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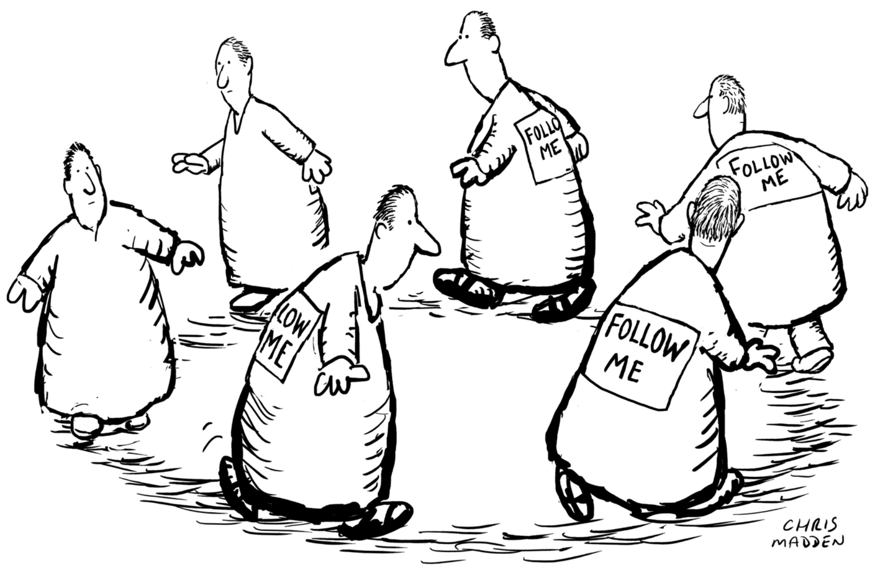
CAPITAL MANAGEMENT

INVESTMENT OUTLOOK – AUGUST 2020

Nothing is Normal Nowadays

"You cannot teach a man anything; you can only help him discover it in himself."
– Galileo



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Nothing is normal nowadays. Children are confused, Parents and Grandparents are confused, Businesspeople, Politicians and Bureaucrats are confused. Medical Doctors, Statisticians and Economists – all professionals who make a living out of projecting a higher level of certainty are confused. Therefore, anyone who says he/she is not confused is probably full of it, or at a minimum lacks skin in the game.

The COVID19 virus has turned the world upside down. People deal with stress differently. Some carry-on while others have drastically changed their lives and routines. Given all the unknowns, there is no real correct answer – for most it comes down to the amount of perceived risk one is willing to assume. Some of us may answer only to ourselves, while others have elderly parents, family members with pre-existing conditions, or strict employment policies to consider and abide by.

Many people believe they act rationally, but in reality, we are irrational beings – especially when it comes to uncommon outlier events such as this virus.

Often times markets are counterintuitive. Linear thinking = If A occurs then B follows may be proper logic for software engineers but can quickly get investors into trouble. If I had a nickel for every time the market moved in the opposite direction than what would have been expected after a statistic had been released… well, we all know the saying.

Many investors, advisers and clients are scratching their heads at the explosive market reaction over the past few months. Few people expected the rebound to move as far as it has, which is a good thing. Because, if they had anticipated the rebound, in all likelihood prices would be much lower than they are today. In the short term, markets are known to move in the direction that will inflict the most pain, both monetary and emotional, on those who can least bear it.

