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Stolper Asset Management
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Portfolio Comments
For the Quarter Ending June 30, 2020

According to those who tally such data, an unusually-subdued Warren Buffett said "I don't know" an unprecedented 30 times during his virtual Annual General Meeting address on May 2nd. Offering an analogy for adverse economic conditions acting as the great revealer of financial strength, he has famously quipped in the past that "only when the tide goes out do you discover who's been swimming naked". The disruption wrought by the COVID-19 pandemic has, however, laid bare uncomfortable truths extending beyond the economic and financial. The U.S. stock markets recouped a sizeable portion of their first quarter losses, but some underlying seismic shifts have taken place that will reverberate for a long time to come.

A society's prosperity is measured by much more than the value of its stock markets, but also the value it places on dignity, health, education, safety and access to opportunities for its citizens. Echoing Mr. Buffett, "we don't know" is the honest answer when projecting the short-term trajectory of asset prices, economic recovery, and political and social changes. But longer-term we are optimistic and hopeful that our economy, community and country will emerge more resilient and prosperous, by all measures.

The S&P 500 closed on June 30th at 3,100, representing an astounding return of 20.54% for the second quarter, but -3.08% for the first six months of 2020. The Dow Jones Industrial Average (DJIA) ended June at 25,813 for a return of 18.52% in the past three months and -8.43% for the year to date. While it's too soon to call the 'shape' of an eventual economic recovery, both indices rebounded sharply off their March lows in a distinctly 'V' fashion as regions cautiously reopened and an extremely accommodative Federal Reserve took unprecedented measures to provide liquidity and support asset prices. There was a pullback toward the end of June, however, as reports of spiking numbers of new COVID-19 cases in a number of large states were reported.

In its June meeting, the Federal Reserve left the Fed funds rate target unchanged at 0-0.25%, repeating their commitment "to using its full range of tools to support the U.S. economy…until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals." Based on current projections by members of the Federal Open Market Committee (FOMC), a higher Fed funds rate is not anticipated until at least 2022.

This is understandable given the Fed's expectation that U.S. real GDP growth will contract by 6.5% in 2020, contrasting with the 2% expansion forecast made at the end of 2019. According to the National Bureau of Economic Research, The U.S. economy entered recession in February, a month ahead of the pandemic declaration, and the contraction figure for GDP is expected to be far worse for the second quarter than the 5% reported by the Commerce Department for the first three months of 2020.

However, there are nascent signs growth had begun to perk up. Manufacturing and housing numbers showed a rebound. According to the National Association of Realtors, pending home sales in May jumped 44.3% from April (although still down 5.0% from the same period last year). New orders for durable goods - products designed to last at least three years - spiked 15.8% in May, well above the 9.8% projection. Still, new orders for nondefense capital goods excluding aircraft (a figure cited as a proxy for business investment) rose only 2.3%.

To further support the economy and the smooth functioning of financial systems domestically and beyond, The Fed has been busy taking unprecedented measures for these extraordinary times. In addition to reigniting its Quantitative Easing (QE) tools through the largescale purchase of U.S. government and asset-backed securities to pump credit into the banking systems, such measures have included promising to buy up to $500 billion in state-and local-government debt and $750 billion in corporate debt, including high-yield bonds and corporate debt Exchange Traded Funds (ETF's). It has supported the commercial paper market (very short-term debts) and provided liquidity operations to foreign central banks to ease disruptions that can arise from a shortage of dollars abroad resulting from interruptions in regular spending and trade.

In the middle of June, the Fed also launched its $600 billion Main Street Lending Program for small- and medium-sized businesses, whereby the Fed commits to buying 95% of each qualified loan from lending institutions, thereby assuming most of the risk, while borrowers receive favorable rates and repayment terms. Unlike the previously-launched Paycheck Protection Program (PPP) loans, Main Street loans are not forgivable and they do not have to be used to help retain the workforce.

The combined result is that the Fed's balance sheet ballooned rapidly to new heights. Acting on its powers to make a myriad of asset purchases under "unusual and exigent circumstances", the central bank's balance sheet now stands at $7.1 trillion, up from $4.2 trillion in early March, although the pace of its growth slowed and then reversed toward the end of the quarter, as stabilization measures took effect. Critics of the scale and pace of the interventions raise concerns that the Fed has created market dependency on its overt support and that, in the absence of an orderly path to unwind its positions, it will have "monetized" debt (effectively permanently increased the money supply in order to fund its debt purchases) and encouraged fiscal imprudence in government borrowing and spending. According to figures released by the Congressional Budget Office, the federal budget deficit was about $1.9 trillion in the first eight months of fiscal year 2020 (October - May), a jump of over $1.2 trillion from the same period the prior year.

On the job front, weekly new unemployment applications peaked in the first half of the year at nearly 7 million in late March, falling to about 1.5 million each week in June. Continuing claims for unemployment, although falling in recent weeks, on the back of jobs growth in May, stand close to 20 million. The Labor Department's Bureau of Labor Statistics (BLS) reported a May unemployment rate of 13.3%, although they subsequently acknowledged some misclassifications that, when corrected, would have put the true figure around 16.5%.

These numbers signal a slow recovery of the jobs market, exacerbated by a resurgence of reported COVID-19 cases and hospitalizations in a number of regions, likely resulting from a combination of higher testing capacity and an easing of social restrictions. We are also experiencing the competing forces of continued waves of layoffs, especially in harder-hit industries, juxtaposed with rehiring as economies attempt to open back up. The percentage fluctuations in unemployment are not homogenous across the nation.

