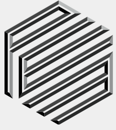


PALUMBO
WEALTH MANAGEMENT
PARTNERING TO DELIVER STRENGTH

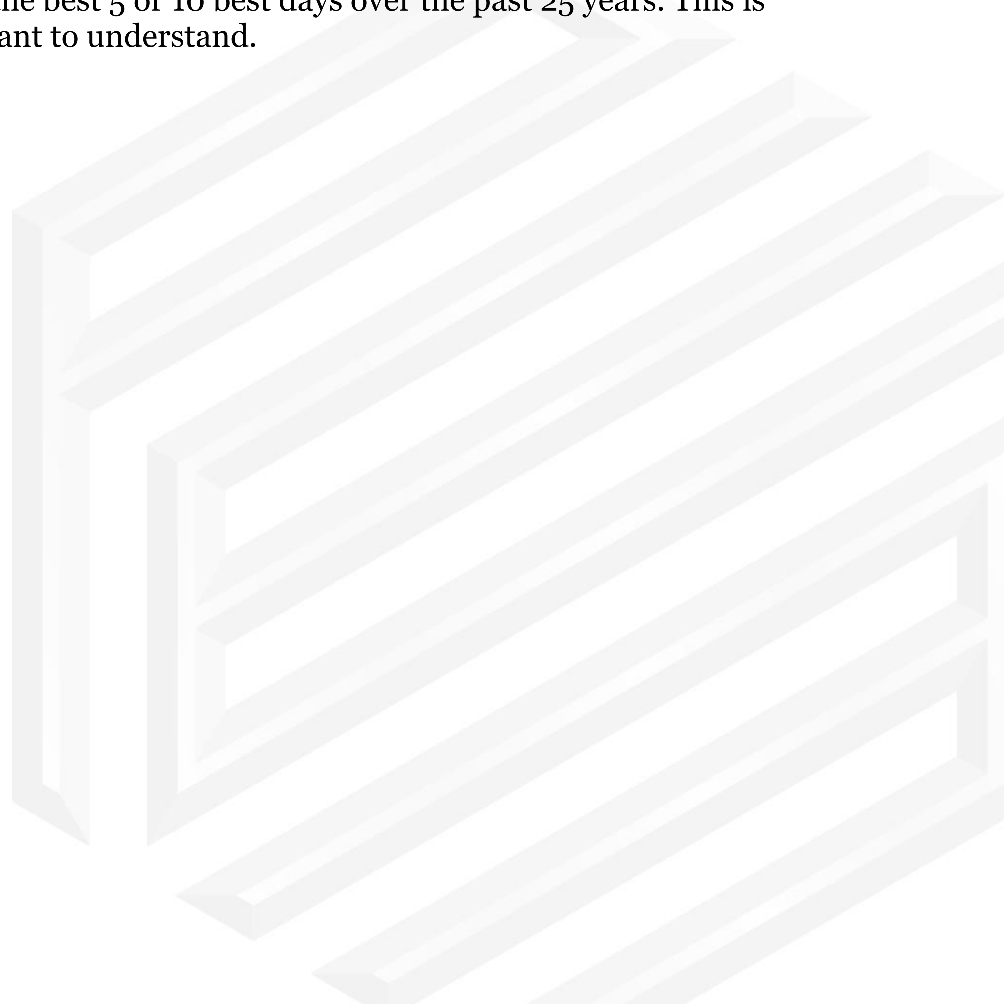
Weekly Commentary

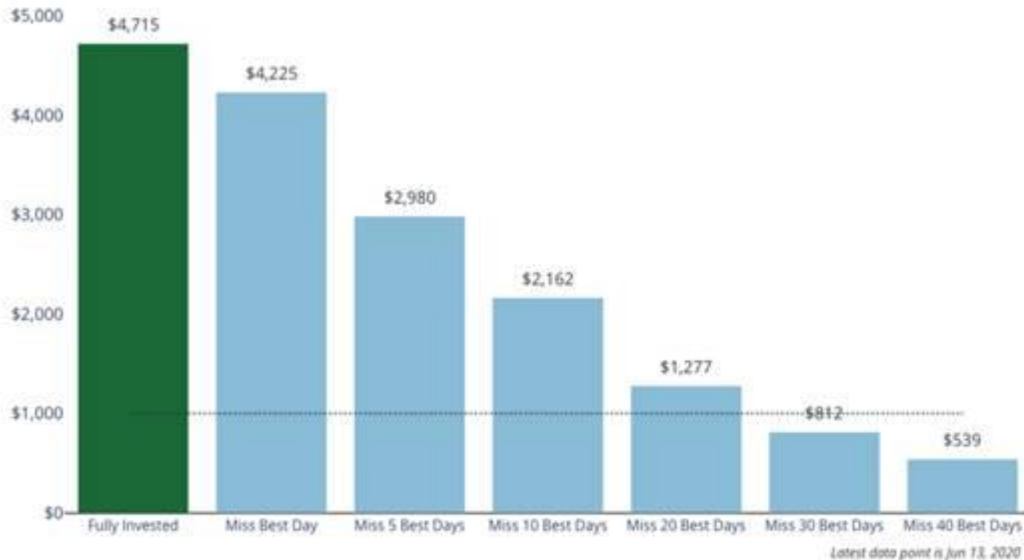
June 22, 2020

Chief Investment Office PWM | 22, June, 2020
Philip G. Palumbo, Chief Investment Officer, philip.palumbo@palumbowm.com

The Retirement Conundrum

This week we want to start by featuring what we view as an extremely important article in the Wall Street Journal. The article discusses the issue of experiencing large losses as you near your retirement and one of the most difficult investing decisions these investors will make: **Do I stay invested and wait out a potentially long rebound or exit the market altogether?** According to data from Fidelity in the WSJ article, nearly a **third of investors ages 65 and up sold all of their stockholdings between February and May**, compared with 18% of investors across all age groups. The example in the article is an ophthalmologist (Dr. S) who made the decision to sell all his stocks at a **"substantial loss" in the first quarter** of this year because he was 62 years old and **"he couldn't risk seeing his portfolio take a bigger hit"** and did not "have 10 to 15 years left to recover my losses". This type of stop and start investing/market timing substantially diminishes an investor's ability to meet their investment targets by diminishing the long-term return benefits of having equities in their allocation. In reviewing the below chart, you can see the diminishing impact of equity returns just by missing the best 5 or 10 best days over the past 25 years. This is quite significant and so important to understand.





We want to make three key points about Dr. S's situation:

