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General Market Commentary

The past six months have been quite the roller coaster ride for the investing public! The near record highs seen in the beginning of the year turned quite suddenly in early March with an overall market decline of 30%. The sharp and swift selloff was driven not so much by COVID-19 but by the high use of leverage, or buying using margin, that began in early October 2019. At that time, the Federal Reserve announced that they would inject additional cash to stabilize the repo market (made up of short-term loans backed by collateral) that was signaling a possible credit crunch reminiscent of the 2008 financial crisis. A large percentage of this cash ended up in the stock market.

With low interest rates and an appreciating stock market, the use of leverage intensified. Individuals, hedge funds, and other large pools of money that follow trends and momentum began making very large investments in or bets on the stock market. This continued into early 2020. But as the world's economies began to shut down due to COVID-19 and economic uncertainty increased, nearly all of this leverage had to be unwound. A massive free fall in equity prices over a 3 week period ensued.

Incredibly, even though fear levels increased significantly except for some minor selling, the public maintained their investment positions. We commend all of our clients for "hanging in there" and staying the course during a difficult and painful market environment!

June has ended with the world's economies continuing to reopen, massive fiscal and monetary stimulus still working its way through the economy, social unrest, concern about the resurgence of COVID-19, as well as a volatile stock market. Unfortunately, there is still a large percentage of the population unemployed, businesses of all sizes are trying to stay solvent, and an overhanging sense of despair exists among many people. Despite all this, there is a cautious sense of optimism.

It has been amazing to see American ingenuity at work coming up with ways to keep both their employees and communities safe as they reopen businesses — not to mention the overall kindness and concern of people in general. It is very reminiscent of the way the United States came together to win World War II.

Surprisingly, the stock market averages have continued to move higher and people are concerned that the market is moving too fast, is overvalued, and another correction will occur. Markets can and will fluctuate wildly and with little notice. What we can tell you is what has occurred several times since the 1980-1982 recession. Coming out of a recession it is not unusual for the market to appreciate significantly, much faster than the economic performance at the time would justify. This causes price to earnings ratios, based on both trailing and projected earnings, to become exaggerated and somewhat meaningless. Eventually the market averages stabilize and move sideways for a number of months. The economy improves, earnings accelerate, and the ratios come back into balance.

Regardless of what the market has been doing, it has been encouraging to see clients continue to save — from millennials becoming more interested in investing and trading, to recent college graduates starting periodic investment programs, to mid-career individuals and baby boomers adding to their portfolios or increasing retirement contributions to 401(k)s and IRAs.

Setting market performance objectives in the short term is always somewhat of a guess. However, for planning purposes we believe it is prudent for investors to expect annual potential returns over the next couple of years in the range of 6% - 9%. Markets can fall with very low volume and few participants but longer term advances need lots of individuals interested in investing. It is important to get people back to work. We will all have better returns if large numbers of people are employed and participating in economic growth.

As you know, our investment strategy is to invest in quality assets with an emphasis on both growth of principal and cash being generated. Growth stocks, particularly technology stocks, continue to appreciate. Companies that are considered blends of growth and value that support attractive dividend yields have lagged the pure growth stocks.

However, taking advantage of these stocks enables one to start the year off with a portfolio that generates an approximate 3% income return from dividends. It doesn't require significant portfolio appreciation beyond this point to obtain an objective of 6% or better total return. Yes, corporate earnings will be challenged in Q2 but we believe they will stabilize and improve in the 2nd half of the year and into 2021 as the economy improves.

One obstacle that will impact an investor's total portfolio return is the general low level of interest rates of fixed income investments we are currently observing. Our objective is always to buy solid investment grade bonds with an emphasis on safety. This assures that our principal will be returned at maturity. Regrettably today, the retail investor is competing against the U.S. Federal Reserve. As part of their numerous monetary stimulus programs, the Federal Reserve is now buying investment grade corporate bonds. This increased demand has caused bond prices to increase resulting in short-term corporate bond yields of approximately 1.2% with Treasuries significantly below 1%.

The near-zero interest rate environment will last at least through year end and likely many months beyond. The Federal Reserve is committed to protecting markets to keep the economy from cratering and, equally important, maintain full employment. They have stated their intention to keep short-term rates near zero until at least 2022.

Global pandemic concerns also continue to affect the credit markets resulting in an overall "flight to safety." This creates further pressure for rates to remain very low. For now we have to be both patient while the pharmaceutical industry works on a COVID-19 vaccine and creative in trying to improve cash flow.

Our recent strategy has been to invest part of one's maturing bond proceeds into dividend-paying stocks and rolling over the remaining proceeds into a corporate bond. For example, if one had 20 bonds or $20,000 maturing, we can consider rolling over 15 bonds and adding the remaining $5,000 to some of the client's dividend-paying securities. This "compromise strategy" increases the effective yield on the entire $20,000 to slightly over 2%, still preserves principal, and creates growth of capital over time. This is not a perfect situation but we believe an appropriate plan to make the best of a difficult near-zero interest rate environment.

