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Summer 2020

Topics Reviewed in this Edition

- **The "New Normal", at least for now. Companies and families adjust to the COVID-19 virus. We review the winners and the less fortunate.**
- **A very "narrow" market. We review the cause for new highs in major stock indexes despite the continued economic slowdown.**
- **Tired of your bank's high fees and poor service - Schwab Bank may be a solution.**
- **Time Segmentation - A retirement income planning strategy that increases confidence and reduces the 3 big risks in retirement.**

We're a bit late with this summer edition of our semi-annual newsletter, but things have been busy at Integra Capital. Notably, Operations Manager, Christina Sherman gave birth to her daughter Alina back in June. Christina recently returned from maternity leave and we are glad to have her back at the office!

The "New Normal"

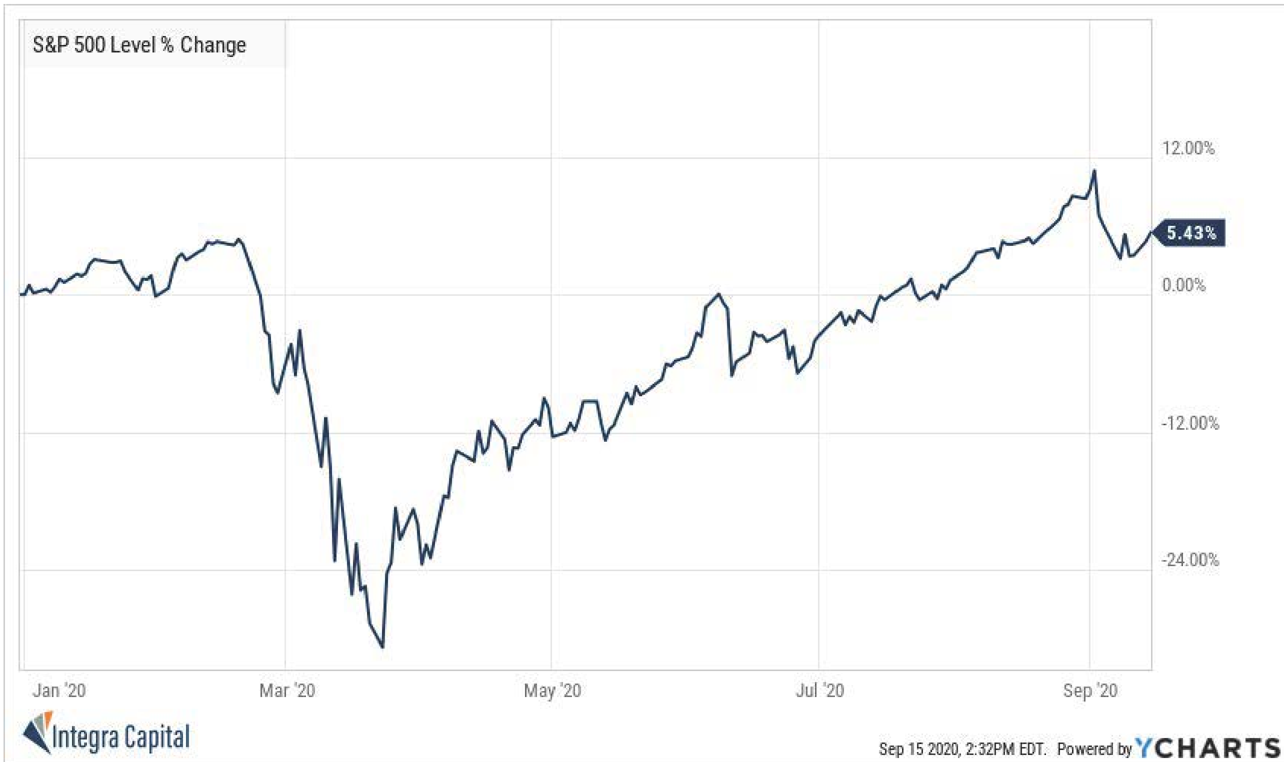
Restaurants and airplanes half full. Masks worn in indoor public places. Hotels only 25% - 40% full. Many employees working from home. The list goes on and on with the ways the COVID-19 virus has impacted our lives in the last 6 months and it's obvious it's not over yet. We aren't qualified in the health field, but we believe the virus will eventually pass. It appears that we have at least another 6 months and likely more of dealing with the inconveniences we are now experiencing.

