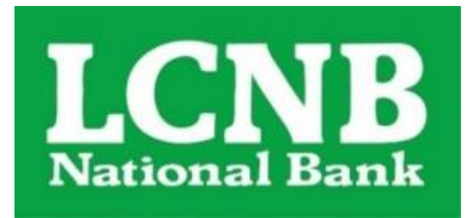
# Wealth Management Bulletin
## *Spring 2020*




## It's Spring …

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The birds are singing, the weather is warming, the trees are starting to come to life, and I haven't seen my next door neighbors for three weeks. This Spring we get the usual and the unusual as Winter sheds its heavy coat and puts on a light jacket.

The interesting thing about a "shared experience" such as the current Pandemic, is that it is the same for everyone yet completely different for everyone. While we are all subject to the "Stay at Home Orders", the grocery store shortages (who knew toilet paper would be so valuable), the economic realities, and the social distancing requirements, we are all processing these similar experiences in dissimilar ways.

While I have friends and colleagues whose "staycation" includes pets, children and other relatives, Mary and I are at home by ourselves. While others may be, unfortunately, suffering through furloughs, layoffs, and other harsh economic uncertainties, both of us are able to continue to work and earn in our chosen occupations. Our health and that of our immediate family members has not yet been compromised. Other families, of course, are confronted by any number of serious health crises.

My mother, Kathleen, passed away this past Sunday at the age of 96. Born in 1924, her life was impacted by the "Roaring Twenties", the "Great Depression", "World War II" (her husband served), the "Korean War", the "Cold War", the "Civil Rights Movement", the "Vietnam War" (her brother served), the "Iraqi and Afghan Wars", and the events surrounding "9/11". All of these "shared experiences" left her and society changed in many different ways. And from those experiences came lessons to be integrated into and used throughout a life well lived.

And the lessons from the current "shared experience," the Pandemic? Planning is the key. Economic planning, societal and relational planning, and planning for events that can't even be reasonably anticipated. More importantly, we are learning that we really do need each other. In our families, in our work places, in our places of worship and in our communities we truly rely on each other. While we might be able to survive individually we can only thrive collectively.

The LCNB Wealth Management team, though working remotely, is still together in our attention to your planning and investment needs. Inside you will find some great information about the recently enacted CARES Act, how the current Pandemic has impacted investing, and our usual solid investment detail. We stand ready, as always, to engage and to help you and your family thrive.

It's Spring. Be safe, and if you happen to see my next-door neighbors, give them my best.

Best regards,
Mike

## The CARES Act and Your Planning

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Due to the health, social, and economic consequences related to the COVID-19 pandemic, 2020 has been a whirlwind so far. On the heels of the SECURE ACT, signed into law shortly after Christmas and that modified many retirement plan and IRA rules, Congress recently passed and the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") in late March. In addition to enhanced unemployment benefits, loan deferral/suspension protections, and small business loans to provide relief, the CARES Act generates certain benefits that may affect your near-term wealth planning. Here is a brief summary of those changes and the planning considerations.

Income Tax Filings. - The IRS and the states have moved income tax filing and payment deadlines from April 15 to July 15. No extension filing is required, but note that if you pay quarterly estimates, based on current guidance, your second quarter estimates remain due on June 15, 2020, while your first quarter estimates are due on July 15. Also, you now have until July 15, 2020 to make 2019 IRA and Health Savings Account contributions. If you are due a refund, you should file as soon as possible. If you will have a tax liability due, you can now delay filing and payment until July 15.

Stimulus Payments. - The CARE Act provides for Economic Impact Payments ("EIP"s) of up to $1200 per individual and $2400 for some ($2400 for married filing jointly) plus $500 for each child you have under 17. However, there are income restrictions. Only individuals with AGI of under $99,000 are eligible, with reduced payouts for individuals with AGI between $75,000 and $99,000. For married couples filing jointly, phased reductions begin at $150,000 AGI with the eligibility cutoff at $198,000. Importantly, the income limits are based on your most recently filed tax return. Thus, if you expect your 2019 income to be higher than your 2018 income, you may wish to delay your 2019 income tax filing until later this spring or summer, after you receive the payment.

