THE NEXT GENERATION WEALTH PERSPECTIVE

Is It A 'V-Shaped' Recovery Or Not, That Is The Question

Macro Summary

Federal Reserve	▪ The Federal Reserve has injected in excess of $3 trillion (and increasing) to support the financial markets and improve the economy since the health pandemic started. ▪ Interest rates are expected to remain near zero until 2022; with nearly all officials believing the fed funds rate will still be at near-zero in two-and-a-half year's time.
Economy	▪ First quarter Real Gross Domestic Product (GDP) declined five percent, reflecting decreases in consumer & business spending, partly offset by positive contributions from federal, state, and government spending. ▪ A decline in second quarter GDP growth is projected to range from -25 percent to -40 percent, but recent estimates have been trending more favorably. ▪ The unemployment rate was 3.5 percent in February but surged upward in the ensuing months to 14.7 percent in April. ▪ A surprising 2.5 million increase in the May payroll report brought the unemployment rate down to 13.3 percent. In addition, there were 4.8 million jobs added in June which lowered unemployment to 11.1 percent.
Consumer	▪ Consumer confidence rose in June to a three-month high, buoyed by a reopening economy. ▪ The personal saving rates began climbing in the first quarter reaching 32.2 percent in April before a modest retreat in the subsequent months. This trend mirrored personal income streams as households have increased their precautionary savings. ▪ Mortgage purchase applications have reversed the pandemic-related drop, and are up fifteen percent over the previous year's level, aided by record low interest rates. ▪ May building permits jumped 14 percent from April, an indication that housing starts will continue to rise in the months ahead. ▪ The Personal Consumption Expenditure (PCE) Index increased a modest 0.5 percent since May 2019, with energy exerting deflationary effects upon the index.
Equities	▪ Prices of West Texas intermediate crude oil almost doubled over the quarter, ending at $39.27. The price traded negatively on April 20 as markets were in disarray caused by Covid-19 and producer wars. ▪ Many companies in health care, consumer staples, and information technology industries have weathered the pandemic; however, the crisis has devastated businesses in the entertainment, travel, retail, and many other service-related industries.

	Q2 RETURN	YTD RETURN
Standard & Poor 500 Index	20.54%	-3.08%
Balanced Portfolio - 60 / 40	12.77%	-0.05%
Dow Jones US REIT Index	13.91%	-13.87%
MSCI EAFE Index	14.88%	-11.34%
Barclays Aggregate Bond	2.90%	6.14%
Barclays Municipal Bond	2.72%	2.08%

What's Happening

Over the past few months, there has been a tremendous amount of debate between market observers and Wall Street concerning the shape of the recovery. We all have repeatedly heard opinions from these individuals that the recovery would come in the shape of a 'V', 'U', 'L', 'W', 'square root sign', or some other combination of a letter and a shape. The Covid-19 pandemic forced a shutdown of nearly 95 percent of the global economy at some point over the last few months, which unsurprisingly caused a precipitous drop in economic activity and a global recession.

Governments around the globe already had the recession recovery playbook from the Great Financial Crisis of 2008. In opposition to this recessionary environment, central banks and governmental entities have put forth stimulus measures of epic proportions to stabilize and stimulate economic growth. For example, in the US alone, the Federal Reserve and US Government have launched a remarkably large stimulus package that includes the nearly $3 trillion CARES Act, which provided support programs for individuals, businesses, hospitals and even other governmental entities. These programs now total more than $9.5 trillion, or greater than 44 percent of the United States' annualized Gross Domestic Product. This is a staggeringly large level, never-before-seen total, and we're not the only ones doing it. The global total is now in excess of $24.5 trillion or greater than 28 percent of global annualized GDP. The governments and central banks around the globe have executed the playbook almost flawlessly and with unprecedented speed up to this point. For reference, the chart below highlights the global stimulus measures that have been initiated in just the past four months.