We've been teased with news of progress on a vaccine, but it will take time to finalize testing, trials and ramp up production to inoculate a high enough percentage of the world's population. Bottom line appears to be that we all need to be smart, safe and help minimize the spread until a medical solution is identified and distributed.

Perhaps the most shocking thing has been the performance of the world's stock markets in the face of the worst economic slowdown since the Great Depression. While the duration of the current economic recession remains to be seen, we can say with a high level of confidence it isn't close to over yet. In the next section, we'll examine the stock market's rise and pose some ideas on why it has happened and where we believe it may go in the next several months.

Recent Record Levels for U.S. Stocks

In late March, at the bottom of the 30+ percent decline for stock prices, virtually no one said, "This is the bottom and in 5 months or so we'll be back at record highs". Not even the most optimistic analyst dared to utter such a thought. Yet, there we were in late August with the NASDAQ and S&P 500 Index at all-time record highs. How can this be with unemployment near 10% and almost a million new unemployment claims each week recently? The chart on the next page of the S&P 500 Index for 2020 shows the recent rollercoaster ride.



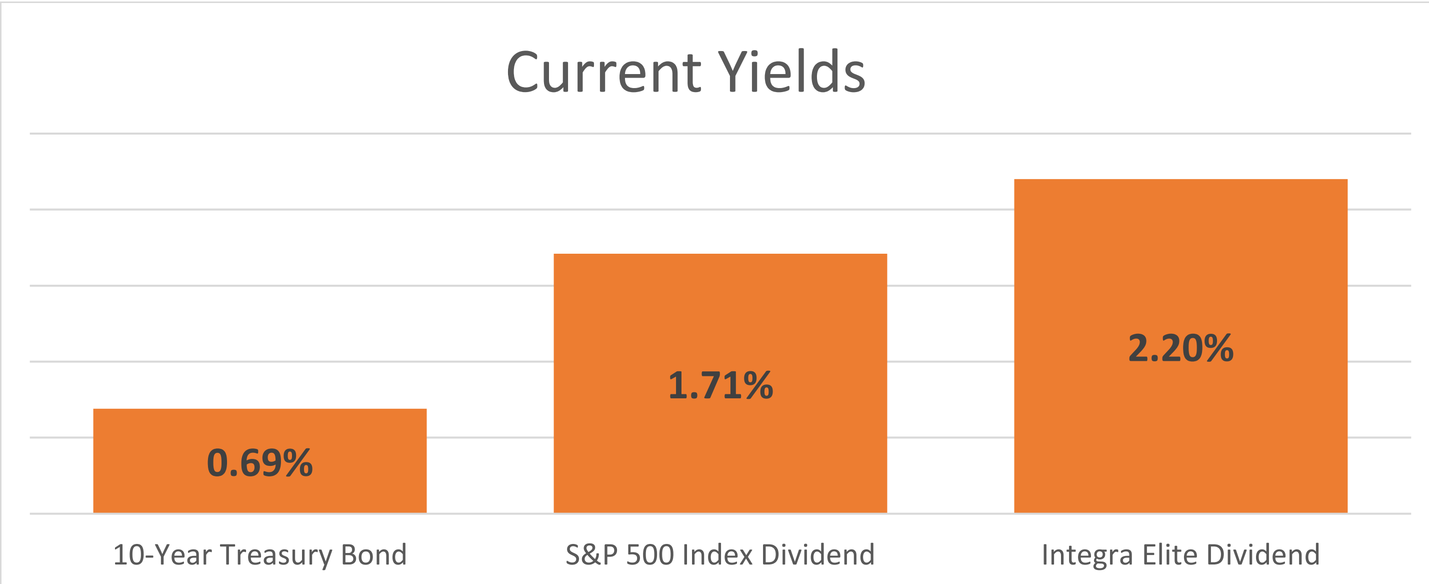
Markets look forward. Stock prices usually start declining before an economic slowdown becomes obvious. Likewise, they usually start moving higher when the news is still bad near the end of recessions. Therefore, the idea that stock prices would rise from the March lows as we begin to grasp the challenges of the current economic malaise is not surprising, but record highs in just a few months is unprecedented.

Let's review a few ideas as to how this may have come about.

First, is the old Wall Street saying "Don't fight the Fed". This short sentence means that when the Federal Reserve acts to pump liquidity into the system through tools like reducing interest rates and purchasing bonds, eventually corporate profits will recover along with the economy and investors purchase stocks in anticipation of this fact.