Required Minimum Distributions. - Required Minimum Distributions ("RMD"s) from IRAs, 401(k)s, and 403(b) plans are waived for 2020. The waiver may be very helpful to you if the market value in your retirement accounts decreased significantly due to the current bear market. Also, depending on the make-up of your assets, your tax rate, and overall cash-flow needs, you may be able to forego retirement plan withdrawals, which would be fully taxable to you, and instead utilize more tax efficient vehicles such as excess cash, Roth IRAs, and taxable investments to satisfy your living expenses. Finally, if you have already taken all or a portion of your RMD, you may be able to re-deposit it into your retirement account under certain circumstances.

Penalty-Free Early Withdrawals from Workplace Retirement Plans. - If you need to withdraw funds from your 401(k) and other workplace retirement plans due to the pandemic to satisfy immediate needs, you may be able take out up to $100,000 this year from those accounts without the usual 10% penalty. The withdrawals are generally taxable to you, but you will have up to three years to pay the related taxes. Alternatively, depending on your plan's rules, you may be able to treat the withdrawals as loans and re-contribute them to the plan over the three-year period. Typically, withdrawing funds from your employer's retirement plan should be considered only as a last resort because it will generally make sense to leave assets in your retirement vehicles for the long-term. But this relief may be utilized if an urgent need exists.

Charitable Deductions. - To help incentivize charitable giving during the crisis, for 2020 there is a new above-the-line deduction for charitable contributions up to $300. Thus, when you file your 2020 taxes, you may utilize both the standard deduction and up to $300 of charitable contributions as deductions. Further, the adjusted gross income limit on charitable deductions has been changed from 50% of AGI to up to 100% of AGI, which may be very helpful to those taxpayers who normally itemize their deductions even with the increased standard deduction.

There has been much activity in recent days and there is much information for you to digest, so please do not hesitate to contact your LCNB trust officer and portfolio manager to discuss these law changes in further detail, how they affect you, and how you can properly plan for them. Most importantly, please stay safe and healthy, and we look forward to seeing you again in person when everything stabilizes.

## Economic Summary – Hunkering Down

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As we hunker down with our loved ones and practice social distancing to curtail the spread of COVID-19, it is a good time to reflect on an historic first quarter. It presents an opportunity to look at what we got right, what we missed, and to plan for the challenging months ahead. Throughout 2019, we noted numerous "late cycle" signals from inverted yield curves to converging unemployment and wage gain data. We also noted the strength of the U.S. consumer (low debt to income ratios, low unemployment, and rising wages) and suggested the cycle would persist, as long as consumer confidence remained strong.

Hindsight being 20/20, we can now see what we did right in portfolios and where we missed. Starting in 2018 and into 2019 we began to move portfolios into somewhat more defensive positions. We lightened stock exposure from overweight to neutral with an emphasis on quality stocks. We also moved our fixed income allocations from higher exposure to credit and high yield to an overweight on Treasuries. These defensive tilts helped limit some of the downside in February and March as markets crashed. Looking back, we now wish we had gotten even more defensive.

What we missed was the potential speed of a collapse in consumer confidence and spending activity. In a typical recession, if there is such a thing, you would see a more gradual deterioration in jobs and consumer confidence. Comparing the recent decline in economic activity to the Financial Crisis of 2008 and 2009, we see a night and day contrast in the speed of decline. In the Financial Crisis, the first signs of weakness in the housing markets came as early as 2006 and jobs numbers started to decline as early as July of 2007. The collapse of Bear Stearns in March of 2008 signaled the true start of the crisis, but Lehman did not fail until October of 2008. The stock market did not bottom until March of 2009, a full year after Bear Stearns was absorbed by JP Morgan. While the Financial Crisis wiped out jobs and economic activity over the course of a year-plus, COVID-19 is going to do it in a month. If the Financial Crisis was a slow-moving hurricane with advanced warning, then COVID-19 is a tornado that hit with little warning in the dead of night.

At present, the economy remains in a self-induced coma. In the meantime, we await what is certain to be dreadful economic data. The pace of jobs lost, slowdown in consumer spending, and overall economic activity will be unprecedented. Estimates vary on the magnitude of lost activity and jobs, but what is known is that it will be devastating. The good news is this is already priced into markets. What is still unknown is the length of the shutdown and pace of the recovery. The longer we must all shelter in place, the longer the recovery will take. Financial markets are likely to remain very volatile until we get some clarity on these two important questions.

