CCR
WEALTH MANAGEMENT

July 2020 Outlook

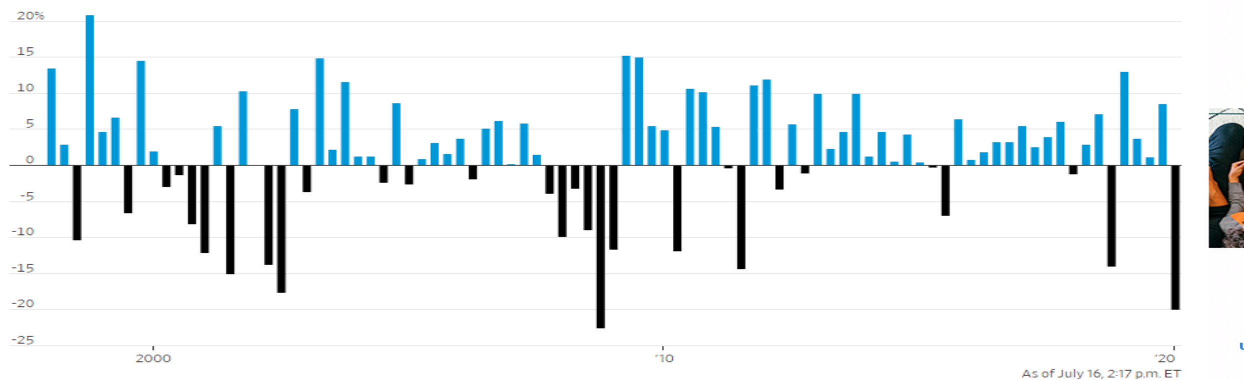
THE WALL STREET JOURNAL.

MARKETS | U.S. MARKETS

U.S. Stocks Finish Best Quarter in More Than 20 Years

But the market's rally has slowed lately following a resurgence in coronavirus cases in some parts of the U.S.

S&P 500, quarterly performance



This was the headline in the Wall Street Journal on July 1st. CCR Wealth Management sent out e-mails to our clients in February and early March cautioning against reactionary trading during sharp market declines. On March 13th we wrote: "**Most will come to learn that the best days, weeks or even quarters tend to follow the worst days, weeks and quarters. Asset allocation is designed to bridge this gap.**"

Overwrought and well-worn predictions of "depression", popular in the media at the time, have, of course, not come to fruition. The media, a familiar target of our commentary, will continue efforts to separate you from your financial plans, and ultimately a good portion of your wealth. Today's resurgent pockets of COVID-19 around the country were always inevitable in the process of re-opening the economy. We will discuss the "second wave" nomenclature further on in this Outlook, but CCR Wealth Management does not expect another national shut-down. We can only hope that politicians, this time around, focus efforts on protecting who we already know are

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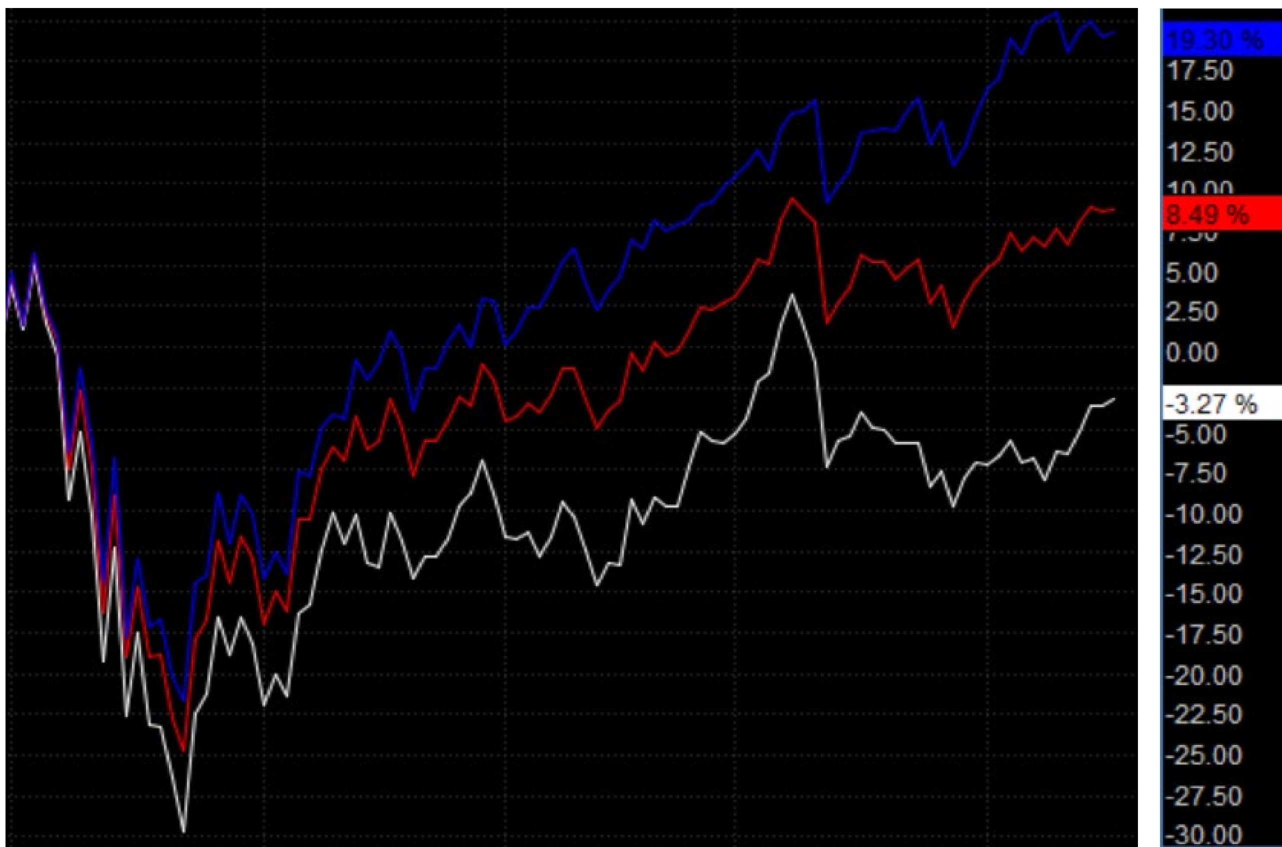
vulnerable. For the rest, social distancing need not impede economic functionality while we await a vaccine.