1. Dr. S's situation is likely a function of poor investment planning. If the recent market decline scared him so much, he was simply taking on too much risk in his portfolio. An advisor should have determined what his tolerance for risk was, and then designed his investment portfolio accordingly. That is why a financial plan is so important. Retirement planning is more than just investing, it is a holistic analysis of your entire situation and an understanding of the risks you are willing to bear, and most important, the risks you are NOT willing to bear.

2. With an appropriate balanced portfolio designed for his risk level, Dr. S would likely have no need to even think about selling his stock in the first quarter. As an example, as of June 12 our core, risk balanced strategy model had a YTD return of 7.5% and had a maximum drawdown of 1.7%, as of March 20. All returns measured on a weekly basis - the S&P 500 bottomed on March 23.

3. Let's make an assumption the Dr. S is married and his wife is the same age. In that case. retirement is not just his retirement, it is hers' too, so the appropriate planning period must reflect that. The Joint Life Expectancies Annuity 2000

Mortality Table, based on Society of Actuaries data, indicates that for a male and female both age 62, there is a 50/50 chance that one of them lives to age 92. So, in reality, he and/or his wife are likely to have substantially more than 10 to 15 years to fund in retirement and to recover those loses.

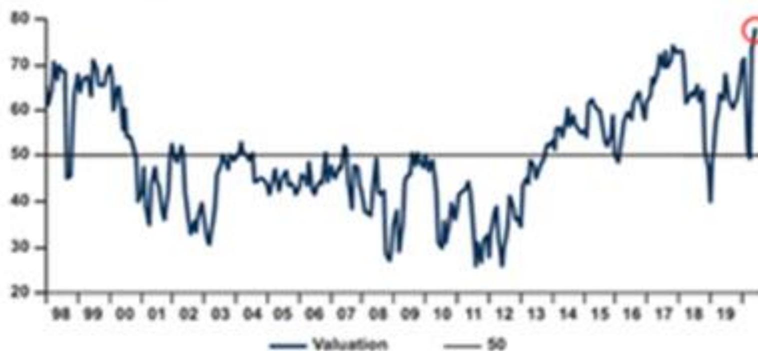
Dr. S is an example of the value of an appropriate financial plan. The risk balanced approach we use at Palumbo Wealth Management would have been instrumental in helping to mitigate substantive drawdowns in this case. This helps clients to stick with their investment plan avoiding the emotional roller-coaster feeling in difficult environments. We always preach that market timing is not an investment plan and making big decisions in times of stress, like Dr. S, forces you to time the market correctly twice: on the way in and the way out. Making one good timing decision is difficult enough, but making two is exponentially more difficult.

