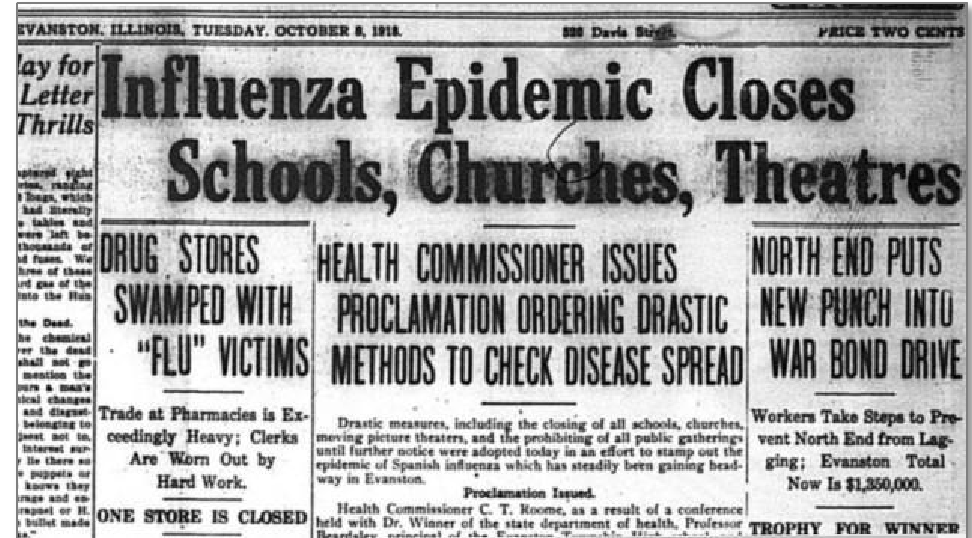
From: Aequitas Investment Advisors

Re: The World Turned Upside Down

In early March, life appeared pretty much as normal in the United States. Schools were in session, people were essentially free to travel, attend worship services, dine out, visit family members in nursing homes and hug their loved ones. In less than four weeks, a new reality was upon us and most of the things we took for granted were no longer possible. By the end of March, 42 out of 50 states, or about 310 million residents, were under some form of shelter-in-place order from their governors. The cascading events of March 2020 ushered in an abrupt end to life as we knew it.

For the financial markets, the month of March delivered one of the swiftest downturns in history. Entering the month, the Dow Jones Industrial Average stood at 25,590 and by March 23rd the market had plummeted by close to 30% reaching an intraday low of 18,214 (remarkably, less than six weeks earlier, the Dow stood at a record high of 29,551!). At the same time, some economists were predicting a 40% drop in our nation's GDP during the second quarter driven by 25 million lost jobs with the unemployment rate spiking up to 20%, or higher. All of this was caused by the novel coronavirus, known as COVID-19, which began more than 7,000 miles away late last year and has spread fear, misery, and death to all parts of the world. Suddenly, our economy was dealing with a *concurrent* global health crisis and a global economic recession. There were no playbooks to draw on for guidance as we had never experienced such a convergence of events. Most recessions have been the result of economic cycles and financial excesses rather than a global pandemic. The only historic parallel is the Spanish Flu Pandemic of 1918 which offers important lessons from a global health perspective; however, the economic conditions in 1918 were entirely different than they are today. At the time, the U.S. was at its height of involvement in World War I and massive wartime spending drove the GDP higher by 9% in 1918 - even the stock market that year gained more than 10%! From an *economic perspective*, those were boon times! All that heighted economic activity occurred despite the fact more than 675,000 Americans lost their lives to the pandemic - almost six times more than the lives lost in battle during our entire involvement in World War I! (Globally, the Spanish Flu ended up infecting one-third of the population with estimated deaths of more than 50 million.)



EVANSTON, ILLINOIS, TUESDAY. OCTOBER 8, 1918. PRICE TWO CENTS

Influenza Epidemic Closes Schools, Churches, Theatres

DRUG STORES SWAMPED WITH "FLU" VICTIMS

Trade at Pharmacies is Exceedingly Heavy; Clerks Are Worn Out by Hard Work.

ONE STORE IS CLOSED

HEALTH COMMISSIONER ISSUES PROCLAMATION ORDERING DRASTIC METHODS TO CHECK DISEASE SPREAD

Drastic measures, including the closing of all schools, churches, moving picture theaters, and the prohibiting of all public gatherings until further notice were adopted today in an effort to stamp out the epidemic of Spanish influenza which has steadily been gaining headway in Evanston.

Proclamation Issued.

