Quarterly Playbook

3rd Quarter 2020

Current Financial Planning and Investment Themes

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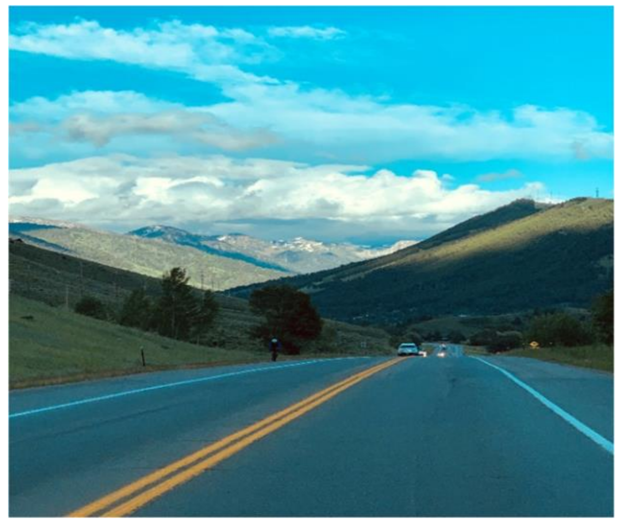
"The road back to normal"

What a strange journey we have been on so far this year, and continue to wonder what lies ahead. At this point, our map has flown out of the window and we are now purely relying on our "gut feeling" of where to turn next. That said, "gut feelings" are rooted in fundamental knowledge and instincts that make up the core of our understanding. With the right discipline, our instincts can prove very useful in times of uncertainty and can allow us to get back on the right road…



"There was nowhere to go but everywhere, so just keep on rolling under the stars."
— Jack Kerouac, Author of On the Road

US Economics

The economy has taken a wrong turn down an extremely rough, unpaved path. At this point, we are no doubt in recession. With mandated closures throughout the nation, many are expecting to see an annualized shrinkage of ~31.9% for the 2nd quarter! Additionally, at the peak of the shutdown the unemployment rate surged to 14.7% in April from a low of 3.5% just two months prior in February. Since then, the news has been largely better than expected with a huge comeback in jobs in May stunning the market. Rather than a rise in unemployment of 19.5%, we saw a drop to 13.3%, which was a positive difference of more than 10 Million jobs from expectations! June brought further improvements, dropping the unemployment rate to 11.1%. With the help of a smartly targeted stimulus through the CARES act, this came in line with our expectations though. We see even more improvements coming in the 3rd quarter with the vast re-opening of the economy and drop off in additional unemployment payments. We likely will see the unemployment rate fall to 7-8% by the end of this quarter. However, heavier lifting will then be needed to get back to less than 5%, which could

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take another 12-18 months, even if all goes well. Other positive news has been a better than expected jump in consumer sentiment and the ISM manufacturing indexes. Furthermore, with the stimulus checks issued and nowhere to spend, the personal savings rate hitting a record-shattering high of 33% in April and continued to be strong in May at 23%. While a high savings rate (and thus lower consumption) may contribute to the decline in GDP, it is a good sign for future consumption. In addition, due to the liquidity assistance that multiple Government institutions injected, it appears the majority of company and personal balance sheets have held up fairly well. Our overall view has been that we are likely to see better than expected news in the short run, followed by some disappointments in the medium term. For perspective, the Wall Street Journal average economic projection for the 3rd quarter is a growth rate of 15.2%. However, the 3rd quarter is likely where we will begin to see some disappointments. Though a well-timed second stimulus package could alleviate some of the concerns...

US Equity Markets

Whoa! I hope you were buckled up! From the peak on February 19th, the S&P 500 fell 34% to the bottom on March 23rd, and then returned to where we started the year on June 8th. Meanwhile the NASDAQ has not only recovered, but is up 17% for the year so far! Unfortunately, the DOW Jones Industrial Average is still down almost 10% year to date. The dispersion between large cap growth and large cap value is a staggering 26%! For the indexes we follow, large cap growth, the Russell 1000 Growth, is up 9.7% as of the end of June while large cap value, Russell 1000 Value, is down 16.28% for the same time period. Similarly, there is a big gap between large and small. With the Russell 1000 Large Cap index only down 3.74% vs the Russell 2000 Small Cap index down 13.61% as of the end of June. That said, it is not unusual for different pieces of the market to exhibit more leadership during times of uncertainty. But we do expect the gaps to tighten significantly. From a valuation perspective, the broad market as measured by the S&P 500 is certainly overvalued at this juncture compared to forward (projected) earnings. However, that doesn't necessarily mean that prices will decline. Rather we expect more of a flat and choppy market while earnings backfill in. We see opportunities in small caps and value stocks as they should start to "catch up" this quarter. Our current view is that we see a choppy third quarter followed by a modest rally in the fourth quarter to finish the year in a mid-single digit positive return. However, we do not expect another 20% draw down….