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact 2020 Feb to June (CSM)

	Potential Central Bank Liquidity Injection		Potential Fiscal Stimulus		Central Bank Liquidity Injection and Fiscal Stimulus	
	$ Tln	% GDP	$ Tln	% GDP	$ Tln	% GDP
U.S.***	$6.21	29.0%	$3.30	15.4%	$9.51	44.4%
Eurozone	$1.78	13.3%	$4.02	30.2%	$5.80	43.6%
Japan**	$1.03	20.0%	$2.08	40.3%	$3.11	60.3%
U.K.	$0.37	13.6%	$0.14	5.1%	$0.51	18.7%
China****	$1.33	9.3%	$1.22	8.4%	$2.54	17.7%
Others*	$0.68		$2.38		$3.05	
Total	**$11.39**	**13.2%**	**$13.14**	**15.2%**	**$24.53**	**28.3%**

*incl RoW and ADB, IMF, WB ****China CB stimulus incl liq injections and other activities, e.g. re lending, RRR, direct small biz lending, etc

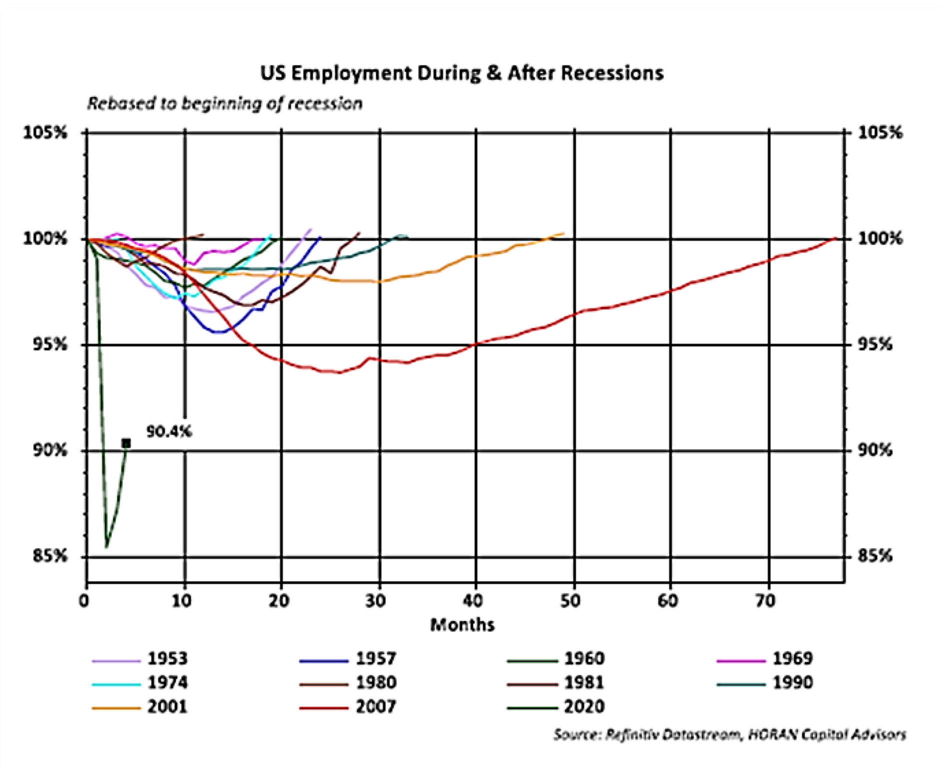
Source: Cornerstone Macro

The Economy – Covid-19 Is The Most Important Near-Term Variable

Not since the 1960's and 1970's has the United States experienced social upheaval like it is experiencing today. We have protests (both peaceful and otherwise), and a massively divided political landscape. On top of that, we have a virus that is spreading across the country creating fear and an acceptance of economic shutdowns. Initially, the scientists said we needed 15 days to slow the spread. These same scientists have consistently lengthened the time they believe keeping the economy relatively closed is a good idea. Yet, eventually, as the number of new cases of COVID-19 slowed, people revolted against these constraints and states began to reopen. Today there is an increase in new cases (aka 'surge'), which is causing officials to reverse prior decisions and instead they are again closing businesses.

Moreover, gasoline usage, which had been down about 50 percent from the year before at its worst back in April, is now down just 10 percent. And Apple mobility data, which reflects requests for directions, most likely bottomed in April, down nearly 60 percent from the January 13, 2020 benchmark. Since April, the mobility data has rebounded 19 percent.

