ANCHOR
Investment Management, LLC

# Q2 COMMENTARY 2020

**July 10, 2020**

| Market/Index | 2017 Close | 2018 Close | 2019 Close | 2019 Change | As of 06/30/20 | 2020 Change |
|---|---|---|---|---|---|---|
| DJIA | 24,719.22 | 23,327.46 | 28,538.44 | 22.34% | 25,812.88 | -9.55% |
| NASDAQ | 6,903.39 | 6,635.28 | 8,972.60 | 35.23% | 10,058.77 | 12.11% |
| S&P 500 | 2,673.61 | 2,506.85 | 3,230.78 | 28.88% | 3,100.29 | -4.04% |
| Prime Rate | 4.50% | 5.50% | 4.75% | -0.75% | 3.25% | -1.50% |
| 10-year Treasury | 2.40% | 2.69% | 1.92% | -0.77% | 0.66% | -1.26% |

## Second Quarter Rebound

Coming off a terrible 1st Quarter, the S&P 500 had its best quarter since the 4th Quarter of 1998. We were researching 1998 to find similarities and got a chuckle out of what it looked like 22 years ago. The 3rd Quarter of 1998 saw a tremendous selloff due to the collapse of a hedge fund called Long Term Capital Management. The Dow had hit an all-time high of 9,337 in July and then fallen to 7,539 by August 31, a 19% decline in 6 weeks. The FED cut interest rates to 5.25%, and bonds rallied to an all-time high as the yield on a 30 year US Treasury fell to a record low of 4.96%. Sounds familiar, but it would be really nice to have those yields now.

In the 4th Quarter of 1998 the S&P 500 rose 20.8%, to all-time highs. In the 2nd Quarter of 2020 the S&P 500 has risen 19.95%, down only 4.04% for the year and 8.6% off its all-time high. The two years look pretty similar, and the good news is that in the 22 years since then, through the internet bubble of 2001, the financial crisis of 2008, the pandemic of 2020, and countless other anomalies, the total return of the S&P 500 is still 271% during that time. We are going to be OK, but the road forward won't be without hurdles we have to navigate…

## The Reopening

In June, states and municipalities allowed certain businesses to reopen. As expected, the number of new COVID-19 cases is rising and politicians are now put in a no win situation. If they open the economy they will be accused of putting people's lives at risk; if they don't reopen they will bankrupt their constituents and their communities. We wouldn't want to be in their shoes right now. But here are some staggering numbers to think about. For every one person who has been diagnosed with COVID-19, 16 people have filed for unemployment. For every person who has died from COVID-19, 800 people have filed for unemployment, and for every person of working age (19-65) who has died from COVID-19, 4,000 people have filed for unemployment.

The unfortunate truth about COVID-19 is that it's highly unlikely that we will get a vaccine quickly; we currently only have vaccines for 23 known diseases. Barring a vaccine, the next most effective approach is herd immunity, whereby a majority of people get the disease, recover from it and become immune. Luckily, COVID-19 seems to be less dangerous than we first thought. New projections estimate that 90% of cases are undiagnosed. If so, that means 98% are asymptomatic, and the death rate in the US is currently under 0.4%. Of those deaths, 80% are people who are over the age of 65 and no longer in the workforce. Economically it makes sense to open the economy, morally it remains a predicament. But public sentiment is shifting towards reopening.

## The FED Bubble

The Federal Reserve has moved into uncharted territory in the last three months. When manipulating interest rates they have typically bought and sold US Treasuries. Earlier in the year they started buying Corporate Bonds through Exchange Traded Funds. Last week they disclosed that they are now buying bonds of individual companies, both foreign and domestic; and the FED will soon become a direct lender to companies, bypassing banks completely. This is all in an effort to backstop the US economy and make sure that companies have the capital they need to weather the storm. But it erases any doubt that the Federal Reserve is manipulating asset prices and creating a myriad of problems in the future such as "Does this put the FED in a position to pick winners and losers?" and "How do we unwind this?"

After the 2008 financial crisis the Federal Reserve's Quantitative Easing process added about three trillion dollars to the economy over a ten year period, pushing up asset prices and fueling one of the largest economic booms in history. The FED has added the same amount of money to the economy in two months and it hasn't been deployed yet. It's currently sitting in bank deposits earning little to no interest, and as soon as people get more comfortable with the economy banks will start to lend those funds and people will start to buy assets. There is little reason to buy bonds these days as interest rates are too low, and US equities may be considered the safest asset class for long-term investors. The S&P 500 pays a 1.9% dividend, more than a 30 year US Treasury, and has a 265% total return in the last ten years. The Vanguard Utilities ETF pays a 3.4% dividend and has a 192% total return in the same period. We expect to see a tremendous flow of money into US equities over the next few years, pushing up valuations and creating tremendous wealth for investors. Asset inflation (some call it a bubble) has certainly been created by the FED, and we can't know if or when it may pop.

## Problem Areas

The response to COVID-19 has given us some unexpected areas of concern. First of all, the remote workforce for high paying jobs has worked quite well, so well that many companies are permanently adjusting their business models. Until this spring, top computer programmers moved to Silicon Valley, Seattle, and New York to work for high paying software companies. Now they can work productively from anywhere on earth. Software companies quickly realized they can hire talent from anywhere, for much lower cost, and not have to pay for the real estate and infrastructure to house them. According to some estimates, a computer programmer's salary could fall by up to 30 percent in ten years. Telemedicine will likely do the same thing for primary care physicians, and with 5G internet speeds we could see surgeons using robotics to perform surgeries around the world.

