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Coronavirus 2020

BEYOND THE STORM

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PLATINUM BRIDGE WEALTH STRATEGIES

EXECUTIVE SUMMARY

The coronavirus stock crash has caused the United States to plummet into a bear market at the fastest pace in history. It has wiped out trillions of dollars of wealth for investors all over the world. All of the gains that have been realized during President Trump's tenure have been eliminated. It has caused serious disruptions to our everyday way of life, the economy and the stock market. This paper addresses why markets have been so volatile, what needs to happen to get past this crisis from an economic perspective, and how investors should position themselves for the eventual recovery.

FAQS

Q - Why have markets been so volatile?

A - Many market participants (hedge funds, institutional investors, leveraged funds, etc.) borrowed excessively in recent times to take advantage of very low interest rates. Their strategy has been to borrow additional money to invest in stocks in hopes of achieving returns in the future that exceed the rate of interest they are paying on the borrowed money. As this crisis hit, it has forced participants that have borrowed money to sell investments to pay off those loans. This has accelerated the selling pressure during this downturn.

Additionally, computer trading has exacerbated this issue. In 2012, Congressional testimony from the research firm Tabb Group estimated that computer-driven trading accounted for more than half of all U.S. equity trading volumes annually from 2008-2012. Computer generated trades noticeably increased as markets fell. That additional selling pressure as markets declined through certain levels has contributed to the extreme volatility we've seen recently.

FAQs - Continued

Q - When might the markets calm down:

A - The market is a forward-looking indicator. Just as the markets began to decline before most people fully grasped the severity of this situation, the markets will start to recover BEFORE this crisis fully abates. As we are able to test more people and thus have more data points to analyze, the level of uncertainty will decline. As we gain more clarity around this situation, the markets can find some support and then start the process of dealing with the economic fallout of our efforts to mitigate the health threat of this virus. A key element is monitoring the severity of new-case growth around the world. When looking at past epidemics, stocks didn't bottom until new-case growth stabilized. (Past performance is not a guarantee of future results.)

Q- Will buying opportunities emerge from this fallout?:

A - Yes. Investments of all asset classes have been sold indiscriminately. Solid investments that will be well-positioned to benefit as we emerge from this crisis are being sold right along with investments that will be severely impaired going forward. The average forward Price to Earnings ratio (PE Ratio based) on the S&P 500 is 16.32[11]. As of mid-March, we are trending around 14. In other words, when we look at how expensive the overall stock market is, based on what S&P 500 companies are expected to earn in the future, the market is relatively inexpensive. The baseline assumption is that this crisis is a "temporary" issue, and that the economy should start to pick up once we are able to put this crisis behind us. That, along with a strong fiscal response from the government, extremely low interest rates, pent up demand, low oil prices and improving technologies should make this a decent entry point for those investing in stocks for the next 10 years. However, one has to have a strong stomach to deal with volatility that is almost certain to continue in the short-term.

FAQs - Continued

Q - What are the keys to getting past this virus?:

A - The following, three-pronged approach is necessary to effectively deal with the overall impact of the coronavirus: [15]

1. A public health policy to contain the virus.
2. Monetary measures to ensure financial liquidity and functionality.
3. Fiscal support to contain the real economic damage.

Combating the crisis from these three angles remains critical today — here's how we assess progress in these areas across the globe.

PUBLIC HEALTH:

- Flattening The Curve: The spread of the coronavirus at this point is a forgone conclusion. The goal of a lockdown in certain states and cities across the country is to avoid overwhelming the healthcare system. Many people died during the Spanish Flu of 1918, not solely due to the virus, but because many people could not obtain adequate medical care due to the hospitals being stretched beyond capacity. [17]

