Investor Insights & Outlook

April 2020 1st Quarter Concorde Investment Management

Domestic and International Economic Overview

A Message from Concorde Investment Management

In 2018, we rolled out an app for your smartphone or tablet that allows you to view your entire portfolio and includes a vault where you can access your quarterly reports, billing summaries, and share documents with Concorde from a secure portal. If you are not yet set up with the app and would like to utilize this feature, please contact Barbie Spicer for assistance.

First off, we hope everyone is safe and healthy. Our thoughts are with all of you and everyone impacted by this coronavirus. This will be the global event that will be discussed for decades to come. Everyone on the planet is dealing with this in some form and the time for comparing and contrasting how various governments and economies performed will come in due time. In the meantime, please keep your loved ones close and be thankful and optimistic. We will get through this.

Normally, we split the domestic and international sections given there is data and behavior that can be looked at differently across the globe. Unfortunately, right now every single country on earth is dealing with the same thing at various stages and they are all in economic stress. It is always humbling to be reminded that assumptions never continue on a linear path. We'd love to be writing about trade deals, Q1 growth, the US consumer's balance sheet, or purchasing manager's index levels in China. Instead we are thinking about how things change on the heels of this global pandemic. Obviously, the economic expansion the United States has been enjoying abruptly ended at the end of the first quarter in what we would refer to as a self-induced coma. Different from other economic recessions, this one did not arise from structural imbalances or financial excesses and our financial institutions are in great shape to support the eventual recovery. This one was forced for health safety. Interestingly, stay at home orders really didn't need to be enforced. Data from Open Table, a popular restaurant booking app showed people dramatically altered their eating out behaviors about a week to a week and a half prior to official announcements of the orders in various states. People feared/fear for their safety and getting them to stay home was pretty easy at first. Now we are starting to see 'quarantine fatigue' in addition to an *underwhelmed* hospital system.

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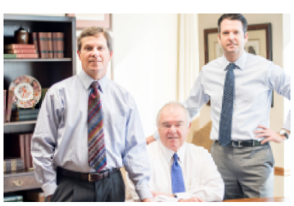
The Concorde Team



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Domestic and International Economic Overview (continued)

Recall, the reason for all the stay at home hoopla was to make sure the hospital systems did not get overwhelmed and the US didn't turn into Northern Italy. Even in New York, the epicenter of our initial outbreak, the hospitals have managed to stay open and have not had to triage patients. The Navy hospital ship Comfort departed NYC at the end of April after treating fewer than 200 patients over the month. Scaring people into staying at home when the curve of infections and hospitalizations has clearly bent is going to be difficult. Regardless, the social distancing and staying at home guidelines were successful in slowing the spread of the disease and bending the above-mentioned curves. Now comes the hard decisions. We will likely find that the pandemic was not what has caused the real economic impact, but rather the response to it.

The key and critical item that we have been constantly discussing and thinking about since before March ended is what does the economy look like once we get a vaccine or antiviral treatment? What happens if we don't? If we do (and our expectation is that we will and much sooner than public health experts will estimate), when does it happen and how will the vaccine or treatment be rolled out? What kind of tailwind or headwind will the US recovery have? How will consumer psychology impact the recovery? There are numerous writings arguing of a 'V', 'U', 'L', square root, Nike swoosh, etc., shape of economic recovery. All recoveries are dependent on data related to the coronavirus. What if we find out that 30% of the population has already had it and for the vast majority of people that get infected the symptoms are not that bad? There is your V recovery with a $4T in government spending tailwind. What if we find out it will be long infection cycle across the country and the immunity from catching the virus only last a few months? That is more a "L" with a possible leg down if we don't have a therapy or vaccine that works. Currently, based on the research and data we have studied, it feels like a potential Nike swoosh or square root. This week we have seen state governments start to do slow rolling openings. While good news, a state government opening up an economy doesn't mean the consumers are going to feel comfortable getting out and in to crowded restaurants/shopping malls/movie theaters/etc. Certainly, nobody is going to feel comfortable hopping on an airplane until we have a therapy or vaccine.

One thing that the coronavirus is only going to exacerbate is government debt and deficit spending. At the end of the US government's fiscal year we will be longing for only trillion-dollar deficits. This year's deficit will be anywhere from $4T to $5T. The political fight that awaits the US in the Fall over the handling of the coronavirus and how to pay for all the stimulus will make the 2016 election look like high school football compared to the NFL of 2020.