Stock Market: Beware End of Quarter Rebalancing

At the end of the first quarter, with the market down substantially, pension funds piled into stocks as they rebalanced to their model allocation. At the end of June, we expect a reversal. With the stock market largely recovered, the June quarter-end rebalancing will find pension funds selling stocks for the same reason. Goldman Sachs theoretical model estimates the pension selling at $76 billion. Of course, then you have to factor in allocation funds and other investors also looking to rebalance. We expect that selling to be ramping up between now and the end of June and could stall the market rise in the very near term.

Market Dichotomy Rules the Day

This is one confused market… The Bank of America Fund Manager Survey (FMS) is a widely followed view of how professional fund managers view the market. The most recent survey was published this week and a record 78% of fund managers expressed a belief that the market is overvalued, a result that garnered substantial media attention.



The chart above was widely circulated and might lead you to believe that we are on the precipice of the next major market decline. We wanted to put some perspective around the survey results, so we produced the chart below as a summary of the key findings from the last three surveys, which can easily lead to a different conclusion.

From our perspective, the key take-aways are as follows:

- Fund managers are gradually getting more bullish, but are far from overly bullish.
- Despite the V-shaped recovery hype seen on financial TV, most have a more realistic view that recovery may be slower.
- The fear of a protracted global recession has been substantially reduced, which we believe is largely a function of central bank actions to feed the economy with liquidity.
- COVID remains the key risk factor, but a Democratic sweep in November has appeared as a significant market risk for the first time.
- The stock market has broadened somewhat more than a month ago, but US tech and growth stocks remain viewed as the most crowded trade.
- Cash levels had a huge decline to 4.7%, down from 5.7%. To put that decline in perspective, the rule of thumb is that when average cash balances rise above 4.5%, it is a contrarian buy signal for stocks. When the cash balance falls below 3.5%, it is a contrarian sell signal.

Summary - BofA Investment Mangers Survey

	June	May	April
Bear Market Rally	53%	68%	N/A
New Bull Market	37%	25%	N/A
V Recovery	18%	10%	15%
U or W Recovery	64%	75%	74%
Global Recession in 2021	46%	77%	93%
Biggest Tail Risk:			
COVID 2nd Wave	49%	52%	57%
Persistent Unemployment	15%	15%	
Democratic Sweep	10%		
EU Breakup		11%	
Systemic Credit Event		8%	30%
Investor Cash Level	4.7%	5.7%	5.9%
Most Crowded Trade	US Tech & Growth	US Tech & Growth	Long Treasuries

Source: Bank of America, Bloomberg, Hedge Fund Tips

Our conclusion is that the market may be overvalued, but that doesn't mean it can't rise further and some indicators imply exactly that. We don't know what will happen next any more than anyone else knows. What we do know is that attempting to time the market generally does not work, so we stick to our plan.

Zombie Companies

Over the last week or two, several companies that have filed for bankruptcy protection have seen their stocks run up in price. The poster child is Hertz, but it has also been the

case with others, such as Whiting Petroleum and JC Penney. Hertz is attempting to use the rally to raise about $500 million of new capital because this capital would be much cheaper and come with fewer restrictions than typical debtor in possession financing. But looking at Hertz enormous debt, $500 million would be a drop in the bucket. The company would still be bankrupt. Fortunately, the SEC asked enough questions to have the filing withdrawn.

The reason for the rallies in these zombie companies is been laid at the feet of retail investors, as we mentioned in last week's comments. The Hertz offering is not for the faint of heart, but that doesn't mean some will speculate that the stock may actually be worth something someday. We are not among that group.

The Hertz situation may be interesting to watch, but there is a larger zombie company issue here. The last 12 years of very low interest rates has allowed many marginal companies to continue to operate when in more normal times, bankruptcy would have occurred by now and that is an economic problem. Capitalism, to be effective, must have failure as a necessary item. It is that failure that allows another company to come along and 'do it better' and become successful.
Persistently low interest rates slow or at times, even stops, this natural process of failure and re-birth and zombie companies become more and more common. That is not a good thing for the long-term economic outlook.

Palumbo Wealth Management (PWM) is a registered investment advisor. Advisory services are only offered to clients or prospective clients where PWM and its representatives are properly licensed or exempt from licensure. For additional information, please visit our website at www.palumbowm.com
The information provided is for educational and informational purposes only and does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your attorney or tax advisor.
The views expressed in this commentary are subject to change based on market and other conditions. These documents may contain certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected. Any projections, market outlooks, or estimates are based upon certain assumptions and should not be construed as indicative of actual events that will occur.
All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such.