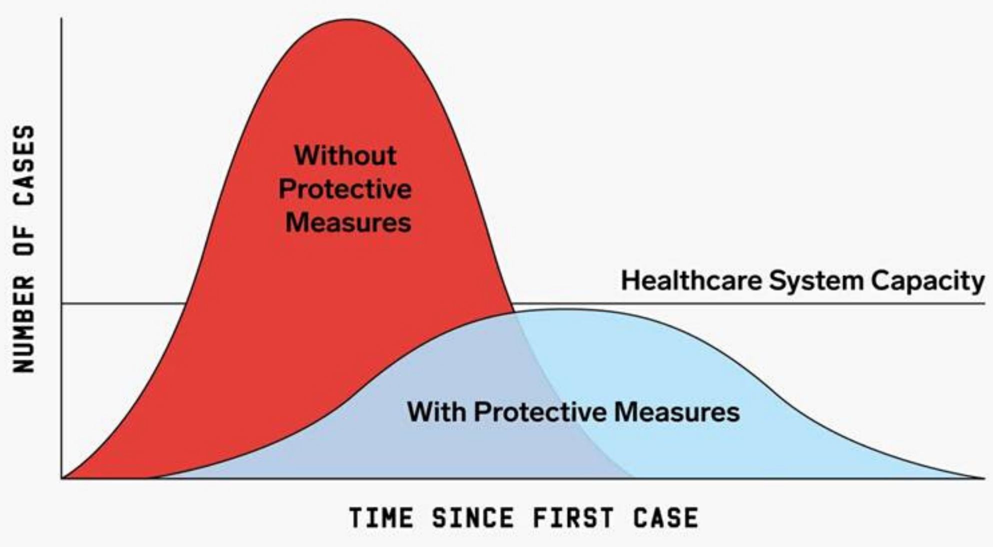


ILLUSTRATION: SAM WHITNEY; CDC

FAQs - Continued

- **More Data:** We need more data in order to understand the broader number of people impacted. This will reduce uncertainty, which will help markets settle down. It will also help to mitigate the absolute fear that people are experiencing by offering some perspective on exactly what we are all facing. Initially, fatality rates for H1N1 (swine flu - 2009) were 4% but ended up at around .07% as more data were analyzed. [1]

MONETARY POLICY:

- The Fed executed an emergency rate cut of 50 basis points in early March, and then provided another emergency rate cut of 100 basis points on March 15.
- When all investors want to sell at the same time, often there are not enough buyers to keep markets operating in a normal fashion. Central banks are moving to keep the financial system functioning by ensuring that there is enough liquidity in the system.
- The Fed will undertake a new quantitative easing (QE) program of at least $700 billion to begin March 16, with asset purchases divided between Treasuries ($500 billion) and mortgage-backed securities ($200 billion). *As of 3/23/20 - this program was expanded to include purchases "in the amounts needed".*
- The Federal Reserve is expected to help banks to extend loans to small businesses and give mortgage holidays to people that are out of work due to this crisis.

FISCAL POLICY:

- China has implemented massive programs such as subsidized loans in order to keep companies running and paying workers while factories were shut down. The Italian government has suspended mortgage payments across the country. Lenders are offering debt holidays to small firms and families.

FAQs - Continued

- European Commission President Ursula von der Leyen announced that it is ready to support widespread fiscal stimulus for euro nations.
- In the US, the administration has approved the CARES ACT, a $2 trillion rescue plan which includes sending checks to many Americans and allocating $350 billion toward helping small businesses.[23] The plan includes $50 billion to help rescue the airline industry and $150 billion to support other sectors, which may include the hospitality industry. Small businesses employ the majority of the people in this country. The consumer makes up 70% of our GDP. If small businesses fail, that would cause massive unemployment and a huge hit to GDP that would span a long time. This would cause a very long and drawn out recovery in the stock market and in the economy.

The Playbook From The Great Recession is Critical

The Great Recession was the United States' longest and worst, economic recession since the Great Depression. There are many lessons learned from that time period that inform how this current crisis may play out.

Observations:

- The Great Recession started in December 2007 - June 2009. (duration 18 months.)
  - However, aggressive policy responses didn't start until much later - this may have prolonged the crisis:
    - TARP (Troubled Asset Relief Program) Oct 2008, 10 months later.
    - American Recovery and Reinvestment Act - Feb 2009

The Playbook From The Great Recession Continued

- Stock market bottomed March, 2009 -5 months after TARP and 3 months before the recession ended.
- We have the Great Recession playbook and many of these same initiatives are being finalized right now.
- The governments and central banks around the world learned important lessons from the Great Recession. Monetary and fiscal stimulus are happening **much sooner** and hopefully will help to reduce the economic impact of this crisis.

