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*Frank*ly Speaking©

Welcome to the Q3-2020 issue of *Frank***lySpeaking**©, now in its 28th year. The purpose of this newsletter is to keep you informed of current issues and global events that could impact your finances. Please feel free to share your thoughts with us, as we welcome your comments.

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In This Issue

Economic and Market Commentary

The U.S. economy officially entered a recession in March 2020. Not that we disagree, but the speed of the announcement was surprisingly quick.

It normally takes a few more months or even quarters until the recession watchdog, the National Bureau of Economic Research, declares the formal end of an expansion.

Question is, how long will it take until the Covid-19 recession is over?

There has been a plethora of surprisingly upbeat economic data lately, but we still do not subscribe to a fast V-shaped recovery of economic activity.

Among the positive news is the extraordinarily strong June labor-market report. The unemployment rate, against all odds and expectations, dropped down to 11.1% from the interim crisis high of 14.7%, reflecting approximately 4.8 million people returning to work. The reopening of many states has definitely helped.

Besides the normal measurement error, the Bureau of Labor Statistic stated the underlying unemployment rate could be as much as 3% higher than the job figures appear and may have been boosted by design features of the Paycheck Protection Program (PPP). This program foresees forgivable loans if certain criteria are met.

Among them are keeping people on the payrolls or quickly rehiring employees and maintaining salary levels.

So, some of the seemingly splendid numbers may be due to temporary effects, rather than underlying economic momentum.

Pointing in the same direction, average hourly earnings dropped by 1% in May, after growing by almost 5% in April. This might well reflect low income workers having been rehired to secure loan forgiveness.

In reference to the PPP loans, there have been some revealing news reports lately, about some business owners feeling confused by complicated forgiveness terms while others are realizing that their business model does not allow them to reopen anytime soon.

These reports are consistent with what recent statistics show. After a strong start in April, demand for PPP loans stalled and in the second half of May, it even appears that businesses returned more funds to the scheme then they withdrew.

This led to the implementation of the PPP Flexibility Act by the end of May to fix the problem. But until now the tweaks have failed to restore demand for loans.

This should at least cast some doubts over any further boosts the program can provide to labor markets in coming months.

The same might be true of generous government support schemes directly benefitting households.

These included temporary boosts to unemployment benefits, as well as the so-called stimulus checks of typically $1,200 per adult.

The checks were officially called Economic Impact Payments or recovery rebates and have been structured in such a way that qualified households can basically keep the money in full, no matter what happens to their 2020 income.

Recent income statistics determined the loss of income from wages and salaries has been more than made up for by recovery rebates and unemployment benefits from government assistance.

Additionally, the household savings rate jumped to over 30% of disposable income in April, with close to no opportunities and little commitment to spend money.

However, these findings come with a few cautions.

First, almost 90% of the recovery rebates have been distributed so moving forward it would be safe to assume households will use the money to cover their costs of living or future shopping.

Second, the increased unemployment benefits run out in July. Like the PPP, current legislation only provides a short-term bridge, meaning unemployment benefits could soon become much less.

With respect to household behavior, it is understandable that as soon as lockdown measures were somewhat lifted, some people, less fearful about the virus, likely feel the need to head outside and to get some sense of normality back.

The consumer reacted predictably and

May's retail-sales report exceeded the wildest expectations, however, the new spike in Covid-19 cases is likely to reverse that lack of fear.

This second spectacular bit of good news was short lived as May's industrial production report jolted sentiment back to reality.

No rebound but rather a stabilization at lower levels which economists believe is how this crisis should be seen.

Unlike other downturns, this recession started with the consumer being suddenly pulled to the sidelines.

The initial shock now works its way through to the supply side and might take some time before it is fully absorbed, especially if further shocks were to arrive in the meantime.

We must focus and not lose sight of what is most important, which is the course of this pandemic.

Following the lifting of lockdowns and the lackadaisical embrace of social-distancing measures the rate of new infections bottomed out but has started to increase again in some states, almost unnoticed.

This is something that was expected and, in some locations, people are learning to protect themselves and to take precautions.

