HEMSLEY ADVISORS, LTD. (847) 381-7314

311 S. WACKER DRIVE
SUITE 1525
CHICAGO, IL 60606

432 N. HOUGH STREET
BARRINGTON, IL 60010

March 31, 2020 Quarterly Newsletter

General Market Commentary

We hope this finds you and your family healthy and safe during these extraordinary times. The COVID-19 pandemic and its unknown effects on individuals' health and economic activity precipitated a sharp decline in the stock averages in March. Fear and anxiety levels rose as investors watched a significant percentage of wealth disappear on a daily basis. The aggressive action by the Federal Reserve, along with the passage of a fiscal stimulus bill by Congress, gave the market reason to recover somewhat in late March. The first quarter ended with losses of -23.2% for the Dow Jones Industrial Average, -20.0% the Standard & Poor's 500 Stock Index, and -14.2% for the NASDAQ.

Compounding the downturn was a dispute between Saudi Arabia and Russia regarding oil production. The two countries could not reach a deal to cap maximum daily production, so Saudi Arabia increased their own supply and began to flood the market. This action, coupled with lower demand due to COVID-19, caused prices to decline below $25 per barrel – a 17 year low. Historically, this might have been welcome news by U.S. consumers as gas prices have fallen significantly.

However, the U.S. is now a large oil producer but with higher production costs than OPEC and its allies. The oil industry creates numerous jobs throughout the U.S. but many producers have borrowed heavily to support this growth and are dependent on higher oil prices to continue to operate. We suspect that at some point a truce will be established between Saudi Arabia and Russia, but given reduced world economic activity, prices are likely to remain well below levels prior to COVID-19.

As world stock markets declined and recessionary fears increased, there was a rapid flight to safety towards cash and Treasury bills. In any market when large numbers of individuals and entities want to sell and there are few interested buyers, bid prices drop significantly. This caused anyone who needed to raise cash to suffer large declines in the value of their assets from February's higher values. We even heard stories from bankers that individuals were withdrawing large sums of cash due to fear. Yields on high quality investment grade corporate bonds increased to over 3% on one year maturities and yields on short-term municipal bonds increased to well over 2% due to lack of buyers. Investors were only interested in cash or Treasury obligations as panic selling increased. Effectively the credit markets had become frozen!

Fortunately on March 18th the Federal Reserve announced a series of actions to stabilize the credit markets. They declared their intention to purchase investment grade corporate bonds and short-term municipal bonds as well as support money markets that are backed by commercial paper (corporate IOUs). These actions began to stabilize the stock market by creating confidence in the credit markets and thawing them out. We can't overstate the praise the Federal Reserve deserves for their actions in facilitating the free flow of credit to large and small companies throughout the United States and helping create financial stability throughout the world.

The market decline has created attractive dividend yields in stocks, frequently 4% or higher, that have not been seen since after the credit crunch in 2008 and 2009. Additionally, growth stocks such as Starbucks Corporation, Facebook, Inc., and others are well off their 52 week highs and could be solid additions to a portfolio. Utility stocks, historically defensive in nature, declined more than expected. This was due to both equity market declines and disruptions in the credit markets as utilities are somewhat interest-sensitive securities. As a result, quality electric utility companies such as CenterPoint Energy, Dominion Energy, and Duke Energy now have dividend yields ranging between 5% - 7%. Utilities generally are not viewed as growth stocks, but given the decline, we suspect a snap back rally will occur. If so, the appreciation plus dividend yield will make for an attractive total return over the next year or two.

Despite the high fear levels, it is important for individual investors not to panic during market declines. One usually needs to "ride out the storm" and wait for some semblance of stability to be reestablished. At that time and with a holding period of at least two years, any accumulated cash that is not needed can be added to existing or new positions. The objective is to increase one's portfolio cash flow and see appreciation over the next few years. It might require patience as the world works through the COVID-19 issues and, equally important, seeing how consumer spending and savings habits evolve over the next few years.

Our investment strategy has always been to create portfolio growth via a combination of growth stocks and value stocks, with an emphasis on generating cash flow. In addition, we include short-term bonds to create a margin of safety and to help reduce volatility. Cash flow in a portfolio can be reinvested and compounded for the future or used to help meet current income needs. When more cash flow is produced, fewer dollars of principal have to be liquidated to meet a particular objective. While this might not be a perfect strategy, in our experience focusing on cash flow helps clients get to and through retirement successfully.

We also like to emphasize the importance of planning ahead for your cash flow needs. Imagine the pain of having to sell in today's down market for cash needed in the short term. Ideally, outflows should be planned 6 months or more in advance. One never knows what market conditions will be one month before your cash is needed. For retirees, we always like to enter the year having the cash to meet their required distributions in a money market fund. Between October and December, we typically estimate what the required distributions will be for the upcoming year, then add our fees and subtract the anticipated portfolio income from this total. The net result is usually negative and what we refer to as "a consumption deficit." We will try to fund this deficit prior to entering January by selling securities and placing them in a money market fund. This process enables the retiree to go through the year knowing that regardless of market fluctuations, including declines as we have experienced, they won't be forced to sell any stocks in a down market and that their bonds can be rolled over. At a minimum, this provides a small amount of comfort as the retirement asset value changes as the market fluctuates.