The Reality:

The current downturn has been the fastest decline into a bear market ever. A bear market is defined as a 20% drop from the market high. We have experienced 12 drops of 20% or more since 1929 and the average duration from peak to bottom was 16 months. This time, we entered a bear market in 16 days.[13]

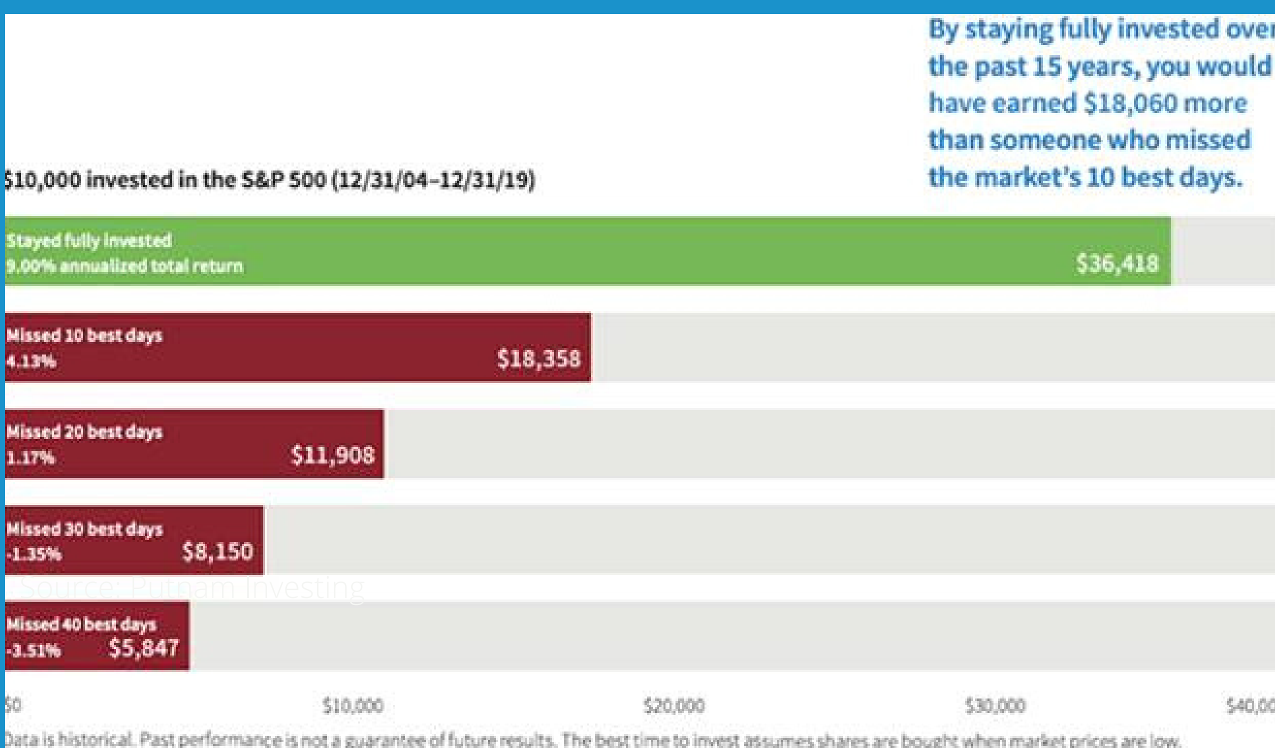
- The markets are gripped by fear and investors have been selling everything indiscriminately. Investment decisions have not been based on economic fundamentals. Historically, this situation has presented a buying opportunity for investors.
- The public health impact of this virus, and the associated containment efforts will have a dramatic impact on the global economy. A JPMorgan Chase research note predicted the economy would shrink by 14 percent between April and June, the worst contraction in post-World War II history.[12]

Steps To Take Now For The Eventual Recovery

Stay Invested:

It is imperative to remain invested, as any encouraging news may have an immediate positive boost to the markets.

