BlackDiamond Financial

INVESTMENT INSIGHTS

FIRST QUARTER 2020

Key Topics

- Global Pandemic and OPEC Dispute Drive Stocks into Bear Market
- New Daily Infections a Key Metric for Investors
- Government Delivers $2 Trillion Fiscal Stimulus Package
- Fed Commits Full Arsenal to Maintain Orderly Debt Markets

MARKET UPDATE

COVID-19 Brings the Decade Plus Bull Market to an End

Global Pandemic and OPEC Dispute Drive Stocks into Bear Market

As COVID-19 infections spread throughout the world, governments enacted quarantines, travel bans, school closings, and other measures to slow the contagion. Global supply chains are disrupted and declining demand is weighing on many industries, especially travel, hospitality, and leisure. Plummeting oil prices have exacerbated the economic turmoil as a price war between Saudi Arabia and Russia pushed oil to its lowest price since 2002. Economic uncertainty created unprecedented stock market volatility. The S&P 500 declined 33% in just 33 days before the $2 trillion fiscal stimulus plan helped limit the loss to 19.6% by quarter-end. Amid the uncertainty, 2020 earnings estimates have been slashed and many companies have pulled earnings guidance completely.

This quarter was the worst for stocks since the 2008 Financial Crisis. Small company stocks were especially hit hard and declined by 30.6% while international stocks dropped 23.4%. A significant decline in interest rates drove the bond index up 3.1%, representing a lone bright spot. Typically, real estate would benefit from lower rates, however, tenants have already begun to skip or delay rent payments causing a decline of 27.0% for this sector.

COVID-19 is unprecedented in its impact on the economic landscape. A recession is now a reality. The critical question economists are focused on is what shape the recovery might take – "V" which implies one to two quarters before growth renews, "U" which indicates a twelve to twenty-four-month downturn, or "L" which implies a depression. It is impossible to predict when stocks will fully recover, but patient investors will likely be rewarded when stocks rebound and achieve new highs.

Comparative Returns

		Annualized Performance			
	Q1 2020	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks[1]	(19.6%)	(7.0%)	5.1%	6.7%	10.5%
Small Cap U.S. Stocks[2]	(30.6%)	(24.0%)	(4.6%)	(0.2%)	6.9%
International Stocks[3]	(23.4%)	(15.6%)	(2.0%)	(0.6%)	2.1%
Real Estate[4]	(27.0%)	(21.0%)	(3.0%)	(0.4%)	7.4%
U.S. Bonds[5]	3.1%	8.9%	4.8%	3.4%	3.9%

1 S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy.
2 Russell 2000, which includes the 2000 smaller stocks of the Russell 3000 index.
3 MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets.
4 MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks.
5 Bloomberg Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market.

New Daily Infections a Key Metric for Investors

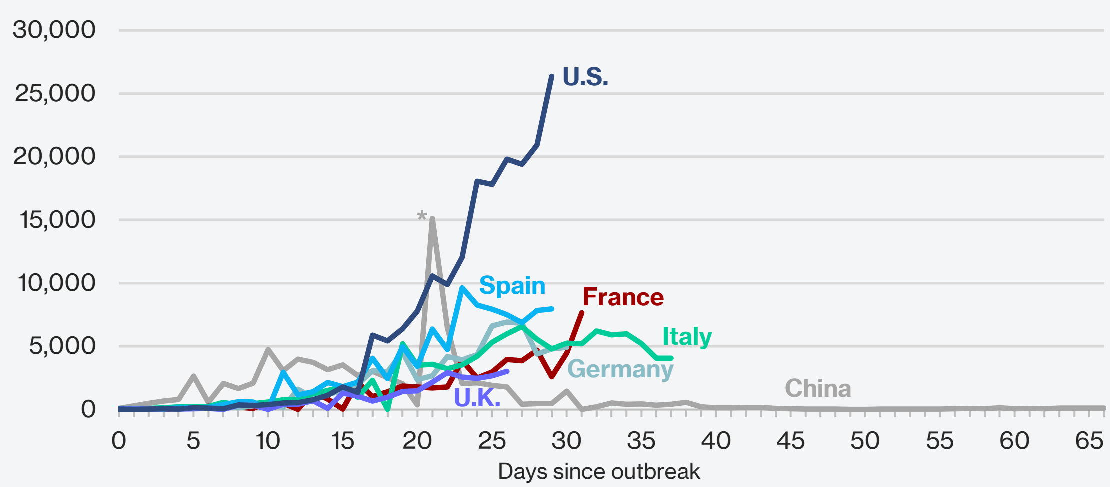
The widespread impact of COVID-19 has taken a tremendous emotional, physical, and financial toll on society. The U.S. has likely entered a recession and many analysts predict a 20% economic decline in the second quarter. In addition, unemployment is spiking as job losses rise at an historic pace, including a record 6.6 million lost jobs during the week of March 26th. Over 30 states have mandated that non-essential businesses close and approximately 250 million Americans are sheltering in place as we write this letter.