Ben Carlson, writes the blog, "A Wealth of Common Sense," and also works as a portfolio manager for Ritholtz Wealth Management. His recent entry below, "The Most Counterintuitive Recession Ever," caught my attention as he does a good job of highlighting economic data which tell a different story than what is commonly held by conventional wisdom.
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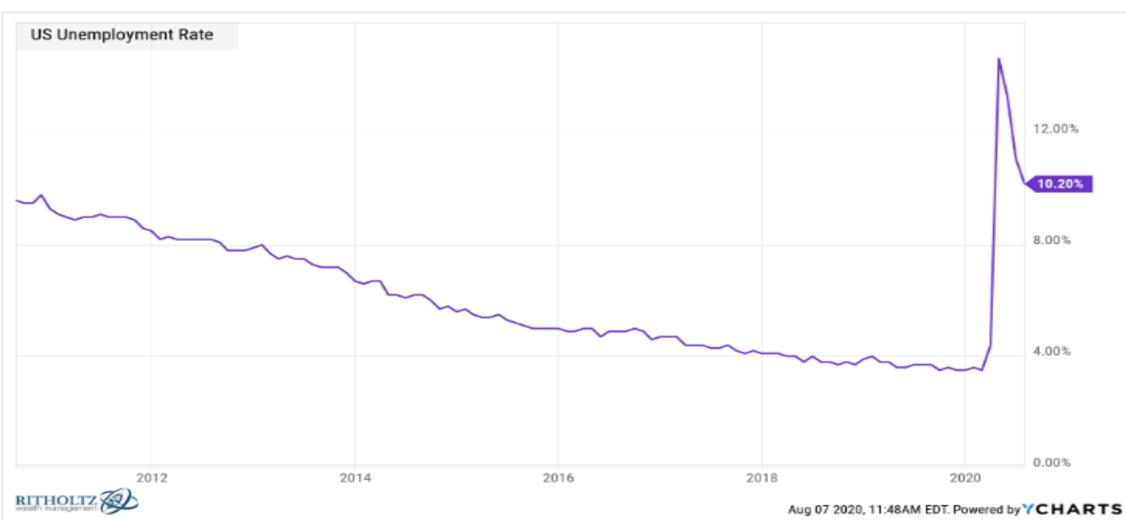
The Most Counterintuitive Recession Ever

August 9, 2020 by Ben Carlson, CFA
Blog Post – A Wealth of Common Sense

In February the U.S. economy was humming along nicely with an unemployment rate well under 4%. Then the pandemic hit our shores. And the economy was quarantined. So the unemployment rate spiked to nearly 15%. Now it's back down closer to 10% and will probably be under double-digits by this time next month:

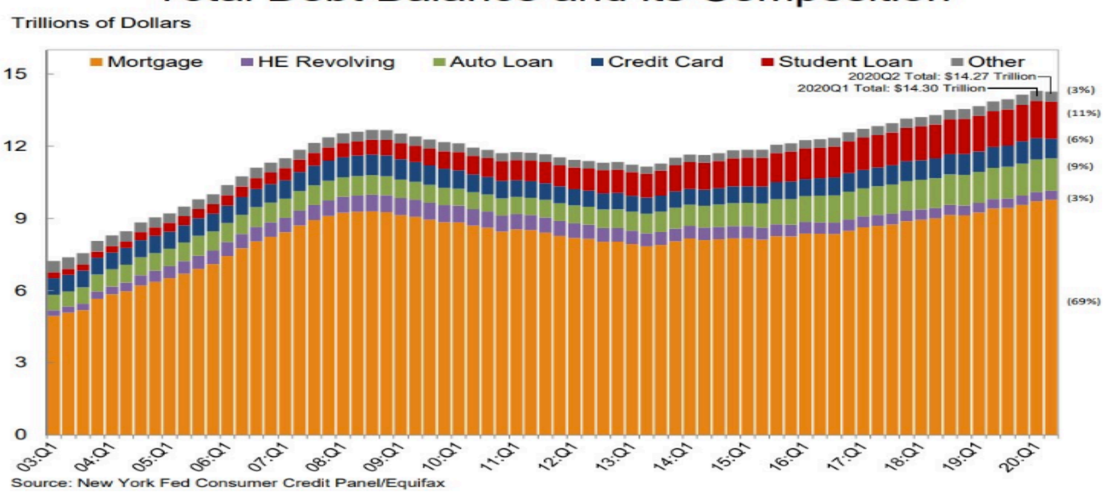


When you stop to think about everything, we've thrown at the economy in 2020, it's amazing that it's been able to continue functioning as well as it has.