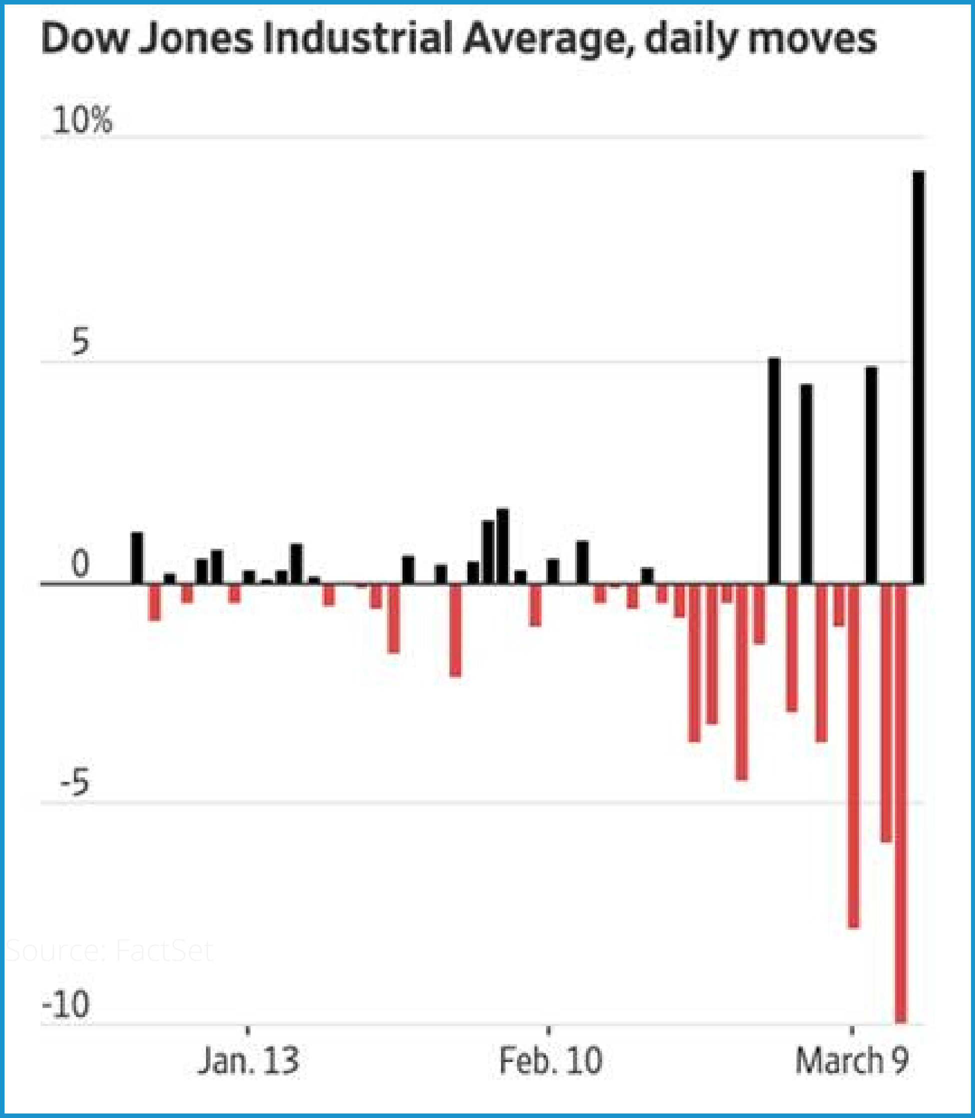
- Repositioning of portfolios is prudent to help mitigate further downside volatility and to be optimally positioned for a potential rebound.
- Historically, six of the ten best days in the market occur within two weeks of the ten worst days.[9] You must still be invested to capitalize on the up days once the market starts to recover. The market is a forward-looking indicator. By the time the news hits that we are past the pandemic the market would have already started to recover. The chart below shows that if investors merely miss the top 10 days in the market, over a 15 year period, they essentially cut their returns in half.[18]



Source: Putnam Investing

Stay Invested - Continued

The following chart shows the extreme volatility that we've dealt with. Note how the market has shown the capacity to go down around 10% in one day. It has also shown the capacity to go up approximately 10% in one day. Investors must be present in the market to experience potential outsized gains as markets eventually bottom, stabilize, and begin to recover from this bear market.



Buying Opportunity

While this is a very unsettling time, pandemics eventually come under control. As investors, we have dealt with severe downturns before, and we will get through this one as well. To quote Jim Bianco of Bianco Research, " In the period from 1998-2018, we experienced the tech wreck, a terror attack, a global financial crisis, the European debt crisis, Brexit, and many infectious disease scares (H1N1, SARS, Ebola, and MERS) and the S&P 500 Index still climbed 7% per year.[12] A $100,000 investment in the market in 1998 would today be worth over $400,000".[13] Think long term and stay the course.

