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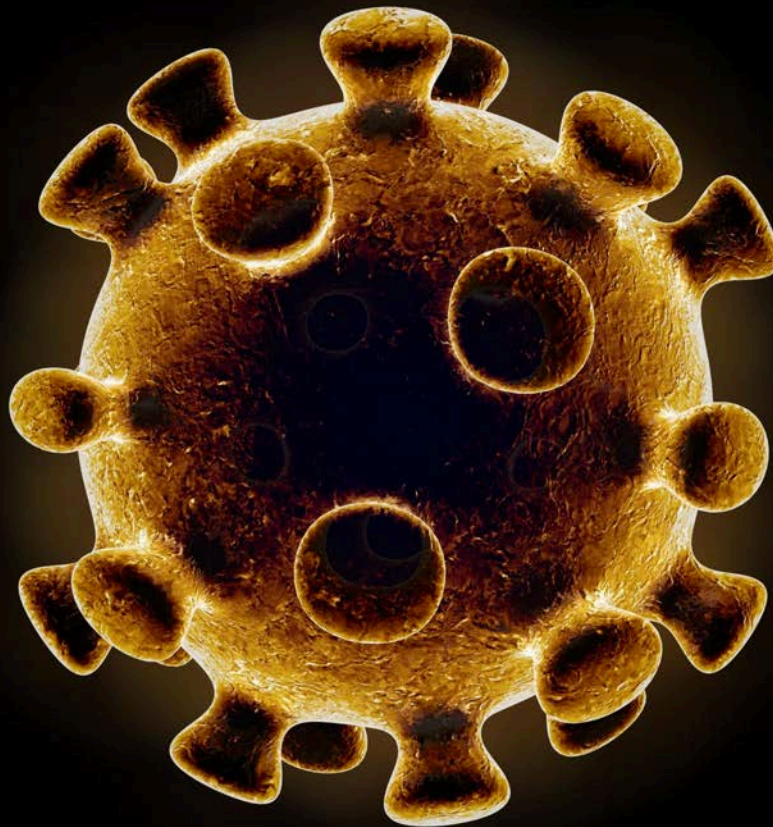
# PINNACLE QUARTERLY

## Coronavirus And The Market

The Pinnacle Investment Team

A Brave New Coronavirus World

Kelly Wright



April 2020

At Potomac Insurance and Financial Services, our goal is to help business owners protect and grow their business and family wealth. Since 1985, we have been overseeing our clients' insurance and financial affairs, from commercial to personal, so they can focus on what's important to them: Running their business.

We help our clients select the best investment management approach for their private wealth with the least amount of risk. This approach includes personal retirement planning, risk management, family education funding, financial protection planning and assisting the business owner with company-sponsored retirement and group-health plans. We unite insurance and financial planning so that our clients know their business and personal wealth are taken care of in one place.



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*Investment strategies are provided by subadvisor Pinnacle Advisory Group, Inc., Columbia, MD*



## A Brave New Coronavirus World

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Director of Financial  
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I write this from my kitchen table. It is my new office, and my family has to check that I am not in a virtual meeting to come into the kitchen, because I am easily distracted. I am on the cell phone and the computer all day long. My wife is also working from home. We had to set rules for interruptions: Don't unless it is urgent... and "I'm hungry" isn't urgent.

Grocery shopping takes hours, and requires nitrile gloves and a face mask. I meet my wife on the front porch to help decontaminate the food as it comes in the house. Packages are sprayed down and opened on the front porch. Junk mail doesn't even make it into the house. Is it ok to eat take-out?

I remain six to ten feet from my neighbors when I see them. At any other time, I would be considered standoffish. My car may grow roots where it is now. My hair is too long, and for the first time I do not feel guilty about postponing my annual physical or my dental checkup.

Happy hour is done through Zoom. I miss my friends and co-workers. I can't put my finger on it, but this is all so strange: the unknown, the changes, the fear. I count myself as one of the more fortunate that I can continue to work and do so remotely, but I need to get out of here. The lack of change in scenery is distressing. If the kids were much younger, I'd have to work out of the garage. My pattern of the day is drastically different, and it is a bit uneasy. When we have virtual company meetings, I find myself yelling at people to keep their hands off their faces... then I realize I am doing the same thing.

## The New Planning Landscape

The planning landscape that had been reasonably static has become far less so. It is a challenge to keep up with the changes. Even though I am at my kitchen table, I have never been so busy communicating with co-workers and clients.