The pandemic is not expected to slip fully out of control again but expect a lengthy proactive development that might require selective and regionally limited shutdowns of economic activity.

Smaller, more frequent lower magnitude events could determine the pace of the recovery and economic reports project the U.S. economy to catch up with pre-crisis levels by the beginning of 2022.

A similar pattern was presented by the U.S. Federal Reserve (Fed) in their updated Summary of Economic Projections for the June meeting where it was reported that a recovery, reflected in unemployment rate forecasts, is predicted to take until 2022 while inflation is predicted to remain below the 2% target over the entire forecast.

This gives confidence that the Fed will continue to support the economic recovery with all its tools, keeping rates low and providing liquidity through various buying programs with a keen eye on financial conditions.

Later, at a testimony before Congress, Chairman Powell reiterated his plea for more fiscal stimulus looking ahead.

All in all, the positive surprises in economic data have reinforced confidence that the rescue packages can deliver what they have been designed to do, substitute for lost economic activity and support the recovery.

Even with monetary policy working at its maximum, there is room for another round of fiscal support this time focusing on households and small businesses without destroying economic incentives.

This could prove more effective than just sending out checks or subsidizing industries which can always reach out to the Fed for funding.

Such a strategy would strengthen consumption while giving people a chance to prepare for the post-Covid-19 world instead of simply putting them back to work in a potential inefficient or even dangerous environment.

Mortgage Rates Hit All Time Low

MCLEAN, VA, July 02, 2020, (Globe Newswire) - Freddie Mac (OTCQB: FMCC) today released the results of its Primary Mortgage Market Survey® (PMMS®), showing that the average 30-year fixed-rate mortgage averaged 3.07%, the lowest rate in the survey's history dating back to 1971.

The 30-year fixed-rate mortgage (FRM) averaged 3.07% with an average 0.8 point for the week ending July 02, 2020, down from the previous week when it averaged 3.13%. A year ago, at this time, the 30-year FRM averaged 3.75%.

The 15-year FRM averaged 2.56% with an average 0.8 point, down slightly from the previous week when it averaged 2.59%. A year ago, at this time, the 15-year FRM averaged 3.18%.

The 5-year Treasury-indexed hybrid adjustable-rate mortgage (ARM) averaged 3.00% with an average 0.3 point, down slightly from the previous week when it averaged 3.08%. A year ago, the 5-year ARM averaged 3.45%.

As of January 1, 2016, the PMMS no longer provides results for the 1-year ARM.

(Average commitment rates should be reported along with average fees and points to reflect the total cost of obtaining the mortgage. Borrowers may still pay closing costs which are not included in the survey.)

Sam Khater, Freddie Mac's chief economist, reported that mortgage rates continued to slowly drift downward with a distinct possibility that the average 30-year fixed-rate mortgage could dip below 3% later this year.

He also noted that, on the economic front, incoming data suggest the rebound in economic activity has paused over the last couple of weeks with modest declines in consumer spending and a pullback in purchase activity.

CARES Act Modification

Americans who have been adversely affected by the COVID-19 pandemic may now be able to access retirement accounts to help cover daily expenses, penalty-free.

Now, in addition to those who have lost their jobs during the COVID-19 pandemic, you may access your retirement funds without being subject to the 10% distribution age penalty if your income was reduced, or if you had the start of a new job delayed.

The expanded guidelines also let people dip into their retirement accounts if they have lost a job offer, or if their spouse's income was impacted because of the pandemic.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act was designed to help Americans deal with the economic impacts of the COVID-19 pandemic.

Under the CARES Act, the Internal Revenue Service has recently released updated guidelines that will allow more Americans to access money in their retirement accounts without penalty.

Estimates project that up to 31 million Americans may access their retirement savings to help them weather the economic turbulence caused by the current global health crisis.

It is important to remember that CARES Act funds must be used for coronavirus-related financial needs. Those taking advantage of these funds have up to three years to repay a pandemic-related distribution to undo any potential tax situation.

