

*Building & Preserving Wealth by Design - Not by Chance*

# QUALITY FINANCIAL CONCEPTS

## QFC's Insights

Date: March 6, 2020

Category: Market Impact & Opportunity

### *Market Impacted by Coronavirus and Other Issues* *"In the Midst of Concern – Opportunities Can be Found"*

By: Doug Horn, CFP®

In such a fluid situation, it is difficult to provide meaningful updates, and some opinions which may be expressed can be proved incorrect within days or perhaps hours. However, looking at cumulative data may provide insight into what is to come. The data includes new cases, recoveries, and deaths, not just here in the United States, but China where it started and the two hot spot countries, Italy and South Korea.

The item of greatest concern from this virus is the occurrence of a death. While I will be discussing the numbers, it is not without compassion for those families who were impacted the greatest. Between February 12<sup>th</sup> to the 18<sup>th</sup>, the daily deaths reported ranged from 98 to 146. Since that time, the virus has spread creating two new hot spots and many more countries are reporting cases as well as deaths. However, the daily deaths reports between February 25<sup>th</sup> and March 5<sup>th</sup> ranged between 37 and 102. It is disappointing deaths are still occurring; however, if containment and treatment were not improving, as more time passes and the virus spreads farther, the number of daily deaths would be expected to be higher than the mid-February range and not lower. This is not to say the data cannot shift as each day passes, but for those predicting *dooms day* scenarios, the current data just does not seem to support such extreme fear. Sadly, not every newscaster believes it is appropriate to avoid sensational type questions or commentary and with the expanse of social media, it is very important to understand the source of the information to avoid misinformation and its spread.

To understand the possible cycle of this virus, looking to China provides one of the best insights. Worldwide cases are 100,720 and cases in China total 80,576 as of this morning. A key metric is the number of recoveries, which is reported as 53,929 for China and is supported by reports many people are returning to work and factories are returning to production. A U.S. company which has a very large presence in China is Starbucks who reports many of their cafes there are showing improving conditions. The CEO of Exxon also reported yesterday they are seeing some improvements in their China operations. While other countries may be earlier in the virus' cycle, understanding the Chinese data is showing improving conditions and is not getting worse may provide insight into the impact elsewhere in the world.

*Insights Continued:*

This morning the employment numbers were released with results showing the U.S. economy remains strong. Jobs grew by 273,000, the unemployment rate dropped to 3.5% from 3.6%, and the average hourly earnings rate also increased. This data is backward looking and does not include the potential impact of the coronavirus but shows the strength of the domestic economy going into this difficult situation.

In addition to the virus, politics are also impacting the markets. It appears the markets expressed a sigh of relief after Super Tuesday, because the apparent strength of Joe Biden and the lessening of support for Bernie Sanders. The cause of this change for most appears to be the claim by Bernie to be a Democratic ‘Socialist’, which for many causes fear and the memory of the socialistic regimes that many Americans and others lost their lives defeating. While Bernie may not be a true socialist, his leaning to that direction is clearly opposite of what (for the last 244 years) has built the economic power of the United States: capitalism. I am reminded of Margaret Thatcher’s quote regarding socialism, “The problem with socialism is that you eventually run out of other people’s money.”

Beyond the negative headlines, there are opportunities and benefits. With the decline in oil prices, the cost of utilities and fuel for autos should be lower, making more of each paycheck available for other types of spending or saving. Interest rates have also fallen providing yet another bite at the apple to lower cost of home ownership. Those who have adjustable rate mortgages (ARMs) should consider refinancing and locking in their mortgage rate. For most, my recommendation would be a new 25-30 year mortgage. For those with a fixed rate mortgage, the question becomes at what existing rate should be refinanced. At this moment in time, it appears any rate above 3.5% should be refinanced; however, the costs and rate obtained must be confirmed to insure this is a proper decision.

In the adjacent chart, there are a number of examples of existing mortgages at various rates. I was able to confirm a 2.95% rate was available for those with high credit scores in East Tennessee. Rates across the country may vary. This shows all rates would benefit by refinancing.

	Examples		
Current Mortgage Rate	3.60%	4.20%	5.80%
Outstanding Debt	\$314,000	\$135,500	\$54,000
Remaining Term (months)	282	198	76
Current Principle/Interest Pmt	\$1,651.68	\$949.79	\$850.69
Remaining Total Payments	\$465,773.76	\$188,058.42	\$64,652.44
New Mortgage Rate	2.950%	2.950%	2.950%
New Term in months	360	360	360
Estimated Cost to Refinance	\$4,200	\$3,400	\$2,900
Amount Financed	\$318,200	\$138,900	\$56,900
New PI Payment	\$1,332.98	\$581.87	\$238.36
Amount of Monthly Savings	\$318.70	\$367.92	\$612.33
Months for Breakeven of Cost	13.18	9.24	4.74
<b>If the monthly savings is invested:</b>			
Mortgage Balance after original term	\$94,506.38	\$77,677.18	\$48,681.60
Total Payments after original term	\$375,899.98	\$115,210.07	\$18,115.44
Total Amount invested	\$89,873.78	\$72,848.35	\$46,537.00
Total Money spent	\$465,773.76	\$188,058.42	\$64,652.44
Investment value @ 5% growth	\$170,587.93	\$112,846.33	\$54,616.16
Excess Investment Value over Debt	\$76,081.54	\$35,169.15	\$5,934.56

Those who are disciplined and want to create additional net worth, should invest the monthly savings from the refinance and invest these funds consistently. I generally recommend a separate investment account labeled “mortgage” so the funds are left alone to accumulate. If the return on this home account is only a conservative 5%, the chart shows the accumulated value at the same point when the original mortgage would have been paid off. It also shows the remaining balance of the new mortgage on that same date. At this point in time, the same amount of money has been spent as what would have been spent had the original mortgage not been refinanced. By refinancing and investing the monthly savings, this provides additional liquidity to the investor and creates additional net worth with the investment account exceeding in value of the balance of the new mortgage. Electing not to refinance and continue existing mortgage payments is throwing away cash unnecessarily unless the owner does not expect to be in the home for at least the period of break even for the costs.

*Insights Continued:*

For most people, taking time to benefit from this current drop in mortgage rates will be a step in the direction of greater financial net worth. Locking in the new lower rate for the longest period possible provides financial certainty for many years to come. Those who dislike debt and prefer to pay extra on mortgages should consider the strategy presented as they could actually cause the mortgage to be paid off more quickly. They should always consider that the amount owed on their mortgage is the amount of the mortgage less the value of this separate investment account since it can always be liquidated and applied to the mortgage. They will see this number be reduced by the actual mortgage payment and for most months, the increase in the value of the investment account.

I have presented a case to invest the difference once a refinance has occurred. To be clear, I am not proposing anyone should expand the debt on their home so they can withdraw a portion of their home equity to then invest the proceeds.

I hope this information has been beneficial. Long term investors should continue with their objectives as this market volatility will eventually subside. Please call if you have questions.