Given the low interest rate environment and stock market volatility, it is important to plan one's cash flow needs in advance whether for general living expenses to a new car, a home project, or a child's education. Don't wait until you need money to liquidate securities. Let's start planning now for money that you may potentially need in the fall or next year.

Despite concerns about COVID-19 and the global pandemic, low interest rates, stock market volatility, and social unrest, there are a number of positive factors occurring. Pharmaceutical companies are vigorously working to develop a vaccine, housing activity is coming back quickly, the oil markets are rebalancing, and nearly every day there is an increase in daily passenger travel as reported by the Transportation Security Agency at TSA.gov. Many other factors also exist that gives one confidence in the future. Maintaining a positive attitude is good for one's health.

Financial Planning

CARES Act

Last week, the IRS issued guidance regarding the waiver of the required minimum distributions (RMD) for 2020. As you know, the CARES Act substantially eliminated the RMD requirement for this year. However, taxpayers who took their distributions pre-COVID-19 were not able to roll their distribution back into their IRA or retirement plan. The new guidance allows the taxpayer to rollover their distributions that were withdrawn early in the year back into their IRA, inherited IRA, and other types of retirement accounts. However, this contribution needs to be rolled back into the account prior to August 31, 2020.

Another provision of the act was the $1,200 economic impact payment to individuals. Recently several individuals have told us they have not yet received their payment. If you are having trouble logging onto the IRS website or are concerned about receiving your payment, don't hesitate to contact us for help.

Last, a few of our clients received money through the Paycheck Protection Program (PPP). The program officially stopped accepting new applications on June 30, 2020. It is estimated that $130 billion in funds were left unused. We are likely to see Congress appropriate the leftover money in a much more targeted way for certain types of small businesses.

2020 Estimated Tax Payments

In early June it was reported that the IRS had 10 million pieces of unopened mail. This is important for people making estimated payments either July 15th or later in the year. For safety and efficiency consider using the IRS' Direct Pay option and have the payment withdrawn from your checking or savings account. It is free, convenient to use, and avoids the delay and uncertainty of regular mail. Go to IRS.gov to get started. If you have any questions don't hesitate to reach out.

Alternative Minimum Tax and SALT Deduction

Many of you are aware of the ongoing controversy regarding the $10,000 limit regarding the deductibility of property taxes on Schedule A of Form 1040. The limit is actually a total of the combination of property, state, and local taxes paid during the year or "SALT" limitation. It is particularly painful to people in states with high real estate property taxes. However, most taxpayers do not know that the SALT limitation permitted the substantial reduction of the alternative minimum tax (AMT).

The AMT was established in the late 1960s as a way to require 200 high income taxpayers to pay a minimum amount of tax. Over the years slight adjustments have been made but basically the limits from the 1960s have remained largely unchanged. Therefore, year after year, we have seen many more taxpayers having to pay this tax as their incomes and itemized deductions have increased.

With the Tax Cuts and Jobs Act of 2017, many taxpayers were no longer subject to the onerous AMT. Even though the SALT deductions were limited, many taxpayers saw their overall tax liability decrease. Today only an estimated 200,000 taxpayers are affected by the AMT. This tax is currently scheduled to be effective again in 2026 but might occur sooner if there is a change of administration. Should this occur, the number of taxpayers affected will exceed 5 million. This will increase both one's tax liability and the cost to prepare a more complex tax return.

Building Credit History

Starting a credit history is a necessary task for any young person or new college graduate, as a credit history helps with eventual mortgage applications and other large purchases. Yet during a recessionary environment, this is the group that is hardest hit as most banks are reluctant to issue new credit cards to people without credit history. Banks are worried about the potential risk. It's a catch-22 situation.

One issuer bucking the trend is Discover Bank through its "Discover it Secured" credit card. This is the highest rated card for people trying to establish new credit or repair a blemished credit record. A secured credit card is similar to a regular credit card but it requires the cardholder to open a bank account and deposit funds as collateral. In this case, funds must be deposited with Discover Bank. The amount of your credit line will equal the amount of collateral deposited.

As with any credit card, monthly payments must be made and card usage is reported to the three major credit bureaus. After eight months, Discover reviews your account and determines if they can return your security deposit. As with other Discover cards, you will earn cash back on purchases and can review your FICO score monthly for free. More information is available on Discover's website. This is a great option for young people who want to start a credit history.

These are certainly challenging times. Don't hesitate to call with any questions or concerns. Stay healthy, safe, and sane!

Have a nice summer,

George

Nick JoAnne

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