Pullbacks, Corrections and Bear Markets

The COVID-19 outbreak has put tremendous pressure on stock prices, prompting some investors to sell positions blindly and indiscriminately at a time when the entire market is trending lower.

Many worried investors believed "this time it's different."

When the market drops, some investors lose perspective that downtrends, and uptrends, are part of the investing cycle.

When stock prices break lower, it is a good time to review common terms that are used to describe the market's downward momentum. We dig deeper and research if it is a fundamental breakdown or behavioral event driven.

Is it simply a pullback which represents the mildest form of a market selloff? You might hear an analyst or a trader refer to a dip of 5-10% after a peak as a pullback.

Or maybe it is a correction, a more severe downturn when a market or markets retreats 10% to 20% after a peak. Now you are in correction territory. At this point, you may likely be on guard for the next tier, a Bear Market, where the decline is 20% or more since the last peak.

All of this is normal. Pullbacks, corrections, and bear markets are a part of the investing cycle.

When stock prices are trending lower, some investors can second-guess their risk tolerance. But periods of market volatility can be the worst times to consider portfolio decisions.

Pullbacks and corrections are relatively common and represent something that any investor may see from time to time in their financial life, often several times over the course of a decade.

Bear markets are much rarer. What we just experienced was the ninth (and shortest) bear market since 1926 which followed the longest bull market on record. The average bear market lasts 146 days for the Standard & Poor's 500.

A successful retirement strategy has market volatility factored in.

It is our job to differentiate the difference between a pullback, a correction and a bear market and make adjustments to our strategies to help you pursue your goals.

Market Behavior & the Economy

As states cautiously begin the process of relaxing their COVID-19 restrictions, have you wondered why is the stock market doing so well when the economy seems to be doing so poorly?

Great question and fortunately one that has been answered before and is dependent on lead, lag, and coincident indicators.

"Lead indicators" are factors that are used to anticipate what may happen 6-9 months in the future.

Think of the stock market as the foremost lead indicator. Now, imagine that the stock prices today are anticipating where the economy will be in 6-9 months. Is it correct? No one knows for sure.

Alternatively, "coincident indicators" attempt to show the state of the economy right now. For example, gasoline deliveries are currently trending higher, consumer confidence appears to have stabilized, and airlines are seeing more bookings.

Even the supply of toilet paper seems less of a concern these days, with Google searches for TP falling to near-normal levels. This may hint at higher consumer confidence.

Finally, "lag indicators" provide insight into past economic data. They may confirm long-term trends, but they are not accurate at forecasting.

The consumer price index is a historically classic example of a lag indicator. It tells us what inflation was but does not provide much insight about the future.

When trying to evaluate why the markets are reacting a certain way, it is important to gather as much data as possible, especially when trying to determine the behavioral aspects of what's going on.

Economic indicators can help provide context for what can often seem counterintuitive behavior, especially in the face of intense global disruption but are only a piece of the puzzle.

V-Shaped Inflation Recovery

There is reason to believe inflation could see a V-shaped recovery as many postwar recessions have followed this well-known pattern.

In any downturn, whatever its cause, private households and companies typically become thrifty and the overall economic savings rate rises.

In typical economic models of aggregate demand and supply, the demand curve shifts to the left (negative side). This leads to a new equilibrium in which both economic output and price levels are lower than before.

According to many economists, depending on how flexibly wages and prices react, the slump can persist and only government stimulus programs can help output to swiftly return to its previous level.

There has been no shortage of fiscal and monetary support lately, however, the Covid-19 recession has also severely hurt the supply side of the economy.

Many bans have been imposed to prevent the virus from spreading. Restaurants, hotels, gyms and other service providers were hit particularly hard by various lockdown measures.

In the aggregate demand and supply model, this state-prescribed reduction in supply leads to both supply and demand shifting to the left.

A Covid-19 recession balance thus translates into significantly lower economic output, however, the decline in the aggregate price level would likely be quite modest and recently published inflation data seem to confirm this theoretical view.

Without considering the energy component, which, thanks to the oil price, fluctuated wildly in 2020, the inflation rate in the Eurozone was 1.3% in June. That is the same level as at the beginning of the year which leaves the question how quickly the supply side is likely to recover?

