The Federal Government Fiscal Response

The Federal government has met the economic challenge presented by the pandemic by passing aid programs that are unprecedented in both speed and size. As of the writing of this newsletter, this is a quick, non-comprehensive summary of what is currently available. New guidelines and direction are being issued daily on how these programs will be administered. Most immediately, the government will issue cash payments to tax filers in the amounts $1,200 for individuals, ($2,400 for married couples) and an additional $500 for each child in the home ages 16 and under.

These payments will be made in full for individuals up to $75,000 in AGI and then phase out, being eliminated at $100,000 – double these amounts for married filing jointly. These payments will be paid as Refundable Tax Credits for 2020 based on most current tax return filed (2019 or 2018). If most current return on file income exceeds the phase out thresholds, but your 2020 income is lower than the thresholds the Recovery Rebate will be applied to your 2020 Return.

The government provided relief for retirement plans. It extended the deadline for 2019 IRA contributions to July 15, 2020 from April 15, 2020. No RMDs will be required for 2020 in any IRA or employer retirement plans. Inherited IRA RMDs are suspended and 2020 will be ignored as a year for the 5-year rule. If RMDs have already been taken in 2020, they can be undone if done within 60 days. Additional relief is also available regarding withdrawal penalties as well as loans to from your plan.

The spread of the coronavirus is giving small businesses a series of challenges: liquidity, workforce capacity, and supply chain disruption. Three separate packages have been approved. Some of these benefits are outlined below. These packages are cumulative and generous. The details of the acts are being promulgated. It is contemplated that these programs will be administered through the banks.

The SBA is providing disaster relief loans with broad eligibility and attractive repayment terms. The government now requires all private businesses with fewer than 500 employees to provide emergency paid sick or family leave for affected employees. To cover this cost of businesses, those with fewer than 500 employees will receive a 100% tax credit against their payroll tax liability up to the capped amount of benefits they must pay, and health care costs are included in the credit. Self-employed individuals can receive an equivalent credit. The Paycheck Protection Program allows all businesses with fewer than 500 employees to borrow monthly payroll costs for businesses up to 2.5 times their average monthly salary. If used for payroll, mortgage interest or other qualified expenses, these loans will be forgiven if the employer maintains 75% of their workforce through June 30, 2020. The PPP also allows employees to collect unemployment if they are unable to work due to illness or need to care for an infected individual.

Also, it's imperative that you keep a one or two-page list of all your accounts, insurance policies, and most importantly your email account log-in. Your inbox is now more important than the mailbox on the street. Colonial can help by providing access to an account aggregation web portal that allows you to link all of your accounts and generate a detailed balance sheet.

All these programs are works in progress. Details, guidance and eligibility are changing. If you have a business that you believe may qualify for these programs, please contact your banker.

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In The Spotlight

The tumultuous first quarter has ended, and it was the worst first quarter on record for the DOW and the worst quarter in the broad markets since the Financial Crisis. Given the business restraints of the Coronavirus, we are forgoing our typical newsletter and we are putting our thoughts into a letter, which is being both emailed and printed in-house. We hope to provide context to the quarter's moves and highlight opportunities and the rationale for a long-term investment approach. The news flow regarding the Coronavirus is moving quickly and we will continue to provide updates in our email commentaries, which reach our clients and friends quickly. If you are not already receiving our email updates, please check your junk mail and/or email us at mail@colonialtrust.com to be added to the list.

Market Commentary

The S&P 500 began the year with a gain of 5.1% to an all-time high on February 19, 2020, building on the strength from 2019 and optimism about Phase 1 of the trade deal. The market began to sell off in late February as the Coronavirus moved from China to South Korea and Italy. The markets stabilized the first week of March, before falling sharply through mid-March as it became clear the virus would impact the world's health, economic activity, and capital markets. From the market high to March 23rd the market fell 33.8%, which was the low for the quarter. The market rallied 15.6% from the low to quarter-end, which brought the S&P 500 total return for the quarter to -19.6%.

