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QUALITY FINANCIAL CONCEPTS

QFC's Insights

Date: December 2, 2020

Category: The Markets / Commentary

Our Public and Private Economies

"A Race to a Change in the U.S.?"

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It has been a number of months since my last *Market Insight*, but more like a lifetime of issues and concerns have occurred with CoVID-19 still prevalent, sadly, a death sentence to many, but hopes for a treatment and vaccine somewhere in our near future.

Many expected the markets to drop significantly due to CoVID-19 plus the action by local, state, and federal governments' mandates regarding the operations of so many businesses, both publicly owned and private. Yet at the time of this article, most of the indexes are near their all-time highs, and the selloff occurring in February and March turned into just another blip in the long-term trend of the markets. For many, this does not make sense; and for the thousands who exited the investment markets, they only managed to lock in their losses during the brief downturn and did little to preserve their investment values.

It is my belief, when the U.S. economy is facing anything catastrophic, there will be unprecedented action from the Department of the Treasury, as well as the Federal Reserve, and Congress, even when there is as much political discourse as there is now. The actions by these three to offset the impact of CoVID-19 is not new. All three took extraordinary steps in 2009 during the *Great Recession* as well previous periods of financial stress in our economic history. However, the speed this time at which support was created and released was astonishing, helping to limit the duration of the market's downturn.

Was the action by the government guaranteed? No. But, there was also no doubt action would be taken to protect our financial systems; not to protect the rich or the top one percent as some may assert, but to protect the solvency of the banking system and the ability to transact business, and to obtain and distribute financial resources. When the fear was at its highest that the economy was shutting down, not one or two, but most businesses who had lines of credit with available balances, the ability to automatically draw down on unfunded loans, managed to strip many banks of the available cash on hand. Without action by the Federal Reserve, this rush to raise cash by so many businesses could have impeded the general public's access to cash that could have created a level of fear not seen in a century. Our central bank, The Federal Reserve, provided the required liquidity to the banking system, thus avoiding even the hint of an issue.

While the banking systems were shored up, thousands of businesses were going to be in need of cash in order to pay ongoing expenses while their revenue slowed or even stopped due to CoVID-19's impact on the economy. Add in the mandatory shutdown by local, state, and federal agencies, and many businesses' ability to continue to operate was in question; however, the response by publicly owned businesses differed from those privately owned. There are many differences between publicly and privately owned businesses including the amount of annual revenue, size of management teams, the amount and diversity of managerial experience, ability to access capital, number of banking relationships, and amount of cash reserves naming just a few. It is partly due to these differences which permitted many of the publicly owned businesses to adapt and for some even flourish while so many of the private businesses are suffering and bleeding losses. For thousands of others, they are still shut down and may never reopen under the same ownership.

Most privately owned businesses were forced to rely upon state and federal relief through forgivable loans, grants, and low interest rate loans. While this support allowed many businesses to bridge the gap of their mandatory shutdown, many like restaurants, gyms, theaters, and bars have not been able to open with their normal capacity; thus their profits, if any, are not strong enough to restore their cash reserves while paying the higher expenses due to cleaning requirements and any new debt now in place. Without additional federal relief, many of these privately owned businesses will fail and their doors will remain shut for months and perhaps years until a new entrepreneur is willing to take a chance on a new business.

For publicly owned businesses, their path to recovery was different and perhaps more certain. Many market traded firms issued additional shares of their stock, resulting in the additional cash needed without taking on new debt payments. Others issued bonds and with the support of the Federal Reserve there was a ready and unlimited supply of buyers of these new bond instruments. This allowed businesses whose revenue was clearly impacted to obtain the cash needed to continue operations. Since the market always moves on "anticipation", the likelihood the major indexes to remain in their depressed state in March and April was unlikely. Add in all the stimulus spending and payments to the public, the beneficiaries were the larger public businesses rather than many of the smaller privately owned.

On top of the tremendous health scare taking place, the U.S. was facing an intense and very politically charged national election. For about half of our country, if President Trump was re-elected it would result in the imminent decline of the U.S.; while the other half felt if candidate Biden were elected our economy would falter and Socialism would take hold in our country. Both beliefs are extremes and not likely to occur. However, it now appears we have a 2/4 party system at the federal level. For Presidential candidates, we have the typical Republican and Democratic parties. But, for the House and Senate elections, it appears there are four parties; the extreme left, moderates, conservatives, and extreme right. There were a number of legislative initiatives that failed during Trump's tenure because the conservatives and extreme right members could not reach a consensus and thus could not win a vote over the Democrats. It now appears the extreme left have gained in numbers which may create similar issues for the Democrats during Biden's term. If the extreme left cannot reach a deal with the moderates, they too will not be able to win votes over the more conservative Republicans. Most investors see this as a positive, since one group cannot push through legislative changes without reaching compromises from opposing points of view. In addition to these four groups, it appears at this time the Democrats will control the House of Representatives, although their seats went from 235 to 222 with the Republicans gaining the same number of seats. The Senate may remain under Republican control with the pending runoff election in Georgia providing the final numbers.

For the investment markets, the expected significant increase in federal spending will lead to increased profits for many businesses, and this financial impact should be felt until the first quarter of 2021. I expect the overall indexes will increase during this time, although I expect some segments of our economy to lag others.

My concern for the U.S. lies within the race to reduce the tax burden on our low- and middle-class citizens. This in itself is admirable, and all of our citizens should pay their "fair" share of the operating costs of our government while permitting those who are creative or entrepreneurial to be rewarded for their creativity and not stifled by paying more than 50% of their earnings in state and federal taxes. When excluding Social Security and Medicare taxes, the number of citizens who pay nothing toward the operations of our government is increasing annually. Eventually, this voting block may have the size to elect representatives who will raise the taxes on the 'wealthy' and provide an increase in benefits or payments to those who elected them. Once a group of our citizens can vote themselves a raise, our democratic process may be in jeopardy. This is driven by the sheer size of our government. It is currently spending far more than its revenues; and add in the impact from the CoVID-19 spending, our federal debt is no longer growing by the billions, but by the trillions. If the federal government can continue to finance its spending with low interest bonds, the balancing act of our economy should continue. However, should interest rates have to increase to attract purchasers of our federal debt, the additional cost of interest on the federal budget will become immense. This concern may be years and perhaps decades in the future, but it seems to be the path we are traveling.

In the past, politicians have claimed to reduce the federal budget. What occurred was the growth rate of the federal budget was slowed, but the budget continued to increase, just not as fast. In my opinion, the federal budget is going to have to shrink for several years. This will be a difficult task as legislators seem to have an insatiable desire to benefit their constituents and reducing or taking away benefits just does not fill this agenda. The size of our government is heading to the point where its citizens may not be able to provide the funding without taxes taking even a greater share of our income.

While it is always challenging to remain steadfast during uncertain and volatile times, it is usually wise to remain with your short and long-term goals until the current crisis has passed. If the market volatility during the crisis was too extreme for your comfort, a re-evaluation of your goals is in order. If you determine there are changes in your objectives or have questions, please contact our office to schedule a time to visit by phone or in person.