US Fixed Income

After a spirited first half of the race, the bond has been stalled on the side of the road for the last several weeks. The large gains in Treasury bonds are still holding, while the losses in the credit markets have subsided. Though, there is still more room to catch up from High Yield, Floating Rate and Preferreds. Probably not a lot of excitement here, but a slight opportunity to take advantage of the dislocations in the underperforming bond categories. We do not expect the interest rate environment to move in any significant way. Therefore the gains held by Treasuries and high-quality credit should remain intact…

International Markets

At this point, international equities appear to be relatively more attractive than US stocks at this juncture. From a broad perspective, the US market recovery is far ahead of its international counterparts, which creates a dislocation opportunity. Not to mention, the eurozone's combined monetary and fiscal stimulus adds up to 44% of the region's GDP, and Japan has launched stimulus equal to a jaw-dropping 60% of its GDP. Much like how the US threw the kitchen sink at the problem, the rest of the world seems to be throwing the whole house. They probably need to though, as relative economic strength was much lower coming into the global shutdown. We see the stimulus helping to close the gap somewhat here in the second half of the year. Policy concerns remain, but there should be opportunity here.

Real Estate

The good news is that we are likely at a turning point for consumer spending and business activity, which bodes well for real estate. Recently, we have seen REIT assets significantly recover from the lows. However, the tenants' troubles during the COVID-19 shutdown have become problems for the property owners as well, as many tenants have struggled to pay their rent on time, have closed store locations, or gone out of business completely. That said, the degree of complications varies widely according to property type. Overall, though, rent growth slowed with the softening of demand. Surprisingly, rents in the first quarter were still higher on both a sequential quarter-over-quarter basis and also versus one year ago. Unfortunately, economic and business conditions worsened sharply in April and May and rents may well show decline in the second quarter. We expect the weakening in demand and rents to weigh on real estate prices going forward with prices likely to stagnate.

Interest Rates & the Fed

Jerome Powell, also known as the financial Rambo, has since put down his Bazooka and is back to hiding in the camouflage. It appears that they have won the battle (backstopping the economic and market downturn) and are likely to win the war (full recovery). The Fed will likely remain in a "peace-keeping" capacity, with low interest rates and balance sheet stimulus for an extended period of time. There has been talk about further action, if needed, to take the form of yield curve control – meaning buying and selling treasury bonds of different maturities to keep yields within a specified range. This would be yet another unprecedented action, but is designed to illustrate that they are far from "out of bullets". Despite all the monetary fire power unleashed so far, the inflation rate fell in recent months to well below 1%, with the headline Consumer Price Index clocking in at 0.2% and the Fed's preferred measure. Personal Consumer Expenditures, posting 0.5%. We continue to hold the view that inflation will not emerge as a threat for the foreseeable future.

Legislative Affairs

With the election less than 4 months away, the attention will be turning more toward the likely make up of the presidency, house and senate. Our long-standing view is that President Trump will win re-election, which is based upon voter turnout and enthusiasm. We did not foresee a Democratic challenger to be able t bridge the gaps that have formed withing the Democratic party. The strongest unifying view is the dislike for President Trump, which is not enough to energize turnout at the polls, in our view. Meanwhile, the Republican base seemingly gets stronger with each additional attack strategy against President Trump. This bears out in fundraising totals, which show that as of June 25, 2020 the three Republican committees have accumulated $639 Million vs the three Democratic committees' accumulation of $475.9 Million. The polls, however, tell a different story with the Vice President Biden having the advantage. As far as the House and Senate, currently it appears that the balance of power would remain with the Republicans controlling the Senate and the Democrats controlling the House. However, both of these are very close and cold swing either way. Admittedly, the emotions and circumstances that have flared up in 2020 have added some cloudiness to our forecast. That said, we always remind clients that, while elections do affect the strength and trajectory of the economy and markets, the resiliency of businesses and the consumer remains, despite who controls Washington.

Financial Planning Corner

10 Estate Planning Steps to Avoid Fracturing of Families

Source: Law Offices of Jennifer C. Surmacz, P .C."

1. Create an estate plan while you are healthy and of sound mind If you wait for an illness to create an estate plan, you either may not get it done or may not be in the best position to communicate your wishes clearly or work most effectively with an attorney. When you're ill, you want to focus on your health and not be burdened by decisions that can be better addressed in advance.

