March 31, 2020

Wenzel Analytics Inc

Clients,

The good news is that the S&P 500 recently went up 23% meaning that technically we are in a bull market. Whoever thought we would not be elated with a bump like that? However, volatility is predictable, and the rise is merely in line with previous volatility. It is too early to tell if the public infusion of funds will support the upward prices, or whether the continuing economic stress will cause a retest of the lows or take us even lower. The data are so far outside the norm that the typical models such as from Morningstar and Moody's don't have much to go on.

Of course, it would have been good to sell before the selloff. The preparedness of allocating to an up or down market worked great the first week or so. When the market was down 12%, we were down 5%. However, since that time the dynamics of the pandemic have overwhelmed normal patterns. Mostly my current strategy is in line with the advice coming from every advisor to advisors – ride it all the way through. To try to sell and buy again at the right time requires being right on both counts, which is difficult.

However, I have increased the cash allocation modestly thinking it is good to balance the probabilities of markets going up with the probabilities of further decline. All but one position in the Nate's Notes portfolio were sold because of its goal to exceed an up market; it wasn't beating the down market. We missed about half the recovery to date. I selectively sold a few other positions from the Exceed portfolios that had weak fundamentals or low dividend stability ratings. Dominos Pizza sold for a gain over 30%, depending on your purchase date; the chance of a decline seemed greater than that for continuing gains. A few positions were sold that had gains far exceeding the average for the week of the federal emergency legislation. Some were sold because they are candidates for the one-year dividend suspension required in the CARES act. Other general goals have been to preempt further decline, have cash to cover regular withdrawals, and have some dry powder for when the market has a more stable uptrend.

Total sales after the beginning market gap down on February 24 took a loss of 19% (realized losses) from their 1/1/2020 value (or purchase during the quarter). Comparable realized losses are -1.7% based on total assets. Most of these positions were sold at a gain from their original purchase.

My perception is that most big institutional investors support the President and accept his optimism, accounting in part for the bump last week. For example, Louis Navellier comments (March 31):

> *These big short-covering rallies make the likelihood of a market retest much less likely, plus there has been a lot of capitulation selling on high volume, which also makes a retest less likely. One other reason that the markets will not likely retest is that most of the credit market problems have been addressed, both by Congress and the Federal Reserve.*

In the same weekly newsletter Bryan Perry has an excellent article that is not as sanguine. (https://navellier.com/3-31-20-a-snap-back-rally-validates-some-key-sectors/) Personally, based on the public health experts and data, I think there is more damage to come which we will mostly ride down and back up. It is hard to tell how things will play out.

(Over)

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Rather than risk it all one way or the other, I've taken a balanced approach, witness the cash allocation:

Cash equivalents	21%	(Cash and precious metals)
Stocks-equity	47%	(Common stocks or ETFs; returns YTD about 5% above EQAL benchmark)
Debt-leverage	32%	(Preferreds, real estate, high-yield leveraged)

Cash equivalents are divided almost equally between cash and gold along with some other precious metals.

Typically, the bond or debt market is driven by dynamics different from equities and together they balance out. This unique decline is driven more by Main Street (economic factors) than Wall Street (financial factors). For example, fast food restaurants have been very volatile; usually they are considered good defensive stocks. The preferreds, sometimes referred to as baby bonds, have responded to the high-yield market. They have dropped dramatically, in large part because most of them are very illiquid. Many of the preferreds would go 15-20 minutes without a single trade. If a preponderance of sellers sell at market, either out of panic or because of a margin call, and there are no buyers, the price will not reflect the value of the security. It is like spontaneously requiring that a house listing sell today. The results will be exaggerated. Presumably the dividends keep coming; the amount of the dividend doesn't change with the price of the preferred stock. All of our preferreds are cumulative, meaning that even if a dividend is missed one quarter nonbankrupt companies must pay it later. Most prices have correlated with the high-yield market more than its common stock. Preferred prices have come back much more than for common stocks.

The real estate market has suffered more than I would have expected. Because of the tangible assets and the liberal Federal Reserve policies, I think it will prevail.

I have not sold any of the high-yield securities.

I've not been rebalancing accounts on an individual basis except for one client who was anxious and to ensure ample cash for those taking regular withdrawals.

The consequences of the virus, its impact on markets and economic activity as well as governments responses will continue to disrupt normal patterns and expectations. Required Minimum Distributions have been canceled; I have already taken mine. Those companies taking loans that prohibited dividends on common stocks will impact the retired person living on dividends, losing not only the dividends but the valuations based on the dividend. Will companies doing large layoffs be good investments or poor investments? There are many unknowns.

I wrote a piece on the lens through which we see things that left us so unprepared and will have us unprepared for the next pandemic. wenzelanalytics.com/HealthFinance

Hope you are well and stay safe!

Lee