Globalism might be officially dead after the outbreak of this virus, at least for the next several years. From a US national security perspective (or any government for that matter) relying on other countries to produce goods and services that are critical to national security, much less everyday commerce, will not be relied upon again as it had become so in recent decades. In no way will any country be depending on China for manufacturing any critical goods in the future. The Japanese government has already indicated their willingness to pay for companies to relocate their manufacturing hubs back to Japan from China.

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Domestic and International Economic Overview (continued)

The US is just starting those discussions and we expect them to gain a lot of traction. Two big winners from that standpoint will be Mexico and Canada as manufacturing relocates back near the largest market. Regional economic activity will increase as global economic reliance changes. "Just in time" manufacturing might change too as people can no longer have such dependence on complicated supply chains that can be disrupted. In reality the whole economic landscape to which we and others have been anticipating changes, just got hit with an adrenaline shot that will accelerate the changes. Anything that was going to be a slow process over a decade will now likely take place over 2 years. Public companies will suffer if the market determines any sort of fault lines in their supply chain management.

From our 4th Quarter new letter:

"The Chinese must be particularly pleased they got something done in December as January brought about the Coronavirus and fears of an overall slowdown to their economy. Their growth is increasingly driven by consumption and virus fears will have a short-term negative impact on their economy, especially given it is happening during their New Year on January 25th, which is essentially our July 4th and Christmas rolled into one holiday."

We suspect that will be the last time we, or anyone else, will expect the Chinese government to be able to control or be forthcoming about anything.

Equity Markets

Volatility struck with a vengeance in all global markets as expectations were reset in the wake of the health related economic shutdowns. The S&P 500 fell over 35% in about 5 weeks for the quickest bear market (minimum 20% drop) in history. The rapid correction resulted in liquidity problems in passive investment products and in fixed income markets as changes in strategy by investors and margin issues for leveraged vehicles exacerbated the selloff. Subsequently, markets have recovered to some degree as investors are beginning to differentiate individual equities and their prospects for surviving or benefitting from the anticipated economic landscape over the next two years. Clearly the potential for outperformance has increased for active management and this has already been revealed as many individual stocks and sectors have outperformed significantly in March and April. Expectations for returns are difficult to project until a better sense of timing for a return to normal business activity is known. Although most individual securities are well below prices reached early in the year, the recovery during April may be ahead of itself with the amount of uncertainty still remaining.

With respect to attractive equity prospects, we believe this universe includes both companies that clearly can survive easily or even thrive in the current environment along with stocks in sectors that are clearly under revenue distress. For a candidate to be attractive from this second group they must have a strong financial position with a nimble and creative management and Board. Historically financially strong businesses have been able to enhance their long-term competitive position during downturns as competitors are weakened or fail to survive. The ability to invest with a long-term perspective creates superior opportunities during these periods. Particular sectors that appear attractive as a result of lower valuations or changing scenarios include technology, healthcare and financials. In addition, we are exploring investments in industrials, transportation, energy and real estate that may be attractive because of supply chain shifts and changing business behavior.

Fixed Income

Essentially all risk sectors of the domestic fixed income markets exhibited high volatility during late March as investors adjusted to the uncertain economics going forward. Ironically for a short period in March, even very high quality bonds, including government issues, struggled in the market as liquidity problems surfaced and investors managing funds under stress were forced to sell their highest quality holdings to provide for redemptions and reduce debt. Several of the programs initiated by the Federal Reserve assisted in solving these liquidity issues, however pricing in many cases is still at a discount from early March levels despite some recovery in April. As should be expected with a dramatically reduced outlook, higher risk corporate and municipal credits have been repriced in the market.

Despite the gyrations in late March, overall yields on all maturities of Treasury securities have dropped significantly since the beginning of the year. (See table below.)

The Fed did reduce the short-term Federal Funds target to near zero as a first step response and this essentially pulled yields on longer maturity issues lower. It is fairly certain that Treasury yields of at least short to medium term maturities will remain at these lower ranges for the near term.