In the days before COVID-19, we were still sorting out clarifications from the 2017 Tax Cut and Jobs Act (TCJA). Then very suddenly the SECURE Act put an end to stretch IRA distributions! Next were new life expectancy tables... and now we have extended deadlines, clarification on extended deadlines, the CARES Act, notices on interpretation of the CARES Act, and who knows what's next.



Then I realize it doesn't matter what is next. We will continue to inform all the people with whom we work, either through sending out information directly or our regular education and committee sessions during which we share all the challenges we face together. We have a structure in place that makes all this work, and it has done so surprisingly well. We have grown as a team and this helps our cherished clients. As with most challenges, we have become a stronger group. I am fortunate that all our CFP® advisors are smart and understand the importance of changes in the planning environment.

Much of what I write is on the technical side, and those developments have been more formidable, fastidious, and fast-paced than ever. Nevertheless, we have been organized, we have headed off problems, and effectively found solutions to the obstacles we have faced. We have supported each other and through doing that, been more supportive than ever to our clients. My family has been more supportive of each other as well, respecting the now blurred lines between work and home. We have more time to catch up at dinner than we used to as the children are not off in so many different directions.

This experience, while having its accompanying anxiety, will have some rewards. Most of us will be able to look back on this with pride and a sense of accomplishment. Perhaps with new hands-away-from-face rules and hand washing norms, we can be far healthier in the future.

Until then, we must and will get through this challenge. As we do, please know you have a team of concerned, dedicated, well-educated, very

competent professionals to help guide you through this tumultuous time. Know that we are making constant evaluations of all the new rules and discussing them as a group, so that we can understand and help.

Above all, know you are not in this alone, and that together we will get through it. Please stay safe and healthy.



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# MARKET OUTLOOK

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A careful reading of Pinnacle's fourth quarter investment review will find no mention of a pandemic that would, within a matter of weeks, create the conditions for a global recession. The necessary closing of economies around the world has resulted in the first ever recession by proclamation, where market participants everywhere and at the same time realized that markets were overvalued based on the easy forecast that corporate earnings were about to evaporate. The result was a record-breaking collapse in both equity and credit prices as liquidity dried up and markets seized, reminding many of the Great Financial Crisis in 2008.

The decline in the S&P 500 Index was breathtaking for the speed (rather than the magnitude) of the sell-off. From February 19th to March 23rd, the Index fell by 34%, eclipsing the amount of time it took for other famous (or infamous) peak to trough declines, including the Great Depression and the 1987 crash. Notably, a 34% decline is well within the parameters of historical bear markets where the average bear market decline is -35%, and the average decline after the stock market had just made a new all-time high is -39%. Fortunately, only about 1% of all Pinnacle clients are invested in a portfolio that is allocated to 100% in risk assets, with the remaining 99% of clients owning a balanced portfolio designed to significantly reduce client exposure to the risks of unexpected stock market declines. And while returns for the first quarter of 2020 were certainly disappointing on an absolute basis, they may not lead to a disaster that requires a change of lifestyle for Pinnacle clients.



The cause of all of this, as all of our readers know, is the COVID-19 virus. Interestingly enough financial markets watched the virus and its impact on China for several weeks with no real inclination to sell. However, once it became clear that the virus had escaped the borders of China and that the only way to contain it was to implement the kind of draconian steps undertaken by Chinese authorities, market participants commenced a quick re-rating of the prospects for global growth, and the stock market rout was on. In our view, the U.S. may follow a path for virus cases that is more similar to Italy than it is to China—and hopefully even less invasive—and that the peak in new cases in the U.S. will occur somewhere between mid-April to early May. It certainly didn't help that in the middle of all this, Saudi Arabia and Russia decided to engage in an all-out price war in oil by flooding the market with more supply than it can handle, causing prices to crash and exacerbating market volatility. In any event, we are focused on the point when economic activity will revive after the virus recedes, and how policy makers will balance sound public health policy with the obvious problem that the U.S. (and the rest of the world) can't remain in economic lockdown for too long without creating catastrophic economic losses.

For what it's worth, we currently believe that the earliest economic restraints could be lifted would be late May or early June. Notably, many commentators suggest that even this is too soon, considering that the U.S. is a large country and that the virus could surge in different cities at different times. It's hard to know how national, state, and local policy will impact our ability to return to the workplace, and how consumers will behave once they are told it is safe to do so. We believe that the notion of a Post-WWII-style "party in the streets" once the government announces an all-clear is unlikely. We expect Americans will remain cautious at least until there is a proven, efficacious treatment for the virus, proper testing and surveillance for outbreaks, and proof that the health-care system is not overwhelmed by virus cases. Of course, the best case will be the development of an actual vaccine, which we expect to take eighteen months or more. How this plays out will undoubtedly have an enormous impact on corporate earnings and consequently, stock prices.

