Quarterly Economic Update

Second Quarter 2020

ZEPHYR INVESTMENT MANAGEMENT

A Registered Investment Advisor

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No one expected the longest bull market in history to see its demise brought on by a virus. While U.S. equity markets were able to withstand a trade war with China, a presidential impeachment, the potential for a global recession, and global uncertainty, including Brexit and civil wars in the Middle East, the U.S. economy was ambushed by a silent and highly contagious virus.

The first three months of 2020 were filled with COVID-19 fears and economic responses. The world is experiencing a pandemic and a financial crisis that is causing many investors to feel a level of anxiety that they have not had for over a decade. It's almost impossible to remember that in Mid-February, equity markets were experiencing all-time, record highs. Now, we are in an unprecedented, event-driven bear market.

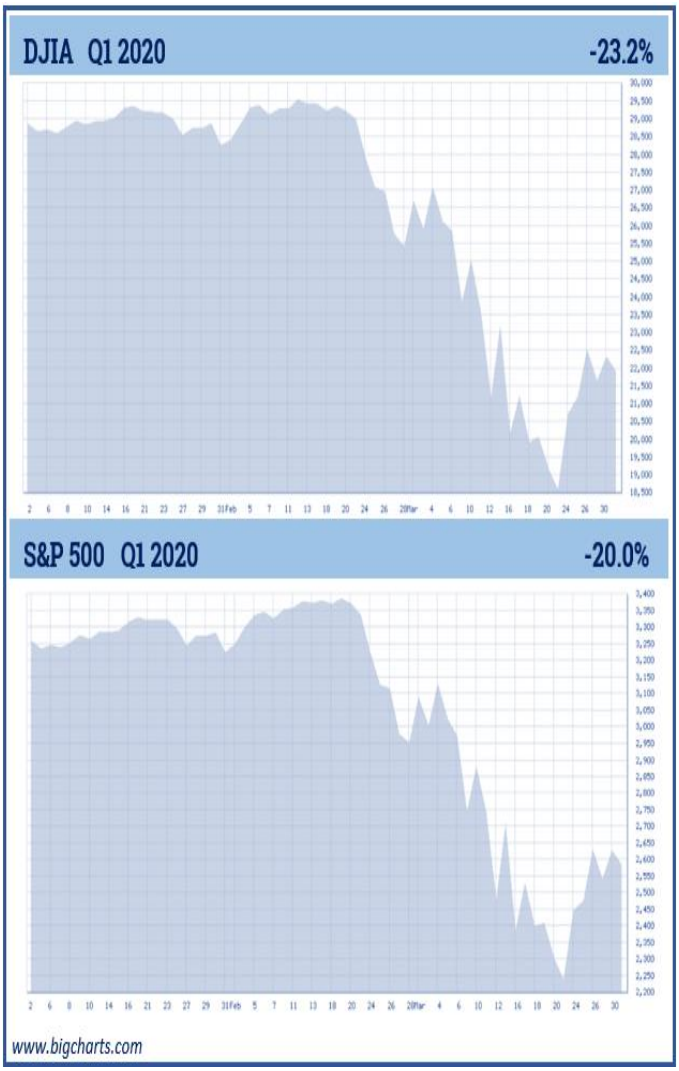
In the first quarter of 2020, more specifically, on March 12th, the longest bull market in the history of the S&P 500 ended. This was the worst quarter for the Dow Jones Industrial Average (DJIA) since 1987 and its poorest first three-month start to the year ever.

The Dow Jones Industrial Average's decline of 23.2% for the quarter was its biggest since the 25.3% drop seen during the fourth quarter of 1987. The S&P 500 posted a 20% decline (a recovery from the 34% drop intra-quarter). Before this waterfall downturn, the stock market seemed unstoppable. Many investors who remained vigilant during that time were generously rewarded. In just a few weeks, the stock market experienced several firsts in its history, including:

- In less than three weeks, the S&P 500 fell from a 52-week *high* to a 52-week *low*.
- The Bloomberg Barclays U.S. Corporate Bond Index lost more than 7% in a week.
- The New York Stock Exchange (NYSE) experienced its worst set of down days where 90% or more of NYSE-traded stocks closed lower for the day.
- The S&P 500 hit the circuit breaker and triggered a trading halt four times.
- The Nasdaq Composite Index suffered its largest one-day percentage decline ever.
- The Dow Jones Industrial Average posted its biggest weekly gain since 1938.

