There is a very real lesson here. There is no such thing as high return with low risk. Interest rates are at historic lows while the stock market has had a run of single digit returns. When publicly traded and transparent investments are generating low returns, there is a strong tendency for salespersons to come up with higher yielding offerings and then claim them to be "safe." That was the sucker line in 2007 and it is again today. There is no secret way to get high return with low risk. If you seek that combination, what you will get is a big dose of hidden risk.

We believe there is a bright future ahead in a couple of years as we recover and begin to rebuild from this coronavirus storm, but to reap the benefits of that bright future, it is critical that we exercise prudence, patience, and perseverance today.

Until Friday, we remain at our posts, observing, analyzing, and holding to the prudent long-term course.

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