Health Commissioner C. T. Roome, as a result of a conference held with Dr. Winner of the state department of health, Professor

NORTH END PUTS NEW PUNCH INTO WAR BOND DRIVE

Workers Take Steps to Prevent North End from Lagging; Evanston Total Now Is $1,350,000.

TROPHY FOR WINNER

The Headlines from 1918 Ring a Familiar Bell to the Headlines of Today

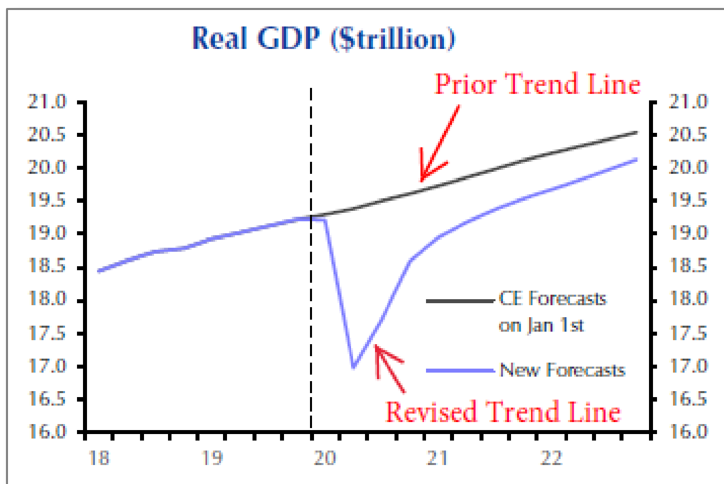
Bold Actions by the Federal Reserve and U.S. Government

As the pandemic gained steam in the United States in March and the economy appeared to be in freefall, the Federal Reserve acted quickly and boldly to shore up the financial system and assure that businesses have access to credit during the downturn. Jerome Powell said the Fed will do whatever it takes to keep the economy afloat. The federal government did its part as well, by swiftly enacting the $2 trillion CARES Act designed to provide financial lifelines to businesses and workers during the economic storm (it looks like more funding will be required for the small business loan program which has already exhausted its appropriation). These historic monetary and fiscal measures served to allay fears of a much deeper recession and provided at least a temporary lift to the stock market. More recently, the market has been buoyed by reports that Italy, Spain and France might be turning the corner on the coronavirus curve along with some cautious optimism of progress in the U.S. Discussions *and debates* are now in progress as to how quickly we can begin to reopen the economy. While this is all very welcome news, the timeline to safely reopen the economy needs to be carefully engineered with an appropriate balance between health and economic repercussions. While the curve of the pandemic might be improving, the curve of the economy is still trending downward and we should be prepared for bad news regarding unemployment and corporate earnings over the next few months. This

will probably be the worst quarter (April through June) for the economy in more than 60 years. As reported by POLITICO on April 6th, former Fed Chair Janet Yellen stated, in an interview on CNBC, that our economy is taking a "huge, unprecedented, devastating hit." Yellen went on to say, "If activity could begin to resume as many assume in June and may be back to something more normal by summer, I think a [quick recovery] is possible." In the meantime, most financial pundits believe the stock market will be in for a bumpy ride over the next few months with many predicting the market might test its March low point before beginning a more sustainable recovery.

Alphabet Soup to Describe the Coming Economic Recovery

Given the lack of a true historic parallel, speculation about how the economy might recover looks a little like alphabet soup. The most optimistic scenario (and least likely) is for a "V" shaped recovery beginning the second half of the year as businesses gradually reopen accompanied by a sharp bounce back in economic activity and consumer spending based upon pent-up demand. This scenario assumes the coronavirus curve has turned sharply downward and has been reduced to a manageable level for our healthcare system. The odds of a such a quick "V" shaped recovery scenario seem very low given the length of time required to safely reopen businesses and develop a vaccine. The predominant view is that we may experience a "U" shaped recovery where the economy begins recovering as business gradually reopen with somewhat less onerous shelter-in-place restrictions until the end of the year or early 2021. In this scenario, the economy would show meaningful improvement in the fourth quarter of 2020 with a sharper pick-up in economic activity in 2021 (especially once vaccines are available). The most pessimistic scenario is an "L" shaped recovery which is based upon the possibility that we do not make significant progress in our fight against the coronavirus and that shelter-in-place orders are maintained, or reimposed if slackened, for much longer until a vaccine is widely available. There is another potential shape to the recovery which doesn't look like a particular letter in the alphabet. In the chart on the bottom left, Real GDP ($trillion), Capital Economics, a global macroeconomics research firm, has indicated what the pre-coronavirus trendline forecast (black line) was compared to their current trendline forecast (blue line). They estimate that our economy will sharply contract over the next few months, but should have a substantial partial bounce back in the second half of the year. Rather than being fully "V" shaped or "U" shaped, the line looks more like an elongated check mark in that economic growth will probably not return to its pre-coronavirus level for the foreseeable future. An important reason for this lower level of economic activity is that about 20% of the GDP in the U.S., and about 20% of payroll jobs, are tied to hotels, tourism, airlines, cruises, entertainment, restaurants, bars and retail sales (excluding food and beverage). Unfortunately, these industries have taken the hardest hit in this downturn and it will take many months, if not several years, for them to fully recover. In the meantime, consumer spending patterns may change as consumers realize they might need to save more.



