TRANSCRIPT: Q2 2020 Market Update

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Steve Elwell: Hi everyone. This is Steve Elwell, Chief Investment Officer at Level Financial Advisors and this is your second quarter 2020 market update. You probably don't need me to tell you that the second quarter for the global stock market was fantastic. I guess some people may say against all odds, but the market rallied strongly through April, through May, had a little bit of bumps in June, but finished the quarter in the U.S. stock market up 22%, which was the best quarter in the last 20

[00:00:30] years. Global stocks were up about 15% in developed countries and another 18% in emerging markets and global real estate was up about 11% over the second quarter. This might be one of the most unloved stock market recoveries that I can remember. I think it kind of defied belief for a lot of people as they watched the market recover and certain states and areas, especially in Europe, did a good job of flattening the curve and lowering the spread of virus cases.

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We have obviously seen a rebound in certain areas, especially here in the U.S. over the last few

[00:01:30] months, but the stock market has really shrugged that off over the last couple of months. And so many portfolios have recovered a significant amount of the decline that they lost in March in a timeframe that was faster than what I would say most people thought possible. There can be several different things you can point to obviously. A reopening of the global economy slowly in some places faster than others, the enormous amount of stimulus and help that the treasury and the federal government provided specifically through the cares act. I mean, they've really moved mountains to do a lot to help the liquidity crunch in the bond markets to help corporations, lending

[00:02:00] to small business, stimulus checks for individuals, unemployment benefits. In fact, at this current point in time this recording they're talking about round two is the unemployment benefits are scheduled to run out here in a couple of weeks.

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So they're talking about doing even more to continue to help businesses, especially small businesses and people continue to get through the pandemic as we continue to fight against the virus. Some of the rebound also, I think, would be due to a couple of other factors and things that as individuals and investors, we're not really trying to predict or figure out. This is the type of stuff that is not in our realm of expertise. And one of the things is the fast track development of

[00:03:00] vaccines. I've had several good trials that have happened for the various vaccine, I think there's over 30 vaccines out there that they're in early stages of testing. Several of those are entering later stages of testing with the most recent updates being that potentially vaccine may be ready for September or October, which is, if that's true, will be an unbelievable medical achievement for the global medical community.

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I'm not going to guarantee that's going to happen, but you can imagine from a long-term stock market investors perspective. If that's true, if we have a vaccine and it's implemented and distributed by the fall, the highest rated concerns you have as an investor about another shutdown of the global economy from a second wave is basically taken off the table. I mean, assuming the vaccine is effective and the virus is effectively stamped out as a result of that, the biggest concern that you have weighing on you right now is effectively gone. And we turn around and look back and say, " Okay, well, now things, if that happens, would presumably go back to somewhat considered normal in businesses and individuals would be able to operate the way that they want to and concerns about things like travel and tourism and restaurants and retail shopping, all those safety concerns kind of evaporate as soon as we see the effectiveness of the vaccine."

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So as certain investors digested that information and we saw it on several days. I mean, there were a big pops in the stock market especially small stocks when that vaccine information came out, when those trial results came out and that's not surprising. That's not surprising at all. So it was a great quarter for stocks across the board. It was one of the things, we talked about at the last market commentary was many times when the worst quarters hit the best quarters aren't far behind. We talked before about some of the really bad quarters, like third, fourth quarter of 2008, early 2009, and then phenomenal quarters of positive returns in the second and third quarter of 2009, which obviously is right after when the worst quarters hit. And we have a repeat of that scenario. Now that doesn't tell me what's going to happen in third quarter of 2020 or fourth quarter of 2020, but we have a repeat of that scenario where a historically terrible first quarter and now we've had, at least for the U.S. stock market, a historically good quarter in the second quarter.

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So that's encouraging. Obviously as an investor, you want to see your investments recover whenever there is a dip, a decline and you always hope the declines are temporary, which traditionally they've always have been. The question just is, how long does it take for me to recover, in this case, the recovery is not done." We're not back to even for January 1st or from the peak before the decline started from the virus, but a substantial amount of money has been made back for investors that stuck with it. So to be a little more specific about that, the Russell 2000 really led the way, which is effectively small stocks earning about 25% this quarter.