Now imagine what this does to urban municipal governments. The jobs that can leave are high paying jobs. What happens to New York without the banking industry? Silicon Valley without software companies? Housing values could fall dramatically, previously built infrastructure might never be used, and toll roads and subway systems might not be able to pay for themselves. If you want to know what that looks like, think Detroit…

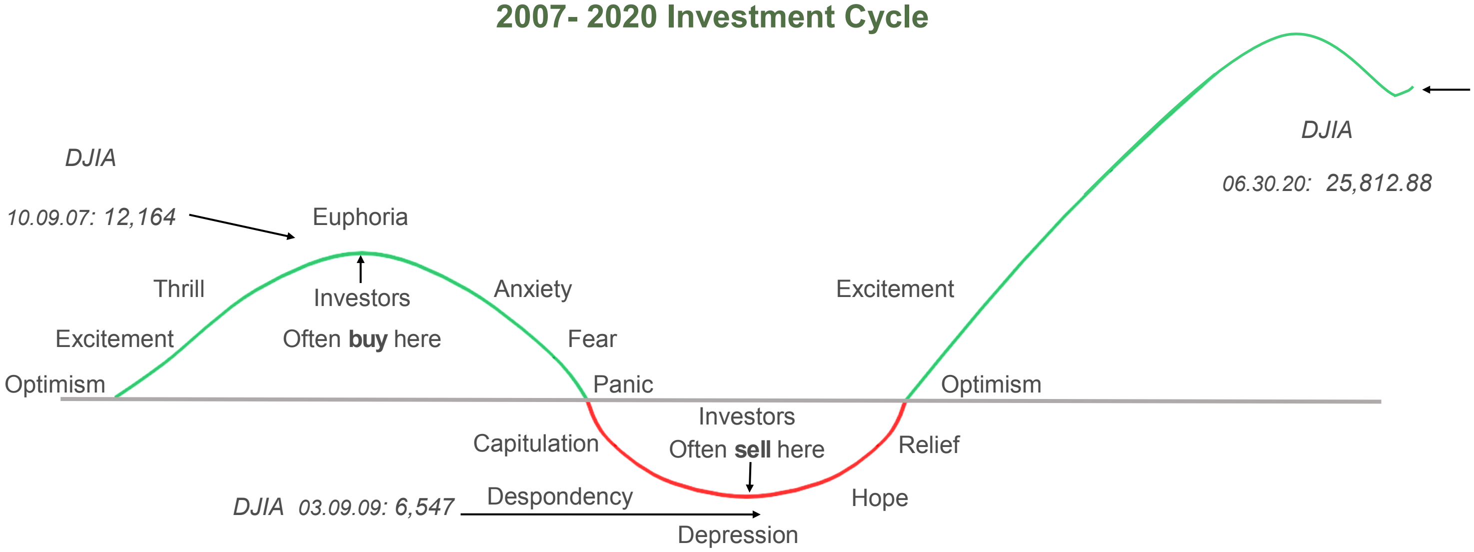
There is also a large concern about getting laid off workers back to work. The National Bureau of Economic Research released a study that found 68% of jobless workers are temporarily bringing home more than what their job was paying them. In fact, unemployment benefit payments replaced 134% of lost wages for the average jobless worker. There isn't much incentive for lower income workers to return to their previous jobs, and those with low skill levels can easily be replaced. We fear there will be a tremendous lag for the return of low skilled workers, putting further pressure on social programs which are paid for by already starved state and local budgets.

## Social Unrest And The Income Gap

The last few months have seen a tremendous rise in social unrest across America and the rest of the world. Some of this could be exacerbated by the isolation and frustration we feel as we have socially distanced ourselves, but a good deal of social protests is warranted and will drive positive changes going forward. One thing that is not going to change is the divide between the haves and have nots; it will likely accelerate tremendously in the years to come. The COVID-19 shutdown will cause a reduction in the wealth of the middle class. Small business owners are hurting; laid off employees are spending their retirement savings; and young adults entering the workforce will be paid lower wages. Taxes will be raised to pay for social programs and workers will have less take home pay. Meanwhile, asset prices will increase due to stimulus money inflating prices and as they say… the rich will get richer. Implore upon your children and grandchildren to accelerate their savings now. Anchor would be honored to help build a savings plan that includes retirement needs, college funds for the kids, and buying a new house. Just have them call us and we can help keep them ahead of the curve.

All of us at Anchor Investment Management appreciate your trust and confidence and we look forward to seeing you face to face in the near future. Please keep yourselves safe!

## 2007- 2020 Investment Cycle




**On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) as part of the $2 Trillion stimulus package. The CARES Act provides for a waiver of required minimum distributions (RMDs) that would otherwise be payable in 2020 for individual retirement plans (IRAs). Please contact our office if you would like additional information about this provision.**

***Disclaimer -*** *This synopsis is based on research of information available at this time and is provided for general information purposes only. Every attempt has been made to ensure the information contained herein is valid at the time of publication. If you are a client of Anchor, please notify us if there have been significant changes in your financial situation or investment objectives.*

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