

# Protecting Your Financial Future in Today's Market

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Today we are facing one of the most significant economic declines as a direct result of an unprecedented global health crisis: COVID-19. Nothing has prepared our country for this pandemic economically or health-wise, and no country is left immune. Why this crisis is so detrimental to the global economy is that it is operating in an environment with a high degree of uncertainty. Contributing drivers such as the shortage of COVID-19 testing and no viable vaccine continue to widen existing health gaps and have forced the U.S. government to institute social distancing policies with the intent to help control the spread of the virus and strain on the health system. Past actions and current circumstances will continue to impact the demand for goods and services and drive even greater pressure on the earnings of businesses both large and small. For or against these government actions, which are centered around the country's health of its citizens, is not the debate of this paper. The focus of this paper is to educate on actionable steps to protecting one's financial future in today's uncertain time.

In order to properly understand the different types of risk and how to potentially address them, the following topics will be examined:

## Key Topics

- **Where We Were:** The U.S. economy prior to the COVID-19 pandemic
- **What Changed:** How COVID-19 spread globally and the U.S. government's response
- **Where We Are Now:** The current U.S. health guidelines and economic status
- **How History Can Guide Us:** Government spending's impact and market recovery spans
- **Key Takeaways:** What information can be utilized to base future financial decisions
- **Action Steps:** What you can consider doing today to protect your financial future

## Where We Were

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As recently as February 2020, the U.S. markets were viewed as 'normal' by investors and the U.S. economy was considered 'strong' after 2019's trade negotiations restored investor confidence. It was a time for investors to enjoy a recovering economy, compared to The Great Recession, only twelve years prior. The Standard and Poor's 500 (S&P) was steadily advancing upward, and all indications were that the U.S. economy was trending in the right direction:

- The S&P 500 hits an all-time high: 3,386 (Yahoo! Finance 1)
- Unemployment was at a 50-year historic low of 3.5% (Vickery)
- 10-Year Treasuries were at historic lows (Oh)
- The Federal Reserve predicted a 2% growth for 2020 (Amadeo)

### Normal S&P 500 January 1, 2010 through February 28, 2020



Source: Yahoo! Finance Interactive S&P 500 Chart (Yahoo! Finance 1)

## What Changed

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Even though there were signs of economic slowing throughout 2019 for both the international and domestic markets, the upward market performance during the first quarter of 2020 painted the picture of a strong U.S. economy. This discrepancy created mixed market signals, leaving investors unprepared for what was to come next, as COVID-19 started to spread throughout the world in early 2020.

Governments in multiple countries started responding by issuing initiatives to protect the public's health. Travel restrictions between countries and regions implemented as emergency health measures to combat COVID-19 proved that the virus was relentless. The world watched as lives were lost and global economies started to tumble. It appeared that no country was prepared to combat the virus as mass numbers of victims emerged, regardless of their health condition. As this virus spread, the young and healthy were not immune, nor were the rich, famous, or otherwise.

Meanwhile, here in the United States, the S&P 500 peaked at 3,386 as the U.S. seemed unaware that COVID-19 would also soon impact its shores. Unfortunately, less than 60 days later, the U.S. entered the 'Health Phase' of response to COVID-19. Investors responded to COVID-19, and the S&P 500 suffered the fastest historical decline ever recorded, losing 34% of its value over two weeks (Yahoo! Finance 1). The velocity of the decline required trading to be suspended on multiple occasions as a loss prevention measure. Soon after, trading was no longer happening on trade floors or by electronic trading.

## COVID-19's Timeline

- 12/31 China announced the first cases of COVID-19
- 1/11 China reported the first official death
- 1/21 Multiple countries, including the U.S. confirmed new cases of COVID-19
- 1/30 The World Health Organization (W.H.O) declared a global health emergency
- 2/2 First COVID-19 death outside of China
- 2/14 First COVID-19 death in Europe
- **2/19 S&P 500 closed at all-time high: 3,386**
- 2/23 Deaths in Italy spiked to 132
- 2/29 First U.S. death from COVID-19
- 3/11 The W.H.O declared COVID-19 a global pandemic

*Source: NBC News "Coronavirus timeline: Tracking the critical moments of COVID-19"*

## How the U.S. Government Responded

### Part 1: Health

At the end of February 2020, The U.S. administration issued travel restrictions and warnings covering countries in Europe and Asia. An \$8.3 billion emergency health spending package to fight COVID-19 was approved, and two days later, new travel restrictions were announced for 26 additional countries.