(Sources: marketwatch.com 3/16/20, WSJ 3/27/2020)

An 11-year bull market has changed into one of the quickest bear markets of all-times. Not only is the world trying to stop the spread of a highly contagious virus, but it is also scrambling to fix the disruption of global supply chains and the decline of consumer demand.



MONEY RATES

(as posted in Barron's 4/6/2020)

	LATEST WEEK	YR AGO
Fed Funds Rate (Avg. weekly auction -c)	0.09%	2.42%
Bank Money Market -z	0.16%	0.23%
12-month Cert -z	0.46%	0.97%

c- Annualized yields, adjusted for constant maturity, reported by the Fed Reserve on a weekly average basis. z – Bankrate.com (Source: Barron's; bankrate.com)

Interest Rates Are Still in the Spotlight

After lowering the federal funds rate by a half-point to a range of 1.0% to 1.25% in between its regularly scheduled meetings, as a response to the risks the COVID-19 Coronavirus outbreak, the Federal Reserve cut its benchmark interest rate in mid-March by a full 1% to 0%-0.25%. When the Fed first started reducing interest rates, many experts noted that the central bank was "catching up" to where markets had headed. Now, it seems as if they are responding to both the economy and the fact that the 10-year Treasury had fallen to all-time lows.

The all-time low for the Fed Funds Rate is effectively zero. The Fed has only lowered its rate to a range of 0% to 0.25% twice: once during the financial crisis of 2008 and now in March to a range of 0.75% to 1.0%. ***(Source: The Balance, 3/30/20)***

CNBC reported on April 1st that the "10-year Treasury yield falls to 0.6% as the Coronavirus crisis deepens." With interest rates at or near all-time lows, many investors cannot generate income or meet their long-term goals with a full portfolio of cash and bonds. ***(Source: CNBC, 4/1/20)***

Oil Prices

Oil prices suffered an extremely rough stretch this quarter. As if things were not bad enough, the oil price war between Saudi Arabia and Russia, which emerged suddenly and dramatically on March 7th, compounded the already ultra-bearish demand backdrop. The Saudi Arabia and Russia, oil price war resulted in a massive price drop on March 8th, 2020, when U.S. oil prices fell by 34%, and crude oil fell by 26%. ***(Source: CNN.com; 3/8/2020)***

The Coronavirus' impact on oil consumption is unlike anything in modern history. Governments continue to impose flight restrictions and other travel bans, enforce lockdowns and require non-essential businesses to close doors. Numerous school closures also mean many fewer buses and cars will be on the roads. As the quarter closed, there was pressure on the president to step in and assist in resolving the price war. Oil prices saw the worst month and quarter in oil price history down over 50%. With energy companies and oil still being a contributing factor to the overall economy, oil prices are a topic we are keeping a watchful eye on. ***(Source: Washington Post, 4/2/20)***

The CARES Act

The government is trying to help businesses and prevent the threat of a recession through the $2.2 trillion-dollar Coronavirus Aid, Relief, and Economic Security (CARES) Act. This emergency relief package, the largest economic-relief package in U.S. history, included: **Extensions of unemployment benefits, $150B** for state and local governments, **$500B** in general corporate aid, **$350B** in small-business loans that will be facilitated by community banks, **$100B** for the healthcare system and **direct payments to individuals:** Individuals can receive up to a maximum of $1,200 per person ($2,400 per couple) depending upon their income.

The estimates for the total monetary and fiscal output to manage this crisis is $4 trillion, according to Jurrien Timmer, Director of Global Macro for Fidelity Management and Research Company.