To their credit, policy makers in the U.S., as well as around the world, are doing what they can to stabilize the financial markets and the global economy. In the U.S., the Federal Reserve has announced a blizzard of programs designed to provide liquidity to



credit markets (and others), in partnership with the U.S. Treasury, that will provide grants and loans to U.S. small businesses. The Federal Reserve Chair, Jerome Powell, has announced unlimited Quantitative Easing, which is a nice way of saying that the Fed stands ready to create as much money as necessary to prevent the economy from collapsing. Many of the policy tools being used by the Fed were first created during the Great Financial Crisis, so dusting them off and implementing them will be relatively easy compared to when they were first created in 2008-2009. It is hard to overstate the impact of this new policy over time; it is a river of liquidity designed to assure investors that markets will continue to function normally, and that systemic risk is properly managed. (Note: The Fed added an additional \$2.3 trillion of stimulus on April 9th.)

Just as impressive as the Fed's \$2 trillion of policy relief (now \$4.3 trillion) is the \$2 trillion fiscal package recently passed by the U.S. Congress and signed into law by President Trump. The CARES Act is a comprehensive package of grants, loans, debt relief, employment benefits, investments in certain critical U.S.

industries, and checks paid directly to U.S. taxpayers, all designed to offset the staggering shock that is expected to the U.S. economy in the second quarter. Congress is already targeting the next stage of relief since experts have no way of accurately forecasting just when restrictions on social behavior will be lifted and U.S. citizens can get back to work. In our view, although the total of U.S. monetary and fiscal relief equals a whopping 30% of U.S. GDP, both the monetary (Federal Reserve) and fiscal (U.S. Congress) programs will do no more than keep the U.S. economy afloat for the next four to five months. We question whether these programs will act as stimulus, but do believe that they will keep us from falling into a more serious economic depression. Of course, whether or not investors view these programs as stimulus for the stock market is an entirely different matter.

## Strategy

When markets crash, as they did from February 19th to March 23rd, one problem that investors face is to find data to evaluate whether the change in prices is rational or if the markets have overshot or undershot in waves of panic selling. In this case, the 34% decline in the S&P 500 Index occurred with little corresponding data regarding U.S. economic performance or corporate earnings. We know that analysts who follow corporations usually rely on guidance from the companies they follow in making their forecasts, and we know that companies will have a very difficult time giving investors any help in light of the unprecedented halt to business activity. Consequently, we expect consensus analyst estimates for the second quarter and the rest of the year to be all over the map. Historically this amount of uncertainty is not typically supportive of higher stock prices.

The equation of bad COVID-19 news + bad earnings news + bad economic news offset by news of overwhelming policy intervention both on Main Street and on Wall Street = a dilemma for investors, and



certainly for Pinnacle. That's especially true when considering the magnitude of the bear market decline we've already gone through, and the over-20% stock market rally we are experiencing as of this writing. We executed a series of trades once the market began selling off to take the portfolio to (what is for us) a significantly defensive posture. Our current investment thesis is that we expect, in the short-term, the stock market will digest the upcoming earnings news and gradually grind its way back to the prior lows set on March 23rd. At that point (and perhaps even earlier) we may use the opportunity to begin adding risk back into the portfolio in anticipation of better news ahead, both on the virus front and the economic and financial market fronts. Notably, we may already be seeing some better news on the virus front as it appears the peak in cases may be occurring earlier rather than later.

Importantly for our clients, we expect markets to normalize over the next year or two, with significant potential for us to opportunistically find investment ideas to earn excess returns. While the current recession was created by proclamation, once health authorities give the "all clear" for us to get back to normal, the question isn't whether the markets will recover, but how quickly they will recover. Considering the amount of stimulus in the pipeline and the flexibility and creativity of global business, much better times lie just ahead.

## Disclosures

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Risk associated with equity investing include stock values which may fluctuate in response to the activities of individual companies and general market and economic conditions.

Investing in foreign domiciled securities may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Although bonds generally present less short-term risk and volatility risk than stocks, bonds contain interest rate risks; the risk of issuer default; issuer credit risk; liquidity risk; and inflation risk.



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