In mid-March, President Trump declared a national state of emergency and extended travel bans to Ireland and the United Kingdom, social distancing advisories were implemented in multiple states, discretionary travel was halted, and 95% of Americans in 42 states found themselves under a COVID-19

lockdown. All were measures to help curb the loss of American lives. Americans started working from home, or not working at all, and the stock market tumbled as the reality of a collapsing economy began to sink in (Muccari and Secon).

## Part 2: Economic

On March 27<sup>th</sup>, 2020, the U.S. government responded to COVID-19 with The CARES Act (The Coronavirus Aid, Relief, and Economic Security Act), a \$2.3 trillion stimulus bill to help sustain the U.S. economy. Topping the responsive spend was stimulus for businesses in the form of loans and grants, expansion of unemployment benefits, one-time checks for all Americans, and disaster assistance for state and local governments and healthcare initiatives (CFRB).

### CARES Act Breakdown

Expand & Extend Unemployment Benefits	\$260 billion
Issue One-Time Checks	\$290 billion
Provide Small Business Loans & Grants	\$377 billion
Support Loans & Guarantees for Businesses & Governments	\$510 billion
Support State and Local Governments	\$150 billion
Increase Health-Related Spending	>\$180 billion
Support the Safety Net	\$42 billion
Increase Disaster Assistance	\$45 billion
Increase Education Spending	> \$32 billion
Support Transportation Providers & Industries	\$72 billion
Reduce Individual Taxes	~\$20 billion
Cut Business Taxes	~\$280 billion
Other Spending	>\$25 billion
<b>TOTAL ~\$2.3 trillion</b>	

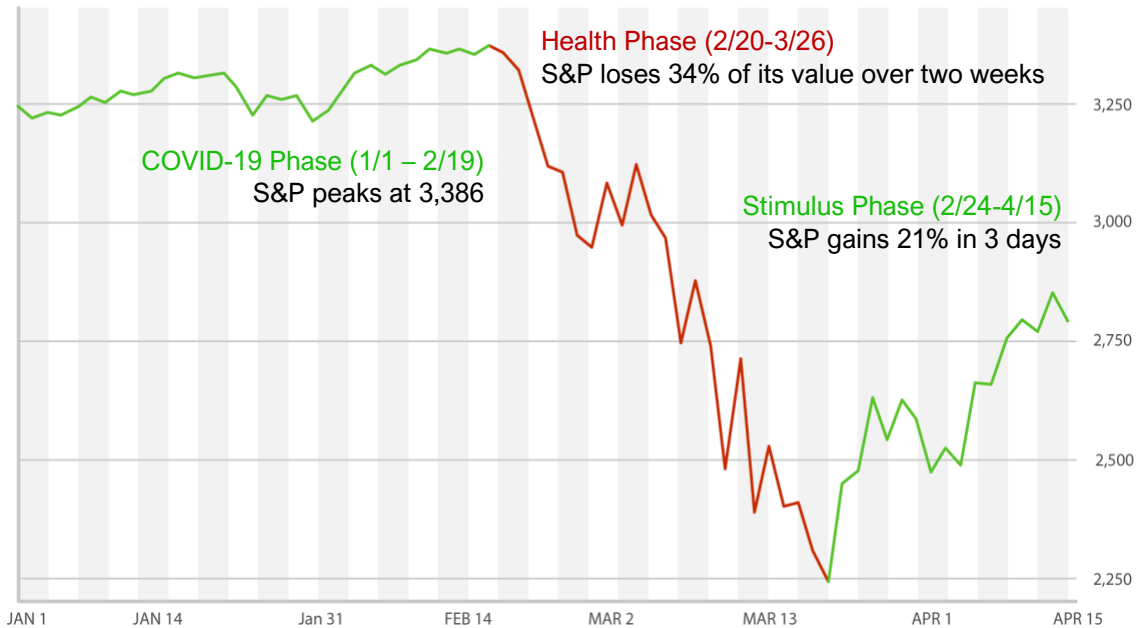
Source: Committee for Responsible Budget (CFRB)

The government actions related to passing the CARES Act were the catalysis for the S&P 500 to respond positively, tracing back up 21% in just three days. However, these historical moves only left investors with additional uncertainty, as the market reacted in unexpected ways. Historically, rising unemployment has caused the markets to drop in value. Yet, that did not occur; instead, it left investors speculating and wondering if this change represented the new “normal” (Yahoo! Finance 1).