One question on most clients' minds is regarding the safety of their dividend income. Currently we believe most dividends are secure except perhaps for the oil industry, whose cash flow is somewhat dependent on oil prices. Remember companies do not like to cut dividends as they know people rely on them. Therefore, instead of reducing their dividend, many companies may opt to not increase theirs for a year, or increase it a smaller amount than the last few years. In addition, some companies are reducing or eliminating stock buybacks to protect their balance sheet and their dividend payouts.

The recent market decline, along with the current economic shutdown after 11 years of steady economic growth, has provided everyone, regardless of age, with much to think about. Market declines are painful and a significant correction usually occurs every 5 – 10 years. Fortunately they always recover but one needs to constantly ask themselves: will my lifestyle, cash flow, comfort level, and the ability to pay my bills be affected if my portfolio unexpectedly drops 30%? How will college education be paid? What would happen if, through no fault of my own, I lose my job? Should I consider keeping more money in the bank or in a money market fund? Or do I start increasing our cash reserves 5 years prior to retirement and getting all large expenditures out of the way? Should I work another few years prior to considering retirement?

These and many other questions should constantly be considered. We hope they help stimulate your thinking. We are here to help you with your cash flow, savings, budget planning, tax questions, as well as other financial planning needs. And, of course, your retirement questions.

Financial Planning

Coronavirus Aid, Relief, and Economic Security Act, or CARES Act

The recently passed legislation contained provisions that cover retirement accounts. In an effort to help retirees recover some of their lost retirement account value, Congress has suspended the required minimum distributions for 2020. This applies to IRAs including inherited IRAs, SIMPLE IRAs, SEP-IRAs and qualified plans, e.g. 401(k)s. This provision presents an attractive tax planning opportunity for some taxpayers. If one has other funds available, they can consider reducing or eliminating their 2020 distributions to save tax dollars.

Another provision in the law allows taxpayers who do not itemize their deductions to deduct up to $300 in charitable donations for 2020. The standard deduction was increased significantly beginning in 2018 and now only about 15% of taxpayers itemize. Hopefully this provision will cause funds to quickly flow to charities that are most needed in this time of crisis.

Separately, COVID-19 has shed light on the importance of having one's medical information updated and available to family members should the need arise. In addition, as we have mentioned in the past, it is important to update your list of financial accounts, insurance policy numbers, passwords, and any other pertinent information. A family member should be advised as to where this information can be found.

Increasing your Insurance Liability Coverage

Prior to this past quarter's decline, the U.S. had an economic expansion that lasted over 10 years with an associated stock market appreciation. There has also been a trend toward increased retirement savings from millennial and mid-career individuals. All of this has resulted in the net worth of the country increasing. Therefore, it is important for all individuals, particularly young and mid-career workers, to consider an umbrella liability policy. This coverage provides excess liability coverage above the limits of a personal auto policy or homeowners insurance policy. It protects the owner from negligence caused by an auto accident, someone injured at your home, an accident on a ski slope where another skier was seriously injured, and numerous other perils.

Most licensed drivers have liability coverage but there are limits. One major auto insurer recently told us that their maximum limits for a personal auto policy is $500,000 per person and $1,000,000 total per accident. Given that the auto accident rate has spiked 20% since 2016 (primarily due to phone usage), these limits for many individuals are very insufficient. An umbrella liability policy will provide you with excess liability coverage up to higher amounts. It is inexpensive, typically purchased in one million dollar increments up to $5,000,000, and will protect your current net worth and future earnings potential against a financial judgement.

Many people think they have to own a home to have coverage under an umbrella policy. Not so. You can rent a home or apartment but you will have to have a renter's insurance policy. We encourage you to give this type of protection serious consideration and encourage you to, at least, contact your insurance agent for an opinion.

We understand everyone is concerned during this challenging time. Remember we are your partners and here for you not only to answer financial questions but also a sympathetic ear. We will get through this together.

Newsletter Disclosures:

1. This newsletter may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements.

2. Past performance is not indicative of any specific investment or future results. Views regarding the economy, securities markets or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss to the investor.

3. Inclusion of index information is not intended to suggest that its performance is equivalent or similar to that of the historical investments whose returns are presented or that investment with our firm is an absolute alternative to investments in the index (if such investment were possible). Investors should be aware that the referenced benchmark funds may have a different composition, volatility, risk, investment philosophy, holding times, and/or other investment related factors that may affect the benchmark funds' ultimate performance results. Therefore, an investor's individual results may vary significantly from the benchmark's performance.

4. Any information provided by Adviser regarding historical market performance is for illustrative and education purposes only. Clients or prospective clients should not assume that their performance will equal or exceed historical market results and/or averages.

5. This newsletter is intended to provide general information only and should not be construed as an offer of specifically tailored individualized advice.