As I write, the latest indications are that some semblance of "normal" will return later this month or in early May. Returning to the coma analogy, we expect the patient to regain most of their faculties very quickly, but full recovery will take months or even years. This is due in large part to several factors that should lead to an initial, rapid recovery phase. First, the consumer came into this crisis in a strong financial condition. For those that retain their jobs or can quickly regain employment later this spring, their spending habits should remain mostly intact. Second, as unprecedented as the shutdown phase has been, so too has been the response by fiscal and monetary policy. A $2 trillion dollar stimulus package including $350 billion for small businesses to help retain employees and quick action by the Fed will help bridge the gap and accelerate the pace of recovery.

While much of the economy can recover quickly, we have no doubt that COVID-19 will leave a lasting impression on consumer psyche and dampen the overall economy for some time to come. Some industries may never fully recover, and it is likely that some of our spending and social habits will forever change. For investors, it is important to stay on course and focus on the long-term. One of the biggest mistakes you can make as an investor is to over-react in times of market upheaval. We should remember that timing the market

is next to impossible. For this reason, we build portfolios for all seasons. Portfolios should be allocated to weather a storm with appropriate liquidity and fixed income securities for current needs and to add ballast to the portfolio. Investments in stocks or riskier asset classes should be limited to long-term needs and should be expected to see significant drawdowns during recessionary periods. It is the risk from these types of investments that allows for the extra return over time. During time of upheaval, we will look to rebalance and tweak our asset allocations as valuations change.

| Equity Summary: | 1st Qtr | YTD | 12 Month | 3 YR | 5 YR |
|---|---|---|---|---|---|
| S&P 500 (Large Cap Domestic) | -19.60 | -19.60 | -6.98 | 5.10 | 6.73 |
| Russell 2000 (Small Cap Domestic) | -30.61 | -30.61 | -23.99 | -4.64 | -0.25 |
| MSCI ACWI Ex US (International) | -23.36 | -23.36 | -15.57 | -1.96 | -0.64 |

## Equity Update – What Goes Up Must Come Down

The only thing that dropped faster than the economic data are global stock markets. The S&P 500 index peaked on February 18th at 3386. By March 23rd the index had dropped to 2237 or over 34% in just over one month. Whether or not the March 23rd low is ***THE*** bottom is yet to be determined. As some positive news on the spread of the virus began to surface in late March and early April, stock markets started to recover. The S&P recently climbed above 2700 which is roughly 20% from the peak and 20% from the bottom. A 50% retracement after a dramatic selloff is typical and often does not hold up. In other words, don't be surprised if we revisit the March 23rd low (or close to it) as markets digest the ever-changing news and upcoming economic data.

We know that earnings for 2020 will be substantially below initial expectations. Some dividends in the financial, hospitality, and oil sectors especially will be cut or suspended. However, markets will be looking through the next couple of quarters and try to discount future cash-flows based on expected earnings and dividends in 2021 and forward. After a decline like we just experienced, it can often take 24 months or longer to revisit the highs. Even if it takes 3 years to get back to the recent high, that would represent a nearly 10% annualized return from current levels and significant premium over returns from other asset classes.

We recommend investors stay invested in equities and look for opportunities to rebalance to their target allocation weights. We continue to see valuation opportunities in international stocks and recommend an emphasis on quality. This includes stocks with strong balance sheets, limited debt, consistent earnings and cash-flows, and sustainable dividends. Investors should limit exposure to hospitality and leisure industries that have the most exposure to a prolonged downturn.

| Fixed Income Summary: | 1st Qtr | YTD | 12 Month | 3 YR | 5 YR |
|---|---|---|---|---|---|
| US T – Bill 90 Day Index | 0.28 | 0.28 | 1.74 | 1.69 | 1.11 |
| BC Municipals 5YR | -0.36 | -0.36 | 2.86 | 2.58 | 2.15 |
| BC Intermediate Government/Credit | 2.40 | 2.40 | 6.88 | 3.79 | 2.76 |

## Fixed Income Update – Risk On, Risk Off

Since the end of the great recession 11 years ago, the risk on trade has worked exceptionally well in the bond market. With the flip of a switch, investors flocked to quality during the first quarter of 2020. As the stock market started its sell-off on February 20th, rates on the 10-year Treasury plummeted going from approximately 1.60% to a bottom of 0.31% on March 9th. Over the past few weeks, the 10-year has loosened, settling at 0.70% for the quarter. During the first quarter, high yield bond spreads widened dramatically from 3.36% to 9.19%, as investors fear that COVID-19 will disrupt this highly leveraged space. We have had a very conservative tilt in our fixed income allocation for the past few years feeling as though we were not being rewarded for taking on risk. With treasury rates falling and spreads widening, we will be looking for opportunities to move to a more market neutral stance on credit risk.

