MWA 1st Quarter Update: The COVID-19 Pandemic

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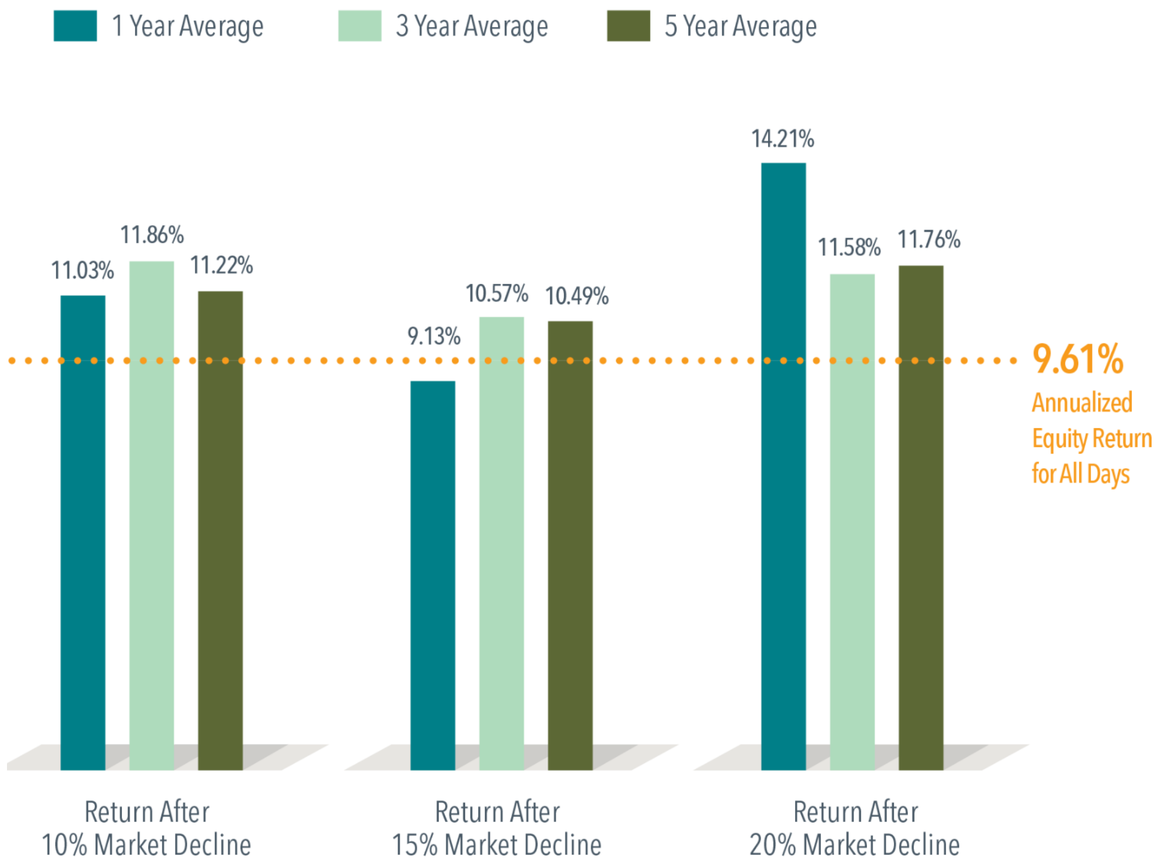
Section I: Market Update Report

The first quarter of 2020 was volatile, to say the least. If you click on this link, you will be able to download our graphical review of the first quarter. In this, you will find that all global equity markets were down, real estate was down, but luckily quality fixed income was up and is the reason why we have it in our portfolios.

Section II: MWA Quarterly Commentary

I hope you and your loved ones are safe and well. I want to take a second and say how proud I am of all my clients. You guys have done an amazing job of executing on the toughest investment quality of all: ***"Sticktoitiveness"***. Warren Buffet said, ***"Investing is simple, but it ain't easy."*** I think the recent decline has retaught us all that riding through market volatility isn't easy, but it is the price of the long-term guaranteed success. All we need to do to win is to determine how much income we need… *"**Check**"*, set our investment policy ***"Check"*** and wait for the inevitable gains to materialize ***"waiting again."*** When stocks decline, we sell our defense and buy more offense ***"Check"*** while prices are low, and when they rebound back to previous levels, we replenish our defensive reserves. That's basically our plan and you guys have executed it flawlessly. I wish we did not have to endure the pain of the inevitable declines, but they are short-lived when compared to the length and size of the gains. Many people will recommend trying to sell before markets decline, but every time investors sell out, they must then get back in, forcing them to be correct twice. I have seen investors succeed but have also seen many more get half of the equation right and miss buying back in at the appropriate time. It is much easier to ride through the decline and add more money to equities when fear is near its peak and it is evident everywhere you look. I believe fear is somewhat ascertainable and fundamentally, this is the strategy we have recommended as a firm. It has worked in the past and it will continue to work in the future because we are using reliable, evidence based and low-cost investment tools.