With regards to investment positioning, the recent changes have created some value in very high quality corporate, mortgage backed and municipal issues as long as selectivity is exhibited. Many individual bonds in these sectors are more attractively priced compared to Treasuries than earlier in the year despite the short-term recovery. Short to medium maturity yields are likely to stay relatively low as they are loosely tied to the Treasury rates that should remain low as a result of Fed purchasing programs. The risk of generally higher rates resulting from rising inflation is worthy of monitoring but likely not a concern for a year or two.

U.S. Treasury Yields (%)

	2 Year	5 Year	10 Year	30 Year
12/31/2019	1.58	1.69	1.92	2.39
03/31/2020	0.23	0.41	0.73	1.34

Source: Fact Set; Morgan Stanley

On March 27, the president signed the Coronavirus Aid, Relief, and Economic Security Act (“CARES” Act), the third COVID-19 relief bill, into law.

The CARES Act provisions below impact our clients.

Retirement Plan Relief

- **Plan Withdrawals:** Waives the 10% early withdrawal penalty for distributions up to $100,000 from qualified retirement accounts by certain individuals impacted by the coronavirus made on or after January 1, 2020, and before December 31, 2020.

  – Income attributable to such distributions would be subject to tax over three years, and the individual may recontribute the funds to an eligible retirement plan within three years without regard to that year’s cap on contributions.
- **Plan Loans:** Increases the maximum loan limit for qualified individuals who have been impacted by COVID-19 and extends the due date of any qualified individual’s loan repayment that would otherwise be due during 2020 (but on or after the date of enactment) to the later of (1) one year after the otherwise applicable due date or (2) 180 days after the date of enactment.
- **Temporary Waiver of Required Minimum Distribution (RMD) Rules:** Waives RMD rules for all types of defined contribution plans (including 401(k), 403(b), and governmental 457(b) plans) and IRAs for calendar year 2020, providing relief to individuals who would otherwise be required to withdraw funds from such retirement accounts during an economic slowdown due to COVID-19.
- **Single-Employer Plan Funding Rules (Defined Benefit):** Extends single-employer funding obligations due during 2020 to January 1, 2021, with interest for late payments. And, a plan sponsor may elect to apply the plan’s funded status for the 2019 plan year as applicable in determining the application of benefit restrictions for “plan years which include calendar year 2020.”

Money Market Funds

- **Exchange Stabilization Fund:** The legislation gives Treasury temporary authority, but does not require it, to use the Exchange Stabilization Fund to guarantee money market mutual funds. The Emergency Economic Stabilization Act of 2008, legislation passed to stabilize the financial system during the subprime mortgage crisis, included language prohibiting Treasury from guaranteeing money market funds. Any guarantee established as a result of the application of this section shall terminate not later than December 31, 2020.

Health Care and Health Savings Accounts (HSAs)

- **Telehealth services for High Deductible Health Plans (HDHPs):** For plan years before December 31, 2021, allows HDHPs established before December 31, 2021, to provide telehealth (or “telemedicine”) and other remote care services without cost-sharing or a deductible.
- **Health Savings Accounts (HSA) for over-the-counter medicines:** Expands the definition of “qualified medical expenses,” allowing HSAs, Archer MSAs, Health Flexible Spending Accounts, and Health Reimbursement Arrangements (HRAs) to cover certain over-the-counter medications (without a prescription).
- **Coverage of diagnostic testing for COVID-19:** All testing for COVID-19 is to be covered by private insurance plans without cost sharing, including copays, coinsurance, and deductibles.
- **Rapid coverage of preventative services and vaccines for COVID-19:** Requires group health plans and health insurance issuers offering group or individual health insurance to cover any qualifying coronavirus preventive service. Also provides free coverage without cost sharing of a vaccine within 15 days for COVID-19.

Charitable Contributions

- **Partial Above-the-Line Deduction:** Allows partial above-the-line deduction for charitable cash contributions in 2020 permitting taxpayers to deduct up to $300, whether they itemize their deductions or not. The above-the-line deduction provision explicitly excludes contributions to donor-advised funds.
- **Additional Modifications:** Will curtail 2020 limitations on deductions for charitable cash contributions by individuals who itemize and corporations. For individuals, the 60 percent of adjusted gross income limitation is suspended for 2020. For corporations, the 10 percent limitation is increased to 25 percent of taxable income. This provision also does not apply for contributions to donor-advised funds.