Part of this was driven by the second straight month of job gains. The US added 4.8 million jobs in June, and the unemployment rate fell to 11.1%. Over the past two months, manufacturing has recovered 606,000 of its lost jobs, and these are unlikely to be affected much by the closure of bars and restaurants.



Many feel as if the world is falling apart, and we are dealing with a series of issues that are causing uncertainty. However, it's important to remember history.

During the Civil War, the US lost 620,000 lives—that was 2 percent of the population, the equivalent of more than 6 million people today. World War I, World War II and the Spanish Flu were also devastating. Yet, in every case, the United States continued to prosper.

Please understand we are completely aware of this history as well as the belief of many that this particular time is different. But we will get back to normal. It may not happen immediately, but it will happen. Competition among states, businesses, and everyday people to grow and enjoy life will push everyone to realize that we truly can't stop a virus. Just like 9/11, people will fly again. They already are. They will go to restaurants again, and sporting events, and theaters... But it will take time.

Guggenheim Investments recently wrote (and we agree): *'Ultimately, our public health policy will take center stage. Progress in testing, treatment, non-pharmaceutical intervention and vaccine development will be the biggest determinants in the shape of our economic recovery.'*

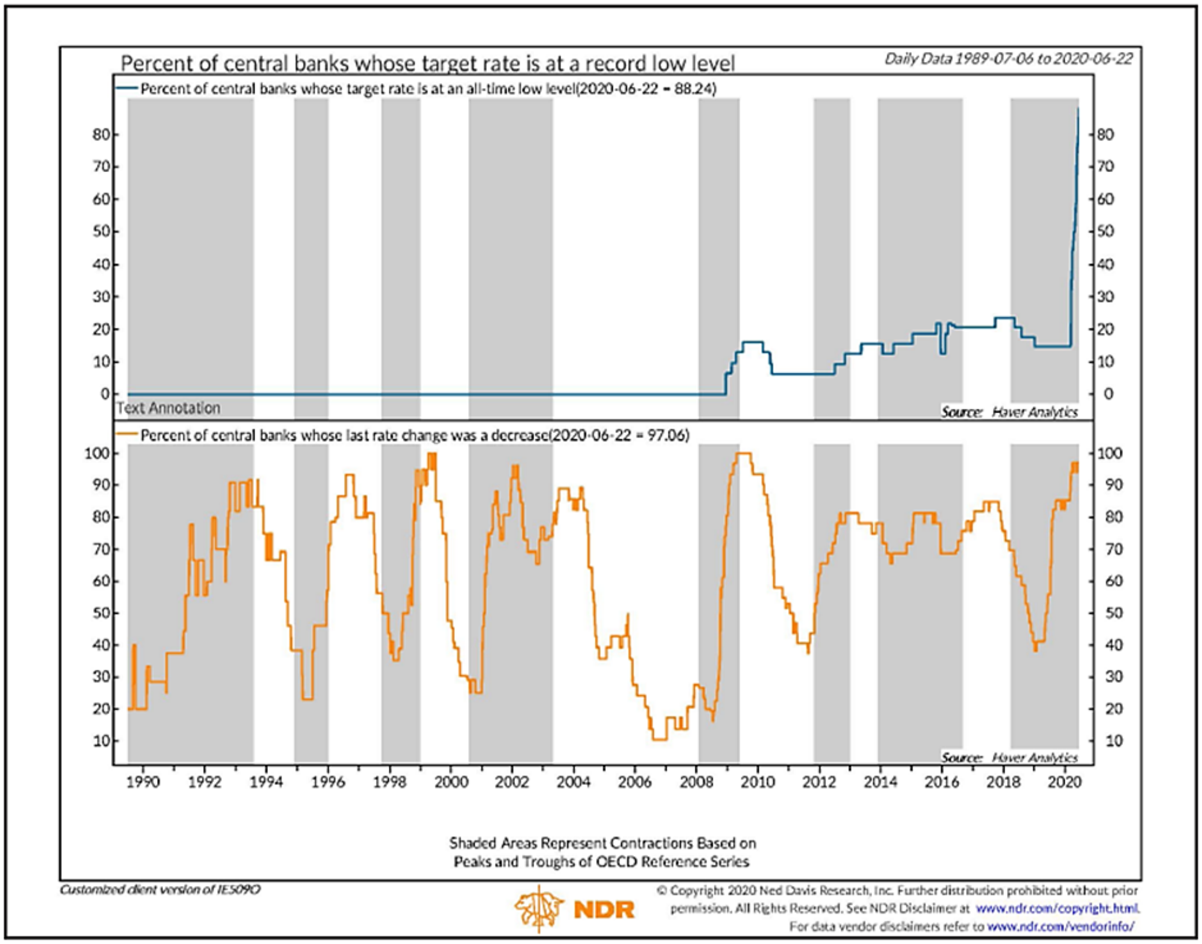
Investors that are expecting a complete 'V-shaped' recovery for the economy will end up disappointed in our opinion. These first months may look like a 'V', but the recovery will grow more slowly unless we get a widely-distributed vaccine. We may not see 4 percent or lower unemployment rates again until 2023 or perhaps longer. Day-by-day, week-by-week, month-by-month, progress will be made as global economies start to reopen and relax social distancing standards. The timing, availability, and effectiveness of treatments and vaccines are also highly uncertain but crucial variables for the economic outlook.

