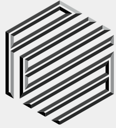

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Weekly Commentary

April 27, 2020

Chief Investment Office | 27 April, 2020

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One of the most difficult things to do is to keep your head about you when others are losing theirs (apologies to Rudyard Kipling). The reason is that you never know if you are just completely out of touch with reality and don't understand the situation, or if you see it all too clearly. That appears to be our current dilemma, both as it relates to COVID and to markets.

The battle to re-open the economy is building, there is evidence of social unrest in some quarters while others appear ready to stay inside until there is zero risk of infection. As usual, reality lies somewhere between. If we all head out and go to restaurants and movie theaters and cruise ships, the odds of a rebound appear rather high, throwing us into more economic chaos. On the other hand, this virus isn't going away so waiting for zero risk isn't feasible either and that will also result in throwing the economy into chaos.

Risk: It's Part of Everything We Do

The reality is that we accept risk every day. We drive our cars without even thinking about the risk because we see those risks as small and we are willing to accept that risk. The virus is not going away, so ultimately, we will all need to make choices about how much risk we are willing to take and then decide when we venture out again and where we are willing to go. At this point, the evidence clearly suggests that the young are at the least risk, and the risk rises with age and accelerates with comorbidities. From this perspective COVID is similar to the flu, but because it is a new virus, it has greater potential for dire outcomes. Because of these characteristics, there will be a group of 'early adopters' that will be rather bold in their return to civilization, and others will only venture out when they see proof that all is OK. That's just human nature.

The politics of the issue is that governments, at all levels, have no idea when to re-open. Open too early and the next surge is on you, open too late and kill off more businesses. This situation, like everything else, is about establishing a reasonable balance between risk and reward. As our knowledge of the virus expands over the next few weeks, we will begin to define how that balance is reached using an expanding set of tools to help us reach that balance. In the meantime, here is a summary of re-opening plans around the world. We will all be gathering a lot of new information over the next several weeks and expect some changes to this timeline.

Date	Event
24-Apr	All stores in Texas will re-open as "retail to go"; Georgia starts to re-open economy
26-Apr	Colorado stay at home order ends; Spain lockdown ends
27-Apr	Stage 2 of Texas reopening
28-Apr	California governor to address lockdown end date
30-Apr	Alabama, Arizona, Florida, Georgia, Illinois, Michigan, Texas stay at home order ends
1-May	Ohio begins 1st phase reopening
3-May	End of Italy lockdown
4-May	Germany reopens schools
6-May	Japan state of emergency ends
7-May	End of UK lockdown (tentative 3 weeks)
11-May	France reopens schools
15-May	End of NYC lockdown; New York, New Jersey, Connecticut, Massachusetts, Pennsylvania, Rhode Island, Washington DC stay at home order ends
20-May	Connecticut stay at home order ends
25-May	Memorial Day

Source: BofA Global Investment Strategy

Contract Tracing: One of Many Risk Mitigating Approaches

Contact Tracing is a methodology that is now getting more attention as a means to re-open the economy. Here is an explanation from Time Magazine:

> "Contact tracing is a little like detective work: Trained staff interview people who have been diagnosed with a contagious disease to figure out who they may have recently been in contact with. Then, they go tell those people they may have been exposed, sometimes encouraging them to quarantine themselves to prevent spreading the disease any further. Think of it as part public health work, and part investigation."
>
> "The technique is a "cornerstone" of preventative medicine, says Dr. Laura Breeher, medical director of occupational health services at the Mayo Clinic… "
>
> "Contact tracing was used during the 2014 Ebola virus outbreak, as well as in the SARS outbreak in 2003. It's also used to combat sexually transmitted infections and other communicable diseases like tuberculosis. And as COVID-19 has gone global, countries like South Korea and New Zealand have aggressively used contact tracing in an attempt to control outbreaks."

Rhode Island has already instituted a voluntary program designed to use mobile phone data for contact tracing. If you don't want to give up your mobile phone privacy, start by keeping a journal of everyone you come in contact with and the places that you go. If you do become infected, you have a ready-made contact list. No matter the method, we need to find a way to cooperate with the effort. It will speed the recovery and save lives and livelihoods.

As we learn more about this virus, we as a society will learn to accept and make modifications such as contract tracing to help mitigate the spread of the virus as we move forward toward recovery.