Positive Factors In Support of Long-term Market Growth:

- **Low Interest Rates** -Low rates boost economic activity, as it is less expensive to borrow money to start businesses, buy homes, make purchases, etc.

- **Low Oil Prices** - Cheap gas prices puts more cash in the pockets of consumers to spend more in other areas.

- **Global Stimulus Program** - There will be tax cuts and other supportive programs around the world to get the economy working again post crisis.

- **Pent Up Demand** - Too much time at home creates cabin fever. People may have postponed big purchases due to lack of certainty around this situation. People will be anxious to get back out, visit restaurants, take their vacations and get back to a normal life as soon as possible.

- **Changing Workplace Dynamics:** The world may change permanently as a result of this scare. Corporations around the world will adjust employee work policies to include more telework options, virtual technologies will advance and become essential elements of the world infrastructure.

Buying Opportunity - Continued

- **Discounted Valuations -** Stocks Are on Sale - as of this writing, stocks are trading at around a 15% discount to their long term averages.

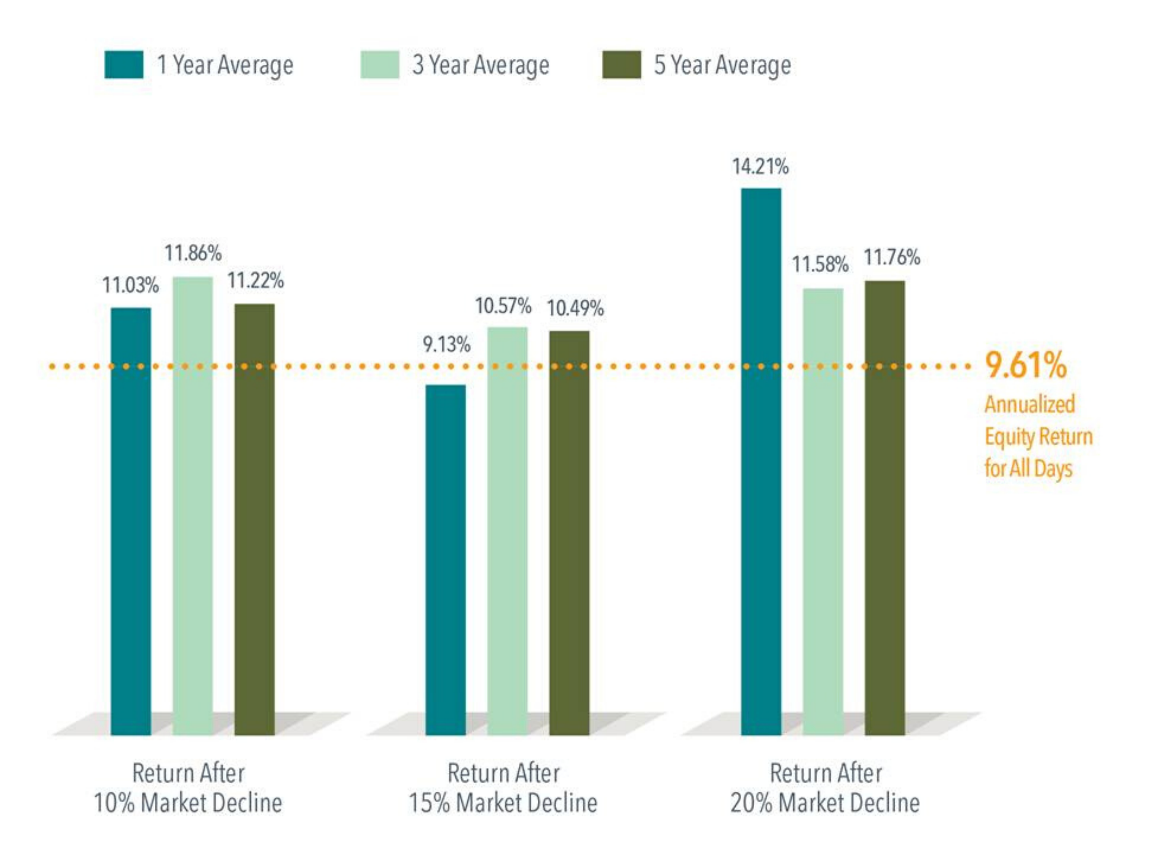
- **Indiscriminate Selling** - When panic hits a market, sellers want out of ALL assets, regardless of the price. There are some very good companies and sectors that have been sold off categorically, without regard to their long-term investment prospects. That often creates great long-term opportunities for smart investors.