Look at Figure 1 below and you will notice that money deployed after a 20% decline has on average made over 14% in 1 year and over 11.5% in 3- & 5-years periods. One key to winning with this strategy is deploying defensive reserves through rebalancing or continuing to save if you are in the accumulation stage or both. All the new money put to work after this recent re-pricing should be well rewarded.



Periods in which cumulative return from peak is –10%, –15%, or –20% or lower and a recovery of 10%, 15%, or 20%, respectively, from trough has not yet occurred are considered downturns. Returns are calculated for the 1-, 3-, and 5-year look ahead periods beginning the day after each downturn. Whether a period is considered a downturn is analyzed on a daily basis, and therefore the 1-, 3-, and 5-year look ahead periods are overlapping. The bar chart shows the average returns for the 1-, 3-, and 5-year periods following 10%, 15% and 20% downturns. For the 10% threshold, there are 3,442 observations for 1-year look ahead, 3,396 observations for 3-year look ahead, and 3,345 observations for 5-year look ahead. For the 15% threshold, there are 3,175 observations for 1-year look ahead, 3,167 observations for 3-year look ahead, and 3,166 observations for 5-year look ahead. For the 20% threshold, there are 2,561 observations for 1-year look ahead, 2,560 observations for 3-year look ahead, and 2,560 observations for 5-year look ahead. Peaks and troughs are patterns that are developed by the price action experienced by all securities. Peak is the highest point prior to a drawdown, and trough is the lowest point after the peak. Data provided by Fama/French available at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.

Figure 1

What should you expect going forward?

I think the economic activity is going to look bad for quite some time, probably at least a few more quarters. Markets are forward-looking pricing mechanisms, and I think the markets really like the amount and speed of the stimulus package. Clearly when governments borrow or begin money printing trillions of dollars there will be an effect on prices, future inflation, and tax policy. I listened to a webcast with a renowned labor economist, Professor Edward P. Lazear, and he discussed how monetary authorities might respond to the COVID-19 virus as well as what recovery may look like.

Lazear seemed to think that for the next four quarters growth might be -1/2%. He also seemed to think it would take about six quarters to get back to where we were pre-COVID-19, and that today's prices are about right for what we know today as markets look well into the future. He compared today to two similar periods in the past. The first and closest similarity was right after WWII, markets were dislocated at first then things took off as the economies came roaring back. The second instance occurred in the dissolution of the former Soviet Bloc; markets responded in a similar fashion.

I thought this was an interesting chart about housing. Construction is an important part of the economy but notice the decline in housing starts following the crisis. Short-term, we believe prices will pull back, stabilize, and rebound. In Tarrant County, there is not a lot of supply, so I think our housing prices will hold better than in other areas of the country.

NAHB Housing Market Index: "Builder Confidence Posts Historic Decline on Coronavirus Pandemic"
dlvr.it/RTqYBR