Is Inflation A Risk?

Our team is reading a lot in the financial press and having meaningful conversations with our clients about the risk of inflation in the United States given the massive stimulus from the Federal Reserve, along with the multi-trillion-dollar debt-financed fiscal support programs.

We don't view inflation as a near-term risk because there is too much slack in the economy due to the decline from Covid-19, absent a major supply shock that more than offsets the demand shock. It will take a while - likely a few years at least - for our economy to get back to operating at full capacity and full employment. Until then, the slack should restrain consumer price inflation and wage inflation. It's also worth remembering that even when the United States economy was at full employment in the months before Covid-19, core inflation was still below Chairman Powell's target of two percent. Now, with the economy running below its potential, inflation is a lesser risk.

But isn't inflation 'always and everywhere a monetary phenomenon, in the sense that it is produced only by a more rapid increase in the quantity of money than in output,' as noted economist Milton Friedman famously said fifty years ago? It's true that the Fed's aggressive stimulus has caused the growth rate in the money supply (M2) to soar to an extraordinary 24 percent year over year rate. This is unprecedented. But it shouldn't be immediately inflationary because the velocity of money (how often a dollar changes hands in economic transactions during a given period) - which Friedman ignored - has dropped to an all-time low. Falling money velocity offsets the surging money supply.



As we saw in the aftermath of the 2008 Great Financial Crisis, the Federal Reserve's liquidity showed up in price appreciation for financial assets, rather than in price inflation in the real economy. We see this as likely to replay again given the significant rebound in equity and credit prices since late March.

However, there is a risk these policies will translate into inflation if they remain extremely loose after the economy reaches full capacity and full employment. Jay Powell is signaling they won't act preemptively to curb inflation in this cycle, unlike how the Committee behaved in the past. The Fed is apparently content to effectively monetize the debt created by government deficit spending. If the Fed continues these policies beyond the COVID-19 crisis, it runs the risk of falling behind the inflation curve. This could lead to an inflationary surprise, and a sharp repricing of assets.

Besides a resurgence in the Covid-19 pandemic, here are our top four other macro risks:

1. Increasing social and political unrest
2. An escalation in United States - China geopolitical tensions
3. The November elections and policy-related uncertainty (i.e., a repeal of the Trump corporate tax cuts if the incumbent party loses)
4. The potential for corporate earnings to disappoint this year and beyond

Investment Strategy

> *"As far as paying off debt is concerned, there are very few instances in history where any government has paid off debt."*
> — Walter Wriston

The Fixed Income View – Low Rates

There is currently very little debate in the fixed income market as to where interest rates are headed. The Federal reserve has stated emphatically that monetary policy will continue to be as accommodative as possible. Since the last crisis in 2007-2009, monetary authorities have consistently shown through their actions just how aggressively they will act to keep interest rates from rising in order to foster economic activity.