We wish to highlight and further flesh-out one other important item from our March 13 e-mail to our clients in which we outlined CCR Wealth Management's "game plan" in the face of the market-rout. We explained then that we would be placing a significant emphasis on "growth" equities relative to "value" equities going forward, using the significantly lower market prices to realize tax losses in many cases. Many clients likely saw swaps of mutual funds which had in their title "Equity Income" for funds which were more "Growth" oriented. In ETF trades, we swapped investments closely aligned with the Russell 1000 Value index, with ETFs closely aligned with the Russell 1000 Growth index (these Russell indexes serve as popular benchmarks for the large-cap "value" and "growth" investment strategies). Let us look at what these benchmarks have done over the last four months or so. Below is a chart of three ETF's which track the Russell 1000 Growth index (blue), the Russell 1000 Value Index (white), and the S&P 500 (red), which is comprised of both growth and value stocks. This is price-only data from the beginning of March through mid-July. As depicted, there is a dramatic 22%+ difference in the



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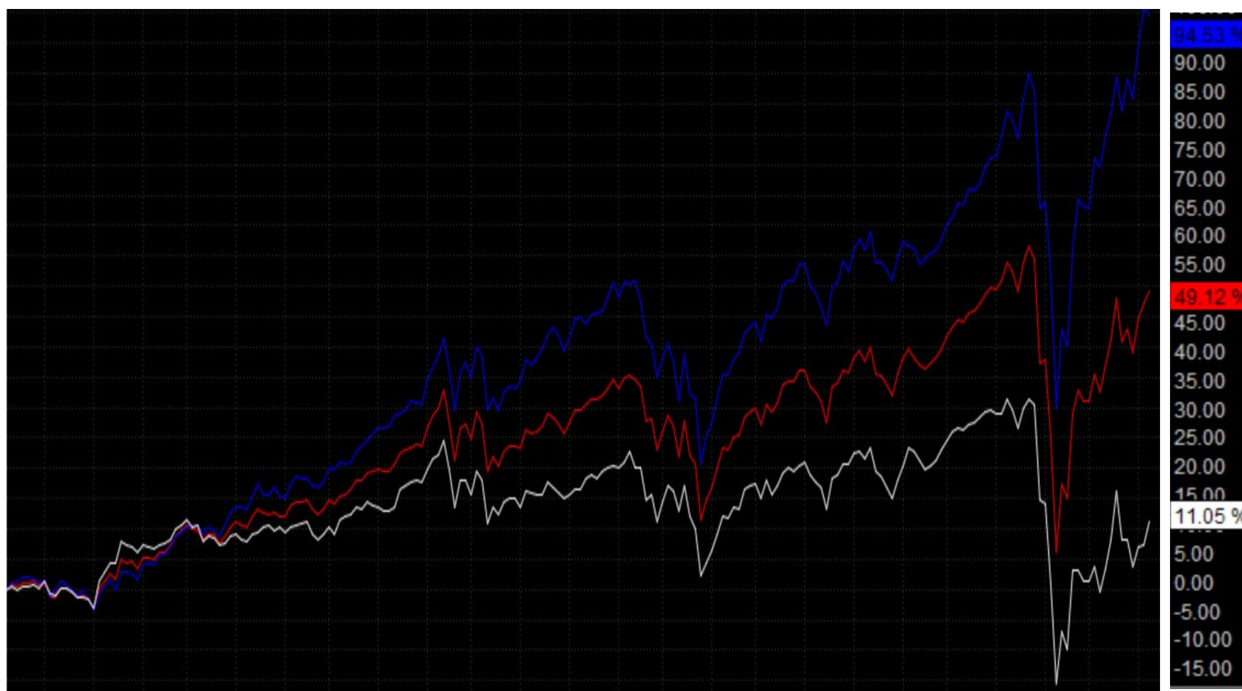
recovery rates of value-oriented and growth-oriented equities. Our anticipation of this disparity stems from two observations; cyclical history, and secular trend. The first, cyclical history, recognizes that growth stocks have a strong and persistent tendency to outperform their value counterparts in bear markets and recessions. This is not necessarily intuitive, however. The term "defensive" has been broadly (and in our opinion, incorrectly) applied to companies whose prospects, while less cyclical, still have high correlations with the broader economy. In fact, when economic growth vanishes, the tendency for investors has been to seek out any growth still apparent in the markets. As we have seen and pointed out in our April Outlook, plenty of growth-oriented businesses have proven virtually impervious to the shut-down economy. Some have even thrived.

