TFC FINANCIAL
The Financial Counselors

MARKET UPDATE
March 27, 2020

OUR VIEW

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Government Response to the Pandemic

The Senate responded to the Covid-19 pandemic by approving a $2 trillion emergency aid bill on March 25; the House of Representatives is scheduled to vote on the bill today. The bill attempts to provide relief to the businesses and families hurt most by the economic disruption caused by quarantines, shelter-in-place orders and "social distancing." The relief package is more than double the size of the $800 billion stimulus passed during the Global Financial Crisis.

The bill provides support to hospitals and researchers, funding to businesses and payments to families. Small businesses, among the hardest hit by the crisis, get access to loans or grants. The bill provides incentives for small businesses to use the aid for payroll, rent and utilities. Loans and other aid will also be provided to large companies, states and municipalities. Airlines will receive grants to help them pay worker salaries and benefits. Restraints and oversight mechanisms are designed to prevent government aid from being used for stock buybacks, dividends or executive pay; the intent is for the aid to be a "bridge" that keeps workers employed. Expansion of unemployment benefits are an important component within the bill, lengthening the duration of benefits, raising the amount of unemployment pay, and extending unemployment pay to include contract workers and non-traditional "gig" workers. Direct payments of $1,200 to adults and $500 per child (subject to income phase-outs) are designed to supplement the income of middle- and low-income workers; the hope is that the direct payments will boost consumer spending but the more likely outcome is that it will be saved until social distancing measures ease.

The magnitude and structure of the relief bill was positive news for investors and a pleasant surprise for us. We think the bill that passed the Senate is considerably better than the early ideas floated out of the White House and on Capitol Hill. Specifically, we think that the bill does much to target the companies and individuals hurt in the initial stage of the pandemic. No legislation is perfect, but we think this will certainly help. It will take time to digest the details within the bill, and certain aspects of it will undoubtedly be controversial. One crucial detail is yet to be determined: How quickly will the funds be distributed? Obviously, the sooner the money is disbursed, the higher the effectiveness. We are aware that the benefits of the relief package will fade if the economy remains shut down for an extended period.

The fiscal support provided in the Senate bill accompanies extensive monetary measures initiated by the Federal Reserve in response to the pandemic. The Fed realized early in the crisis that the availability of credit and smooth functioning of markets was more an issue than the "price" of credit. The Fed's policies went beyond their normal "playbook" of lowering rates. The Fed is buying Treasury, mortgage-backed, investment-grade corporate and asset-backed securities to maintain market liquidity; the Fed is also taking steps to help money market funds. The actions taken by the Fed have parallels with European Central Bank president Mario Draghi's response to the euro zone debt crisis in 2012. Draghi rescued a currency union verging on collapse by saying "within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough." Fed Chair Jerome Powell is having his own "whatever it takes" moment during this pandemic, and in our view is rising to the challenge.

Congressional and Fed actions may only provide temporary relief for a country forced to make uncomfortable choices between prioritizing physical or economic health. Without progress on containing the pandemic, another relief package may be needed in the not-too-distant future. Lessons learned from Asia, particularly South Korea, may provide a roadmap for the U.S. and other countries. Advances in testing, tracking and treating those infected with the coronavirus would help contain the pandemic and reduce the need for drastic social distancing measures. Life may not return completely to normal, but economic activity would gradually start to recover.

TFC has done a considerable amount of trading in recent weeks. A subset of the trading activity reflects our response to a changing economic outlook. We've learned from experience that high leverage often brings negative consequences during times of economic hardship. Companies with high leverage and weak balance sheets are vulnerable to the slowdown in economic growth and may not have the staying power to benefit when the pandemic is contained. Highly cyclical companies may also struggle in this environment, with energy companies particularly vulnerable to the combination of slowing demand and the deluge of supply resulting from the oil price war between Russia and Saudi Arabia. Consequently, we have sold mutual funds and ETFs that focus on the segments of the market that we think are more vulnerable; we reinvested the sale proceeds in mutual funds and ETFs that we think will offer a better combination of return potential and risk mitigation. In these uncertain times, we are prioritizing liquidity and capital preservation over seeking the investment options that offer the highest but most uncertain potential returns.

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Tax-loss harvesting represents another dimension of our trading activity: we have temporarily sold some mutual fund or ETFs that are at a loss, replacing the sold position with a similar holding. Most of our tax loss harvesting has been in index or factor-based investment strategies.

Until there is a slowdown in the number of new Covid-19 cases and progress in the ability to treat victims of the outbreak, it will be hard for people to resume normal living. Consequently, we have been cautious in our approach to rebalancing between fixed income and equities. We've incrementally rebalanced between fixed income and equities, but generally remain underweight to equities in client portfolios relative to their long-term investment policy targets. We will continue to monitor developments in the outbreak and implications for economic growth, evaluating whether further changes are called for. In the meantime, please do not hesitate to contact us or your TFC advisor with questions.

Sincerely,

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