Regal Wealth Management, LLC

WEEKLY COMMENTARY

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Why Investors Need Guidance During Bear Markets and National Emergencies

First and foremost, we once again hope that you and your family are safe, quarantined, and healthy. These past few weeks have not been easy for any of us and we have been thinking about you each day. If I or my team can be a resource to you in any capacity, please do not hesitate to reach out. With the complete understanding that there is no point in repeating current events, it is my hope the below summary helps better contextualize recent market developments.

Not all bear markets are created equal, and this one is no exception. Work stoppages, state lockdowns, and limited demand due to the coronavirus have already begun to affect the economy in unprecedented ways. To make matters worse, it's unclear whether this will last weeks, months or even longer. While controlling the spread of the coronavirus is still the primary focus, markets are already worried about the follow-on effects. With the S&P 500 down 31% year-to-date, and 34% from its peak just a month ago, it's important for investors to understand these concerns.

One key concept in corporate finance is the difference between *financial* and *economic* distress. These terms separate the underlying business of a company - i.e. its products/services, whether there is demand for them, and whether they can produce them profitably - from how it is financially managed - i.e. how much debt is raised to fuel growth, whether capital is used for reinvestment or share buybacks, etc. **This is an important distinction because financial leverage can sometimes make bad companies look good, and companies with sound business models can fall victim to poor financial management.**

As the oft-quoted Warren Buffet saying goes, "only when the tide goes out do you discover who's been swimming naked." The tide isn't just going out - the water is already drained. The question is whether individuals and companies can stay covered until the tide inevitably comes back. In normal times, this depends entirely on the strength of balance sheets. While the years after 2008 witnessed corporate and personal de-leveraging, this has somewhat reversed itself. While large cap companies do not appear to be over-levered compared to the housing bubble years - because earnings and equity values have both risen - small and mid caps have increased leverage over time. For markets, a legitimate concern is that even if these companies are otherwise economically sound, they may face financial distress as demand dries up.

All of these concepts apply to personal finance as well. **The strength of an individual's balance sheet can be the difference between high-profile athletes that go bankrupt and middle-class workers that successfully save for retirement.** Fortunately, while certain areas of debt, such as student loans, have increased for Americans, the average household balance sheet is still strong. Household net worth has doubled since the expansion began in 2009.This is not to say that many Americans will not face difficulty, nor does it imply that all households are created equal. Jobs data, including last week's jump in initial jobless claims, already show that many will need assistance. To the extent that the market and investment portfolios react to aggregate economic information, these data show that American finances are much stronger than they were in 2008.

Not only are these not normal times, but we learned many lessons from 2008. Due to the incredible speed by which the coronavirus has spread, and possibly the systemic nature of the economic slowdown, the government is pulling out all the stops in order to support individuals and businesses. Officials are using their 2008 playbooks with far larger numbers and a faster response. For instance, the Fed has now pledged open-ended asset purchases, often dubbed "QE infinity," after pushing rates to zero. Although we strongly anticipate congressional approval on simulative legislation, as of publication, no final agreement has been reached, and the holdup is weighing heavily on the markets. Tax deadlines have already been pushed back. Many industries, especially in travel and hospitality, will likely receive government bailouts. Whether one agrees with this philosophically or not, and whether or not it creates bad incentives, it's hard to argue that it's not needed to stave off *financial* distress - as long as these individuals and businesses would otherwise be *economically* sound.

Thus, while the underlying causes of bear markets may all be different, they have two similarities:

First, they are generally caused by recessions which can be exacerbated by financial distress. De-leveraging and re-leveraging cycles take time, making these recoveries slower but no less robust than recoveries from shallower market corrections.