The Market: Phases of a Recovery

Of course, markets are constantly repricing the timing and speed of economic recovery. This week started on a pessimistic note, but as we learn more about the virus, the statistics get a little bit better and the talk of re-opening the economy gets louder and the stock market responded later in the week to reverse that initial decline and close about flat for the week. But human nature is embedded in markets as well, and we suspect the optimism will be tested from time to time for a variety of reasons. The economy is recovering too slow and unemployment is stubbornly high; new COVID hot spots are developing, risking more closures; too many businesses are permanently closing; these are just a few. We expect the news flow to extend the market volatility for a while longer.

The question then is how do we, as advisors, respond to this? We think the answer is with patience. One of the more interesting pieces of research we came across this week was from Richard Bernstein Advisors. Rich was formerly the chief strategist at Merrill Lynch before venturing out on his own.

There have been many descriptions of bear markets, which are all basically the same, but Rich's version is simple and intuitive.

> **Phase I:** The bear market is temporary and won't last and the market has already discounted the worst.
> **Phase II:** The fundamentals are worse than anyone imagined, and
> **Phase III:** The bear market will never end. The economy will never recover. A 'new normal' is forming.

Although this feels like this episode has been a long time, it really has not been long at all, at least in market terms. Declines usually take longer and recoveries take longer still and they are usually interrupted by a second decline… the re-test that we have been talking about recently. It certainly appears we remain stuck in Phase I. We've had a quick decline, and a 50% snap back, which sets us up for the "It's worse than we thought" moment.

The question that Rich addresses is whether it's best to buy before Phase II, or after Phase III. For most of the last 12 years, we have been in a FOMO (fear of missing out) market. It's only natural to think that markets move so quickly today, it's hard to call the bottom, so you might as well be early and make sure you catch all the rise. Rich comes to a very different conclusion. To judge that he measured returns from 6 months before the trough of the market and 6 months after the trough. About 70% of the time, you were better off buying 6 months after the trough, allowing the fundamentals to show real improvement before venturing back into the market. The data is below.

Total returns for the six months before and 12 months following a bear market trough

	1932*	1942*	1949*	1957*	1962*	1966*	1970*	1974*	1982*	1987	1990	2002	2009	AVERAGE	MEDIAN	% Of Instances With Positive Returns
6 Months Early	34%	34%	36%	19%	2%	14%	14%	-4%	46%	-3%	17%	-5%	-3%	16%	14%	69%
6 Months Late	59%	27%	11%	24%	15%	14%	17%	11%	29%	13%	11%	23%	12%	**20%**	**15%**	**100%**

Source: Richard Bernstein Advisors LLC, Bloomberg, S&P, ICE BofA
* Based monthly trough dates prior to 1987, determined by the lowest month-end S&P 500® level adjacent to the month of the bear market date. Note: "6 months early" assumes S&P 500® returns for the full 18-month period. "6 months late" scenario assumes 3-month Treasury Bill returns as a proxy for returns on cash for the 12 months and then S&P 500® returns for the final 6 months. Treasury Bill returns prior to 1982 are based on Ibbotson data.

Rich closes his report with some words of wisdom that are worth repeating:

> "Volatility can be unsettling to investors, but investors must stay dispassionate. The pressure to sell as the market collapses and the pressure to buy during subsequent rallies reeks of panic and typically leads to poor investment decisions. Have you ever heard anyone say, "I'm so glad I panicked?". Of course not. The surest way to be dispassionate is to follow the fundamentals not the news flow or the market's momentum."

Conclusion:

As I have been advising many clients since the downturn, I have said numerous times that your opinion about where you feel the market or economy is going is not an investment strategy. An investment strategy is the following:

1. **A portfolio that is designed to achieve a certain return based on your life and financial goals**
2. **Based on the level of risk that you are comfortable with**. For example, pre-COVID, investors understood that markets have declined 20%-60% historically during major economic downturns. When you initially designed your portfolio this should have been a discussion to understand how your portfolio can potentially decline during a downturn. Nobody likes to see the value of their portfolios decline, but that is the risk we take to achieve a return that we NEED to achieve our goals.
3. **Balance your portfolio with asset classes that have low or negative correlation**. I have mentioned this numerous times, Long-term treasuries and gold have always been an amazing hedge against a downturn in stocks. This year is no different with both being up 26% and 13% respectively for the year.

4. **Rebalance your portfolio when there are dislocations in the various asset classes that you are invested in**. For example, the dislocation are in stocks this year. So, rebalance by selling parts of your treasuries and gold to buy stocks.
5. **Take your emotion out of the equation**. YOUR OPINION IS NOT AN INVESTMENT STRATEGY.

If you consistently follow these rules over time, you will have tremendous success.

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