Volatile markets then reacted in unexpected ways:

- **March 26<sup>th</sup>, 2020** - 3.3 million new applications for unemployment, the S&P 500 rallies 6.24% (Long and Fitzgerald)
- **April 14<sup>th</sup>, 2020** - Unemployment reaches 17 million, the S&P 500 rallies 3.06% (Zaroli and DeCambre)

## S&P 500 January 1, 2020 – April 7, 2020



Source: Yahoo! Finance Interactive S&P 500 Chart (Yahoo! Finance 1)

### Where Do the Markets Go from Here?

The unknown future impact of the coronavirus, coupled with market confusion, leads to many differing opinions on how the markets might recover:

#### U RECOVERY

**“I don’t think it’s going to be rapid. We’ll probably have to restart activity fairly gradually and there may be subsequent periods of slower activity again.”**

*Ben Bernanke, Former Federal Reserve Chairman  
April 7, 2020 (Miller)*

#### V RECOVERY

**“I think a ‘V’ is possible, but I am worried that the outcome will be worse, and it really depends to my mind on just how much damage is done during the time the economy is shut down in the way it is now.”**

*Janet Yellen, Federal Reserve Chairman  
April 6, 2020 (Cox)*

#### W RECOVERY

**“How long and how deep it's going to be, we really don't know. And this one is unique in that ... its root cause is a pandemic, and because it is the actual economy itself pulling down the financial markets.”**

*Paul Kaplan, Morningstar Research Director  
April 21, 2020 (McCormick)*

# How History Can Guide Us

## Market Recovery Spans Vary

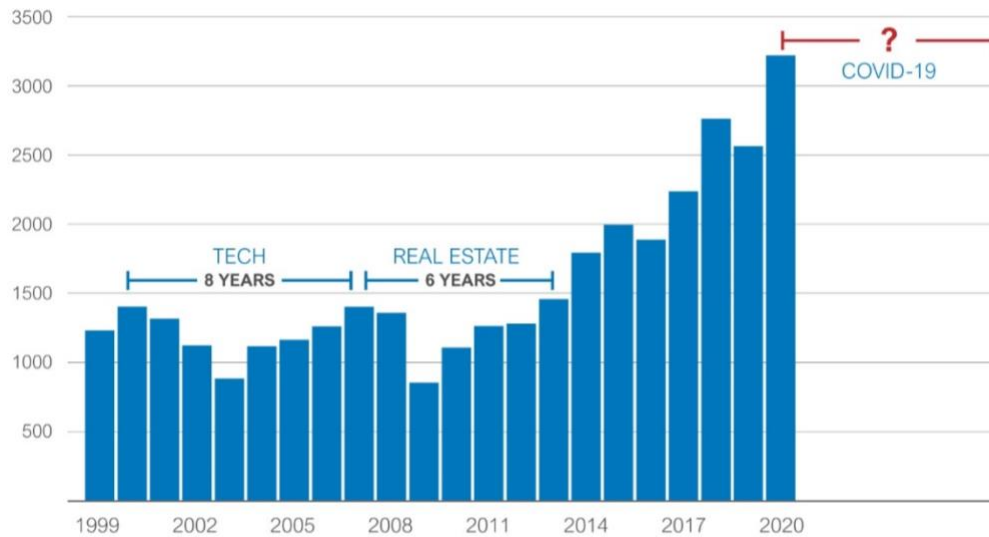
Investors need to be aware that true market recovery occurs when prices fully return to the peaks they had reached, prior to the decline in market value. Investors can often be confused by headlines declaring that a market is out of being in a “bear market.”

The following are important technical terms to understand:

- “Bear markets”: Defined by a decline of 20% or more. (Fidelity)
- “Bull markets”: Defined by an increase of 20% or more. (Fidelity)

The chart below illustrates different historical stock market events that moved into an official bear market, but more importantly, the data communicates the time difference between a market coming out of a bear market “technically,” versus the market recovering to a full “price” recovery. This is a major takeaway for all investors, as not all crises are the same and recovery times are complex. Investors should plan accordingly by looking towards a longer time frame for “full price” recovery.

