June 2020 Market Commentary

"I'm Hans and he's Franz and we want to pump.... you up!" - Pumping up with Hans & Franz (SNL)

If you are a Gen Xer like me, you long for the days of SNL that included Dana Carvey, Adam Sandler and of course the never to be duplicated – Chris Farley (RIP). Being that I was seriously into pumping iron all throughout high school (First person at my prep school to bench press 400 lbs.), I would always crack up at the skit on SNL of Hans and Franz as they would look to poke a little fun at Arnold Schwarzenegger. As Arnold would freely admit, he was on the "Juice" – steroids, during his run as the Mr. Olympia champion from 1970 through 1975. While I have never taken steroids, being a competitive athlete in football between college and the NFL, they were always individuals I played with or against that were willing to get on the "Juice". For our June 2020 Market Update we'll discuss how the Fed has added Monetary Steroids to the capital markets here in the US and how the Federal Govt. has provided life-saving steroids to the real economy.

As I mentioned earlier, as an athlete when you start moving into the highest levels of your respective sport, many of your competitors and sometimes team-mates are looking for an edge... after all it's about performance. I always hated the idea of taking steroids – due to a myriad of reasons, health, cheating, etc. but mainly, I knew it was only a temporary fix with diminishing returns. Over time, your body shuts down production of your own testosterone the longer you're taking it, effectively making it impossible to remove it from your system unless you are willing to forgo the performance benefits that it can bestow. My analogy here is the US Capital Markets are like a football player that was drafted into the NFL 11 years ago (2009) and has had a great run, but now, after 11 years in the league, the athlete is getting a little tired or long in the tooth... his choices are either to retire (Suffer a Market sell-off) or to start taking performance enhancing drugs – the "Juice" to maintain that performance of his younger years (2009-2019). I think this is a proper analogy for what we are seeing play out in our capital markets currently.

At the conclusion of 2019 we were roughly 11 years into a full recovery from the last financial crisis in 2008. We had achieved an unemployment rate of 3.5% nationally one of the lowest measurements on record. The US Stock Market as measured by the S&P 500 was on all-time highs. Then bang – the Covid Health-care crisis hits, sending the US and global economy into a sudden recession. The Fed seeing that investment assets prices were diving in late February through March of this year made a choice to inject the global markets with Quantitative Easing (QE), what amounts to Monetary Steroids, by purchasing debt securities of all types in the open market. While many critics feel that these purchases do absolutely nothing to help the real economy, they certainly have acted to help instill investors with confidence (Real or misplaced)

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Contact

Koa Wealth Management

11260 El Camino Real
Unit 220
San Diego, CA 92130

760-602-6920

info@koawealth.com

www.koawealth.com

KOA WEALTH MANAGEMENT®

that the Fed "Has their back" stoking "Animal Spirits" and overall risk taking in markets. What we've seen on the back of this multi-trillion-dollar injection is one of the steepest rallies in market history that followed one of the steepest market declines. To say we are living/investing in strange times is an understatement. Within the last few weeks, the tech-heavy Nasdaq pushed to new all-time highs while the S&P 500 was a stone's throw away from high-fiving its own highs as well… something you shouldn't expect to see happen while the economy is in recession and the unemployment rate has zoomed past the levels we saw in the last financial crisis in 2008. The Fed wants to keep asset prices up and the aging athlete (The Market/Cycle) performing… hence "The Juice"! As investors we now need to weigh what will happen to the markets if the Fed decides to stop injecting the Monetary Steroids, do markets begin to wither or has the Fed figured out how to smooth economic gravity so that recessions in the real economy divorce themselves from asset priced in the market economy? The chapter of this book is yet to be written – but to say the least the future outcome is concerning and puts the Fed in a "Box" by where they may have no ability now to exit Capital Markets in a meaningful way.

Let us now turn to the real economy, Congress and the President have approved individual and business aid programs that again measure close to 3 trillion dollars. These "Life-Saving Steroids" however, serve a different purpose – to keep the economy functioning. Think of these steroids more akin to the treatments that hospitals are now administering to some of the most severely ill patients in the ICUs. While these steroids can help the patient to survive Covid, anyone who experiences this near-death experience comes away scarred physically and mentally from the experience. I believe a similar thing is playing out in our economy currently – businesses and individuals are receiving a stay from death at the moment, but to expect that they will walk away from this crisis whole or in good shape any time soon, is fiction. As May has moved into June, the data from lenders, credit card companies, etc. show increases in payment delinquencies of all types – auto loans, mortgages, credit cards. There is real stress on the consumer which is also playing out in consumption and manufacturing data. May and June are seeing a bounce back in activity from the depths of April, but with the recent spike in cases in Florida, Texas, California and Arizona – we run the risks of rolling back the progress that we are making in reopening the economy.

At best we believe that we will continue to see heightened volatility as we continue to move through the back half of 2020. While grappling with recovering from this health crisis, we as Americans will also have our day at the voting poles in November. While 2016 showed that national poles are not necessarily fully reliable, at current, Joe Biden looks to be the front runner for the 2020 Presidential Election. There are also figures showing the possibility that the Democratic Party will also regain control of the majority in the Senate in 2020 as well. If Democrats are to take power across the board in 2021, the Corporate and Individual Tax Cuts made by President Trump will most likely be rolled back (Joe Biden has recently promised as much) – the question is when and by how much? Our best guess is that regardless of the change in Washington come 2021, whoever gets into power is going to be dealing with a sickly patient in the form of our economy and will most likely need to do something to give it a shot in the arm. A well thought out Infrastructure bill would be a great idea, but it has been talked about for so many years now with no action, that I wouldn't hold our collective breath. Expect more chatter about increasing transfer payments to those most affected by our current downturn or possibly the idea of instituting UBI (Universal Basic Income) initially as a bridge to a recovery, but potentially as a New Program aimed at helping Millennials get out of the debt hole and into household formation.

In the meantime, we continue to counsel our clients with much of the same advice since we entered 2020 – stick with high quality – especially in the form of balance sheets. At this juncture we don't know how long it will take for the global consumption to recover to previous levels. We want our investments to not only survive but be in a position to thrive as we work through the opportunities that we expect to materialize as bankruptcies roll through the system from those that were unprepared for this economic shock.

Michael Souza,
KOA Wealth Mangement, CEO