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Harman Wealth Market Bulletin

Examining Expectations from Here

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Now that the unimaginable has hit, let's take a look at what to expect from here.

Summary:
On March 12th, portfolios were moved to "capital preservation" mode with an emphasis on (a) maintaining capital, (b) preventing long-term impairment, and (c) adding further protections in a quickly evolving high risk environment. This was consistent with our long-standing investment policy discipline. Now, we must stop and assess what to expect since the U.S. has moved to implement far-reaching containment efforts.

DEFINING THE REALITY WE ARE IN

A Healthy Reminder: The Coronavirus Spread Will End.
As emotionally disrupting as the last two weeks have been, it is important to stop and remind ourselves the coronavirus spread will end. Either by (1) successful containment measures, (2) new medical treatments, or (3) simply the change in weather towards summer, the spread of the coronavirus does have an end date. The problem we now deal with is we don't know when the outbreak peaks and life can start moving back towards normalcy.

Containment is Still Necessary.
There is a lot of criticism regarding the proportionate response based on the statistical threat that coronavirus presents. However, for countries committed to stopping the spread, containment efforts will continue to be enforced to greater degrees.

Despite our unhappiness with closures, it is a simple fact that social distancing really does work. Obviously, disease cannot spread between people who are not in contact with each other.

Other countries around the world are already ahead of the U.S. in implementing closures. As numbers increase (and they will), we will likely see more closures and restrictions in the US in the coming weeks.

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Containment has Economic Consequences.
While last week's closures and suspended events were shocking to or senses, the more dangerous impact is to the economy. Quite simply, ripple effects are being felt across various industries and sectors.

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SECOND ORDER EFFECTS.

Every action has a consequence, and each consequence has another consequence. We are most concerned about the developing second order impact to the U.S. economy and the risks that may come to bear.

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Economic Pain is Coming.
The economic consequences of containment efforts will start showing up this week. This is not a fear-based statement, but a reality-based one. Here is where we expect the hits to start appearing:

Increased Unemployment.
Due to the cancellations in the travel industry alone, unemployment data will increase significantly. There is also a wide ripple effect to related business such as restaurants, bars, non-durable goods, etc. Furthermore, it is easy to assume many businesses will begin a hiring freeze as long as uncertainty remains high.

Decreased Manufacturing Activity.
The clear impact to demand means producers must immediately start slowing down. Survey data will begin reporting this coming week. Our expectations are for declines consistent with pre-recessionary levels.

Decreased Retail Spending.
Retail spending will decline at both big and small levels. Large purchases like homes, autos, and major appliances will get deferred as consumers deal with the immediacy of what's going on. Smaller-level purchases will shrink simply due to the lack of availability caused by closures. Secondarily, gasoline prices have plummeted, and this too will create a year over year decline in revenue

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Further Major Policy Support is on the Way.
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More Monetary Policy Action.
Over the weekend, the Federal Reserve exercised a bold move to lower rates back down close to zero percent. As further diminished activity is revealed, the Fed will examine new versions of quantitative easing.

New Fiscal Spending.
Congress is already underway with pushing through a coronavirus emergency aid package that may include additional support for strained industries and small businesses. Legislators are also likely to push a payroll tax cut for wage earning Americans.

More Market Volatility to be Expected.
The highly volatile daily market moves are likely not over.

Push/Pull Effect of Good News and Bad.

A series of bad data days lie ahead. Metrics will likely plummet to levels consistent with past recessions and shake confidence. On the other hand, new supportive policy moves will embolden investors to maintain faith. This battle on sentiment will continue until things stabilize.

Because the coronavirus numbers will likely worsen before getting better, uncertainty will remain high for a considerable time. Furthermore, it will take a couple of months to evaluate the damage assessment to the real economy.

History's Example.

There is little historical precedence to look to and learn from when it comes to major market moves of this type. However, in 1987 it took two-to-three months of sideways activity before markets generally stabilized. In the shock of 2011, a similar path emerged from August through December.

Expect Months of Volatility, not Days.

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Two Potential Paths to Consider.

Even though the clouds of uncertainty remain thick, we are moving forward with two potential paths that merit consideration.

Scenario One: A Quick Recovery.
If the viral outbreak reaches containment early and the economy can resume normal functioning, the chances of recovery look favorable. Pent-up demand and policy stimulus could unleash a huge wave of consumer spending, assisting both markets and the economy to a robust recovery.

Scenario Two: Prolonged Containment Leads to Higher Risks
Prior to the outbreak, this was a tired, old expansion with pre-existing vulnerabilities. If the outbreak is prolonged and containment is slow, then those vulnerabilities could be exposed. Lost wages result in lost corporate earnings. Both consumers and companies, under financial pressure, could easily fall behind on loans. Banks, responding to rising defaults, would then begin to tighten standards and siphon off lending. And, even though interest rates are low, consumer spending grinds to a halt.

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What to Expect In "Capital Preservation" Mode

Because of this, we will stay in capital preservation mode until we assess that the risk environment declines.

Our Goal: Maintaining Capital Until Risk is Lowered
Under current circumstances, we gauge core economic risk to be high. The expected result is continued market volatility and potential exposure to further sizable declines as stock prices adjust to the changing economic situation. Because of this, we will remain in capital preservation mode until we assess that the risk environment declines.

Current Allocations
At present, portfolios consist of allocations to (1) cash sweep accounts, (2) bond funds targeted at high quality bonds, and (3) hedged alternatives. Because of the bonds and hedged alternatives, there can still be small daily moves in portfolio balances.

Minimize Risky Bets
Now is not the time to make risky bets. The near-term future is far too uncertain. Our mindset is geared towards preserving capital and looking for investments with historical reliability as a place of safety.

Rigorous Monitoring
Obviously, our existing monitoring systems are helping us incorporate new data as it is released. We will continue to evaluate a wide range of investment considerations as the situation continues to evolve.

Interested in Adaptive Business Cycle Investing?

Today's markets, economies, and policies are more complex than ever, challenging investors on what to watch and when to take action.

At Harman Wealth Management, we understand sound investments are uniquely supported by the conditions that favor them. And, when conditions change, so do the investments that benefit.

That's why we conduct rigorous and disciplined tracking of the U.S. business cycle. We also track the cyclical factors that shape our investing environment, like currencies, commodities, and rates. We embrace a world where investing dynamics are constantly evolving and believe it's imperative to have an investment strategy that adapts with it.

With Adaptive Business Cycle Investing we invest consistent with business cycle forces, aligning investments with the conditions driving returns in the present, rather than chasing what worked in the past.

About Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to integrative advanced planning by aligning investment objectives with business cycle opportunities and risks.

At Harman Wealth Management, our aim is to help clients realize their goals within a disciplined, insightful, and rewarding relationship.

For more information about Harman Wealth Management or investing with the business cycle, contact us at 281-719-8601.

Disclosures:

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Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values. Past performance is no guarantee of future results. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.

Please note that individual situations can vary. Therefore, the information presented here should only be relied upon when coordinated with individual professional advice.

The Standard and Poor's 500 is an unmanaged index generally representative of the U.S. stock market and cannot be invested in directly.

In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Bonds are also subject to other types of risks such as call, credit, liquidity, interest rate, and general market risks.

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