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ECONOMIC & MARKET UPDATE

It is difficult to overstate the travail that the United States was forced to endure in the first quarter of the year. The coronavirus quietly slipped into our country, first surfacing on January 21, and began its insidious spread, multiplying exponentially to its current force, inflicting widespread sickness and death. In our country alone infections number in the hundreds of thousands and deaths continue to mount. This is the greatest health care crisis since the Spanish Flu of one hundred years ago. The economic impact has been no less severe, which of course has led to extreme volatility in the stock and bond markets. Our readers are accustomed to an attitude of optimism as we view the future. Here, we will assume the same posture, although it will be fused with realism. In this spirit we are reminded of familiar words.

> "This great nation will endure as it has endured, will revive and will prosper. So, first of all, let me assert my firm belief that the only thing we have to fear is fear itself..."

Spoken by Franklin D. Roosevelt in his first inaugural address on March 4, 1933, in the depths of the Great Depression, these words were a summons to the American people to keep faith in our country and not be immobilized by fear of the future. A reading of the full address reveals words of realism as to the degree of distress in the economy, full acknowledgment of the difficult task ahead, and the sacrifices to be made if recovery were to ensue. Likewise, we find ourselves in crises of health, economy, and investment. We believe we will survive them all.

As we discuss the economy and investments, we issue the caveat that everything is subject to and dependent upon the duration of the health crisis, for until reasonable progress is made on that front all economic and investment scenarios remain uncertain. We assume the most serious mitigation efforts will be successful in at least flattening the curve of incidents and that some of the more restrictive measures can be lifted in the next several months.

THE ECONOMY At this time the U.S. economy is contracting sharply. Although it will not be labeled as such until there are two consecutive quarters of negative Gross Domestic Product (GDP), realistically, we are in the early stages of a severe recession. It is easy to understand why. One of the simpler economic truisms states that one person's spending is another person's income. If that one person does not spend, whether it be out of quarantine, fear, or lack of money, the other person has no income. Without income that person cannot spend, which affects another person's income, and on and on, causing economic activity to cease. With much of the nation being shut down it is obvious why there is so little spending, and why we are in a recession.

If the coronavirus were not enough, the economy also got hit independently with a second blow in the first quarter. The price of oil virtually collapsed, dropping from around $60 per barrel to as low as $20. The oil industry found itself dealing with reduced demand due to the suspension of economic activity worldwide, and a price war begun by the failure of Saudi Arabia and Russia to reach accommodation on oil production. While cheaper oil represents a bonus for consumers and businesses, the oil industry is stressed by these developments as its revenues suffer greatly, forcing sharply reduced drilling activities that represent a major portion of capital spending in the larger economy. The combination of coronavirus and oil price collapse created an economic perfect storm.

Despite all of the above, there is good news. Help is on the way. Our system provides us with a Federal Reserve (Fed) and a legislative branch that can be of great assistance in times like these. Both bodies have responded immediately and aggressively. The Fed has reduced the federal funds rate to essentially zero and, perhaps more importantly, has injected massive amounts of liquidity into the system and has embarked on large-scale quantitative easing. These measures have been taken with the attitude of doing whatever it takes to create financial stability and maintain confidence. Meanwhile, the legislative branch has passed the largest fiscal stimulus package in our history at over $2 trillion. This program will provide immediate help to many Americans in the form of direct payments, extended unemployment insurance, and support for small and large businesses. Cumulatively, these measures represent tremendous stimulus potential.

We offer more good news. We believe the recession should be brief, likely encompassing the first and second quarters of this year, with the second quarter bearing the brunt of the damage. Assuming the virus in our country follows the course it has in other countries, it seems reasonable to expect the recovery to begin sometime this summer or early fall. Our baseline assumption is that two quarters of negative GDP will be followed by a few quarters of robust recovery, leading eventually to a resumption of economic growth at trend levels of approximately 2%.

INVESTMENT As would be expected, the economic crisis quickly spread to the investment world, where stocks experienced an unprecedented decline. From their peak in February the popular averages fell some 35% in less than a month, the quickest fall of that magnitude ever. As the full amount of stimulus by the Fed and Congress became apparent, stocks began to find a floor and have rallied nicely since mid-to-late March. Investors are heaving sighs of relief at a halting of the damage. We are not comfortable assuming the worst is over for stocks, but we do believe that prices reached a point where even the more extreme of possible outcomes were largely discounted. Even if there is more damage to come for stocks, our conviction is high that the types of companies owned in the portfolio are of sufficient strength to survive this period and get back on a path of earnings and dividend growth.

The decline in the stock market was indiscriminate. There was very little differentiation among individual stocks or sectors. In other words, there was no place to hide. Now, we must consider the future and decide how best to be positioned for survival, recovery, and sustainability. As always, we will opt for quality. In addition to survival, quality serves another purpose in times like these. When the market suffers serious damage day after day and week after week, for some it is very hard not to panic and sell out. Succumbing to the pressure to sell out is almost always a failed approach. Staying invested proves itself over time by rewarding investors with the very strong up days that inevitably follow. These up days are the only means of recovering value and building capital over time. Quality helps guard against panic by its assurance that the companies owned are strong enough to manage through periods of great stress and emerge on the other side as strong as ever. That is why we advise keeping the focus on the underlying strength of the businesses, not the extraneous noise that is so often swirling around.

While market dislocations such as this are never pleasant, they can provide opportunities to acquire high-quality stocks at attractive entry points or make changes to better position the portfolio for future success. Where possible, we are taking advantage of such opportunities.

While stocks were declining precipitously, high-quality bonds were actually gaining ground, although these gains were limited by volatility within the fixed income markets due to liquidity shortages. This caused bid/asked spreads among most bonds to widen, but it was another area where the Fed was able to step up and make a difference by injecting massive liquidity into the credit markets. All in all, anyone owning high-quality bonds was very happy with the results during the period of greatest stress, especially compared to stocks. This again proved the virtue of owning bonds as a diversifier of equity risk. With bond yields as low as they are their income-producing ability is severely limited; however, in terms of capital preservation they did their job.

CONCLUSION We leave you with a summary of our views. Looking ahead a year or so, we will still be psychologically and intellectually processing the damage inflicted on our country and the world. It will take a long time to get over this crisis, but we believe the economy will be in recovery because our system functioned, and the stimulus actually worked. There will still be challenges, but the strongest companies will have survived and will be prospering again. In one sense we will have returned to normalcy as we move back toward the familiar 2% world with GDP growing at trend rate, accompanied by very low inflation and interest rates. And, we will be asserting again that taken in its totality this is a good picture, an environment in which companies can execute their businesses well and standards of living can increase.

Viewed from the dark days we are now experiencing, this picture may appear as pure fantasy. We view it as a realistic possibility. We share FDR's belief that this great nation will endure as it has endured, will revive, and will prosper.

John

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Reid and Riege, P.C. is pleased to share this "Economic & Market Update" prepared by Crawford Investment Counsel, the lead investment advisor for clients of our Trust & Wealth Management practice. The practice is managed by David L. Sullivan, CTFA, who has more than 30 years of experience working closely with clients to organize retirement and other investment assets, manage cash flow, execute charitable and family gift plans and assist with other complex financial security needs. For additional information, please contact David at (860) 240-1022 or dsullivan@rrlawpc.com.