Four Things Must Happen for the Economy and Market to Recovery
Jeremy Siegel, Professor of Finance at the Wharton School

In late March, the renowned economist and author of *Stocks for the Long Run*, Jeremy Siegel, laid out four key steps which will be required for the economy and the stock market to recover from coronavirus recession.

1. The first step is that the government must provide bold and substantial monetary and fiscal support to the economy. Siegel says we can check that box given the surprisingly swift actions taken by the Federal Reserve and the federal government.
2. The second step is that we must flatten the curve to slow the spread of the virus so as not to overload our healthcare system. While we can't check this box off yet, Siegel is encouraged by the progress we appear to be making.
3. The third step is the arrival of therapeutics and vaccines. The sobering fact is that a vaccine will probably not be available until early 2021 if all goes well. The problem, Siegel laments, is that the American economy cannot tolerate a shutdown of six to nine months. What might allow a gradual reopening of businesses over the next two to three months is the introduction of a drug which might save lives and lessen the severity of the coronavirus on those inflicted.

Continued social distancing and protective measures must also be maintained between now and when the vaccine becomes available.

4. The most important fourth step is to make diagnostic tools widely available to test hundreds of thousands of individuals. These tests could determine who has antibodies to fight off the virus and can go back to work. Such testing can also identify those who test positive so they, and their close contacts, can be isolated to limit further spread.

While Siegel is optimistic about the prospects for succeeding in our fight against the coronavirus, implementing the remaining three steps will require coordinated leadership on the national and state levels as well as dedication and commitment by all of us to do our parts.

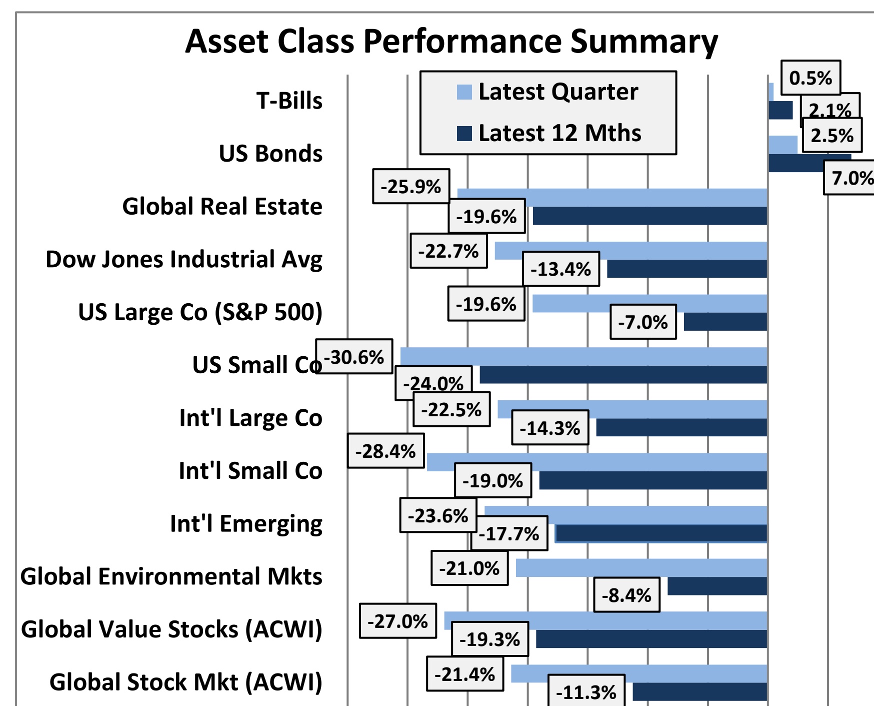
Protecting Our Long-Term Financial Plans
(And Battening Down the Hatches)

At Aequitas, our primary responsibility is to work with our clients as partners and advisors to achieve their financial goals. For individual clients, this means assisting clients in creating a financial plan, monitoring its progress, and making adjustments as personal circumstances evolve and economic conditions change. Certainly, the sudden and severe downturn in the economy over the past six weeks requires that we evaluate various potential economic scenarios in order adjust our assumptions and provide appropriate guidance in order to protect our clients' financial plans.