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Emerging markets, small stocks actually really led the way at 27% return for the quarter, but most people don't have specific investments in that category so I'll politely ignore that category for a second. But the various categories value stocks did a little bit worse, but still had a great quarter. Like I said, emerging markets did well. Global real estate stock wise was really the laggard of the bunch, if we look at that, but all in all a great quarter for stocks sort of across the board.

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As we think about what does that mean and how does it relate to our portfolio and the strategies

that we use to mitigate this, the first thing I think I would point out that all of the rebalancing in tax loss harvesting in anyone who made deposits that maybe had excess cash that they wanted to invest through March, April, May, or any of the Roth conversions that we did through March, April,
[00:08:00] May for clients that that was appropriate for have paid off handsomely in a relatively short period of time.

Again, I'm not going to say that there isn't any chance that the markets have another dip if there is a second wave or if things get out of control and economies need to be shut back down. I think it
[00:08:30] doesn't seem like there's a lot of willingness to shut everything back down again even if there is an outbreak, a deeper outbreak, but I obviously can't guarantee against that. But for those who have rebalanced or taking tax losses more, did Roth conversions, or deposited cash to invest, you have been handsomely rewarded for doing those activities and we've been paid off very nicely for that. I did say, many clients probably remember me saying this, whether through videos or personal conversations, but that's the risk reward story of investing in stocks. We were talking about the best time to invest usually is when no one thinks it's a good idea.

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[00:09:30] And that was the end of March. I mean, nobody was excited about the prospects for the economy or the stock market. And we've seen horrific information, data come in economically from, what did manufacturing reports look like? What did unemployment reports look like? What did job losses look like. I mean, the reports were awful, like off the charts awful. That was not a surprise though. The market knew that was coming. That's why it went down 35% in five weeks back in March. But for those who could take the long-term view and recognize that, "Okay, prices are significantly lower, but if I have time and I have discipline and I have patience, investing right now, even though in the short term feels brutally bad, in the long-term probably will end up being a
[00:10:00] pretty good idea."

That was one of the themes that we had talked about throughout the downturn. You never know
[00:10:30] how long that's going to take to pay off, but in this instance it has paid off fairly quickly for a lot of people and so that's good. That's what we like to see. That's why we think one of the biggest things that we said was rebalancing and take advantage of prices while they're low. When the recovery happens, whenever that is, whether it's the next quarter or the next year or the next two years, whenever the recovery happens, you will recover faster than you would have otherwise because you have accumulated more stock at low prices. And so that has worked. That's exactly what's happened in the second quarter. So we're very excited about that. The tax losses that we were able to take advantage of will literally save many people, 1,000's and 1,000's of dollars in taxes over the
[00:11:00] next couple of years.

That's fantastic. We're obviously always excited about reducing our tax bill. So that's good. For any
[00:11:30] of the Roth conversions that we did to be able to pay tax while stock prices are low, and then have those prices recover and never have to pay tax on those gains, that is obviously something that's very exciting. And then of course, any future growth above and beyond here also is just icing on the cake, which is great from a long-term plan. And then anybody who had cash, they're the people who really took advantage of this. Anyone who invested cash over that period, obviously their cash

[00:12:00] never declined, but they used that excess cash to take advantage of low prices and really made a nice profit off of the investments that they were willing to take and they should have been rewarded.

[00:12:30] Everybody was really nervous during the downturn. And if you took cash and invested it, you really took a leap of faith at a timeframe when just about nobody really wanted to do that. And it's paid off really nice. So that's a nice recap about how the quarter has played out investment wise and how our rebalancing strategy and tax loss harvesting strategies and Roth conversion strategies and investing cash strategies has paid off really nicely so far. So we're very pleased with that. That's good. I want to show one additional piece of information here from JP Morgan because I think there is something that's possible, something that might happen this year that I think a lot of people maybe really would find hard to believe. So let's recap. We have a year where an [00:13:00] unexpected global virus causes a pandemic where millions of people become infected and 100's of 1,000's pass away.

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Something that nobody in the short run would have predicted was going to happen. We saw record declines and job losses in manufacturing activity, businesses shut down, contraction and GDP first recession in 10 years for the U.S., all sorts of negative news. If someone gave you that headline in December of 2019 and said, " What do you think is going to happen?" The stock market 2020. Here [00:14:00] are the headlines. What do you think the performance of the global stock market will be? Undoubtedly, anybody would say, "It's going to be a terrible year." I mean, all that information has to translate into absolutely awful stock market performance. It's just going to be brutal. And there was a brutal decline. I don't want to discount that, but there also was a significant recovery that's taken place. Now the year's only half over. So there's certainly a lot that could still happen, both positive or negative.

