Investor Insights & Outlook

July 2020 2nd Quarter Concorde Investment Management

Domestic and International Economic Overview

A Message from Concorde Investment Management

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Last quarter we combined the domestic and international sections to discuss activity and in this letter we'll discuss some of the economic impacts only to highlight the depth of this impending recession. We also want to share some information and analysis that we can't seem to find in major publications that might give some context to the Coronavirus.

So, what happened during the 2nd quarter with regards to economic activity? Bloodbath seems to be an apt description. Largest GDP contraction on record at an annual rate of -32.9%. 51.1% of households experienced a loss of employment income for the week ending 7/21. The 2nd largest contraction was 1/3 of this most recent quarter back in Q1 of 1958 at an annual rate decline of -10%. Not surprisingly, during self-imposed lockdowns, economic activity ground to a halt. If a business requires in person activity, outside of grocery stores, it was an absolute brutal quarter. A few points to show just how deep the decline in economic activity was along with a couple of points that actually benefited from the lockdowns:

- The TSA tracks daily passenger counts in the U.S. which bottomed on April 14th, clearing just over 87k passengers. On the same day in 2019 they cleared 2.2mm passengers.
- There have been numerous bankruptcies thus far and predictions for mega bankruptcies (more than $1B in debt) will easily set a record this year and large bankruptcies (between $100mm and $1B) will challenge the record set in 2009 after the financial crisis. So far, the list includes well know names such as Diamond Offshore, Whiting Petroleum, J Crew, Gold's Gym, Neiman Marcus, Hertz, GNC, 24 Hour Fitness, Chuck E. Cheese, Brooks Brothers, and many more.
- Restaurant activity ground to a halt with most restaurants only able to survive on to go orders, and even that respite is likely temporary.

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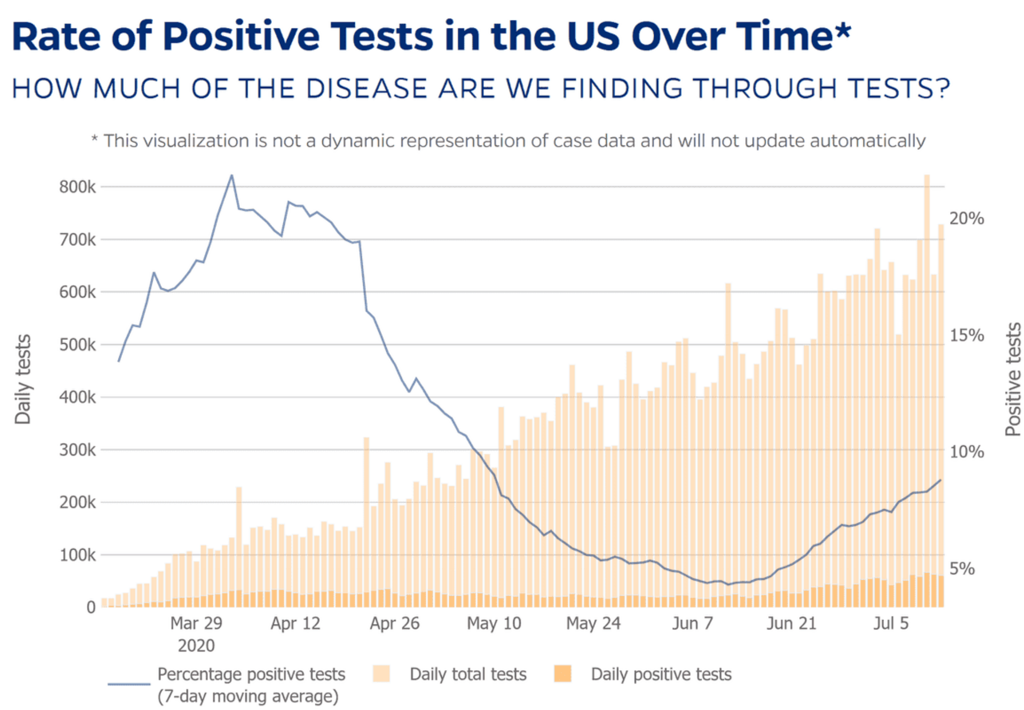
Domestic and International Economic Overview (continued)

- Forbearances are at all-time highs on loans and rental agreements. This only temporarily solves problems though because those payments are due eventually.
- Massive stimulus in the form of direct payments to consumers and loans with attractive terms to companies from the CARES act blunted the impact however not enough to sustain many groups.
- Suppression of interest rates has fueled home sales and refinances. This likely accelerated some future home sales into the present however the preference for single family home ownership may have been permanently increased as a result of the coronavirus due to better ability of social distancing versus being in a condo/apartment.