### Years to Recover to Previous All-Time High



Source: FT Portfolios “History of U.S. Bear & Bull Markets”

## Future Earnings Influence Price Recovery

The U.S. economy is driven by consumer consumption and with 95% of Americans ordered to stay-at-home as early as April, it has quickly crushed the majority of both large and small business across the

country (Secor). Historically, when certain sectors are impacted negatively, it has reflected in share prices, while other uncorrelated sectors have performed strongly. COVID-19 has impacted every sector, which has never been witnessed on a similar scale before.

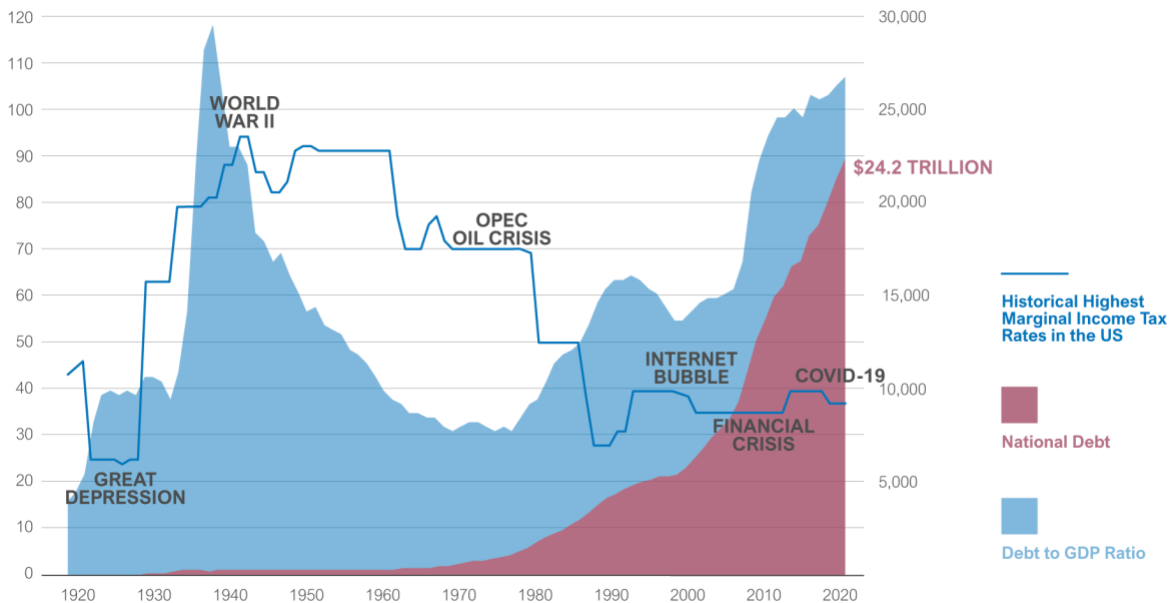
## Government Action Comes with a Price

Another consideration for investors is the long-term impact of government actions relating to economic support during falling markets like COVID-19. What history can teach us is that these types of actions come with a price, usually in the form of higher taxes. The reality is that taxpayers will more than likely carry the burden of paying off the level of debt that the government has created.

They are several points to consider when examining government spending, tax rates and national debt:

- World War II: After the Great Depression, the U.S. officially entered the war and the national debt quickly rose, but the Debt/Gross Domestic Product (GDP) ratio climbed to 119% in 1946. During this time the government raised taxes in the highest tax bracket level to 94%.
- Tax rates are raised by the government above 70% for over 40 years (1940-1981).
- The 2020 U.S. debt reaches 24.2 trillion and the Debt/GDP ratio is estimated to be 106%.

## Income Tax versus National Debt: 1929 through Q1 2020



Source: Investopedia "A Brief History of Taxes in the U.S." (Fontinelle) and The Balance "U.S. National Debt by Year Compared to GDP and Major Events" (Amadeo)

Fundamentally, when you begin to raise taxes you are taking away purchasing power from the consumer, which is the driving force behind the U.S. economy. The typical response to raising taxes is a drag on the U.S. GDP, with a possible result of a shrinking economy.



For example, during the Great Depression and into WWII, the U.S. experienced historical debt and tax levels, at a time when tax rates were held by the government above 40% for over 40 years. Some additional outcomes from this period included higher-interest rates, higher prices, and a broader displacement of class between the rich and poor (Fontinelle).