This whole year has basically been an economic experiment and so many of the outcomes have been counterintuitive to what most people expect from an economic downturn that borders on a depression.

This week the New York Fed released their quarterly data on household debt. The second quarter of the year actually saw household debt *fall,* which is the first time that's happened since 2014.

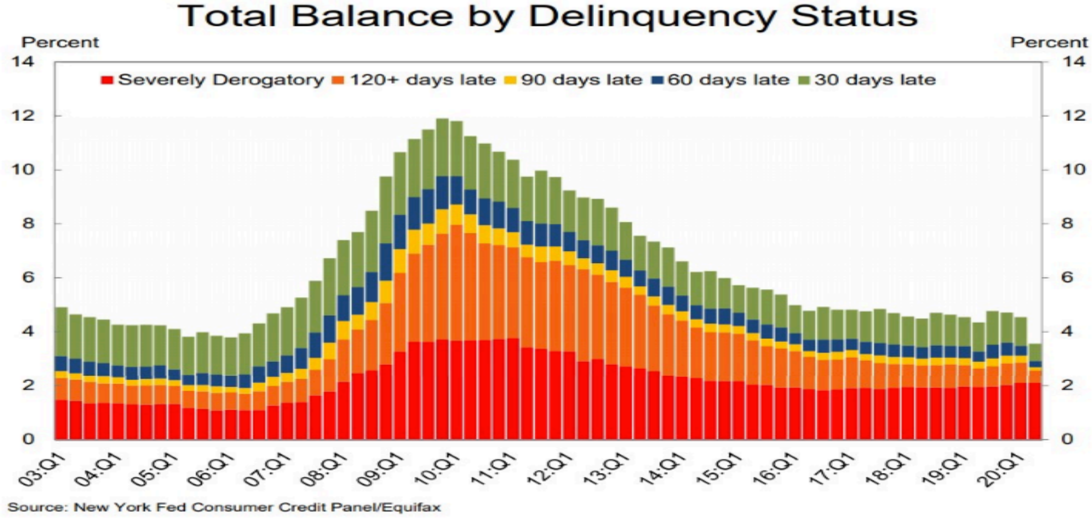
Total Debt Balance and its Composition



Granted, that's still a lot of debt but the fact that consumers were able to repair their balance sheets in the midst of double-digit unemployment rates and the worst quarterly GDP print since the Great Depression would have been unfathomable in prior recessions.

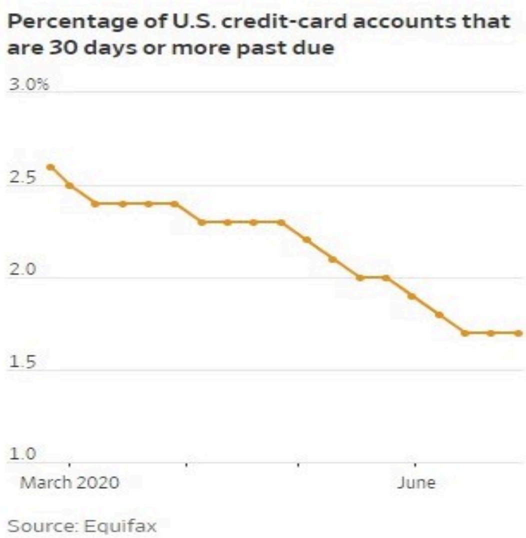
Now look at the delinquency status of household debt:

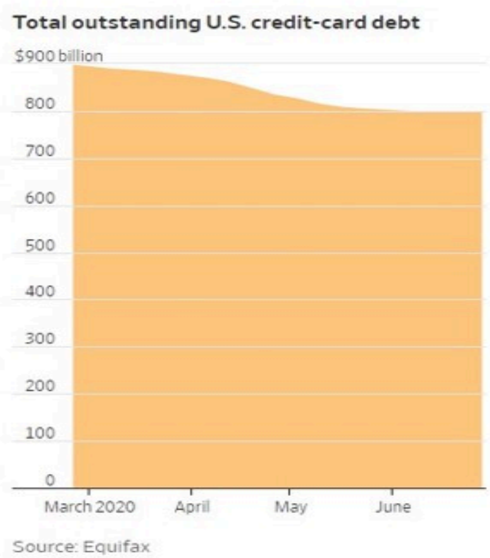
Total Balance by Delinquency Status



It fell more than 1% from the same period in 2019 and is the lowest on record since 2003.

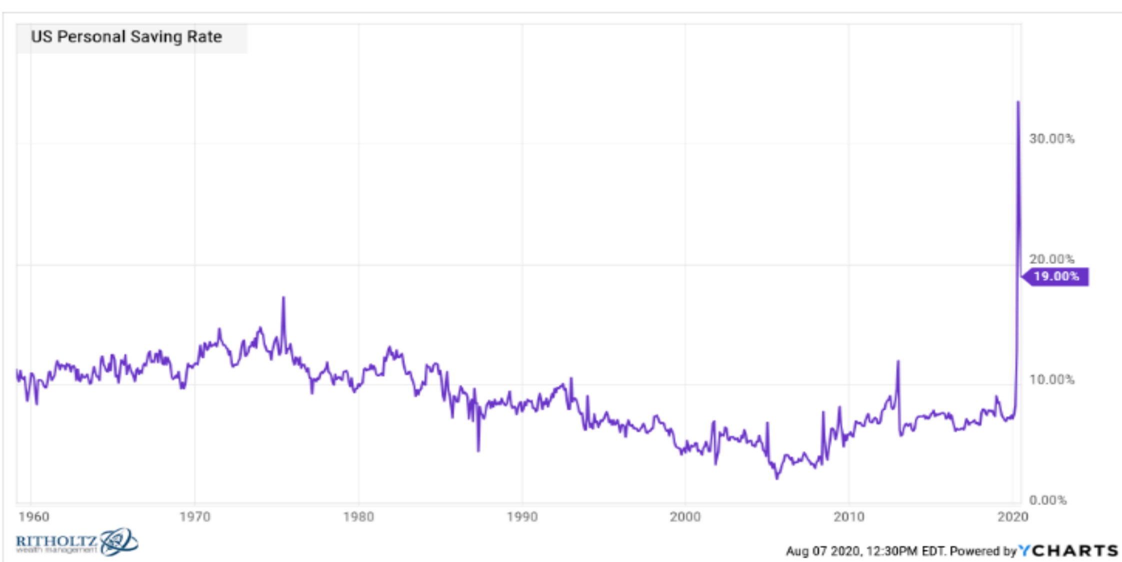
Now check out what's been happening to credit card debt (via the WSJ):





Outstanding credit card debt fell from March to June as did the percentage of credit card bills that were past due. No one could have predicted this would happen during one of the worst economic contractions ever.

Or how about the personal savings rate which briefly shot up to well over 30% and remains exceedingly high:



The real estate market has been red hot after an initial slowdown during quarantine:

I've spilled plenty of ink on the increase in speculation in the stock market over the past few months but it's another completely unexpected reaction to a pandemic-induced recession. Here's a quick summary from CNBC:

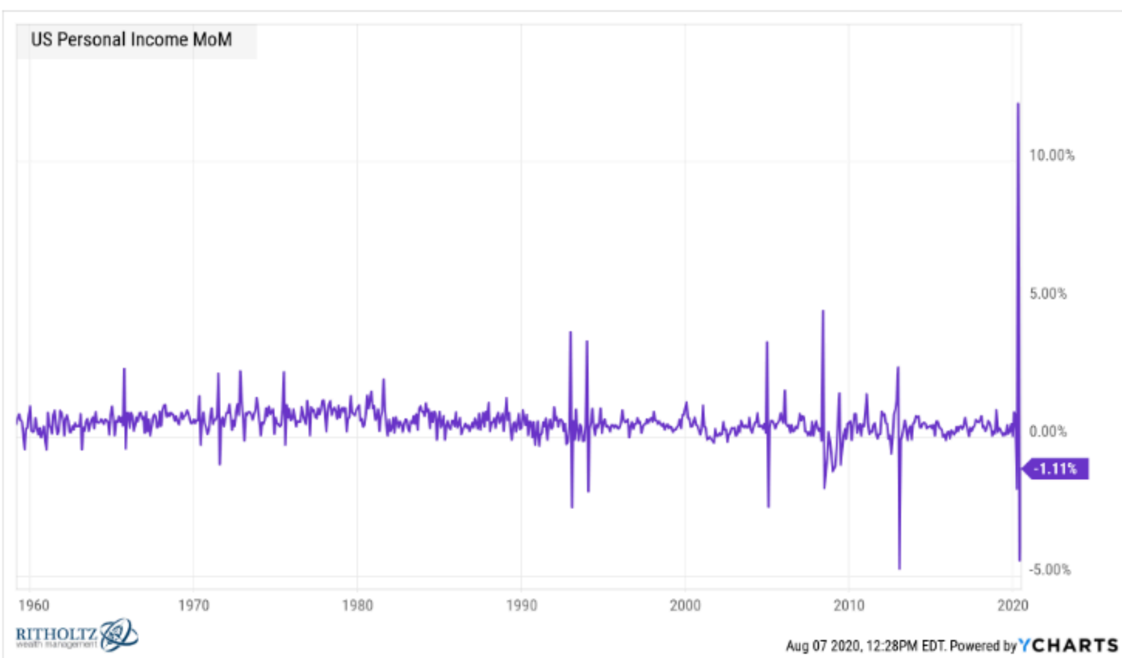
TD Ameritrade said Tuesday it added a record 661,000 new funded retail accounts in the second quarter, surpassing the 608,000 new accounts during the first quarter. The broker, which is set to be acquired by Charles Schwab, also reported a record 3.4 million daily average revenue trades — more than four times last year's levels and 62% more than the prior quarter.

The major online brokers — Charles Schwab, TD Ameritrade, E-Trade, Interactive Brokers and Robinhood — have seen new accounts and trading activity surge this year during the coronavirus recession. The brokerage industry experienced a flood of new, small investors who saw the market rout and subsequent rebound as a buying opportunity.

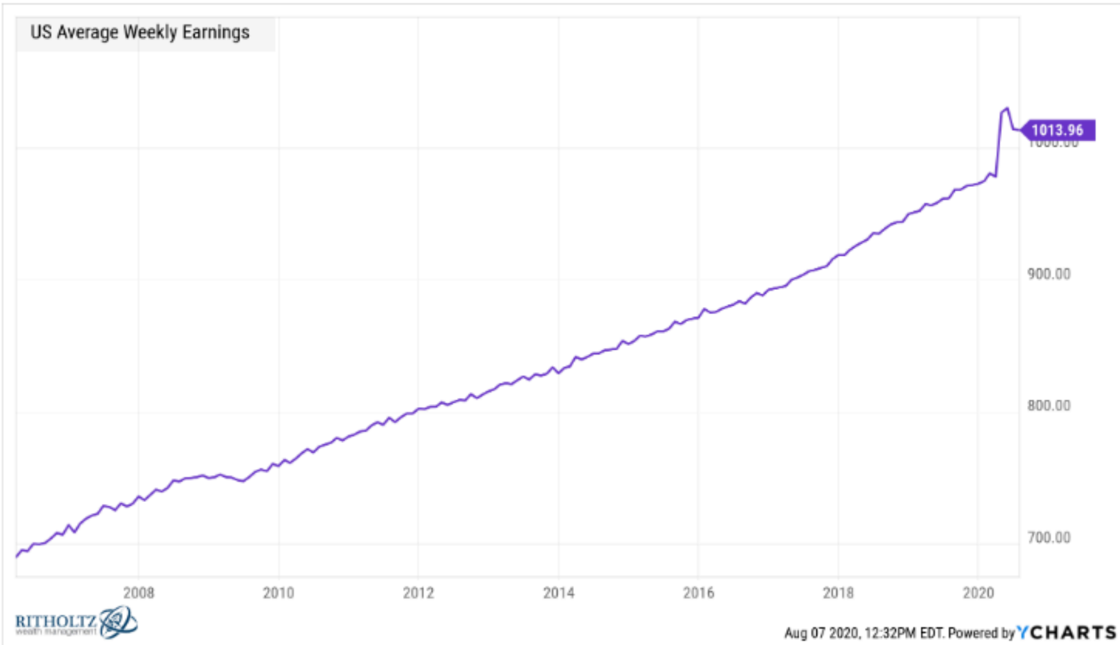
The stock market is also just 1% from all-time highs:

Everyone now knows why these things have happened.

The government flooded the system with money and people either spent it, saved it or invested it in the stock market. You can see the massive personal income spike in April the likes of which we've never seen before:



Now look at the enormous jump in wages from the increased unemployment benefits:



With the benefit of hindsight, it's easy to point out why all of these things are happening. Fiscal and monetary stimulus the likes of which we've never seen were unleashed in record time.

But *no one* was predicting how well these programs would work in terms of their impact on the consumer or the fuse they lit for speculators in the stock market.

There were far more people predicting a repeat of 1929 back in March than 1999 but here we are.

And while the government response hasn't been perfect, the fact that the economy in many places is doing much better than anyone could have imagined 4-5 months ago could have far-reaching implications for policy going forward.

It's possible all of this government spending is a one-off because of the nature of this downturn. This was the first recession in history where everyone knew the exact moment it began. The telegraphed nature and shutdowns forced government officials into action.

But it's hard to believe voters won't push for politicians to enact further fiscal rescue packages in the future. If the government can stop a depression in its tracks, why wouldn't they do so during future recessions?

No one knows the unintended consequences of these types of policies moving forward but it sure feels like 2020 is going to mark a turning point in the way we look at the response to economic crises in the future.

And regardless of the policy implications, this will go down as the strangest recession ever.
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Stay the course. That's our strategy. Large capitalization technology stocks still look good as well as the non-commercial real estate and housing sectors. I fully expect intermediate and long term interest rates to end 2020 at lower levels regardless of what equities do. This means long term US Treasuries and Corporate Bonds should still provide a decent amount of capital appreciation under most economic and market related scenarios going forward.

Going into year end, if we receive positive news related to a COVID19 vaccine or therapeutic, I think it would be logical to anticipate selloffs in outperformers such as large cap technology stocks, while underperformers such as value stocks could have their moment in the sun.

ASSET CLASS & SECTOR OPINIONS		
OVERWEIGHT	**NEUTRAL**	**UNDERWEIGHT**
U.S. Real Estate Equities	**Materials Sector**	**International Developed Market Equities**
Large Capitalization Technology	**Communication Services Sector**	**Financial Services Sector**
Consumer Discretionary Sector	**Healthcare Biotech & Pharmaceuticals**	**Leverage Loans (Floating Rate Debt)**
Healthcare Equipment	**Consumer Staples**	**Treasury Inflation Protection Securities**
Investment Grade Corporate Bonds	**Mortgage Backed Securities**	**Energy Related Equities**
U.S. Treasury Notes & Bonds	**Local Currency EMG Bonds**	
Gold & Gold Miners	**High Yield Corporate Bonds**	
	Emerging Markets Equities	
	Aerospace & Defense	

Sincerely,
Justin Kobe, CFA
Founder, Portfolio Manager & Adviser
Pacificus Capital Management