Currently, the yields on 10-year government bonds are negative in four major countries: Germany, Switzerland, the Netherlands, and France. On the opposite side, several countries that were in financial distress not that long ago delivered excellent returns as Greece and Italy witnessed their yield decline and bond price increase in value. The biggest winner in the quarter was the United States 10-year Treasury bond, as its yield declined to 0.65 percent.

Will Interest Rates Go Negative?

Why hasn't the Federal Reserve followed the policy of the European countries and allowed interest rates to go below zero? According to the current logic, the lower rates go, the greater the economy is stimulated. If the economy needs a shock to get it back on track, subzero level interest rates would make sense, right? The answer to this frequently asked question is not a simple answer.

To begin with, banks typically are not as profitable when interest rates are very low. Deposits by retail clients are their safest and cheapest sources of funding. Negative rates mean the depositors would have to pay the banks to keep their money. Well, this concept is foreign to most Americans and, therefore, would likely result in an extremely low level of savings. Thus, our banks would be hard pressed to turn around and get a sufficient return on their loans to generate strong profits. To highlight, the Fed is aware of the health of the domestic banking system and wants it to remain healthy.

Moreover, in a negative interest rate environment, there would be an outflow of funds into other investments such as the stock, bond and real estate markets. This channeling of money into other areas could lead to asset bubbles (some would argue this condition already exists), as robust demand for certain securities would result in even greater inflated values.

Admittedly, there isn't much of a difference between the Fed funds rate range of 0.00 percent to 0.25 percent and the 0.00 percent to -0.25 percent; however, savers that are already being punished might possibly suffer psychic damage from negative rates as they would have to pay banks to keep their savings. Before the Great Recession, many people, including senior citizens seeking to avoid risk, left a reasonable percentage of their assets in a bank savings account that accrued a solid return thanks to compound interest.

Fixed Income Outlook

It would be a great shock to the fixed income market if interest rates didn't remain low for at least the next twelve to eighteen months. Since the economic crisis of 2007-2009, the Federal reserve has shown repeatedly through its actions that it will go to great lengths to support the United States economy. Historically speaking, large government deficits used to be a major concern among bond investors, but these ever-growing deficits are garnering little to no attention at this time.

Stock Market Review

The first quarter of 2020 saw the swiftest decline into bear market territory in over 100 years of Wall Street history (down 20%). The second quarter experienced one of the sharpest reversals and recoveries – fueled by over $9 trillion in monetary and fiscal stimulus (up 20%). Overall, on an annualized basis, the first six months of 2020 have experienced the highest volatility since the 1930s.