Behind all this data are the lives of real people. A recent report by the Centers for Disease Control and Prevention (CDC) found that some members of racial and ethnic minorities faced increased risks from COVID-19 due to "long-standing systemic health and social inequities". The figures bring to light upsetting truths about racial equality in our nation, a topic that exploded to the forefront following the abhorrent killing of George Floyd, a black man, by a white police officer in Minneapolis. Mr. Floyd's murder, as well as other cases involving the deaths of black citizens at the hands of law enforcement, has ignited protests throughout America and abroad, and shined a light on the existence of systemic racism and racial bias in many areas of modern society in all its pernicious forms.

Tensions were therefore riding especially high when Donald Trump chose Tulsa, the scene in 1921 of one of the worst race massacres in our nation's history, as the location for his first Presidential reelection campaign rally in over three months on June 20th. He has framed himself as a 'law and order' President in favor of employing The National Guard and other organizations to help prevent and quell any unlawful activity sparked by the current unrest. His stance, as well as his ideologies on a range of issues, has further polarized swathes of the electorate. The rally at the BOK center did not draw the numbers Mr. Trump had hoped for, with concerns about the spread of COVID-19 and potential clashes between opposing groups being contributing factors. Critics cited below capacity attendance as a sign of the incumbent President's waning popularity, with national polls showing the Democratic presumptive nominee, Joe Biden, ahead of his rival. If 2016 taught us anything, however, polls do not an election result make!

The coronavirus has undoubtedly dealt a blow to President Trump's campaign pillar of economic growth, but he has staunchly maintained his versions of America-first and tough-on-trade policies. Toward the end of June, markets vacillated over conflicting reports from the White House about the state of the trade deal with China. Administration trade adviser Peter Navarro stated in a televised interview that the agreement was "over", only for President Trump to later clarify in a tweet that the pact with China was "fully intact."

The pandemic knows no borders and the U.S. is, of course, not alone in navigating its fallout. In the World Bank's June 2020 'Global Economic Prospects' report, the forecast for 2020 world GDP growth fell to -5.2%, down from 2019's growth rate of 2.4%. The report noted: "This would be the deepest global recession since World War II, and almost three times as steep as the 2009 global recession." It goes on to predict that, assuming the pandemic recedes during the second half of this year and economic and financial activity pick up in tangent with the reduced health risks, a moderate recovery is envisioned in 2021, with global growth reaching 4.2%. The embedded assumption about the course of the coronavirus spread is, of course, critical to arriving at these projections.

In Europe, German and French governments worked together to formulate a rescue plan to support economic recovery across the region with special focus on weaker countries and hardest-hit sectors. The European Commission put together a package of loans and grants that would be worth 750 billion Euros ($843 billion), or 4.5% of the EU's GDP. This would be the first time European countries have considered a fiscal transfer between member states. The package would be financed by jointly issued "Eurobonds" that will be paid from future EU budgets, which are heavily reliant on Germany's contributions. Italy and Spain stand to be the largest beneficiaries. Also, in its own program of Quantitative Easing, the European Central Bank has expanded its bond-buying Pandemic Emergency Purchase Program (PEPP) to a total of 1.35 trillion Euros ($1.52 trillion) and extended the duration until at least June 2021. Key interest rate benchmarks remain unchanged. The ECB's rate on overnight deposits by commercial banks is -0.5%, encouraging financial institutions to lend excess cash.

In addition to other economic stimulus measures underway in Britain, in a June meeting the Bank of England decided to increase its quantitative easing by GBP 100 billion ($123 billion), while its interest rate target is a low 0.1%. The nation's monetary policy committee (MPC) expects the economy to contract by 20% in the first half of the year. Although Britain exited the European Union at the beginning of the year, negotiations continue with the bloc on withdrawal from the EU's single market and customs area. The talks reflect the broader global themes of increased protectionism of domestic industries and cautiousness in outsourcing vital supply lines.

It's been a very rocky first half for the year, no doubt. Zooming out, the S&P 500 is over two-and-a-half times higher than it was in the middle of 2010 despite a decade of relatively tepid U.S. growth, and the index is less than 3.5% down from the beginning of last December, before the first human cases of COVID-19 were even identified. Some point to a current disconnect between equities and economic reality, masked by a tsunami of liquidity looking to be put to work that has continued to flow into markets. Big-name-mega-cap tech firms make up the top five stocks in the S&P and represent a fifth of the index's market capitalization. Their significant outperformance during the coronavirus crisis has also clouded a more representative picture of the broader business landscape.

There is a limit to how much legislative and financial policies can influence the outcome and timeline of a social and economic emergence from this pandemic. Dousing economies with liquidity isn't a straightforward formula for growth. Setting community rules cannot override many individuals' wariness to resume 'normal' activity. Identified coronavirus cases worldwide have now passed 10 million, with close to 500,000 known deaths. "Cautiously" is likely how we shall all be proceeding for some time to come.

Knowing what we don't know is more important than ever, and, from an investment point of view, our strong bias for durable business models and strong balance sheets is a focusing drive. There are bigger questions, beyond the scope of our purview here, that we don't know the answers to, but we are willing to humbly listen and learn for the betterment of our community and society. We hope you and your loved ones are well, and thank you as you allow us to continue to help you achieve your financial goals.

The S&P 500 is an unmanaged index of 500 widely held companies and over 80% of the U.S. equities market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow", is an index representing 30 companies maintained and reviewed by the editors of the Wall Street Journal. The information contained in this report does not purport to be a complete description of the securities, markets or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Any opinions are those of the investment adviser representatives of Stolper Asset Management and not necessarily those of RJFS or Raymond James. Expressions of opinion are as of this date and are subject to change without notice. Investing involves risk and you can lose principal. There is no assurance any strategy will be successful. There is no guarantee that any forecasts made will come to pass. Past performance may not be indicative of future results. This information is not intended as a solicitation or an offer to buy or sell any security referred to herein. Dividends are not guaranteed and must be authorized by the company's board of directors.