Key Points For Investors

1	**Your health is your first priority!**
2	**Federal funds rates were reduced to 0 - 0.25%.**
3	**Oil price wars between Saudi Arabia and Russia continue to affect equity markets.**
4	**Government assistance was made available to help counteract the impact of this crisis.**
5	**COVID-19 pandemic could have significant ripple effects on the global economy.**
6	**Proceed with caution!**
7	**We are now in a bear market, ending the longest bull market on record.**
8	**Focus on your *personal goals* and call us with any concerns.**

So far, there is a strong response from the U.S. Government, which will need time to see if it produces results. ***(Source: fidelity.com, 3/23/20)***

Bear Market Basics

Bear Market's Most Basic Principle: Bear markets are a part of the investing experience. Many people believe that a bull market means a steady growth in equities. This is not the case. During this most recent, long-standing bull market, there were 13 corrections, and the market moved down intraday into bear market territory (down at least 20%) three times. ***(Source: www.fidelity.com)***

We have now entered into bear market territory (a close of 20% down), so it might be helpful to review some information about bear markets.

Bear markets are driven by fears of an economic and profit recession, and a prolonged bear phase develops when these fears pan out. The next bull market awaits enough stimulus to fuel the next economic recovery. In between, a bottoming process unfolds. Thus, it is key to determine how prolonged the economic downturn will be and if enough policy support has been provided.

Every equity bear market has unique attributes, including the root cause of the earnings downturn and the required policy response. However, there tends to be a familiar rhyming behavior in the ebb and flow of investor sentiment, uncertainty regarding the economic outlook, and whether the policy steps taken will be enough to reflate the economy.

In examining previous U.S. equity bear markets over the past 100 years, a meltdown in equity prices occurs at some point in each bear market. The initial low resulting from the meltdown can be a reasonably appealing entry point for aggressive investors with horizons of 12 months or longer, **provided that a prolonged recession does not occur.** However, it is often difficult to accurately time since equities become deeply oversold and usually bounce quickly, as was the case off the March low. That said, there is typically no rush to buy for those that miss this initial low. U.S. equity prices almost always retest, and often dip mildly lower, before the next bull market sustainably takes hold. Historically, **almost all equity bear markets experience a double or triple bottom.** We are not saying there must be another downdraft – we are just notating the behavior of previous bear markets, which shows we may not be out of the woods yet.

Every bear market is unique, but bottoming phases tend to rhyme

Massive monetary and fiscal stimulus has already been deployed and will provide support for the next global economic expansion. **What is missing at this point**, however, **is a credible health strategy** to make it safe for workers and consumers to return to normal activity. **Until then, equities may struggle to find a firm footing**….

…and, volatility may remain elevated. The chart on this page shares that the six biggest point declines, and the six biggest point increases in the Dow Jones Industrial Average (DJIA) all came in the last five weeks of this quarter. On March 12th, the DJIA fell 2,352 points, which was over 9%. Had you sold that day, you missed the next day's (March 13th) rise of 1,985, also a move of over 9%. This level of volatility is unprecedented, and therefore we will **PROCEED WITH CAUTION** and continue to rely on our Business Cycle Asset Management investment strategy to Navigate the Way Forward.

Six Largest One-day Point Gains and Losses in DJIA History (as of March 30, 2020)

GAINS			LOSSES		
Date	Change	% Change	Date	Change	% Change
March 24, 2020	+2,112.98	+11.37	March 16, 2020	-2,997.10	-12.93
March 13, 2020	+1,985.00	+9.36	March 12, 2020	-2,352.60	-9.99
March 26, 2020	+1,351.62	+6.38	March 9, 2020	-2,013.76	-7.79
March 3, 2020	+1,293.96	+5.09	March 11, 2020	-1,464.94	-5.86
March 4, 2020	+1,173.45	+4.53	March 18, 2020	-1,338.46	-6.30
March 10, 2020	+1,167.14	+4.89	February 27, 2020	-1,190.95	-4.42

Source: seekingalpha.com

Business Cycle Asset Management: *An Investor's Friend in Volatile Times*

A Durable investment strategy

Our clients know that we have a unique method to our investment approach. Zephyr's **Business Cycle Asset Management** strategy seeks to build portfolios that are designed to survive and thrive in all markets – i.e., a durable portfolio.