The ferocity of the market sell-off was staggering, as the market moved from all-time highs to bear market territory in a matter of weeks. The NYSE circuit breakers, which pause trading in volatile markets, were hit four times in March compared to only one other time since imposed in 1997. The downdraft was not confined to the S&P 500, with the Russell 2000 index of small cap stocks down 30.6%, the MSCI EAFE index of developed international markets down 22.7%, and MSCI Emerging Markets index down 23.6% for the quarter. The fixed income market did not offer shelter in the storm during the quarter. Investment grade corporate bonds returned -3.6% and high yield bonds returned -12.7%. WTI crude oil fell a staggering 66.5% for the quarter. During the Coronavirus crisis, virtually all assets moved down together, offsetting the benefits of diversification.

News about the health crisis changes quickly and we try to keep our commentary to the current facts. The federal and many state governments have effectively shut down non-essential economic activity, causing our consumer-based economy to come to a sudden stop. The rationale is to slow the growth in new cases to preserve healthcare capacity and reduce fatalities. This approach is showing progress in Italy and the Drs. Anthony Fauci and Deborah Birx believe this will have the same effect in the US. The most recent guidance provided by the Coronavirus task force is for a peak in cases nationwide in April and a return to economic activity by May or June.

MARKET COMMENTARY

Congress passed three bills to temper the impact of these mitigation efforts. The $2 trillion CARES Act will provide support to individuals, small businesses, and healthcare providers through direct payments, loans, and grants. The purpose is to maintain the country's economic infrastructure to ensure there are businesses and jobs to restart the economy. We believe this legislation will provide a lifeline for many firms, but we will see failures. Additionally, the Federal Reserve is providing liquidity to borrowers to prevent a liquidity crisis from becoming a solvency crisis. The Fed cut interest rates to 0.0% and is buying an unlimited number of treasuries and mortgages. The Fed is also working with the Treasury to provide liquidity to the municipal, commercial paper, and corporate bond markets. We were beginning to see more liquidity and better pricing on trades as the quarter came to an end. Similar fiscal and monetary measures are being employed all over the world.

Investors are trying to ascertain the impact of the virus to earnings, balance sheets, and cash flows to determine the value of equities and bonds in this new environment. Recent economic data is largely backward looking, based on activity in January and February, which were strong. The more recent survey data and unemployment claims provide relevant information about our current situation. Consumer Sentiment fell sharply in the March read, from 114.8 to 103.7 and Consumer Confidence fell from 132.6 to 120.0. Unemployment claims increased from 282k the week before the shutdown to nearly 10 million in the last two weeks. The consumer's mood has deteriorated sharply in the face of falling equity prices, job losses, and fear about their own mortality.

The economy is in recession, the question is the depth and pace of recovery. The growth rate in the first quarter is difficult to estimate and forecasts vary from slightly positive to -9.0%. The second quarter forecasts are being downgraded daily and we will see a sharply negative number. Markets have fallen in anticipation of this sharp reduction in activity and a sharp increase in unemployment. The ultimate question is what happens to activity in the second half of 2020 and 2021. Current expectations are for a rebound from depressed levels in the third quarter; however, we believe the recovery likely be to "U" shaped rather than "V" shaped. The contraction will be greatest on consumer discretionary sectors of the economy, including restaurants, retail, travel, auto sales, etc. The economic strength in this environment has been grocery and medical spending as the quarantines keeps consumer eating at home and healthcare spending is elevated.

The path of the eventual recovery is dependent on the virus and stimulus. Effective mitigation will lead to lower cases and fewer deaths, a positive for the health and wealth of our nation. The stimulus from the Fed and Congress must provide support for the economy and markets to get through this difficult period. Fed action was quickly implemented, and we are beginning to see its impact in certain markets. Fiscal policy takes longer to implement and bear fruit. The speed of its passage is historic in terms of fiscal policy, but it will take several weeks or months to determine the impact. We are monitoring real time economic and health data for signals on these two factors and will update our expectations for the economy as data is available.

