the Connection

A Quarterly Review

1st Quarter 2020

LIFE IN REVIEW

Here in California, we have been locked away since the early stages of the Coronavirus Pandemic. This provided a lot of time for self-reflection. Gavin Newsom, at this point, looks like he made the right call. California has been the standard bearer for densely populated states. It appears we are flattening the virus curve, and we may be the first in operation when this is over. Our introspection begins here.

Why when the Coronavirus was announced in China did investors not see the economic fallout coming? We are now asking ourselves what we did right and what we did wrong as a country and as investors. In the next few paragraphs we will break down everything that happened from a market perspective by examining areas of strength, areas of weakness, and the learning experience that comes from both of these.

GenCap's natural predilection as investors is to buy companies that can maintain revenue growth. Where we went right, even when looking for dividends, is that we did not overreach into Financials, Energy or leisure/retail. We could have had a higher technology exposure, but that becomes difficult to find yield and growth. We also could have reached deeper into Healthcare, which has had its share of decent dividend payers. Healthcare companies were everybody's favorite political punching bag three months ago. Now they are every politician's best friend. Overall, our dividend paying stock portfolio was primarily saved because of exposure to lower paying dividends in the technology sector and a good allocation to Healthcare. In Comparison the Dow Dividend Payer Select ETF (DVY) was down 30%, and the Vanguard High Dividend Yield ETF (VYM) was down 25%.

The bond market suffered from the same collapse. We actually think the bond market will recover quicker than the equity markets, because bonds don't need to show growth. They just need to show that companies can pay their debt. We were examining passive and active income funds just to get an idea of how to grade ourselves. The more aggressive yield funds, like IShares Morningstar Multi-Asset Income Fund, which is less than 40% equities (should make it safer) was down over 20%. Vanguard's conservative growth fund was down over 8.5%. Much of the bond market outside of Sovereign debt and U.S. treasuries traded down in principal. During bad times, the spreads on yields between certain payments (treasuries) and uncertain payments (everything else) goes up. When yield spreads widen, bond prices go down. We do think this is an area of recovery however. The Treasury is going to backstop a lot of these bonds over the coming 18 months, and in doing so will probably end up making money on that backstop. In 2008 when the government rescued General Motors and some of the Financial Institutions, they ended up making a fair amount of money for taxpayers in doing so.

What can we learn from looking at the state of the market? We would say the first lesson, which is the first lesson of investing – don't invest in companies that don't have a ten year relevancy period. The second lesson, even when tempting, don't try to chase or reach for companies that have had their stock price cut in half and appear undervalued but have little chance for recovering their historic market significance. It turns out the outlook for financials and energy companies was too good to be true. We are not going to try to catch falling knives in industries where a recovery will take longer, or may never take place. The most recent example that we can remember is over-leveraged shipping companies in 2008, and offshore drillers in 2011. Those companies never made it back, and the ones that clawed back into some state of normalcy by the end of 2019 just got knocked back into oblivion. Oil will be around in 50 years, but whether it remains an economic asset, or simply an asset of National Security in the U.S. remains to be seen.

The last lesson, and one that we all know in the back of our minds. There is a reason why Microsoft is valued richer than Nordstrom's. Investors pay up for certainty and growth. There is a far greater certainty that Microsoft will be in business, growing, and profitable over the next ten years than Nordstrom's. The old ways of investing for safety need some rethinking. Dividend support for stock prices only makes sense if those dividends can be sustained, paid and grow.

We are Globalists. We believe in a companies' right to source goods and services from wherever it makes sense economically. However, necessities for survival should not fall under this category. Survival as a society deems that the federal, state, and local governments partner with their citizens and corporations to have the ability to survive independently. One of the glaring realities of Globalism is that North America is not currently capable of independent manufacturing of necessary goods. That needs to change. That is not to say we should scrap globalism. It is simply an admittance that we are lacking in supply independence. What we wrote about several weeks ago needs to happen. We need the ability to source everything we need from Panama to Canada. That doesn't mean we buy everything locally produced. What it means is that if we had to, we could. This could mean we build excess capacity that isn't used until necessary. And if our politicians and corporations get the message, we should begin work on this before the end of the year. This will go a long way to restarting the economy, and a long way to an establishment of a middle class. It should also spur inflation, and create new opportunities for social advancement and failure. The 0% interest rate environment has taken a lot of the risk out of investment. With interest rates so low, we can actually achieve this relatively cheaply.

The timeframe for an economic recovery domestically and globally remains difficult to forecast. What we do know is that once we see a flatting of the infection curve, people will be allowed to move more freely and commerce will return. The big question is how many small businesses get left behind. Larger corporations had deeper pockets to begin with and are able to rebound faster. Our enthusiasm for the U.S. equity market being the best place for long term growth remains strong. Excessively low interest rates and government stimulus will provide liquidity through the remaining crisis timeline. Once we are through that period, new economy businesses will lead opportunity for investment returns.

THE ACT OF GIVING

Below is an updated list of some organizations our clients are helping today.

All Local Food Banks
www.sfmfoodbank.org
www.shfb.org
www.foodbankccs.org
www.refb.org

Bloom Marin
www.bloom.org

Maya's Music Therapy
www.mayasmusic.org

Frien*ds of the Urban Forest*
www.fuf.net

Guide Dogs for *the Blind*
www.guidedogs.com

Doctors without Borders
www.doctorswithoutborders.org

The Nature *Conservancy*
www.nature.org

Nationa*l Kidney Foundation*
www.kidney.org

Guide Dogs of America
www.guidedogsofamerica.com

Golden Gate National Parks Conservancy
www.parkconservancy.org

Fine Arts Museums of San Francisco
www.famsf.org

Canine Companions for Independence
www.cci.org

Alzheimer's Association
www.alz.org

The Foundation for Rotary International
www.therotaryfoundation.org

Wildcare
www.wildcarebayarea.org

Homeward Bound of Marin
www.hbofm.org

Whistlestop
www.whistlestop.org

FINCA
www.finca.org

Sonoma Land Trust
www.sonomalandtrust.org

Friends of the Earth
www.foe.org

The American Friends Service Committee
www.afsc.org

Amnesty International
www.amnestyusa.org

Eastside College Prep
www.eastside.org

Northern Sierra Partnership
www.nothernsierrapartnership.org

American Bird Conservancy
www.abcbirds.org

The Cornell Lab of Ornithology
www.birds.cornell.edu

Mono Lake Committee
www.monolake.org

California Trout
www.caltrout.org

Tahoe Rim Trail
www.tahoerimtrail.org

Ocean Conservancy
www.oceanconservancy.org

Global Fund for Women
www.globalfundforwomen.org

Marin Agricultural Land Trust
www.malt.org

Walk to End Alzheimer's – San Francisco, CA
www.act.alz.org/sanfrancisco2019

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