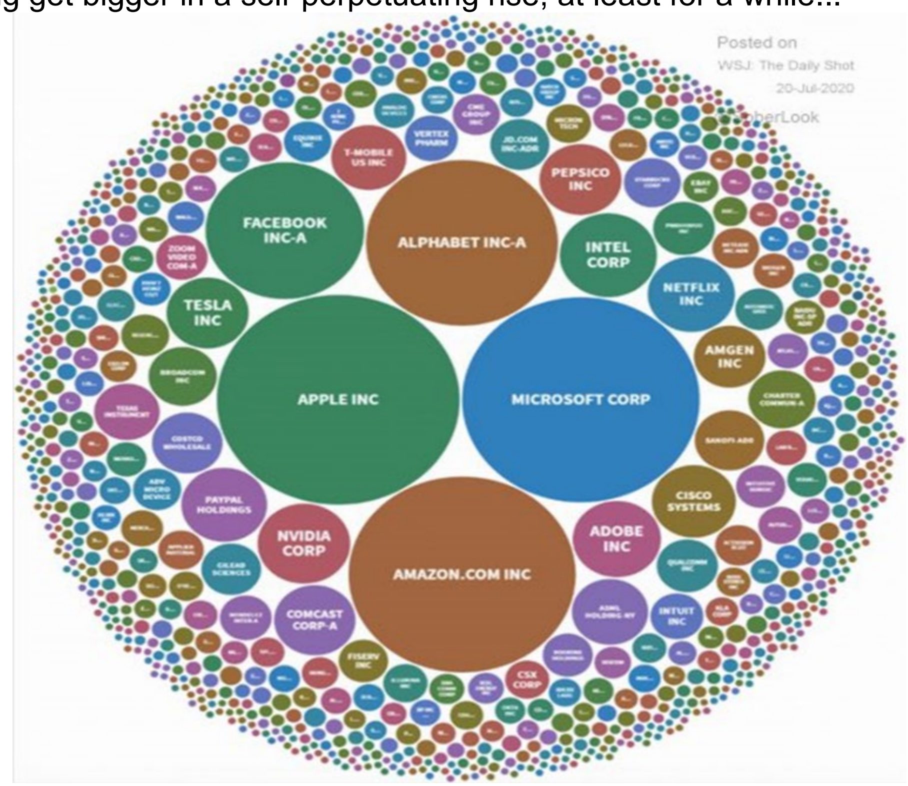
With the Fed pulling out all their biggest weapons to fight the current economic slowdown, and their promise to keep doing it until the economy recovers, investors have voted with their assets to purchase stocks, forcing prices higher. But this rising tide has not lifted all boats. We'll dive deeper into the "narrowness" of the recovery a bit later to examine this phenomena.

Second, is the difference between stock and bond yields. Currently, the 10-Year U.S. Treasury bond has been yielding about 0.7%. That's less than a 1% annualized return locked in for 10 years! High quality corporate bonds are yielding 1% to 2%. But, it isn't any real challenge to buy individual stocks or an Exchange Traded Fund (ETF) holding dividend paying stocks that yield more than 2% and, with patience, realize long-term capital appreciation in addition to the current income. See the chart on the next page.



This yield difference theory may partially explain the rise in stock prices, but most of the rise in major indexes has been caused by stocks that pay lower or no dividends. We'll examine that next.

The rise in index values, namely the NASDAQ and S&P 500 stocks, is due to a handful of stocks rising dramatically. These stock have a few characteristics in common. Mainly, they are all large companies who's price action has great influence in the index value and they are all companies which are either immune or benefit from the COVID-19 virus. This group primarily includes Apple, Microsoft, Amazon, Facebook and Google (Alphabet). There are others, but these are the largest companies in the U.S measured by market capitalization. Vast amounts of capital have flowed into these 5 stocks driving them to very high valuations and the indexes to record highs. The picture below is an illustration of this effect where the big get bigger in a self-perpetuating rise, at least for a while...



This effect is technically called “narrow breadth”, which refers to when the majority of stocks are not making new highs while the major indexes are. Historically, this is not considered a healthy condition, which may resolve itself in one of a couple different ways.