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But I want to highlight this chart from JP Morgan, which we always find interesting and it shows two things. It shows year by year the S&P 500 calendar year return. So that's the gray lines. How did the stock market actually perform? And then it also shows the entry year decline, which is the [00:15:00] red dots that are on the bottom half of the chart. And so this tells us a couple of different things. The majority of times stock market has positive returns because you only see it a handful of negative years there and this is a 40 year period. So that's one thing. But my point, I think, in this is look at how many years there are with big entry year declines. I mean like 10, 15, 20% plus. And how many of those actually ended the year with positive returns?

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Now we're sitting in 2020 with an entry year decline of 34%, which happened at five weeks might I [00:16:00] add. So it was literally a falling knife, but year to date S&P 500 is down about 4%. Now this was as of the end of June. Now don't get me wrong. There are other categories like value stocks, small stocks, international stocks, emerging markets that are down more than 4%. The S&P 500 is being dragged up by the likes of Amazon, Microsoft, Google, Facebook, Apple, these big tech companies that dominate the S&P 500 represent like 25% of it have actually done pretty well understandably, especially the likes of someone like Amazon, which has probably benefited from shutting down global economies or at least people staying home. But the S&P 500 down 4% as of the end of June, [00:16:30] despite having an entry year decline of 34%.

Now we've had some other years that had some pretty phenomenal declines entry year and still [00:17:00] have good years. I mean, the most obvious that I look back at too is 2009. We had a 28% entry year decline, which basically all happened between January and March. And then the second half or second, third, I should say, of 2009 was incredible. It was like a rocket ship for the stock market. I mean, I remember watching in almost disbelief how quickly the market, not only recovered, but continued to move forward. And the year finished up 23%. So you could have big declines entry [00:17:30] year and still have positive years for the S&P 500. And that's because the market can move relatively quickly. So interestingly enough that the year that looks probably closest to this one would be actually 1987, and if for those that remember, that was the year of black Monday where the stock market lost like 22% in one day, which is almost unfathomable. But that year had a 34% entry year decline, but finished the year positive 2%, which is unbelievable.

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That's a bumpy year, that's a difficult year as an investor to deal with, but that's really not that different then what this year looks like so far. We still have six months to go. So I think my point in [00:18:30] showing this is just because there is volatility, just because there's a big entry year decline does not guarantee anything about the stock market having a bad year because of that. Markets can move quickly. They reflect new information immediately. And in this particular case, new information will dominate how the stock market moves because what we're dealing with is so unique. So back to what I was talking about earlier.

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If we had a vaccine tomorrow that is widely available and completely negates any effect of or prevents anybody from catching COVID-19 or having any serious health issues from COVID-19 and all of a sudden the virus is no longer a thing, I would absolutely say that that would be rocket fuel for the stock market. That one of the biggest worries out there would be taken off the table and [00:19:30] things economically would probably start to go back to the way they were before we started dealing with all this. So I just wanted to recap on that and just highlight that big entry year decline certainly had an impact on investors and their behavior and their attitudes toward the markets, but it doesn't necessarily guarantee that it's going to be a bad year for stocks. Prices can move much faster than people anticipate. And that's fortunately happened in the last three months in the second quarter as stock market recovered quite significantly. We still have a little ways to go, but [00:20:00] the stock market had a great quarter and I'm obviously extremely happy to be able to report that for everybody.

[00:20:30] I'm sure many of you have already seen it through your monthly statements and your quarterly statement. And so that will be the second quarter 2020 market recap. As always, if you want to have discussions about the ever changing rules with 2020 is required minimum distribution waivers and whether you should take your RMD or not take your RMD or do a Roth conversion, there certainly still is plenty of opportunity to do that. There are many asset classes that still need a pretty long ways to go to get back to even. So the opportunity to take advantage of the downturn is certainly still there. So if you want to talk about that, give your advisor a call or shoot them an email, or if you have any specific questions about the portfolio or rebalancing or tax loss harvesting

[00:21:00] then obviously reach out to us. And with that, I'll leave it there. I hope everyone has a good quarter and is enjoying the summer as best we can. And we look forward to talking to you next time. Thanks.