

### THIS HAS BEEN DIFFERENT & THE WORLD HAS CHANGED

The world is different now than it was three months ago. It was also different after 9-11. A week after 9-11, the financial markets in the U.S. reopened. One week after that, the market bottomed. It felt bad, there was great uncertainty, a war was starting, and there were extraordinary bargains. Today, people are once again afraid to enter large, crowded buildings; however, society is better prepared for remote computing, education and work.

Capital Management Corporation has 100% remote capability. Our office is open to employees but not visitors. In-person attendance is voluntary. Our thoughts and prayers are with our clients, families and victims of this tragedy.

### MARKETS DECLINE ON FEAR AND UNCERTAINTY

The US stock markets just had the fastest correction and the fastest bear market in history. Declining 20% in just the first three months of this year, the S&P 500 index had its worst quarter since the 2008 Financial Crisis.

In addition to the annual flu, over the last twenty years we have heard of the West Nile virus, SARS, Avian (bird) flu, Norovirus, Swine flu, MERS coronavirus, Ebola and the Zika virus. None of these closed American industries.

Today's Wuhan coronavirus is highly contagious, has over a 7% death rate for those over 80, and still poses uncertainties. When will the contagion peak? Will it be seasonal? Is it recurring? Will it mutate? When will testing kits, treatments, cures and vaccines be available?

The Centers for Disease Control and Prevention (CDC) is studying two already developed drugs that might have merit. A 65-year-old drug, hydroxychloroquine and Gilead Science's Remdesivir are in late stage clinical studies. This spring, interim study results may indicate that these drugs are effective in suppressing the Wuhan coronavirus symptoms (which should result in fewer cases of pneumonia and death). This could result in early approval as it would be inhumane to keep 1,500 patients in each blinded clinical trial on the placebo (e.g. sugar pill).

### Key Dates

04/03	Unemployment Report
04/10	Good Friday – Stock Market Closed
04/10	March Consumer Inflation (CPI)
04/29	FOMC Press Conference
04/29	GDP 1Q 2020 Advance Estimate
05/08	Unemployment Report
05/12	April Consumer Inflation (CPI)
05/25	Memorial Day – Stock Market Closed
05/28	GDP 1Q 2020 Second Estimate
06/05	Unemployment Report
06/10	May Consumer Inflation (CPI)
06/10	FOMC Press Conference
06/25	GDP 1Q 2020 Third Estimate



In the meantime, about 20% of the domestic (and global) economy is essentially closed, including the specialty retail, restaurant and travel industries. This much of our economy has never been closed for three months. There is uncertainty on how it will reopen.

The financial markets can decline as uncertainties rise, and vice versa. As the speed of contagion and death rates decelerate and medical treatments advance, uncertainties should decline. It appears that the initial nationwide shock has passed.

### **FEDERAL STIMULUS ENACTED (the CARES act)**

Signed into law in March, the \$2.3 trillion Coronavirus Aid, Relief, and Economic Security act (CARES) is larger than the 2008 Troubled Asset Relief Program (TARP - \$0.7 trillion) and the 2009 American Recovery and Reinvestment Act (ARRA - \$0.83 trillion) combined.

The majority of CARES funding is directed to the epicenters of this crisis (people, businesses and the healthcare industry). Some of the provisions affecting individuals include:

- One-time payment of up to \$1,200 per adult taxpayer and \$500 per child (with phase-outs starting at \$75,000 of income per individual or \$150,000 per couple)
- Waiver of all IRA and 401K minimum distributions (RMDs) that were required to be taken in 2020
- Expanded provisions for charitable deductions
- Temporary increase in unemployment benefits
- Temporary waiver of government backed student loan principal payments and interest expense
- 2019 Federal tax return and tax payment deadline extended to July 15, 2020

### **RECORD RESPONSE SPEEDS & MAGNITUDE**

Numerous records have been achieved or are expected:

- Nine of the ten largest central banks are promptly expanding monetary policy
- The Federal Reserve (the Fed) is creating approximately \$6 Trillion of liquidity
- The Fed's fifth round of quantitative easing (QE 5) produced more funding in one week than all of QE 1
- US Treasury bonds traded at record low interest rates (all below 1%)
- 30-year mortgage rates have fallen to 3.6% vs 4.3% a year ago, resulting in a refinancing wave
- The federal government passes \$2.3 Trillion (phase 3) of stimulus spending
- Computer trading has become 70% of US trading volume and reacts in fractions of a second
- Quick, massive drop in economic growth
- Record level of weekly unemployment claims
- Record levels of remote working and remote education
- Virus genome sequencing, massive and widespread drug testing and vaccine research (worldwide, all with a singular focus) are rapidly progressing

### PERMANENT CHANGE

As public bans are lifted, many people will rush out of isolation and return to old habits; but our world has changed.