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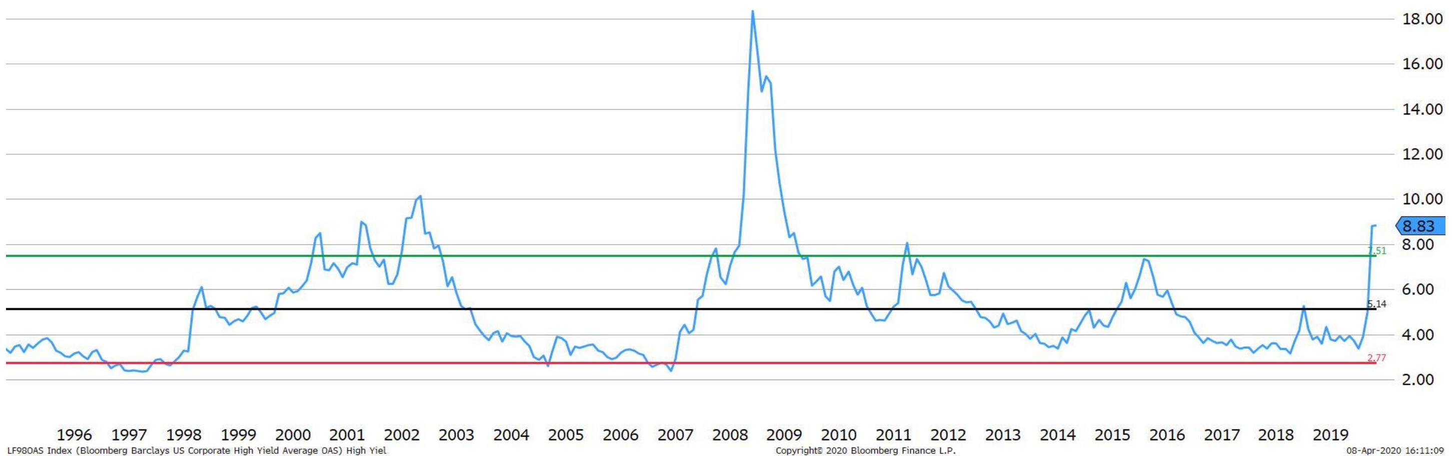


Due to slowing economic activity and tightening financial conditions, the Fed made an emergency cut of 50 bps on March 3rd. As conditions deteriorated further, the Fed stepped back in on March 15th and cut the Fed Funds rate 100bps effectively down to 0%. They also boosted their bond purchasing by $700 billion. Feeling as though they needed to interject one more time, the Fed announced that they would be expanding QE to "unlimited purchases" on March 23rd. The Federal Reserve has often been referred to as the "lender of last resort". They are certainly living up to this nickname with their unprecedented March 2020 decisions.

In August of 2019, the spread between the 10-year and 2-year Treasury went negative. As I mentioned in the Summer bulletin of 2018, every recession since 1970 has been preceded by a yield curve inversion. It unfortunately appears as though this trend is going to continue. Typically, the stock market peaks 18 months after inversion; in this instance it was slightly over 7 months. While Covid-19 is certainly responsible for our economic downturn, the inversion was accurate nonetheless. Though Treasury rates have altogether lowered, slope has returned to the yield curve which is more conducive to a recovery. Negative rates have been present in Japan and Europe for the past few years and on March 25th short term T-bills turned negative for a short period of time. The longer our economic slowdown continues, the more likely US treasury rates are going to turn negative, potentially being the next obstacle for US bond investors.

| **Alternative Investments Summary:** | **1st Qtr** | **YTD** | **12 Month** | **3 YR** | **5 YR** |
|---|---|---|---|---|---|
| Bloomberg Commodity | -23.29 | -23.29 | -22.31 | -8.61 | -7.76 |
| Dow Jones Global Real Estate | -25.86 | -25.86 | -19.57 | -1.09 | 0.27 |
| Morningstar Broad Hedge Fund TR | -11.63 | -11.63 | -6.73 | -0.24 | 0.08 |