The second observation concerns the secular trend of growth stock indices, which count among their constituents the major players in big data, cloud computing, artificial intelligence, e-commerce and fintech (financial technology). Perhaps equally important is the absence of fossil fuels, brick and mortar retail, commodities, and a banking sector reliant on the non-existent spread between long and short-term interest rates. The chart below clearly outlines the secular trend already in-place, even prior to the COVID-19 outbreak. It depicts the same three ETFs over the last four years (July 21, 2016—July 17, 2020). Again, these charts record price moves only,



Exchange-traded funds and mutual funds are sold only by prospectus. Please consider the investment objectives, risks, charges and expenses carefully before investing. The prospectus contains this and other important information about the investment company. Prospectus can be obtained by calling (add telephone number). Be sure to read prospectus carefully before deciding to invest.

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not the total return, which would include dividends. Our four-year look-back shows a cumulative 83.48% difference between large-cap growth and large-cap value—hardly a gap that can be bridged with dividends.
The themes surrounding cloud computing, big-data and e-commerce are, in fact, alive and well. The forced quarantine across much of the United States this spring offered technologies supporting videoconferencing, home delivery services and other less physically interactive activities (both consumer and business-related) a chance to shine. Much of these technological trends were already apparent in the markets, as the longer-term graph above illustrates. The COVID-19 shut-down, however, pulled our inevitable future trends into the present, which allowed for large segments of the economy to continue functioning. It is these trends, along with the prospects for Artificial Intelligence applications, 5-G communications adoption, and e-commerce dominance of retail which has driven our longer-term tilt to growth-equities over their value counterparts.

At the same time, it should be noted that the term “value”, as applied to an investment strategy, suggests price sensitivity. Valuations, and value judgements made by analysts rely heavily on fundamental analysis. Such analysis requires the discounting of future expected cash flows to arrive at an intrinsic value. Cash-flows (revenue & earnings) for massive portions of the global economy all but vanished in March and April, and since future cash-flows for many sectors remain in doubt well into the future, “valuation” has become guess-work in much of the market. CCR Wealth Management remains quite comfortable with our significant growth tilt given these factors. In time, it is inevitable that our economy will more fully open, and businesses will return to a more normalized environment. We do not subscribe to the full-on “new normal” narrative, and we expect there will be some fall-off in technological engagement—especially from consumers (a cyclical view). We will cross that bridge when we get there, but the *secular* theme will remain with us for years to come.

In the four and a half months since the brief (but significant) collapse of the bond market due to liquidity concerns, most bond market sectors have recovered to their pre-crisis levels, with two exceptions. While high-yield corporates (as measured by the ICE BofA High Yield Index) have climbed out of the March abyss, yields have yet to fall to their pre-crisis levels (yields and prices of bonds move inversely to each other), as shown in this chart from the St. Louis Federal Reserve.