The most challenging aspect of the pandemic is the unknown nature of the future path of infection. It took 67 days from the first reported case for total global cases to reach 100,000, but just 11 days for the second 100,000, and only four days for the third 100,000, according to the World Health Organization. U.S. cases continue to accelerate and doubled in just three days from 50,000 to 100,000 and now stand at 188,172. If this growth rate continues, the U.S. will have 5.8 million cases in merely 15 days.

This is precisely why our leaders have essentially shut down the U.S. for some period of time. A relatively optimistic scenario for America suggests that closures and social distancing will effectively reduce the rate of new infections, which will slowly decline after reaching a peak in the coming weeks. That said, until the case numbers meaningfully decline, life won't return to normal and thus the economic toll will continue to be felt.

The key statistic to monitor for guidance on an economic and stock market recovery is the rate of new infections. Unfortunately, this is currently extremely challenging to judge since we lack effective and widely available testing, such as self-swabs. During previous pandemics, stocks only bottomed after the rate of new infections stabilized. As the graph below shows, the U.S. is reporting more and more new cases each day, indicating exponential growth. A financial recovery will likely not start until daily new cases subside. The good news is that it seems many of the countries in the EU are experiencing a slowing of new cases. Once the inevitable recovery starts, it will be propelled by the massive monetary and fiscal stimulus programs initiated by numerous countries including the U.S., China, Japan, Italy, Australia, and Mexico.

Change in Daily Confirmed Cases by Country



Source: CSSE at Johns Hopkins University as of March 31, 2020.
*Note: Counts begin for each region after two total days of 20+ confirmed new cases. *Actual reported increase on 2/13 for China was >15,000 due to change in diagnostic criteria.*

Government Delivers $2 Trillion Fiscal Stimulus Package

On March 27th, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), the largest fiscal stimulus law in history, was passed to provide financial life support for struggling families and businesses coping with the impact of the virus. The bill's intent is to supplement lost income from the halted economy. It also includes aid for the healthcare industry and state and local governments to help fund the important ongoing response efforts.

The package contains a combination of direct payments, unemployment benefit expansion, loans, and grants. The plan was designed to help keep businesses solvent and individuals employed until the economy can recover. To fund this $2 trillion plan, the Federal government will increase the national debt by selling Treasury bonds. Historically low interest rates of less than 1% for 10-year Treasuries will mitigate the interest burden. While some economists are not concerned with additional national debt of this magnitude, a sale this large may impact liquidity in the debt markets. However, the Federal Reserve has released a complementary monetary policy to ensure stability in these markets.

Fiscal Stimulus Package Details

Direct Payments to Individuals

Individuals with AGI up to $75,000 will receive $1,200 with a phase out up to $99,000 of income (double for married couples). Qualifying households receive an additional $500 per child.

Expanding Unemployment Insurance

$250 billion of benefits will be available and include nontraditional employees like freelancers. Current unemployment assistance increases by an additional $600/week for four months.

Loans Available for Small and Large Businesses

$500 billion available for large businesses and $350 billion for small businesses intended to cover rent, utilities, and payrolls. Small business loans may be forgiven if used as intended.

Distressed Industry Aid

$100 billion for healthcare providers, $25 billion of grants available for passenger air carriers, $17 billion for companies deemed crucial for national security, $4 billion for air cargo carriers, and $3 billion for contractors.

State and Local Governments

$150 billion slated for state and local governments with significant needs.

Fed Commits Full Arsenal to Maintain Orderly Debt Markets

The Federal Reserve has taken unprecedented actions to maintain debt market liquidity and has promised further measures if needed. The Fed lowered short-term rates to 0%, committed to purchasing "unlimited quantities" of bonds (potentially up to $10 trillion), and created the Treasury Exchange Stabilization Fund, or ESF.

The ESF utilizes many of the Fed's policy tools to provide vital financial support to markets and key institutions. For example, the Fed has expanded the scope of assets it can purchase to include corporate and municipal bonds. It has added measures to support bank lending, corporate financing, and asset-backed loan markets (which include student and auto loans). In addition, a $400 billion Main Street Business Lending Program is soon to be launched for small and medium-sized businesses. These actions follow a similar playbook to the financial crisis of 2008 and are essential to maintaining liquid and highly functioning markets.

BlackDiamond Financial

ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment advisor with a unique and holistic focus on preserving and enhancing wealth. Our mission is to help you achieve your financial goals through the use of low cost, tax efficient investment strategies. We create individualized investment portfolios for each client that are risk-appropriate, returns optimized, and tax-efficient. Furthermore, we believe cost is a critical factor in any successful investment strategy and therefore offer fully transparent pricing that is well-below industry standard. As an employee-owned firm focused on our fiduciary duty, we make our clients' interests our highest priority.

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