All the above is the direct result of this coronavirus and pandemic burning through the global population. Flattening the curve, aka slowing the spread to reduce the rate of infection that would allow hospitals to function for the sickest patients, was the necessary, if not outright the appropriate, goal. Unfortunately, flattening the curve does not mean we are able to reduce the spread to zero and that was clearly not a rationale or achievable goal given how infectious the disease is and how widely it spread before the broad populace was aware. Flattening the curve spreads out infections over time, it does not eliminate them. Encouragingly, we have learned much better who needs to be protected and how better to treat patients that have been hospitalized.

What has been frustrating is the current infection spread. We should not cheer or deride a state's results based on politics. As we are sure you have read or watched, the number of known infections has risen dramatically during the month of July. This is a result of increased testing. We see sensationalized comparisons in the popular media to earlier months without the context of increased testing. We are currently averaging around 700k tests per day nationwide. In April we averaged between 100k and 150k tests per day. Does that mean if we were doing the same amount of testing in April as we are seeing in July, would we have the current case explosion? Likely not with the same severity because we would have been finding significantly more cases in April. The graph below illustrates the point.



Domestic and International Economic Overview (continued)

This point seems to be missed, either for political purposes or lack of knowledge, and is used to bludgeon California, Texas, and Florida. To date, the U.S. has completed over 52 million tests, have 4.3mm positive tests, and 150k deaths. Ten percent of the cases and 20% of the deaths occurred in New York state, the epicenter of the U.S. outbreak. Given they were hit first, it is expected that they would have the worst outcomes.

The tragic experience in New York, and much of the Northeast, has paved the way for the rest of the country to have dramatically reduced death outcomes. We now know to protect the elderly or people with comorbidities. Treatments have improved and the rest of the country flattened the curve. Finding and reporting factual and contextual news seems to be frowned upon so we are constantly left with trying to understand an individual's goal in how the report the data. Things are never as good or as bad as the reporting by the press would indicate.

This initial wave of COVID-19 has triggered a global recession and certainly slammed the economy in the U.S. Reactions have been both good and problematic. Authorities have reacted, within the context of available understanding of the virus, to preserve lives. Opinions differ on whether we over did it or have not done enough. On the other hand, massive fiscal stimulus, not just in the U.S. but around the world, may prove to be damaging to the integrity of money and perhaps seed inflation, both in prices and asset values. Markets are looking past the pandemic to a recovering economic environment, but many individuals, organizations and business still have a long road to their respective recoveries. Yogi Barra, the famous baseball player/coach/philosopher, often said that "predictions are very difficult, particularly about the future". We think this may be a perfect example of Yogi's wisdom.

Fixed Income

Although most Treasury bond yields dropped marginally during the second quarter, spreads and thus yields on most corporate, asset and mortgage backed securities recovered significantly from the dramatic widening in March when the economic outlook quickly changed. Yields in those other credit sectors still remain higher than early in the year, reflecting heightened uncertainty. The newly enacted government bond purchasing programs are forcing market yields lower than they might be in higher quality corporate and mortgage bonds. The only sector to deteriorate in Q2 was the lower rated (BBB) CMBS market, reflecting distress in the real estate component of the retail and hospitality businesses.

Locating value is very difficult in the investment grade corporate market, however some selective opportunities are available. Treasury and government agency yields have been driven so low as to be almost uninvestable. The risk of higher yields at some point for maturities greater than 2-3 years is high. From an investment strategy perspective, a small allocation to medium term Treasuries can be justified as a hedge to another black swan/deflationary event. Some value can also be found in shorter term, revenue oriented municipal debt and can contribute income and stability to portfolios.

Although the impact will likely not be seen until 1-3 years out, many macro analysts believe the mix of government intervention in fixed income markets, subsidies to consumers and changes to the supply equation for many products and services could lead to a surprising rise in inflation and ultimately rates. We will monitor this potential change closely and will continue to limit exposure to medium and longer term maturities.