Certain restrictions will probably remain in place for many months, in order to avoid renewed waves of illness which means the supply curve would remain stuck to the left of its old level, even as the demand curve shifts to the right (positive side) again, as consumers and businesses start to spend more.

The rising economic output would then be accompanied by a significantly higher price level.

Fears of such a scenario may already be reflected in the bond market. The difference in yield from nominal to real U.S government-bond yields suggests that inflation expectations have risen quite a bit since their lows in March.

It is quite conceivable that unlike the economy, inflation could perhaps see a healthy V-shaped recovery.

Unprecedented Rush to Cash

Americans are adjusting their spending habits in a rapidly changing economy and are building cash reserves at an unprecedented rate.

The Bureau of Economic Analysis reported on May 29th that the personal savings rate hit a historic 33% in April. To put that into perspective, it's the highest number since the Bureau started tracking personal savings in the 1960s.

Economists are struggling with the question of when will consumers be confident enough to start spending some of that cash stockpile?

Optimists say the stockpile was due to forced savings. Staying home has led to less spending overall, on everything from clothes to commutes. As soon as restrictions loosen, that money could flow back into the economy.

On the other hand, pessimists may say that until virus fears drop and the unemployment rate improves, consumers will con-

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tinue to conserve cash as a response to tremendous economic uncertainty.

There is some merit in both schools of thought but we are more optimistic and will be watching the personal savings rate alongside other economic indicators to see what, if any, long-term trends emerge.

The Mainstreet Lending Program

As businesses begin the process of reopening their doors after the COVID-19 shutdown, many have considered turning to the Federal Reserve's Main Street Lending Program for aid.

The Program was announced on March 23, with a goal to help businesses weather the pandemic and the subsequent economic effects.

However, recent changes to the Program may make it even more attractive and useful to business owners.

Just as America has adapted to the challenges of the pandemic, so too has the Federal Reserve.

Recently, the Fed expanded the Main Street Lending Program lowered the minimum loan size to $250,000, extended loan terms to five years and raised the maximum loan size.

It is important to note that these loans are being offered by bank lenders, not the Fed itself. The Fed and the U.S. Treasury will shoulder most of the risk associated with lending, making lenders more likely to approve loans for those who need it most.

The Fed will offer three different types of loans with new maximum amounts:

New loans with a $35 million maximum, **Priority loans** with a $50 million maximum and **Expanded loans** with a $300 million maximum.

For some business owners, the Main Street Lending program may be a low-risk, "stop-gap" measure to help with any sudden dips in consumer spending.

When to Apply For Medicare

If you are like most people, you have probably been thinking about your health quite a bit lately, especially if you are approaching retirement.

When it comes to your health, Medicare may be an important part of your retirement strategy.

Medicare has strict rules governing when you become eligible for the program.

You can apply for Medicare as early as three months prior to the month you turn 65, during the month you turn 65 and three months after the month you turn 65.

If you are actively working but meet the requirements above, Medicare can still be useful because if you have insurance through your employer at the time you apply, Medicare can become your secondary insurance.

If you are still working, be sure to check your company policy regarding the transition of employees to Medicare.

You can purchase a Medicare Supplemental Insurance Plan (Medigap) to help with some of the out-of-pocket costs not paid for by Medicare.

A Medicare Supplement plan lets you choose or keep your own doctor if they accept Medicare patients.

Frankly Funny

Reaching the end of a job interview, the Human Resources Officer asks a young engineer fresh out of the Massachusetts Institute of Technology, "And what starting salary are you looking for?"

The engineer replies, "In the range of $125,000 a year, depending on the benefits package."

The interviewer inquires, "Well, what would you say to a package of 5 weeks' vacation, 14 paid holidays, full medical and dental, company matching retirement fund to 50% of salary and a company car leased every two years, say, a brand new shiny red Corvette?"

The engineer sits up straight and says, "Fantastic! Are you kidding?"

The interviewer replies, "Yeah, but you started it."

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