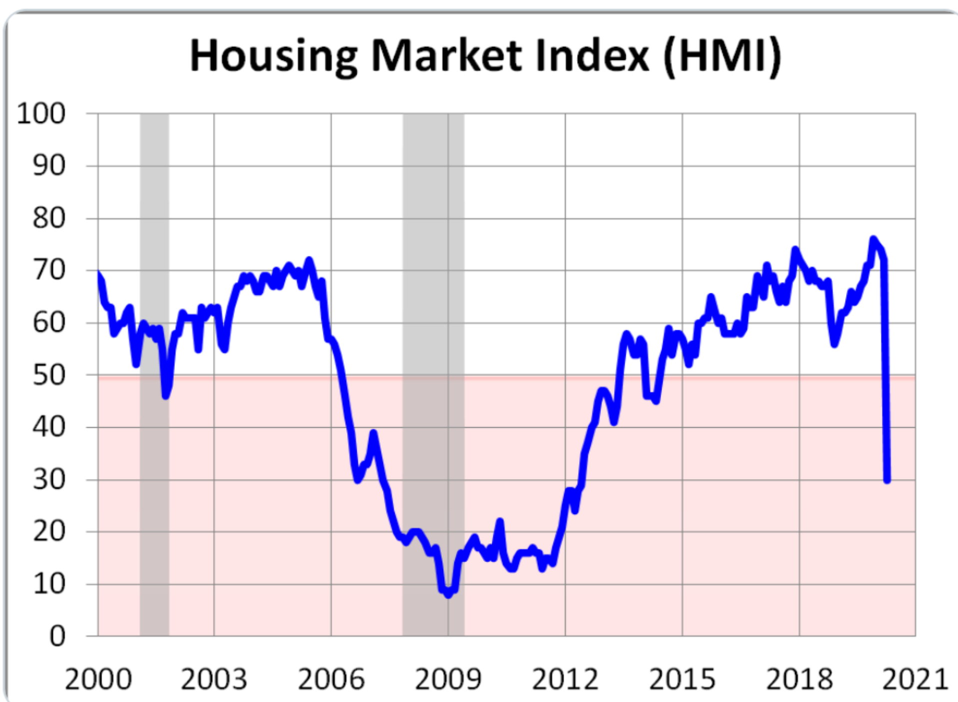


Figure 2

Water always flows downhill. Likewise, liquidity will find its way to where it has the best risk/return. I think we're going to see the Fed keep rates at 0% for quite some time in the short-term and I think the 10-year rates settle in the 40-60 Bps area. One thing to keep in mind is that a Typical 60/40 portfolio may not offer the returns expected with falling rates. With yields close to 0%, alternatives like hedged assets, gold, bitcoin, or TIPs might be better than cash or short-term fixed income.

What trades should you expect to see over the next week to a month?

In a large market decline catching the exact trading bottom is not required to make attractive long-term returns, but please know that we are trying to trade precisely to give your accounts the best chance of long-term success by picking up buys as close to the recent lows as possible.

In our prior trades, we have increased exposure to large-high-quality, high-profit global companies, and we have sold all or a portion of the high-quality bonds that we intend to use to complete our portfolio rebalancing trades. We still have about 4 smaller trades remaining. We need to buy back into emerging markets and the second portion of our global small-cap value trades in the US and overseas. We have held the trades because these lower quality sectors typically increase the most coming out of the muck (and we feel we are in the muck right now). This area of the market has not moved much in price yet, so we hope to add to these positions soon on future weakness. Please know we have been tax-loss harvesting as we rebalance so that we have plenty of tax losses that we can roll forward to offset future gains. We are constantly evaluating our portfolios and will continue to monitor trading opportunities.

On the investing horizon

As interest rates and bond rates approach zero — (many developed international markets are already near or below zero in much of the world)— investors will need to look further and harder to diversify equity risk. Alternative risk premium strategies, infrastructure, real assets—even long-shunned inflation hedging assets—may start to make more sense for some investors, within a diversified portfolio.

Is there anything else I need to be doing from a financial planning standpoint because of the recent market decline?

Another financial planning strategy that we are analyzing is a ROTH IRA conversion while assets are down. This technique allows us to take assets in a traditional pretax retirement account and move them to a tax-free retirement account. While this would create a tax liability in 2020, it will allow the same portfolio assets to continue to grow and be withdrawn later in a tax-free manner.

We believe this strategy works best in a situation where it is unlikely that the assets will be spent, and they are probably going to be passed down to the next generation. If your beneficiaries are in a higher tax bracket, then evaluating a ROTH IRA may create a slight tax arbitrage. Due to the huge deficit spending, those earning higher incomes are probably going to be forced to pay higher taxes to pay for the ballooning government deficits that are being used to fight the COVID-19 virus. If you think you might like to re-run the numbers on this scenario, please let us know and we will analyze this for you.

As always thanks for the trust and confidence you place in us. Stay safe!

- Mike

Section III: Around MWA

I want to take a second and welcome our new Financial Planner, Jim Davis, to the team. Jim is Certified Financial Planner and comes to us from Tolleson Wealth Management in Dallas.

Prior to joining the MWA team, Jim worked for Fidelity Investments and Tolleson Wealth Management. He has extensive experience helping families and small business owners navigate through the wide range of issues that impact their financial lives and is excited to begin working with you all in a similar fashion.

As a Financial Planner, Jim is passionate about helping clients accomplish their personal and professional goals, simplify the complexities associated with building wealth, and bridging the gap between their resources and the goals they have for themselves and their loved ones.

In addition to his work at MWA, Jim volunteers with two non-profits – Family Reach and Pathfinders – as a financial planner and coach in the Dallas / Fort Worth metroplex. These organizations specialize in eradicating the financial barriers that accompany a cancer diagnosis and helping individuals and families find their path from poverty to self-sufficiency.

Jim and his wife, Pyper, have two boys, Atticus (3) and Liam (1), and live in the Fort Worth area. When he is not spending time with his family, you can find Jim reading, listening to podcasts, enjoying the outdoors, skiing, and traveling. He is always on the lookout for a great read and welcomes any recommendations you send his way! Jim and his family are members of the Hills Church in North Richland Hills and are actively involved in the local community.

Section IV: Articles of Value

Staying in Your Seat - Link to Article

Do Downturns Lead to Down Years? - Link to Article

What Market Prices Reveal about Credit quality - Link to Article

What the Cares Act Means for the Market and Economy - Link To Article

Timeless Quotes on Investing Amidst Uncertainty

"… to buy when others are despondently selling and sell when others are greedily buying requires the greatest fortitude and pays the greatest reward." - Sir John Templeton

"I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful." - Warren Buffett

"In investing, what is comfortable is rarely profitable." - Robert Arnott