KWB WEALTH®

APRIL 2020

The "TOO HARD" Pile

2ND QUARTER NEWSLETTER

KEY TAKEAWAYS

We believe the job losses we are experiencing currently will be temporary, not long-term.

The economy was on very solid footing before the coronavirus, putting it in better position to take a significant hit.

Bonds, compared to stocks, have held up well during the bear market. So, if a client needs income soon, we can sell bonds and wait for stocks to recover.

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First, we want to extend our deepest condolences to those affected by the COVID-19 virus. We know in the coming weeks and months more and more people will be afflicted, so it's important we do what we can to limit the spread as much as possible, particularly for those less apt to fight the horrible virus. We remain hopeful that, like most viruses, the warmer temperatures of spring and summer will slow the spread and the amazing scientists around the world will soon have a cure.

As we look toward the economy, the picture is certainly grim. We've seen millions of workers file for unemployment benefits in the past few weeks, and we are likely looking at a double-digit slowdown in Gross Domestic Product (GDP) in the second quarter. However, what's important is whether these are long-term losses or just temporary.

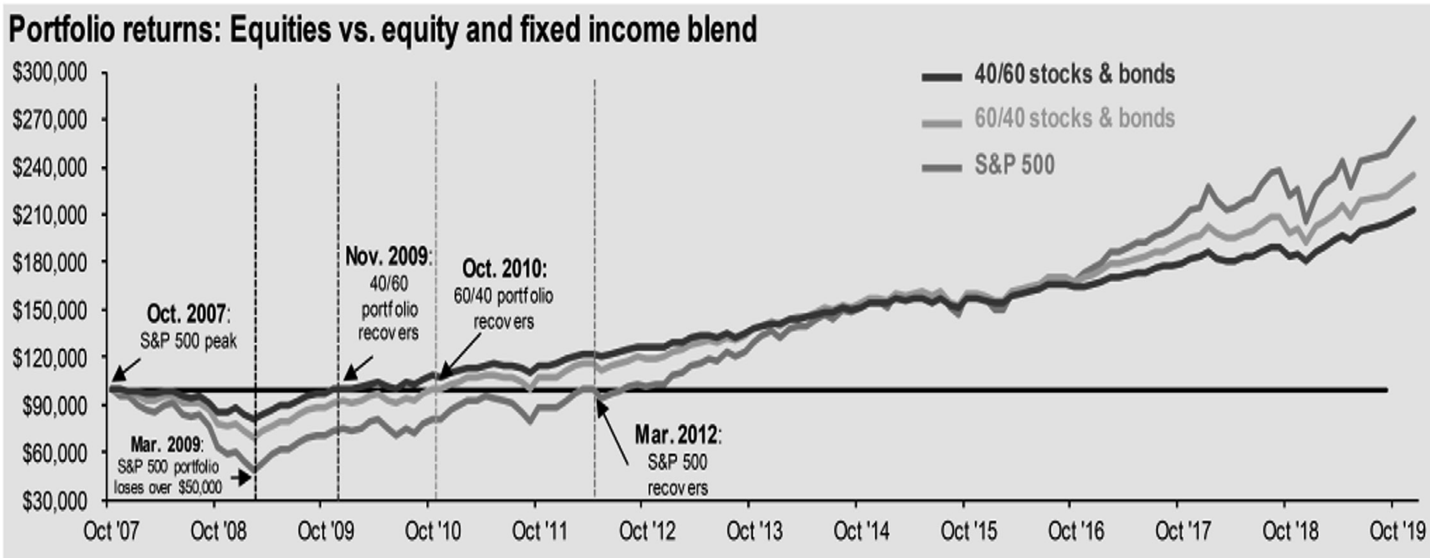

CHART TWO: SOURCES: J.P. MORGAN ASSET MANAGEMENT

Christopher Thornburg of Beacon Economics said in his most recent Beaconomics report, "Truly 'lost' jobs are positions that will not return for a long period … perhaps years, if ever. This characterizes the construction, mortgage lending, retail furniture and appliance, and real estate jobs that disappeared after the crash of the sub-prime fueled real estate bubble more than a decade ago. Today, we are talking about jobs that may only be lost for a period as short as 6 to 10 weeks – of course this is highly dependent on containment of the virus. And while short-term job losses will be a jolt to the system, the impact will be partly offset by employment increases in sectors such as health care and transportation." This, along with the staggering amount of stimulus that the government has enacted, should soften the blow for affected workers.