There will be lingering health concerns with various former activities. Likewise, many venues will change. There will likely be more distance between seats.

Remote work and isolation are changing long-term habits. When American bars, cafeterias, entertainment venues, restaurants and travel services reopen, some consumption will not return.

Some former patrons have found new enjoyment in home cooking and/or home entertainment. Others have discovered a preference for working remote over commuting.

Increased remote activity (work, education, etc.) has stressed parts of the telecom and data networks. As 5G is better equipped for streaming media and data, its nationwide rollout should accelerate.

Increased capabilities of 3G and 4G in previous telecom cycles allowed for other technological advancements. Advancements from the introduction of 5G could enhance the accuracy, automation, efficiency and productivity of future activities.

Rapid advancements are being made in biotechnology, logistics and media. In turn, these advancements allow for enhancements in the quality, delivery and pricing of goods and services. This provides consumers with more choice and enables shifting preferences and improved lifestyles.

One example of new technologies improving choice and quality is 5G making “Over-The-Top” (OTT) media instant, seamless, personalized and less expensive. Household and personal electronics will no longer be attached to numerous landlines, cables and cords; rather, they will receive faster, more reliable, enhanced, two-way, streaming data through 5G Wi-Fi. The data moves seamlessly through the air, “Over the Top” of old technology cable.

OTT will allow a sports fan to subscribe to sporting events and sport news without having to pay for hundreds of other channels. Cooking and travel enthusiasts will similarly be able to subscribe to those services without having to pay for embedded sports networks. Two-way technology will allow for an individual’s immediate feedback and precise, customized selections further advanced with artificial intelligence on both ends.

### MARKET OUTLOOK

Bear markets tend to end before recessions end. On average, markets bottom while unemployment is still increasing. At this time, normal human emotions of fear and remorse are long-term investors’ greatest enemies.

Easing trade disputes and the lagged effect of record fiscal and monetary stimulus should provide a tailwind well into 2021.

History shows that an extremely accommodative Federal Reserve and US government combined with low valuations (company earnings yields relative to bonds) tends to be a profitable combination. Each of these appears to be at historic levels.

A separate document, *Margin Spiral*, describes the collapse of a relative value hedge fund strategy that exasperated market dislocations and likely bankrupted several highly leveraged hedge funds (akin to Long-term Capital – LTCM in 1998). These dislocations can result in both bond and stock market valuations deviating widely from their underlying fundamentals.

Disparities between groups of stocks is also extreme. Some value indices have lagged their growth counterparts by over 16% in the last year. Similarly, smaller-capitalization stocks have lagged the S&P 500 by approximately 20%. After such results, there are attractive small-cap, value and dividend growth stock opportunities.

The recent and rapid stock market sell-off clobbered many stock prices regardless of long-term fundamentals. Plenty of companies that benefit from existing and changing long-term trends have not been spared from the broad-based bear market. This allows investors to selectively pick attractive stocks and realign investment portfolios to better suit their needs.

Today, attractively priced stocks of companies with expected, long-term growth of revenue, earnings and cash flow can be found in:

- 5G (telecom)
- Biotechnology (medical advancements)
- Lithium (rechargeable batteries)
- Logistics & Distribution (internet sales and delivery)
- Shifting Consumer Trends (eating at home, remote working, OTT...)

Currently, a diversified stock portfolio striving for both long-term growth and current cash income can be built with a dividend yield of 4.5%. A high recurring and growing cash dividend stream can fund regular withdrawals without the investor having to invade principal. Since withdrawals can be made without stock holdings being sold, the portfolio remains intact and principal growth might outpace inflation. Compounding is a long-term investor's best friend.

Timothy C. Call, CFA, President & CIO

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