The worst of these resolutions would be for a general decline in equities that impacts stock prices across the board. This could be a full-scale bear market or at least an attention getting correction. During this pattern, we would expect “old economy” stocks to decline less or perhaps rise a bit even if the headline indexes are going down, due to the price drops of the big five companies identified previously.

The next possibility would be a more significant rise in “old economy” stocks, which are more attractively valued and stand to benefit as the negative effects of the pandemic start to eventually fade. The big five companies would likely stagnate in terms of price appreciation, while their profits grow over time and justify their high prices. Keep in mind that as COVID-19 passes, there could be a negative impact on the profits of corporations that have benefited so far from its presence.

Ready For a New Bank?

We have been hearing from many clients who are tired of poor service and high fees from their traditional brick & mortar national, regional or local bank. We have a few thoughts to share on this.

First, we have been hearing of and experiencing positive results with Bank OZK (formerly Bank of the Ozarks). They are a traditional regional bank, but appear to have a customer friendly business model. They have expanded in the last few years in the Florida market (where most of our clients live) through opening branches and acquiring a few smaller banks. If you desire a local branch structure, we suggest checking them out.

Next, if you’re okay with not necessarily having a local branch close by, there are many online banks available that offer fee-free checking and savings accounts that pay at least as much or more interest than the traditional banks, and also generally offer reimbursement of ATM cash withdrawal fees if you use the ATM at any location.

The logical online bank to consider is the Charles Schwab Bank. Affiliated with parent company, Charles Schwab, the bank has some local branches but most of the customers utilize the banking functions such as deposits and online bill pay without visiting the bank through the Schwab mobile app. Traditional paper checks are also available. Schwab Bank also offers mortgages and home equity lines of credit through an affiliation with Quicken Loans and pledged asset lines of credit where you can borrow using your securities brokerage account as collateral.

To open a Schwab Bank High Yield Investor Checking account, you must open a Schwab One brokerage account, which most of our clients already have. It is easy to move funds between the brokerage and checking accounts. We would like to disclose that “high yield” is a relative term in today’s interest rate environment. Currently, the Schwab High Yield Checking account yields 0.1%, in line with most online checking accounts and better than most traditional bank checking accounts. But 0.1% is certainly not a very high number. We like to say that what makes the Schwab checking service so great is what you don’t pay for. There are no account fees and all ATM charges are fully reimbursed no matter where you use the ATM. Call us to learn more about the Schwab High Yield Checking service and we can help you get the account established if you’d like to move forward.

Time Segmentation - A Bit of Clarity

Sometimes calculating and visualizing how your investment portfolio will provide retirement income to complement your Social Security and possible pension income can be difficult. Looking at pie charts that show how much of your assets are in cash, bonds and stocks does not make obvious the amount you can safely spend in retirement for your lifestyle and not run the risk of running out of money if you, hopefully, live a long life. Fortunately, for those concerned about the longevity of their assets to provide for their needs, there is a solution known as "time segmentation". This plan helps address the three big risks in retirement:

1. Inflation Risk - Even low inflation increases the cost of living a lot over a retirement that could run 30 years or more.

2. Sequence of Returns Risk - A large drop in your portfolio value, especially early in retirement, could have devastating impact on your retirement income to maintain your desired lifestyle. Those who take too much risk may find themselves part of the unlucky group, who have to make undesirable adjustments to their lifestyle.

3. Longevity Risk - Quite simply, if you have the good fortune to live a long life, it puts stress on the ability of your investment plan to outlive you, or put another way, you outlive your money.

Integra Capital employs a sophisticated software tool that we use to calculate how to invest your assets to produce a plan, which offers a safe solution to providing the first 5 and 10 years of income. The idea is to not rely on stock investment results for your income for the first 10 years at least. Time has historically reduced the risk of owning growth oriented investments like stocks and if we don't need to rely on them for ten years or more, now we have "time on our side".

These plans are built with reasonable assumptions for inflation, life expectancy and investment returns. We also build in factors for various life events like inheritance, deposits from the sale of a business or other assets and also expenses like that vacation home in the mountains or that expensive special trip for an anniversary celebration.

A time segmentation plan is not necessarily a change in investment philosophy. It is simply a way to align your investments for different time periods in retirement to maximize your chance for a successful retirement income plan. We have also found that most clients have increased confidence and a greater peace-of-mind when this strategy is in place.

We are happy to discuss time segmentation with you. It is usually most effective in the pre-retirement (5 years before retirement) and retirement years. Call us today to learn more.

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