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Q1 2020

THE QUARTERLY

Thoughts Around the Current Bear Market

BY JAMES WALDEN, CFA
Partner and Chief Investment Officer

Through the end of the first quarter of 2020, the coronavirus pandemic has had a significantly adverse impact on global economies and markets. From the market close on February 19 through the close on March 23, the S&P 500's price fell -34% before rebounding somewhat to close down -20% for the quarter. Efforts to contain the virus via "stay at home" measures will ultimately cause a steep decline in economic activity, and we think it's pretty likely that we are now in a recession.

HOW BAD CAN IT GET?

The first quarter included the fastest bear market (defined as a market decline of at least 20% from the previous all-time high) on record. We can't say if we've reached the bottom yet or how large the decline will be if the sell-off continues. But to help frame our thinking, we looked to previous bear markets to provide some clues and perspective.

To begin with, we think it's pretty unlikely that this will lead to another depression. Practically every major decision that policymakers made in the 1930s was wrong: They raised interest rates, raised taxes, and launched a global trade war via the Smoot-Hawley Tariff Act. Collectively, these decisions served to lengthen and deepen the Great Depression.

Conversely, the size and speed of current responses by the Fed and Congress have been unprecedented, surpassing even those of the Great Recession.

We have also studied the 10 bear markets that occurred post-Great Depression. The average bear market

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INSIDE THIS ISSUE

QUARTERLY SEMINAR UPDATE

Due to the uncertainty of the COVID-19 pandemic, and for the health and safety of our clients and staff, we will not host an in-person seminar this quarter. Instead, we will pre-record the presentations and email you links that will enable you to access them from the comfort of your home or office.

As usual, our investment team will be speaking on the current happenings in the market and economy. In addition, the advisor team will be detailing the provisions of the recently passed Coronavirus Aid, Relief, and Economic Security (CARES) Act.

We plan to disseminate the recordings this month and hope you find the information useful. Please be safe, and we look forward to seeing you all soon.

CONTINUED FROM PAGE 1 ▸ decline was -35%. While the market can certainly decline further from here, the peak-to-trough decline of -34% suggests we're in the ballpark of the lows.

POINTS TO REMEMBER

Your diversified portfolio is your first and best mitigator of steep stock-market declines. There's no better example of the importance of diversification than now. While the price of the S&P 500 was down -20% in the quarter, the Bloomberg Barclays U.S. Aggregate Bond Index of high-quality domestic fixed income generated a total return of about +3%.

Low rates might not offer much investment income these days, but high-quality bonds still deserve an appropriate allocation in most investor portfolios because they effectively limit the impact of equity losses on overall portfolio returns.

History suggests that the market rewards those who invest and remain invested throughout the worst of it. On average, the S&P 500 rose 40% the year after the trough of each bear market we examined. Investors who sold out of fear at the bottom not only locked in losses but also likely missed a significant part, if not all, of the market's rebound.

Markets do recover … Investors should keep in mind that we have never experienced a bear market from which we never fully recovered. It took an average of about two years to make up all lost ground in previous bear markets.

… before the economy recovers and all the news is good. The stock market is a leading indicator of economic activity. It typically changes direction before the economy does, and headlines generally don't become favorable until the economy turns. When examining every recession after the Great Depression (12 in total), the S&P 500 bottomed about four months before the recession ended, on average.

HOW WE'RE MANAGING PORTFOLIOS

Clayton Wealth Partners makes tactical, or short-term, adjustments to long-term targets. Long-term clients know that we will make modest adjustments to portfolios to either exploit potential market opportunities or reduce exposure to potential risk. Here, we were modestly defensive during the downturn, holding a bit more cash than we typically do, and we had initiated a position in gold in tax-efficient accounts to further diversify portfolios.

Most recently, we have been using that cash to *nibble* on stocks a *bit*. Stocks have become quite cheap by a number of measures since the sell-off, and the intermediate- to long-term risk-reward tradeoff looks pretty attractive to us.

We are taking advantage of market volatility to rebalance portfolios. With all the wild market swings, our fixed-income investments have generally appreciated or held their relative value while equities have declined. By rebalancing portfolios, we are able to trim some fixed-income allocations to reinvest in cheaper stocks, bringing portfolio allocations closer to our targets. In other words, we are "selling high and buying low" when rebalancing, which helps portfolio returns.

We are using tax-loss harvesting to cut investment taxes. One silver lining of steep sell-offs is the ability to realize investment losses in taxable accounts to offset investment gains or income. Where applicable, it can help reduce taxes now and in the future.

WE'RE HERE FOR YOU

Clayton Wealth Partners knows this is a stressful time. Please call us with any of your concerns or questions. We're here for you.

TAKE NOTE!