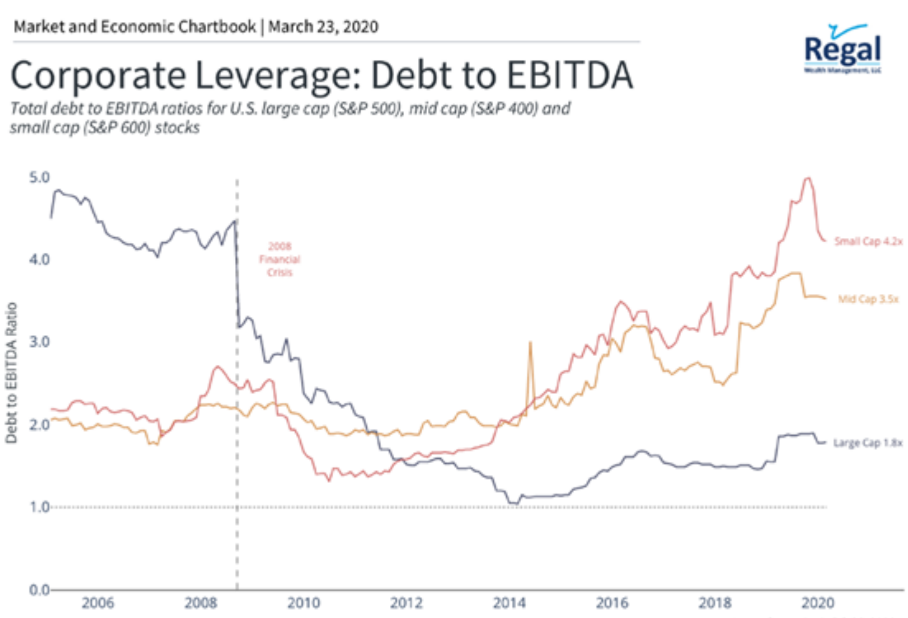
Second, markets often begin to recover when investors least expect it. The beginning of the previous recovery in March 2009 began amid significant global economic uncertainty. And while recoveries may take a few quarters or a couple of years, missing out on these rebounds can have a significant effect on long-run portfolio gains.

In the end, investors should understand that eventually the economy will get back to work. The question will be which companies best are positioned to avoid financial distress during this period, and whether government stimulus will help them bridge that gap. As individuals, avoiding financial distress depends on having a sound financial plan and possibly the guidance of a trusted advisor.

In the meantime, it's important for everyone to stay safe and to tackle the public health crisis together. **As hard as it might be today, staying focused on diversified portfolios while knowing that businesses and individuals will eventually get back to work is the best course of action for long-term investors.**

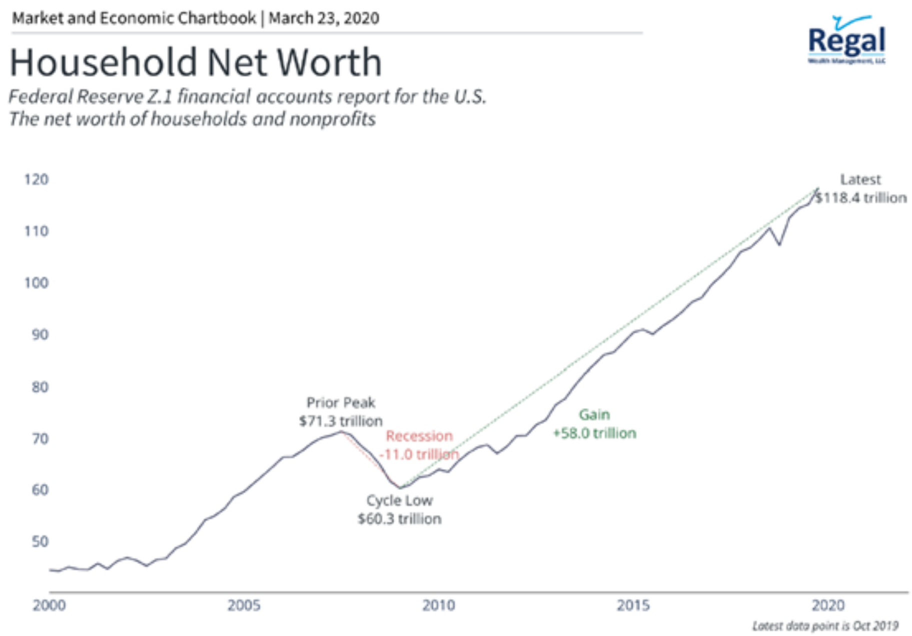
Below are three charts that help to put the market's underlying concerns in perspective:

1. **Corporate debt levels differ based on company size**



While corporate debt levels have remained stable and manageable for large cap companies - since both earnings have equity values have grown significantly over the past ten years - they have risen for mid and small cap ones. This is one reason the government is implementing measures to support individuals and businesses during this time of financial stress.

2. Corporate debt levels differ based on company size



Household net worth has doubled since the bottom of the 2008 financial crisis. At nearly $120 trillion, the growth in assets over liabilities has kept personal debt at reasonable levels on average. Of course, many Americans have already begun facing difficulties in this uncertain time and will need the assistance of both public and private programs during the crisis and once it subsides.

3. Despite different causes, bear markets are similar in two ways

Bear markets are often the result of recessions. These can be prolonged if those recessions are the result of over-leveraged business and individuals. Still, recoveries often occur swiftly and without warning. Even the worst recessions can recover within a couple of years amid on-going economic uncertainty.

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