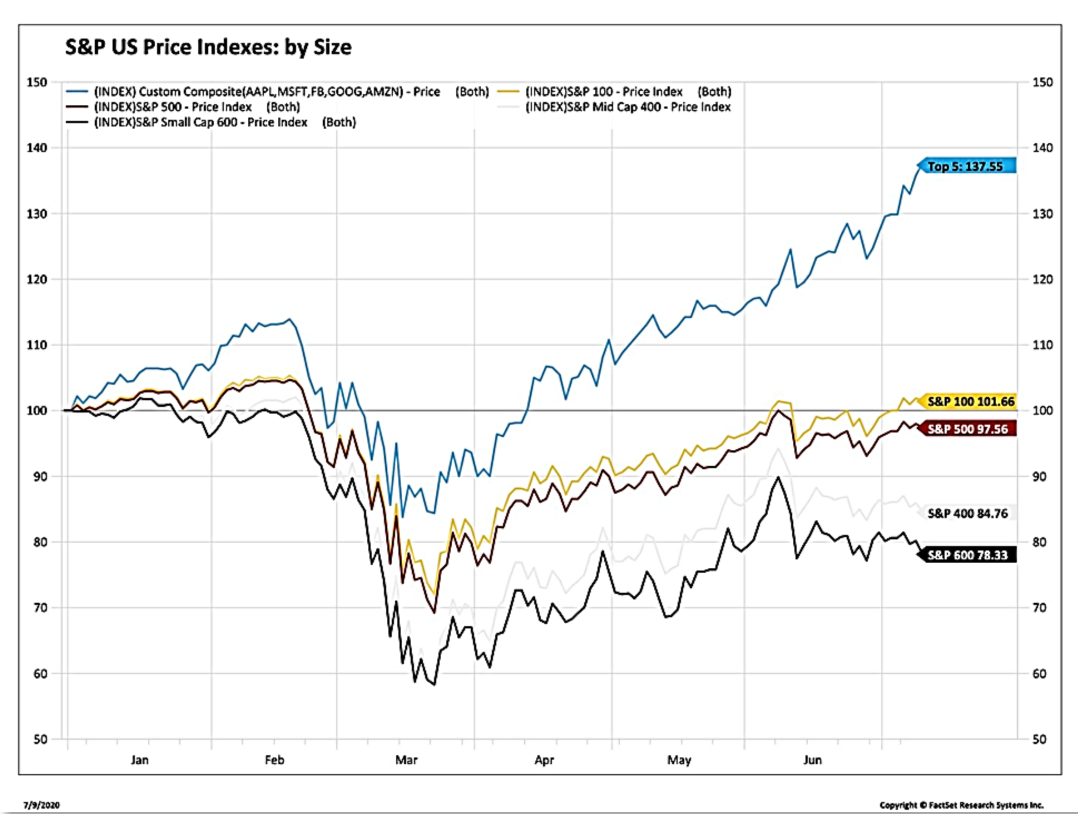
The apparent disconnect between the severe economic impact of Covid-19 and the financial markets is not easy to reconcile. From our perspective, a confluence of factors is driving this disconnect. First, the stock market is a forward-looking mechanism. If investors see 'light at the end of the tunnel' they will price in a temporary, albeit very painful, period of bad news. The Federal Reserve has come out with 'guns blazing' releasing a torrent of liquidity that expanded its balance sheet from less than $3 trillion to $7 trillion, and it is likely on its way to $10 trillion. As discussed previously, Chairman Jay Powell has stated he will do whatever it takes to prevent the economy from falling into a deeper recession, throwing in the proverbial kitchen sink. Substantial progress has also been made on vaccine development, pharmaceutical treatment, and the production of ventilators and personal protection equipment. Businesses continue to reopen across the country, albeit in stop-and-start fashion.

Equity performance has been uneven over the past six months: large company stocks outperformed small companies, and growth stocks outperforming value stocks by a wide margin. Here are some fun facts, all subject to your interpretation:

- The market capitalization of Apple is the same as the entire US Bank Index (BKX). This Index includes twenty-four banking stocks representing the large US national money centers, regional banks and thrift institutions;

- The five largest companies (Apple, Microsoft, Amazon, Google & Facebook) have added a collective market capitalization of ~$460 billion in the month of July alone. This is bigger than the current value of every other company in the Standard & Poor 500 Index; and

- Amazon alone has increased approximately $205 billion in market value which is more than the current value of roughly ninety-five percent of companies in the S&P 500.



Economic Outlook

The economy will not be back to 'normal' until there is an effective vaccine, or the virus runs its longer-term course through a herd immunity process. There are dozens of Covid-19 vaccines being tested through an accelerated Food and Drug Administration (FDA) review process. We remain hopeful but are realistic in our assessment that a successful vaccine and its wide-scale manufacturing and inoculation processes are probably at least a year away. History suggests there is a relatively good chance of a positive 'V-shaped' recovery for the United States; however, those expecting a *completed* 'V-shaped' recovery may be disappointed.

Uncertainties surrounding a possible second wave of Covid-19 cases, along with incoming economic data will continue to produce extreme turbulence in the financial markets. To that point, on June 12, the Dow Jones Industrial Average fell 1800 points, or 6.8 percent, on growing fears of more coronavirus infections. This decline was followed by a 526 point gain a week later based on a record retail sales rebound in May.

Our investment committee expects heightened volatility to continue as the data remains unpredictable. Progress on a vaccine and reopening will be monitored closely, as will economic statistics and the rapidity with which economic progress resumes. If our outlook is accurate, market disruptions will provide unique opportunities for our active asset allocation and flexible investment strategies.