Our office will be closed on the following dates:

FRIDAY, APRIL 10
Good Friday

MONDAY, MAY 25
Memorial Day

FRIDAY, JULY 3
Independence Day (observed)

Clayton Wealth Partners Welcomes New Staff

Zac Pohlenz has joined Clayton Wealth Partners as an Associate Wealth Advisor. For the last year, Zac has worked at Ameriprise Financial Services, Inc. as a financial planning assistant. Zac has experience developing financial planning recommendations and assisting in investment management. He will be working directly with the Senior Wealth Advisors to provide superior service and advice to our clients.

Zac holds a Bachelor of Science in personal financial planning from Kansas State University. In November of 2019, he passed the Certified Financial Planner™ exam.

Zac is originally from Topeka and graduated from Cair Paravel Latin School. Zac is a musician and outdoorsman, and recently became a father. In his free time, you can probably find him walking his dog, playing guitar, or spending time with his wife and brand-new baby boy!

BABY ANNOUNCEMENT!

Zac Pohlenz, Associate Wealth Advisor, and his wife, Nora, are eager to announce the birth of their first child, Ezra James. Ezra made his appearance on March 17th, St Patrick's Day. He was a big baby at 8 pounds and 12 ounces! He brings immense joy to his parents and everyone he meets.

The CARES Act: How This Stimulus Package May Affect You

BY ELIZABETH YOUNG, CFP®
Partner and Senior Wealth Advisor

It seems like just yesterday that we were dissecting provisions of the SECURE Act, which was signed into law on December 20, 2019, and affected most retirement savers in one way or another. Little did we know that just a few months later, we would be sifting through a new act—the $2 trillion emergency fiscal stimulus package (signed into law March 27, 2020) in response to the COVID-19 global pandemic.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act includes provisions aimed at easing the effects of the economic damage resulting from the virus. Given that the 270+ page bill is chock-full of details, I will just highlight a few notable focus areas for individuals.

CASH PAYMENTS

Maybe the most widely publicized piece of the act has been direct relief payments to taxpayers. It is important to note that these payments are really an advance tax credit that is estimated based on a person's 2018/2019 income. It will ultimately be "trued up" on 2020 tax returns.

Individuals with up to $75,000 in adjusted gross income will receive a one-time payment of $1,200, while married couples with AGI up to $150,000 will get $2,400. Additionally, taxpayers will receive $500 for each qualified child. For those who have income over the AGI limits, their payments will be reduced by $50 for every $1,000 that their income is over.

There is a lot of additional detail surrounding the tax return that is used for calculating the payment (2019—or 2018 if 2019 has not yet been filed), how this tax credit will get reconciled on the 2020 tax return, and the potential impact it could have on the taxpayer.

As for the timing of these payments, even though there is obvious urgency in

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CONTINUED FROM PAGE 3 ▸ getting money in the hands of those who have been hit hard, it is likely to be later this month or even early May before payments will be received. For taxpayers utilizing direct deposit, the IRS will deposit stimulus payments electronically. For those who don't utilize direct deposit with the IRS, it should be noted that in 2008, stimulus checks took up to 10 weeks to arrive to taxpayers.

USE OF RETIREMENT FUNDS

The legislation includes a couple of provisions related to using funds from retirement accounts for coronavirus-related expenses.

- The first provision is for coronavirus-related distributions whereby distributions up to $100,000 can be made from IRAs, employer-sponsored retirement plans, or a combination of both by an individual who has been impacted by COVID-19.

  While the distribution will still be taxable, the primary benefit is that these distributions will be exempt from the 10% penalty that is applied when individuals take a withdrawal from a retirement account prior to reaching age 59.5. Additional benefits include that the distribution can be repaid over the years if the individual wants to replace the funds in the retirement account and that the taxable income from the distribution can be spread over three years.
- The second area has to do with enhancements to loans from employer-sponsored retirement accounts. The maximum loan amount from an employer plan is increased to $100,000 (from $50,000), 100% of a participant's vested balance may be taken as a loan, and loan payments that would have been due in 2020 can be delayed for up to one year.

REQUIRED MINIMUM DISTRIBUTIONS WAIVED

The CARES Act has suspended required minimum distributions (RMDs) during 2020. The provision applies to traditional IRAs, SEP-IRAs, and SIMPLE IRAs, as well as 401(k), 401(b), and governmental 457(b) plans. For those who already took their RMD for 2020, there is potential for returning those funds into the retirement account if they wish to do so.

Unemployment Insurance

Enhancements were made to unemployment compensation, including expanded eligibility, longer duration, and bigger checks. Self-employed workers, independent contractors, and those with limited work history can now receive benefits. The waiting period for receiving benefits has been waived, benefits have been increased by $600 per week (for up to four months), and an individual can now receive 13 extra weeks of unemployment insurance.

More Details Coming

Clayton Wealth Partners will be providing additional details on the CARES Act during our upcoming quarterly seminar, which we will disseminate to all clients via email this month. If you have specific questions about any part of the CARES Act, please reach out to us.

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