Using history as a benchmark and comparing to where we currently stand, the U.S. now carries close to \$24.2 trillion in debt with a 106% Debt/GDP ratio (PGPF). Our Debt/GDP ratio indicates that the U.S. owes more than it produces or exports and consumes domestically. Because an economy can only truly recover by producing and selling more than it spends, COVID-19's social and economic impact implies uncertainty for the U.S. based on its 'upside-down economy.' As investors plan for the future, the probability of high taxes seems almost a certainty.

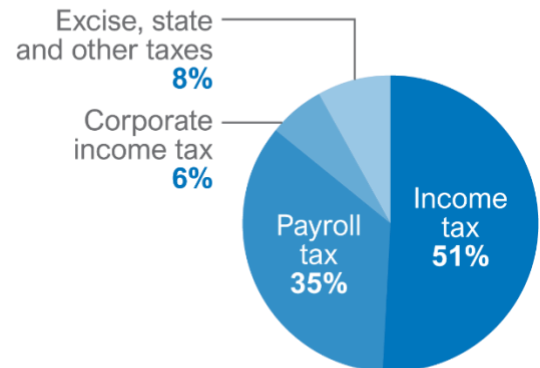
### Can Need for Tax Revenue be Offset by GDP?

When examining this question under the current economic conditions, it places more pressure on the potential need for the government to look at different areas in which they can tax to increase overall revenue.

The following are the four main sources of federal tax revenue, with their associated percentages.

1. Personal: 51%
2. Payroll: 35%
3. Corporate: 6%
4. Other 8%

### Sources of Federal Tax Revenue, 2018

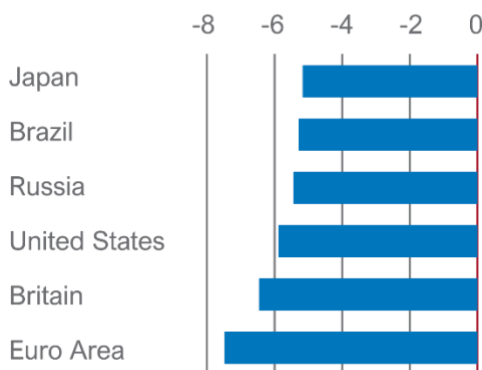


Note: "Other Taxes" category includes profits on assets held by the Federal Reserve.

Source: Office of Management and Budget

### GDP Forecasts

2020, % decrease on a year earlier



Source: IMF

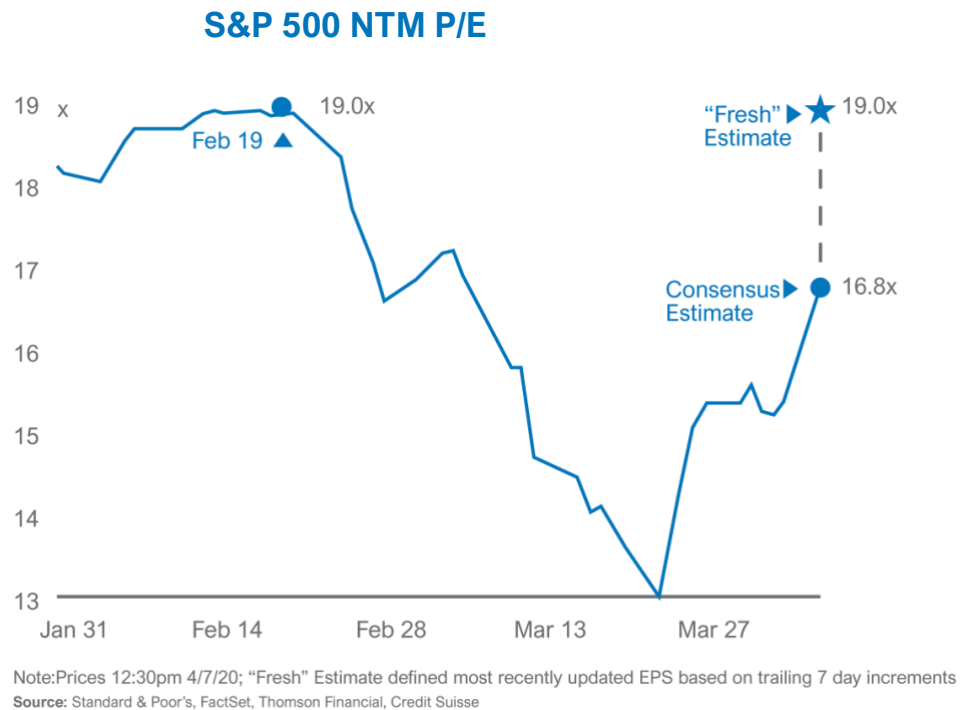
So how does GDP play a role around a potential increase in future taxes? At the beginning of 2020, the Federal Reserve projected a growth rate of 2.0% for the overall U.S. economy. This growth rate would have continued to support the forecasted revenue for the government, until the COVID-19 crisis, which has significantly altered 2020 GDP projections. It is now projected that all major economies will experience a decrease in GDP, with the U.S. suffering close to a -5% decline. This type of pressure coming from a lack of overall output, combined with so many unemployed Americans, will likely force the U.S. and other countries to look at raising taxes to maintain government operations (The Economist.)