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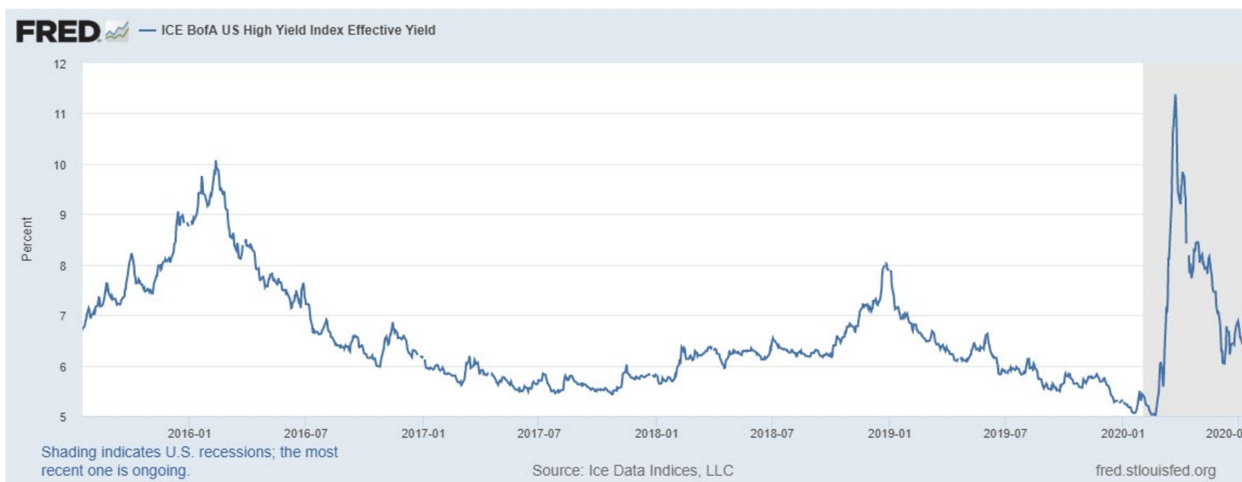

We think it is entirely likely that we begin to see an uptick in high-yield bond defaults in the coming quarter(s). We also believe many companies teetering on the cusp of the investment grade/high-yield BBB- boundary will eventually fall into the high yield category in the months ahead. CCR Wealth Management continues to steer-clear of discreet high-yield allocations in our bond portfolios.

The pace of bond-market sector recoveries has been largely dependent on the sectors' proximity to the Fed. That is to say, it has been dependent on the publicly announced asset purchase commitments the Fed has made. High Grade corporates, agency-backed mortgages, and even high-yield bonds have all been given the nod by the Fed that prices will receive some level of support by the Fed's buying. Noticeably absent among these categories is non-agency mortgage-backed bonds. CCR Wealth Management has some indirect exposure to this bond category, but we remain confident in the general quality of the sector. These are mortgage-backed bonds which originated before the financial crisis 10 years ago, and are considered "seasoned", with mortgage payers owning 40%-70% equity in their homes. As with high yield bonds, this sector has bounced significantly off the March bottom, however the pace of recovery has been slower due to the (as of yet) lack of signaling from the Fed in terms of purchases. In fact, we believe this sector is one of the few bargains left in the bond market.

As we outlined in April, our foray back into non-US stocks in late January took the form of a growth-oriented strategy which is concentrated in Southeast Asia and China. Despite allocating to this fund at the height of the COVID crisis in Wuhan, it remains one of our best performing equity funds year-to-date. Screens used in choosing this investment vehicle included many of the technology-oriented "growth" screens we have applied to our US portfolio. As in the US, these companies have done much to lubricate the V-shaped recovery we have seen so far out of the region, and China in particular.