A durable investment portfolio is one that is constructed such that the owner (investor) feels no need to panic and sell all after devastating losses. The durable portfolio is not free of losses, but it does keep them to a tolerable and easily recoverable level. The durable portfolio will not impress your friends or be the subject of a cocktail party banter. It is purposely constructed to avoid high volatility either up or down, so you may never feel extremely happy nor extremely sad. What you will do is give yourself a place to put your hard-earned capital, knowing that **the goal is returns that are consistent and stable**. Others, meaning most investors, too often have very little discipline. They need to win, and they need to put their money into non-durable investment portfolios. They believe that they will be able to "buy and hold" through tough markets but find themselves selling in wholesale fashion after losses become unbearable. In fact, the sheer act of selling out of an investment strategy is an admission that you are investing in is something that can break or is not durable.

Looking back over the last quarter-century, we are pleased to report that Zephyr's **Business Cycle Asset Management** strategy has performed just like what we would expect from a durable portfolio. But more importantly, we have avoided much of the bear market losses and have regularly operated with only a fraction of the risk of the stock market. We have done so by following our time-tested process of actively managing risk, avoiding huge bear market losses, and seeking good opportunities wherever we can find them.

As of this writing, our Business Cycle Asset Management portfolios are in a capital preservation mode. When the time is right – we will re-risk your portfolios. However, this is not a time to be impatient. There may be some false starts. We will be patiently looking for signs that the volatility is abating. Our investment philosophy has always been that if you can keep most or all of your capital intact during the bad times, then you have it available to work for you during the good times. We have been working hard over the past few weeks to preserve your capital and are looking forward to the recovery that lies ahead.

Helpful Strategies for Investors

Revisit Your Personal Objectives - First and foremost, we continue to urge you to ask yourself four questions:

1. ***Have my financial timelines changed?***
2. ***Have my financial goals changed?***
3. ***Has my risk tolerance changed?***
4. ***Are there any changes my advisor needs to know about my situation?***

Think Long-Term - Investing involves uncertainty, and therefore investors should consider using long time horizons.

Suspend Distributions - If you are comfortable with suspending distributions and looking for a potentially better time to take them, please call us as we can see if this strategy works for your personal situation.

Consider Roth IRA Conversions **-** There are many reasons to consider Roth IRA conversions. For most retirement accounts with

equities, account values are down. This can create opportunities, especially for those investors currently in the 12%, 22%, and 24% tax brackets. Add in the new SECURE Act's changes to inherited IRAs, and it becomes even more prudent to consider the pros and cons of a Roth IRA conversion. Roth Conversions have some complicated rules and guidelines; therefore, as always, first discuss this option with us and your tax preparer to see if they are a good fit for your financial goals.

Think Rationally, Not Emotionally -One of Sir John Templeton's "Rule's for Investment Success" is, "Do not be fearful or negative too often." Market turbulence should remind us that it is a good idea to re-evaluate instead of panic.

Tune Out Media Magnification and Seek the Help of a Professional - One of our primary goals is to make sure you are comfortable with your investments. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations.

We pride ourselves in offering:

- consistent and strong communication,
- a schedule of regular client meetings, and
- continuing education for every member of our team on the issues that affect our clients.

A skilled financial professional can help make your journey easier. **We care about our clients, and we are here for you. Our goal is to be prepared, not scared! If you feel we need to talk, please call. We are honored that you have chosen us to help with your financial needs, and we'll weather this storm together.**

Could it get worse, or will it get better? How long will this last?

We know these are many investors primary questions. A large part of the answers will depend on when the growth rate of COVID-19 cases stabilizes and how quickly a cure can be developed and distributed. It will also depend on whether or not fiscal and monetary emergency measures are enough to help ease the economic crisis. While we are not clairvoyant, we are making our best efforts to stay aware of changes that could affect your personal situation. Our objective is to try to offer the most educated guidance to help keep you on track with your financial goals. We realize that this is a very emotionally straining time and we want to make sure you know we are here for you. Call us with any questions or help with any concerns you may have.

Panic and bad choices can cause more harm for investors than a virus or market downturn!

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"The first wealth is HEALTH." – Ralph Waldo Emerson

"We Cannot Direct the Wind, But We Can Adjust the Sails."

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