Before the coronavirus outbreak when the stock market was at a highpoint in late 2019 and early 2020, we had been advising clients to rebalance their portfolios by trimming Equities and adding to Fixed Assets, including setting up cash reserves and liquidity to provide for their cash flow needs. For individual clients, this might have included raising 2020 IRA Required Minimum Distributions early and for non-profit clients it might have meant raising an extra cushion of cash for planned distributions. When the coronavirus stock market selloff occurred in March, we advised most of our individual clients to create an additional cash reserve by trimming their allocation to international developed markets stocks, adding a foreign stock fund which invests in higher quality and more sustainable companies, and shifting from real estate securities into technology stocks. We believed these shifts would help our clients' portfolios better weather the economic storm and provide favorable long-term capital appreciation potential. At the time, many well-respected strategists posited that the stock market might fall by as much as 40% to 50% as a result of the coronavirus induced recession. We believe that protecting our clients' financial plans during the economic downturn and this unprecedented degree of uncertainty is prudent. Further, despite the most recent rebound in stocks, we believe the current risks to the downside warrant a somewhat defensive posture in the near term. That being said, we believe there may be favorable opportunities for adding to Equities over the next few months by gradually investing excess cash back into Equities or through portfolio rebalancing.

Asset Class Performance Review

A picture, or rather a bar chart, can tell a thousand words and, unfortunately, the picture is not pretty (except for bonds!). In the first quarter, stocks around the globe in all major asset classes plummeted between 20% (US Large Caps) and 31% (US Small Caps). Over the trailing 12 months, which includes the latest quarter, US Bonds performed very well (+7.0%), but the stock market asset classes were down between 7% (US Large Caps) and 24% (US Small Caps). One important point is that the asset classes which have higher expected returns, such as US Small Caps, also have a higher levels of risk, so it is unsurprising they would fall more in this downturn (return and risk are commensurately related). Over the long term, however, we would expect a higher rate of return in exchange for that risk (e.g., for the 20-year period ending March 31, 2020, US Small Caps generated an average annual return of 6.0% compared to 4.8% over the same period for US Large Caps, i.e., the S&P 500).



Enough with the negative numbers (except for bonds!), let us move on to a glimpse into the future!

What Things Might Look Like on the Other Side
By Tim Nash
(Sheltered-in-Place in his Home Office on the Other Side of Hingham)

What a difference a quarter makes in so many ways.....less than two months ago, stocks were registering great returns and we could walk freely into a grocery store, shake hands with acquaintances and give hugs to close friends we hadn't seen in a while. That is all different now.

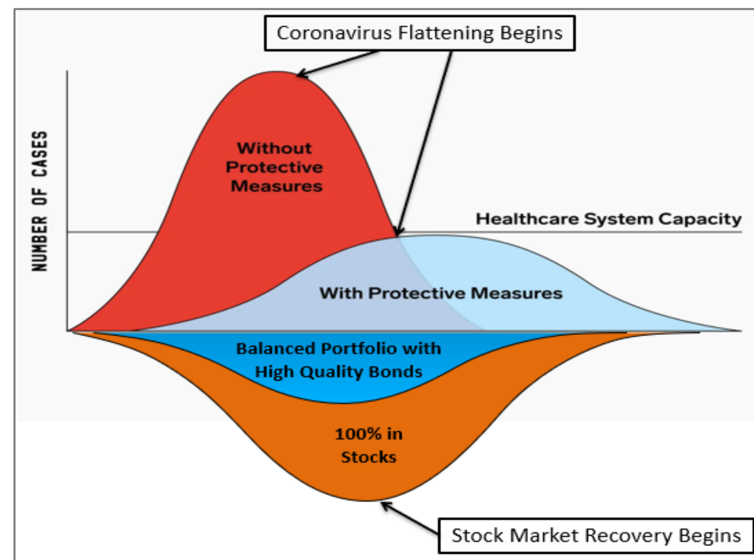
COVID-19 has proven to be one of the fastest spreading viruses in history, potentially killing hundreds of thousands globally and changing the way we go through life in just a matter of months.

Without knowing how this horrible pandemic will completely play out, we seem to be floating around in an undefined world of social distancing and hand washing while wondering what will happen next. This picture reminded me of our NextGen, still early in life, wondering how college, the job market, their careers, and life as young adults will ultimately play out.