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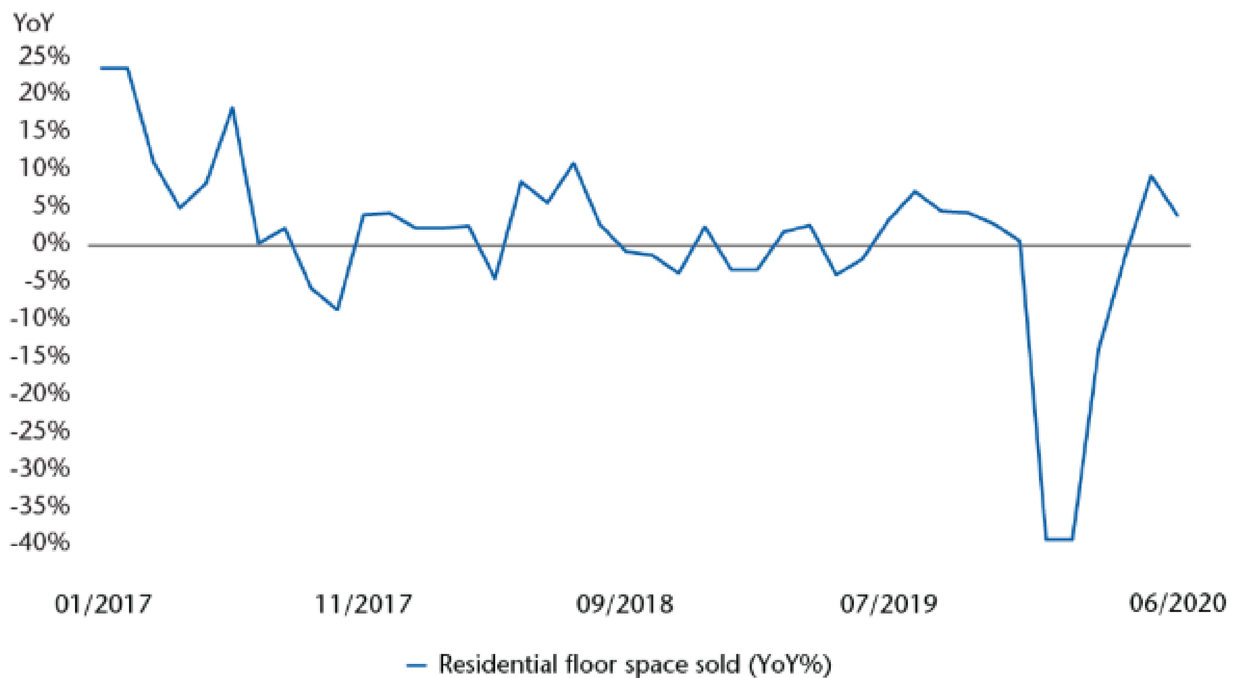
It is important for investors to update their views of China. Not only is China the second largest economy, behind the United States, but it is increasingly driven by consumer demand. In fact, 2019 was the eighth-consecutive year in which "consumer" and "services" together made up the largest percentage share of China's GDP. Consumer spending has bounced back significantly in China, with new home sales, auto, and retail spending—particularly e-commerce, leading the way. No, they are not back above the trendline yet, but it is noteworthy that the IMF (International Monetary Fund) forecasts China to be the only major global economy to grow on a year-over-year basis in 2020.

Figure 2. **NEW HOME SALES BACK STRONGLY**



Source: CEIC

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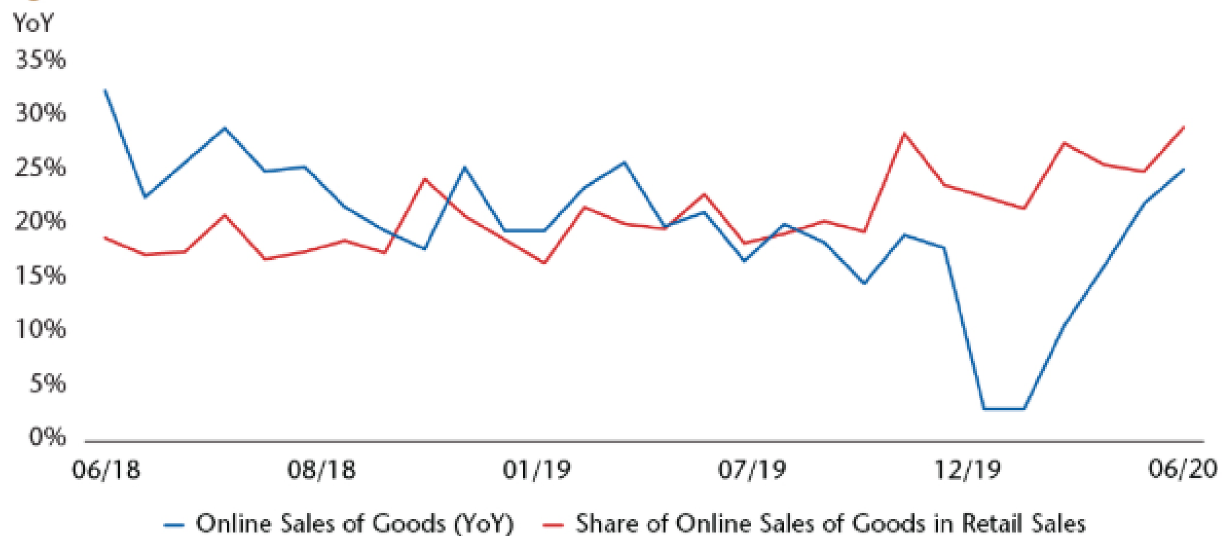

Of course, as it is in the West, conquering COVID (or at least keeping it under wraps until a vaccine is available) is paramount to a sustainable recovery. Here is where we see our Chinese exposure as an actual *diversifying agent*. While communist rule under a single-party system is anathema to most Americans', indeed most Westerners' sensibilities, there have been few questions regarding its effectiveness in tamping out the spread of COVID-19—***and herein lies the diversification benefit***. China's experience with the virus and with reopening, so far, stands in direct contrast to the US, which lies on the other end of the "political liberty spectrum". The chart below from Global Economic Data, Charts & Forecasts depicts China's COVID-19 experience, including the slight bump of resurgence in June.