## Will Reduced Economic Activity Impact Markets?

If the projected GDP forecasts are accurate and the job market stays in its current status, this will be reflected in the ability of many companies to post projected earnings that will inevitably impact the PE ratio that is used to help establish the stock price of publicly traded companies.

The graph below illustrates that at current trading levels, the market price represents the same multiples recorded at the peak of the market on February 19<sup>th</sup>, that being a multiple of 19x. There are many economists and trading professionals who believe this number is not representative of what is actually taking place, and that the multiple should be closer to 16.8. Additionally, they note the potential for this number to move lower in the months to come.

As the earning seasons continue to roll out, it will be important for investors to understand what this could mean to the future value of different investments that they have in the market.



## Key Takeaways

### What We Know

Unknowns include not knowing when social distancing guidelines will be lifted, when domestic and international travel can resume, how the market's price valuations will recover, future unemployment

rates, and how much our economy can recover? No one is sure what type of recovery to expect or when it will happen. What investors do know to be certain:

- Solutions to the Coronavirus are still unknown.
- The COVID-19 market recovery time span is unknown.
- There is a cost to rescue economies.

## What We Can Control

Investors can and do have control over an important element in the equation, which is their own emotions and how they respond to market crises such as COVID-19. So, the question comes down to how best to execute at a time when it can be emotionally difficult to stay committed to a long-term plan.

One of the easiest ways an investor can create an environment for staying emotionally strong is by establishing a solid foundation inside their portfolio. This can be accomplished by allocating the proper percentage of investable assets to investment vehicles that have certain features and benefits that address the critical types of risk:

### Features and Benefits of Principal Products

Risks to Retirement Income		Principal Protected Products Solution
<b>Market Risk</b>	Loss of principal value can decrease investment capital.	Principal protection provides a buffer against stock market fluctuations.
<b>Inflation Risk</b>	Investments not optimally positioned to address the rising costs of goods and services will deplete a portfolio.	Allocating to “safe money” products allow asset allocation strategies to address inflation.
<b>Taxes Risk</b>	Increased taxes erode the investment capital; the investment type and timing are critical.	Leveraging tax-free investment strategies increases investment capital.
<b>Longevity Risk</b>	Investment capital isn't enough to supporting longer lives and long-term care needs.	Utilizing “income for life” features address longevity risks and long-term care risks.
<b>Survivorship Risk</b>	Unexpected loss of a life-partner can lead to lower investment capital.	“Death Benefits” provide a tax-advantaged mitigant against untimely death.

## Action Steps

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So, how do you go about protecting your financial future and establishing a plan that properly addresses the different risks to your retirement income in any type market condition?

As complicated as it might seem, especially during times of crisis like COVID-19, establishing this type of plan requires a complete and intelligent conversation around defining the appropriate portfolio allocation. To do so, investors should consider their own risk tolerance and timeline to retirement. Investors can further determine the proper allocation in their retirement portfolio by answering the following questions:

- How much risk can I afford to take?
- How much risk am I willing to take?
- When do I start taking money?
- How do I create a tax-efficient retirement plan?
- How do I address longevity risk inside my portfolio?
- How do I protect my retirement income from long-term care needs?

COVID-19 will impact our economy and markets over the coming months and years. For this reason, it is critical that investors consider their retirement portfolio's allocation and prepare to protect their financial future during today's volatile market environment. This will prepare their portfolio for future possible COVID-19 scenarios. If you are nearing or in retirement, it is important to consider acting now.

“The best way to measure your investing success is not by whether you're beating the market, but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go.”

- Benjamin Graham  
*Author of The Intelligent Investor*

**If you would like to learn more about your retirement portfolio's allocations, please schedule a complimentary, no-obligation Strategy Session with:**



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