- **Active vs. Index Strategies** - Over the last decade, the use of index funds has emerged as a core investment strategy for many portfolios. Going forward, it may make sense to focus more on active strategies as professional investors separate the wheat from the chaff and pick out investments that have been unjustifiably sold during this rapid market selloff and may be poised for exceptional returns in the future.

Finally, investors should be looking to rebalance their portfolios by bringing them closer to their long term asset allocation targets. After such a meaningful market pullback, your stock allocation can become disproportionately small to the original target. Long-term investors may also consider investing additional money during this time. The following chart shows the average annual market performance over 1, 3, 5 year periods after market declines of 10%, 15%, and 20%. Markets typically have very solid long-term performance after steep declines.

Market Performance After Steep Declines

Fama/French Total US Market Research Index Returns19
July 1926-December 2019



Source: Dimensional Funds - Past performance is no guarantee of future results. Short term performance results should be considered in connection with longer term performance results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Areas of Concern

- **Additional National Debt -** The stimulus needed from the United States government to help mitigate the devastating economic impact caused by shutting down large parts of this country will be enormous. Multiply that by the tactics deployed in countries all around the world and we are faced with a serious global economic slowdown. The famous hedge fund manager from Bridgewater Associates, Ray Dalio, estimates that it may take upwards of $2 trillion from the US government to help deal with this crisis.[20] The government will need to print money in order to provide this level of stimulus. Considering that the annual deficit is already approximately $1 trillion against a backdrop of a $21 trillion national debt, providing these additional funds may have serious implications for our economy in the future.

- **Problems in the Bond Market -** When the market experiences extreme selling pressure, it contributes to substantial market volatility. The national media makes it easy to stay apprised of how this impacts the stock market but what is lost on the average investor is how this also impacts your "safe" investments - your bonds. The stress to our system can manifest in ways that cause bond prices to decline, sometimes dramatically. Depending upon the types of bond exposure you have some investors may experience serious and permanent losses to their bond investments. This may be especially true if you own a bond mutual fund. When everyone heads for the exits, sometimes the fund manager may have to sell bonds, oftentimes at a loss, to raise the cash to give the sellers their money back. This is analogous to a run on a bank, but within a mutual fund. This is more concerning for bond investments as most people have bonds in place to provide safety and to diversify the risk associated with their stock positions. The details of why this happens are beyond the scope of this white paper. However, you may want to have your bonds reviewed by a professional to make sure they are able to weather this storm.

Areas of Concern

- Potential Unemployment - Businesses are being forced to layoff employees as a result of the social distancing measures that are being deployed to mitigate the spread of this virus. The three-pronged approach referenced earlier in this paper will be critical in dealing with this crisis but we need to execute on these strategies as soon as possible to help minimize the long term impact on our economy.

Conclusion

This is a very unsettling time for all of us. Clearly, the health implications of this virus are of paramount concern. As we also consider the economic impact of the virus it is important to be realistic about the obstacles that we face. We are headed for a very difficult time economically and the stock market will continue to reflect these challenges. As this situation plays out, some companies will go out of business and some bonds will default.   However, opportunities will emerge that only present themselves once in a decade. Prudent investors will look to capitalize on very attractive valuations in resilient industries with solid long-term growth prospects. We will get through this crisis as we have so many in the past. It is important during this time to do a full analysis of your current investment holdings. It is very likely that some investments need to be replaced by other investments that are better positioned for growth as we emerge from this situation. While bear markets are no fun, they actually clear a lot of excesses out of the system, and provide the foundation for more robust growth in the future. The stock market has a huge upward bias. The market declines by 41% on average during a bear market, but appreciates 387% during an average bull market.[21] Now is the time to take an objective look at your investments, consider the road ahead, and prepare yourself to take advantage when the next bull market returns.

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