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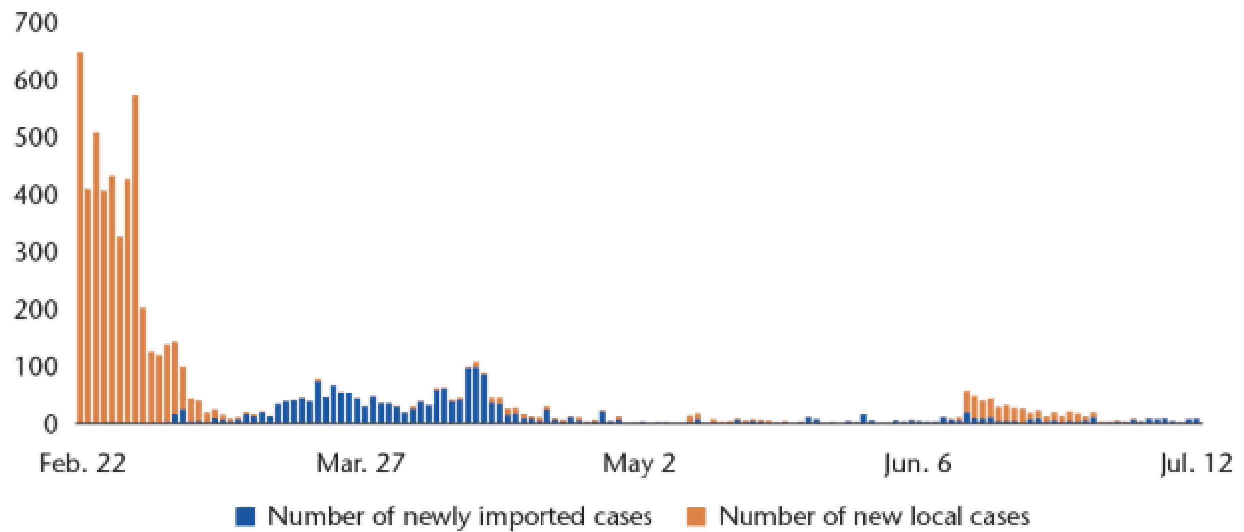

POLITICAL VIRUSES

Having trod into our virtually empty office-space every day for nearly four months, I was happy to get away for a couple of weeks recently to recharge. The chosen getaway consisted of a 23-foot RV, a loose itinerary of friends and destinations we wished to see, and a 13-month-old Thai Ridgeback named Ziggy for company and levity. We were reminded of a similar journey sixty years prior, and we spoke along the way of the similarities of our Travels with Ziggy with John Steinbeck's Travels with Charlie. Steinbeck's trek, of course, began in Long Island and ran counterclockwise around the country, beginning in Fall and concluding in Spring. Our own trek began in late June, and ran clockwise, traversing West Virginia, Kentucky, Nashville, Arkansas and Oklahoma--for respite, and a July 4th celebration with friends. Onto Santa Fe through the Texas Pan Handle, and up to the Colorado High Country to visit with family. Finally, back through Wyoming, Nebraska, Iowa, Indiana, Pennsylvania, and New York.

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Back by mid-July. We also doubt Steinbeck's *Rocinante* (the name he gave his make-shift RV) had anything close to the creature comforts we were afforded in our rented *Four Winds*.

One similarity between Travels with Ziggy and Travels with Charlie was that both occurred during a Presidential election year (1960: Kennedy/Nixon). Steinbeck set out to find a unifying American identity—we set out with no such illusions.

To say we are a politically divided nation is to say no more than what was said in 1960. In fact, it is to say no more than what was said in 1861, or in 1804—the year in which Vice President Aaron Burr shot former Treasury Secretary Alexander Hamilton in a duel in Weehawken, New Jersey *(in part, because of Hamilton's drubbing of Burr's character in the press, no less! Sound familiar?*). If an unexamined life is not worth living (Socrates), an unexamined history condemns us to ignorance. It seems that many live with a glorified vision of a national past in which the lions laid down with the lambs, and political comity was the rule rather than the exception--though such was never the case. On the other hand, a *rewritten* history offers nothing to learn from—though this seems to be a trend in some corners of society on the extremes of the political spectrum. Our travels took us across many red states, many blue states, and even a few "purple" states. We witnessed a variety of opinions and attitudes pertaining to both politics and COVID-19. In doing so, we gained a more nuanced perspective about why there is such resistance to the dictates of "authority" in much of the country. Distrust of politicians and the media was prevalent.