As most of you know, we are a data-driven financial planning firm focused on what we can control, while avoiding the temptation to participate in the usual banter that often appears to be written for the sole purpose of selling news.

As of April 17th, there were over 2.2 million cases of the virus worldwide, over 150,000 deaths and only a hint of a slowdown in the spread of the virus. Ominously, even those dire statistics are shrouded in evidence that even a slowdown in transmissions may well be followed by subsequent "waves" of the virus, and new areas where the virus will take hold and spread rapidly once again.

We have all read about how "Flattening the Curve" can reduce the strain on our health care system – rationing our critical, yet finite health care capacity across a longer period of time, so as not to overwhelm the system. A hypothetical alternative "flattening the curve" graphic in the upper right attempts to superimpose the impact of the crisis on two very different portfolios; one being



"balanced" with bonds and stocks which reduces portfolio volatility and the other being an "all equity" portfolio, subject to greater downside volatility (analogous to the upward-bulging red coronavirus curve we might experience without taking protective measures). More to the point, at Aequitas, we view the principle of having a "balanced" portfolio as a critical part of "protecting your plan," and in the case of our non-profit clients, "protecting your mission," and we remain committed to supporting you in this ongoing effort.

In a recent POLITICO article entitled, *Coronavirus Will Change the World Permanently*, various visions of how life might be different after the epidemic were presented. Here are some highlights:

- Healthcare workers are the new heroes. No longer just someone you visit for your annual physical. Like the brave search and rescue teams of 9/11, they are entrusted with saving lives while risking their own. We are forever grateful to their selfless commitment and courage.
- Rivalries may soften. After the New England Patriots delivered 300,000 N95 protective masks to New York City, the New York Post headlined "Thank You, Pats." Crises often bring out the best in people and seeing this happen was heartwarming. Maybe polarized political rivals will soon find the virus to be a common enemy which they can fight together.
- Stronger domestic supply chains. Our recent experience with shortages of critical supplies to fight the coronavirus, including personal protective gear and ventilators, highlights the need to expand our domestic manufacturing capacity of such items so that we are less dependent upon

global supply chains. Using robotics, local labor, and locally sourced raw materials, we may choose to reduce our dependence upon international trade in exchange for the increased costs to corporations and consumers.

- A healthier digital lifestyle. Zoom, telemedicine, FaceTime and GoToMeeting may become the norm, rather than the exception. This will likely lead to greater productivity, and an increase in the commingling of work and personal life as the lines between the two continue to blur.
- Greater public confidence in science, data, education, research, and experience. Dr. Anthony Fauci, the Administration's Director of Infectious Diseases, has done an extraordinary job of delivering the facts and informing us as this pandemic has evolved. Looking forward, we will be relying more on scientists and their research as we will undoubtedly face future health crises and other global enemies such as climate change.

In anticipation of these trends, and while reflecting upon the past few months, we thought we might reinforce two of our portfolio repositioning recommendations as we look to the future:

- *Increasing Our Commitment to Sustainability* – We remain committed to ESG (Environmental, Social and Governance): Combatting climate change, making the world a better place, and embracing good governance to help keep it that way. We have increased our allocation to sustainable funds based upon our belief that like the pandemic, climate change has yet to be controlled, and by investing in well-run companies that are addressing these problems using better business practices, we will all be rewarded with better returns over the long term.
- *Raising Our Allocation to Technology* – The Fourth Industrial Revolution is a concept which has been introduced in our client portfolios, and while we continue to emphasize fundamental value investing, we are complementing that with a focused allocation to companies involved in technological innovation, including the integration of Artificial Intelligence (AI) and cloud-based technologies to deliver better healthcare, including diagnostic tools which are being used to confirm and detect coronavirus in patients.

Closing Comment

We found the illustration to the right on the website of the National Health Service, which is the publicly funded healthcare system of the United Kingdom. The headline was derived from Winston Churchill's famous speech to the House of Commons in August of 1940 in which he praised the efforts of the Royal Air Force crews who were engaged in the Battle of Britain against the formidable German Air Force. Churchill's actual words were, "Never in the field of human conflict was so much owed by so many to so few." Indeed, we owe a great deal to the dedication of our health care workers and supporting essential workers who are on the front lines in our fight against the coronavirus. Health care workers who, using Churchill's lines again, are "…undaunted by odds, unwearied in their constant challenge and mortal danger, are turning the tide…" in the fight against this global coronavirus scourge.

Together, we will get through this…by doing our parts to flatten the curve, by finding ways to help those on the front lines and, importantly, by assisting the forgotten — those at the bottom of the economic ladder who are bearing much of the brunt of this downturn. If we all do our parts in this hour of need, there will soon be brighter days.