Equity Markets

Equity markets rebounded sharply in the second quarter although the strength was concentrated in both large and growth focused public companies. The stock market rebound likely reflects a better current environment for many public companies in comparison to the thousands of smaller private companies that lack the financial flexibility and management expertise to navigate the current difficulties. Ample time has now passed for companies to disclose, via interim or regularly scheduled quarterly updates, their operating results for a meaningful period during the pandemic environment. For many it is already clear what companies have business models and finances to be able to survive or thrive and which businesses face dramatic changes and possible permanent damage. Equity prices are reflecting this information, although enough uncertainty remains to provide investors potential large risks and rewards. Looking beyond the next two-year scenario, we believe opportunities exist that reflect macro changes that have been accelerated and the new working and leisure environment that is certainly upon us.

Developed international markets also rebounded in Q2, however remain behind domestic performance year to date. After reflecting on both the ability to manage pandemic consequences and the likely longer term changes to global commerce as a result of trading fundamentals and supply chain shifts, we have reduced our direct international equity exposure, although maintaining some via international revenue from several large domestic based investments. We believe emerging markets for the short to medium term could be particularly damaged by both the current health concerns and longer-term business trade and supply chain changes.

Although the equity markets had time to stabilize and assess the implications of the current situation in March and April, the last 2-3 months have seen a wide divergence in performance for individual stocks. We think this environment is likely to persist and is an attractive period for focused investment strategies that are not forced into allocations in sectors or companies with difficult outlooks. Index investing may also become more risky as the concentration of performance from a smaller group of stocks, although representing some very well managed businesses, becomes higher. Regarding current valuations and styles, growth has continued to outperform value investing this year as in most of the last 10 years and the differential is reaching record levels (see table below). Even a modest reversion to the mean could produce good rewards and we believe some of the best investment risk/reward potential resides in the financial, energy and industrial sectors and we are taking some new positions in these areas with a long term outlook.

Large Cap Style Performance (%)					
Quarter to Date			Year to Date		
Value	Blend	Growth	Value	Blend	Growth
14.3	20.5	27.8	-16.3	-3.1	9.8

5 Year-End Tax Planning Opportunities for the Savvy Investor

Following a solid tax planning strategy throughout the year is an integral part of any financial plan, but there are special considerations to make as the year comes to a close that can help maximize your refund or minimize your liability. Are you taking advantage of the following tax-saving strategies with your return?

1) Maximize Retirement Contributions to Traditional IRAs
Far too many taxpayers fail to take advantage of their annual retirement contribution limits and miss out on reducing their taxable income. Traditional IRA contributions are made with pre-tax dollars and aren't taxed until withdrawal, so maximizing contributions could actually keep some individuals from running over into a higher income tax bracket. Contributions to 401(k)s and 403(b)s must be made by December 31st to impact your 2020 taxes, but the deadline for making traditional IRA contributions is April 15, 2021.

2) Contribute to Charity
Donating to your favorite charity is a surefire way to reduce your taxable income, but there are a number of options to explore.

- Donate **cash or goods** to a qualifying charity. Collect and file all receipts with your return.

- Contribute to a **Donor-Advised Fund (DAF).** This strategy allows donors to allocate a lump sum of funds to be distributed to various charities over multiple years. This works especially well if the individual has earned a higher than average income and is looking to offset the increased income right away.

- Donate your **Required Minimum Distribution (RMD)**. Owners over age 70 ½ can transfer up to $100,000 tax-free directly from their IRA to a qualified charity. Keep in mind that charitable contributions can only be made from IRAs, so you may need to first perform a rollover if you're looking to use funds from a non-qualifying account.

3) Defer Income
For business owners, deferring income is an essential factor in year-end tax planning. Think of which items or expenses you may be able to pay out after the new year, such as employee bonuses or income paid to yourself. Pushing these expenses out will be especially helpful for those who anticipate earning less income the following year.

4) Take Deductions Early
The other side of the business planning strategy is accelerating expenses that can be used as deductions in the current year. For example, if you know you will be hiring an outsourced vendor in January, you may request to pay for their services in advance in order to deduct them from your current year's income. Other deductions could include interest payments or medical deductions.

5) Tax-Loss Harvesting
This strategy involves intentionally selling investments at a loss in order to offset (a) capital gains that resulted from selling securities or (b) up to $3,000 in non-investment income. However, there is a limitation to this practice. In order to prevent taxpayers from taking advantage of this perk, the IRS implements the "wash-sale" rule which nullifies a loss claim if the same or nearly identical security is re-purchased within 30 days of the sale.

Like with any plan worth implementing, preparation is essential—especially when time-sensitive moves and deadlines are involved.