The more we learn about the virus' spread, the more it seems likely that the mask *must be* our new normal—but we have been slow in getting there. We firmly believe a more national adoption of facemasks is, in fact, occurring before our very eyes. The adoption will be owed to interest in self-preservation, both physically and economically—as widespread availability of vaccines is likely at least a year away.

As mentioned earlier, CCR Wealth Management's view is that another national shut-down, akin to the March-April quarantine, is highly unlikely. As if aiming to confuse, we have heard several media figures already pushing the "second wave" narrative when discussing the recent surge of

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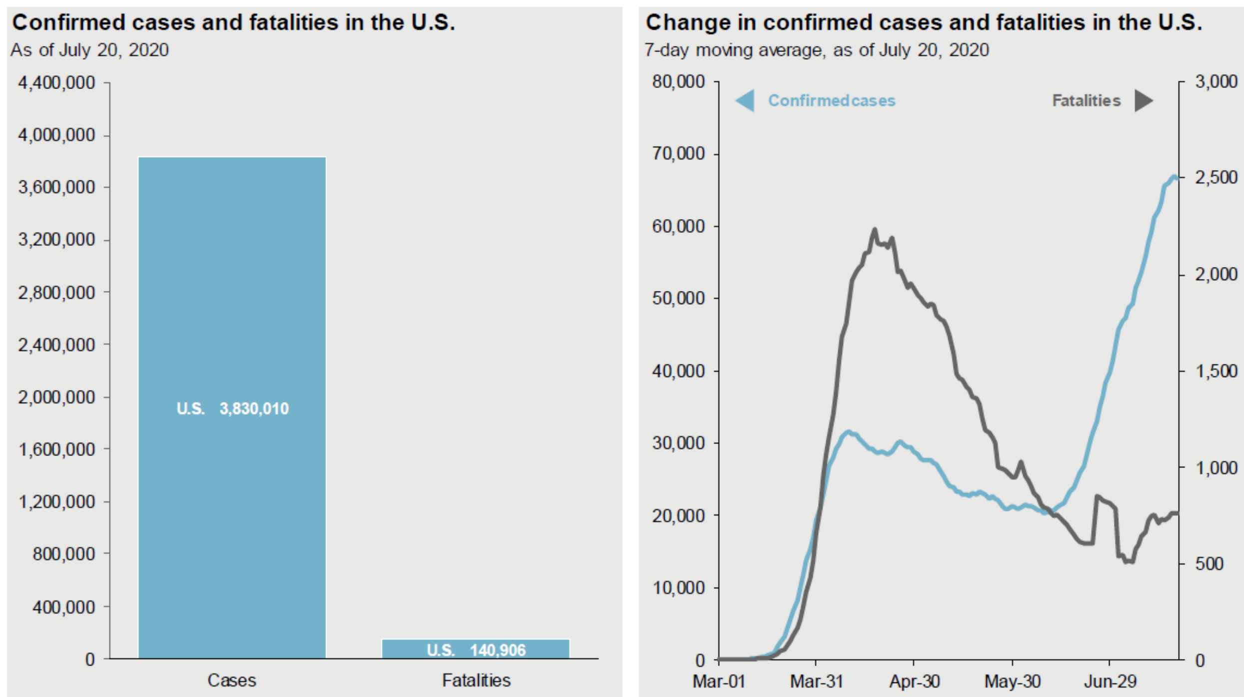
COVID cases is parts of the South and West. The “wave” nomenclature used so much in the media refers to our experience with the deadly Spanish Flu, the 1918 pandemic in which a second wave of illnesses ended up being more lethal than the first. In fact, we believe this virus will be everywhere on the globe, and there is nothing we can do to stop it. States seeing more recent spikes in cases are, for the most part, states which largely dodged the March-April surge. Patchy flare-ups are, as we have said, inevitable—as are restrictive steps taken by State and local governments to deal with them. But here again, confusion is sown—through the media—even by our expert “authorities”, which does not help engender trust and may be slowing our adoption of a common purpose. Former top FDA medical doctor Scott Gottlieb (who seems to have been enjoying a celebrity stint lately as a favorite media consultant) has clearly stated that the recent uptick in COVID cases undoubtedly constitutes a “second wave”, while Dr. Anthony Fauci has said we’re still “knee deep” in the first wave (because we never returned to base-line).