## Alternatives Update – The Death of Oil

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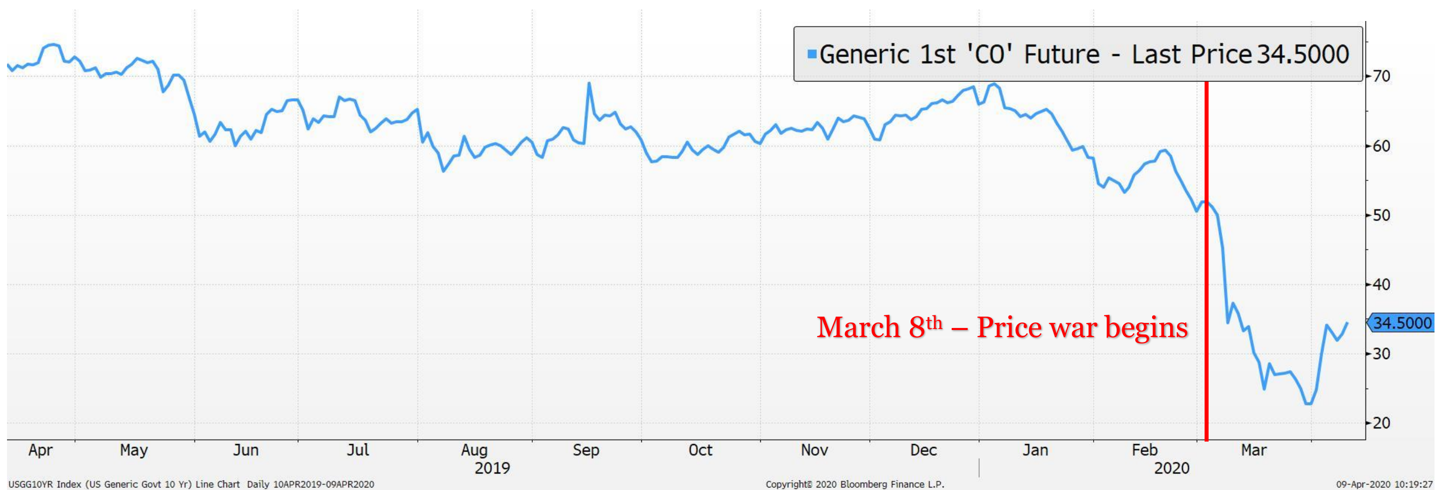
In early March, Saudi Arabia began an oil price war with Russia by dramatically increasing supply. That coupled with the decrease in demand from Covid-19 lockdowns led to 18 year lows reached on March 30th for WTI crude oil and on March 31st for Brent oil. Both recorded losses greater than 65% for the quarter, with WTI ending at $20.48/barrel – 37 cents higher than the low recorded the day before – and Brent ending at $22.74/barrel. Positive news regarding the price war led to a recent bump. However, if OPEC is unable to reach a deal to reconcile the disparity between the current supply and demand and end the turmoil at their meeting on April 9th, oil may have lower lows to reach.




In volatile times and low interest rate environments, gold has historically performed well providing a safe haven for investors. With the exception of a hiccup the week of March 7th, gold has held up as expected. It was one of the few asset classes that actually had a positive return, ending the first quarter 4.2% higher. While other alternative asset classes may not have had a positive yield in the first quarter, they have helped provide some downside protection to portfolios. For instance, broad hedge funds have held up comparatively well during this downturn, only falling 11.63% first quarter versus the 19.60% drop in the S&P 500 and the 23.29% drop in the commodity index. As things begin to stabilize, we will look to adjust our current allocations to take advantage of the impending recovery.

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During this time of uncertainty, each of us are finding new ways to accomplish routine tasks and fulfill our personal and professional responsibilities. Your LCNB Wealth Management team continues to collaborate daily to ensure that you receive the same attention and care to which you are accustomed. Clients can feel confident that we have been operating at full capacity and without interruption.

We are actively reaching out to our clients to ease any concerns and address questions that you may have. While we are not able to hold our valued face-to-face meetings, we are happy to speak with you virtually either by phone, WebEx, or FaceTime. To remain current about measures that LCNB is taking to support our clients, please visit LCNB.com, or click below.

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We hope that we are exceeding your expectations. The best compliment we could receive would be a referral of your friends and family. Please contact Mike Miller @ 513.932.1414, ext. 59101 or mmiller@LCNB.com for more information.