It's also important to remember where the economy was just a month ago. The US was at record low unemployment, business debt-to-GDP was lower than five years ago (even as companies were issuing debt to buy back shares), and bank portfolios looked rock solid due to the restrictions placed on them by Dodd-Frank. Likewise, households were not on the verge of financial collapse. Financial obligation ratios and debt-to-income ratios were at their lowest points in years. Savings rates were at 30-year highs even as housing affordability was at a ten-year low. Consumer debt delinquencies outside of student loan debt are all lower today than they were at any point before the Great Recession. Unlike 2008, this was an economy that could take a hit.

As for the markets, the S&P 500 fell 34% in one month. One of the largest and quickest declines in market history. When the comparisons are 1929 and 1987, you know things are bleak. However, it's always important to know what's happening in your accounts – not just what the stock market has done. The vast majority of our clients are diversified and invested in both stocks and bonds. Bonds have held up quite well since the market topped – the Bloomberg Barclays Aggregate Bond Index is positive since February 20th. When a client has needed funds raised in the last month, we have been selling only bonds to raise that cash.

In the long run, the market has always bounced back and reached new highs. It did in 2009 (and 2000, 1987, and so on …) and we believe it will again. In the Great Financial Crisis (assuming no withdrawals) it took an allocation of 60% stocks and 40% bonds about 1.5 years to recover. We believe that, because of the abruptness of this bear market, we may see a quicker recovery this time assuming a similar allocation and no withdrawals. In the meantime, for those needing income we will continue to sell from bonds as we wait for the markets to recover.

Our best advice in these trying times is to limit withdrawals only to what is necessary. If we can sell only from the bond side of your allocation, it will allow your portfolio to recover more quickly once this is all over. As for when it will be over, we can't say. Our philosophy on these types of drawdowns is very much in line with Warren Buffett's thinking on the subject. When Mr. Buffett is looking at a company to invest in, he has a box on his desk labeled "TOO HARD." The vast majority of companies he considers will eventually go into the "TOO HARD" pile, typically because he doesn't understand the business thoroughly or he doesn't know if the business is a good long-term holding. The COVID-19 virus falls into our "TOO HARD" pile, because we have no clue when the news will start getting better or when the market might look past the headlines and start to go back up. For all we know, the market could have bottomed on Monday, March 23rd. If the market leads the economy by six months, as the saying goes, then it's certainly possible. That's another reason this falls into our "TOO HARD" pile. If there was anyone lucky enough to get out of stocks either before or early on in this drawdown, they have the unenviable task of trying to make the call of when to get back in. If that person was scared out of the market by the news, do you really think they will have the stomach to get back in as the market recovers, even as the news might be getting worse? Making one call – selling from bonds until stocks recover – is much easier than making two calls and getting them both right.

Lastly, it's important to recognize the worldwide response and cooperation we are seeing through this unprecedented time. Not only are governments acting quickly to ensure the safety of citizens worldwide, but individuals are making huge sacrifices in the face of the tragedy going on around them. Health care professionals, grocery store workers, delivery drivers, and even those that are playing their parts and staying home are all heroes. Many private companies in the US are utilizing their manufacturing capabilities to produce desperately needed medical supplies and keeping workers employed ... much like WWII. Hopefully, this massive cooperation will set the world up for a new era moving forward, which will only strengthen economies, and markets, into the future.

Stay safe, stay home, and reach out to us if you have anything you need to discuss. We can all beat this together.