The good news is that we have made progress in treating COVID cases with experimental therapeutics like *Remdesivir* and *Dexamethasone*. Many more are in clinical trials today. These treatments have shown promise in severe and late-stage COVID-19 patients and have promised to increase survival rates and reduce hospitalization stays. Continued progress on this front, along with continued (and expanded) social distancing policies until we reach full vaccination make us confident in a continued economic recovery, though we will be dealing with this thing



Source: Johns Hopkins CSSE, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of July 20, 2020.

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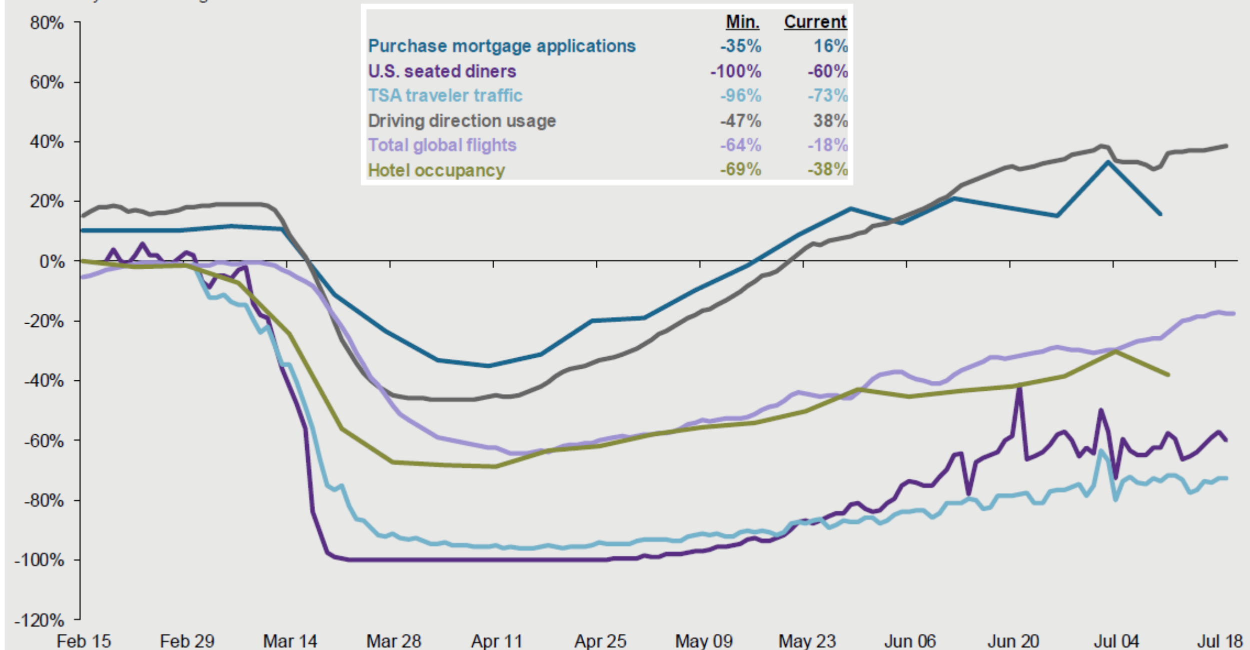
well into 2021. We think more nationally uniform behavior, acting with a common purpose, will eventually come about.

Gross Domestic Product (GDP) for the second quarter will be released on July 30, likely a few days after you read this Outlook. As we indicated in April, these numbers will be bad—*very bad*. Most of the country was shut down in April, and re-openings only began sporadically in May and June. Estimates are all over the place, but we expect something in the neighborhood of a 30% to 40% contraction in economic activity. In our view, we are still in a period where economic data like GDP tells us nothing. For that matter, corporate earnings are equally non-informative. We will see more consistent economic growth return to GDP in Q3, and especially Q4, though a return to the economic levels we were experiencing in February will likely take us well into 2022, or even beyond. High frequency data which maps micro-targeted economic indicators (data production which falls nicely into our growth-investment theme) shows that Americans have once again become mobile, and thirst for cheap mortgages. But while all indicators have shown improvement since our last Outlook hit your mailbox, the long slog will continue at a varied pace.

High frequency data



Source: Apple Inc., FlightRadar24, Mortgage Bankers Association (MBA), OpenTable, STR, Transportation Security Administration (TSA), J.P. Morgan Asset Management. *Driving directions and total global flights are 7-day moving averages and are compared to a pre-pandemic baseline. *Guide to the Markets – U.S.* Data are as of July 20, 2020.

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