As for the market activity during the quarter, the quickness with which the US moved from 1,000 virus cases on March 9th to 190k cases at quarter-end caused market panic. The increase in cases coincided with the fall out between Saudi Arabia and Russia driving oil prices down over 20% in a single day. For the equity markets, we saw massive, indiscriminate selling of stocks, index funds, and mutual funds. This selling included individual investors and leveraged funds facing margin calls. When faced with a need for liquidity, investors sold what they could and drove prices down across the equity markets with little regard to how the virus would impact prospects of these disparate businesses. The massive moves in the equity markets, particularly in the second and third week of March, were symptomatic of forced selling and panic.

As mentioned above, the impact on the bond market was pronounced as well. Without getting too deep in the weeds, we wanted to provide some color about how the bond market functions. Unlike stocks, where for example every single share of Disney is the same, Disney has 163 different bonds issues. They differ in maturity, coupon, security, and the size of the bond issue. Disney's stock trades on the NYSE where buyers and sellers agree on a price. Disney bonds trade via bond salespeople, who interact individually with investors on the phone and email to trade individual bonds. In times of stress, we see an absence of liquidity and sellers are unable to find buyers to purchase their bonds. This is exacerbated by bond funds, which allow investors to instantly sell their funds which own bonds, thereby forcing bonds onto the market when there are no buyers. The trading arms of large banks provide limited liquidity, but when selling overwhelms their ability to hold bonds on their balance sheets, they cannot increase their holdings.

This occurred in March as forced bond liquidations caused price gaps and widening spreads between the price to buy and sell a bond in the municipal market, the corporate market, and even the treasury market. We have seen large price gaps with little trading volume, meaning a small number of sells had an outsized impact on the price. This is like a forced home sale, where the price is more a reflection of the financial situation of the seller than the house value. However, the forced sale of your neighbor's house can impact your home's value as it indicates stress in the market. If you plan to stay in your house for several years, that sale does not reflect the true value of your house. Rather, it may reflect the liquidity available and the situation of the seller. Assuming liquidity continues to return to the bond market, this will likely be the case for high quality bond issuers too. The Fed is providing liquidity across the credit spectrum to reduce the illiquidity discount in the market.

We will close this section with some sober, but optimistic commentary about markets, our country, and humanity. First, our economy and markets have faced challenges in the past - kinetic wars, terrorist attacks, credit crises, and oil embargos, to name a few. In each case, things seemed bleak and few could see better times ahead. Each time our economy and markets were able to find a bottom, being to rebuild, and eventually reach higher levels. It is hard to have a long-term view in the midst of a crisis, but it is this view that allows investors to reap the long-term benefits of capitalism and markets. To be sure, we are reviewing our equity holdings to ensure access to liquidity and credit if necessary and upgrading the quality of our portfolios. Our focus is on getting through this period to prosper when it ends, rather than timing the market. Second, we have been impressed by the actions of many corporations and some government officials during this crisis.

Many large companies have put the health and financial wellbeing of their employees and customers above quarterly earnings. Many politicians have shown a willingness to put party aside to help the American people impacted by the virus. Going into this crisis, there was a lack of confidence in Corporate America and government. We hope the actions of many of these institutions gives people hope we can solve the big problems facing our country. Lastly, the acts of courage and kindness displayed by individuals in this crisis are inspiring. From healthcare workers to grocery store clerks, their actions have been heroic. The acts of kindness seen on TV and in our personal lives are also inspiring. The Italians singing out their windows, the New Yorkers banging pots for healthcare workers, and the kind words we have received from so many of our clients has provided hope for us. We take the stewardship of our clients' assets seriously and your kindness and perspective are appreciated during these times.

The Coronavirus is going to change the world in ways we are only beginning to imagine. Some of those changes will be economic and how we conduct business in the future. Other changes may be on a personal level. During a crisis we realize we are not that different from one another. We fear death and have loved ones we care deeply about. It is our hope that one of the changes is that we remember our common humanity, the bravery of the nurse and supermarket clerk, and the kindness we display and receive from loved ones and strangers alike. We ask each and everyone one of you to be safe and take care. We look forward to seeing you in person when permitted, but as always please contact us with any questions or concerns you may have.