Estate plans that are created or changed during illness or toward the end of life increase the chance that issues over your capacity to execute a will or trust will be raised. This is not to say that plans cannot be changed late in life, but they do require extra precaution.

2. Seek quality independent legal advice free from undue influence Historically speaking, Do-it-yourself plans have been more susceptible to challenge and ambiguity. The attorney's expertise and file documentation can help minimize ambiguity and document your intentions.

The attorney selected should be independent (not your child's best friend who is an attorney) and experienced in estate planning — not the attorney that won your Personal Injury case and will make your Will for a hundred bucks.

3. Use a revocable living trust to avoid probate Estate planning with a funded revocable living trust will usually keep your estate out of probate court. While probate in itself is not necessarily a contentious proceeding, it does provide a ready and accessible forum for heirs and beneficiaries to do battle.

Probate notices must be sent not only to beneficiaries, but also to heirs that you may have otherwise disinherited. Trust disputes can also be brought into court, but it tends to be less likely without the required notices, statutory rights and existing court proceedings.

4. Choose executor and trustee succession wisely Think about the relationship between the fiduciaries, beneficiaries and terms of your trust. Consider what conflicts could arise during administration. The wrong combination can create and foment conflict. Provide trustees with an exit plan and appropriate trustee succession.

In some instances, naming co-trustees can minimize conflict, but in others it may create conflict. If beneficiaries are likely to fight, consider naming an independent trustee. Above all else, the trustee must be trustworthy.

5. Explain different or unequal treatment of beneficiaries Anytime an Estate Plan varies significantly from expectations or treats similarly situated beneficiaries (e.g. multiple children) differently, there is an increased chance for dispute and litigation. This is not to say that you cannot or should not do this, but extra care and diligence should be exercised to ensure that the plan will be upheld if contested. If distributions will be unequal, an explicit "Trust Directive" will be helpful as a deterrent to litigation.

6. Address division and distribution of personal effects Hands down the most common category of estate disputes involve tangible personal property. The basic reasons are twofold: (1) it's easy to divide a bank account into equal shares; it might not be so easy to divide jewelry or collectibles into equal shares, and (2) personal effects often evoke emotion.

There are a variety of strategies that might work best in a given situation, but generally it's best to: (1) have a frank conversation to discuss your beneficiaries' wishes and expectations, and (2) reduce your directions to writing, in a memorandum or list of specific gifts or directions referenced in your Trust. Having the discussion without the writing can lead to unmet expectations and disputes over verbal promises.

7. Address the effect of any lifetime gifts, advances or loans Have you made intra-family loans or provided informal family assistance? Perhaps you've assisted a child with starting a business or purchasing a home. If so, it's important not only to set the expectations during your life, but to identify how these transfers are treated at death.

Was the transfer an advance on inheritance, and if so, will there be sufficient liquidity? A loan to be repaid with interest? A gift? Do you want loans to be forgiven upon death? And what are the tax consequences of the various options? You may know how you characterize the transfer, but does your family? If these types of transfers apply, address them during the estate planning process to avoid confusion and disputes using a "Specific Trust Directive".

8. Be mindful of the consequences of joint asset ownership If you create a living trust, you will generally want to title most of your assets in your trust. Small assets in your sole name can be poured over into your trust at death by Will. But what about joint ownership? It's not uncommon for a parent to add a child to a bank account to help with the finances. This creates a presumption of a gift, meaning that the account belongs to the joint owner upon death. Was that really the intent? Convenience accounts are the source of many disputes and probate litigation and can create major havoc for estate planning purposes.

9. Make sure to update beneficiary designations regularly! Certain assets (e.g. retirement accounts, IRA's, 401(k)'s) cannot be titled in your trust. If separate accounts are payable to certain beneficiaries, then it's important to consider the effect that an increase or decrease in the value of these accounts might have on the disposition of your assets. It's also important to update designations after important life events — divorce, birth, death, etc.

10. Monitor and update your estate plan Estate planning is a lifelong process, not a one-time event. Plans should be reviewed periodically and updated based on changes in the law and important life events for yourself and your beneficiaries — birth, marriage, divorce, death, etc. It is also critical to monitor your assets and your beneficiary designations.

We've all heard the news stories about celebrity estate disputes. Many have probably seen or heard stories from family or friends who have been embroiled in estate disputes or litigation. In many cases, these situations are avoidable through thoughtful planning and deliberate steps to avoid estate planning mistakes that can generate disputes.

We're here to help. If you have questions about these or any other topics, don't hesitate to call us at (855) AFS-4545.

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