Concluding Thoughts

As various parts of the economy open for business, there will undoubtedly be adjustments necessary to the pace of activity as data evolves. The spread among asymptomatic younger people is notable, and the important decisions around returning to school will be a pivotal part of reopening in the coming months. The worldwide race for treatments and vaccines is unparalleled. The fiscal and monetary response to the virus-led economic shutdown is substantial and provides interim support for businesses and consumers, allowing time for businesses to reopen and bring back furloughed employees.

Often times, it is difficult to see the complete picture when negative headlines attract readers' attention. Yes, there are uncertainties with the health pandemic, social and political unrest, an escalation in United States and China tensions, and the upcoming election. The financial markets will not move higher in a straight line, but on balance, recent data would seem to indicate the glass is half full versus half empty. We have been faced with situations of extreme uncertainty at other times and in other cycles of the past 15+ years, and have successfully guided clients through equally rough seas.

We appreciate your trust and confidence in our team. And, as always, if you have any questions, please contact one of our team members at (414) 257-4248 for a personal conversation. Please visit www.ngwealth.com for company news, articles of interest and our recent commentaries.

Stay safe. Stay healthy. Be well.

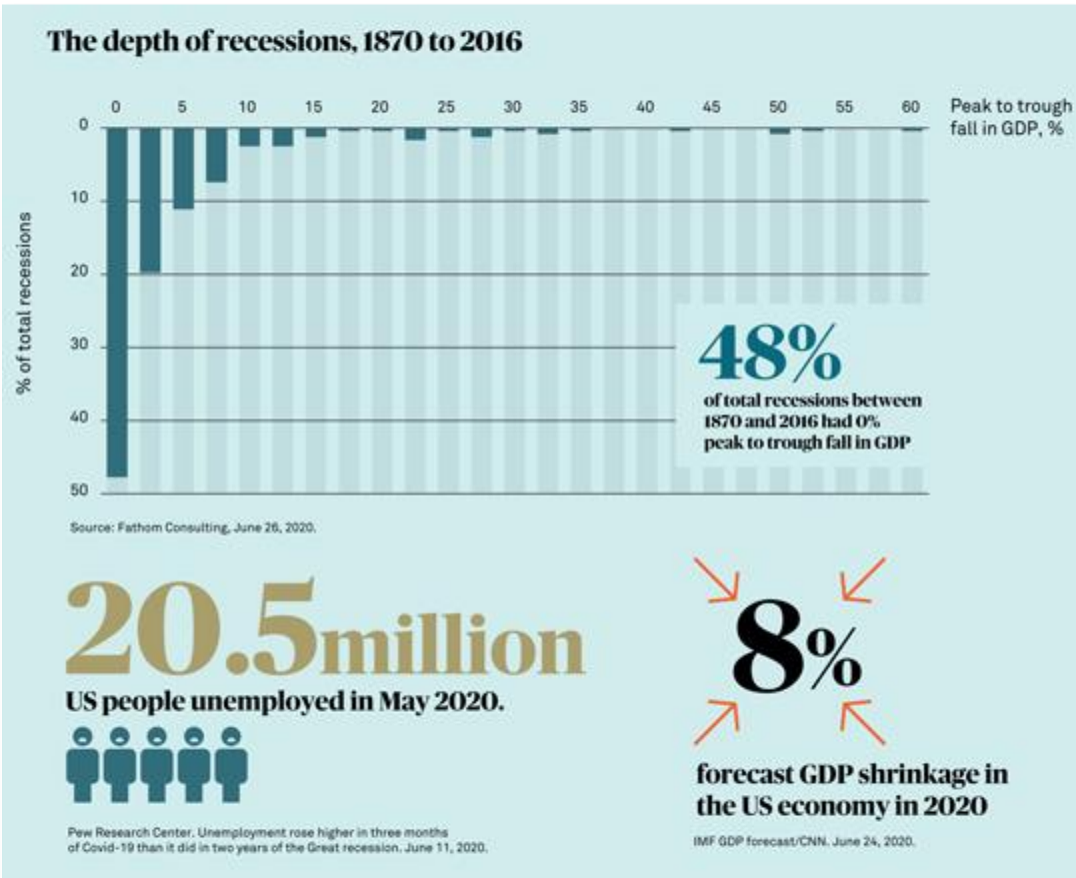
Respectfully,

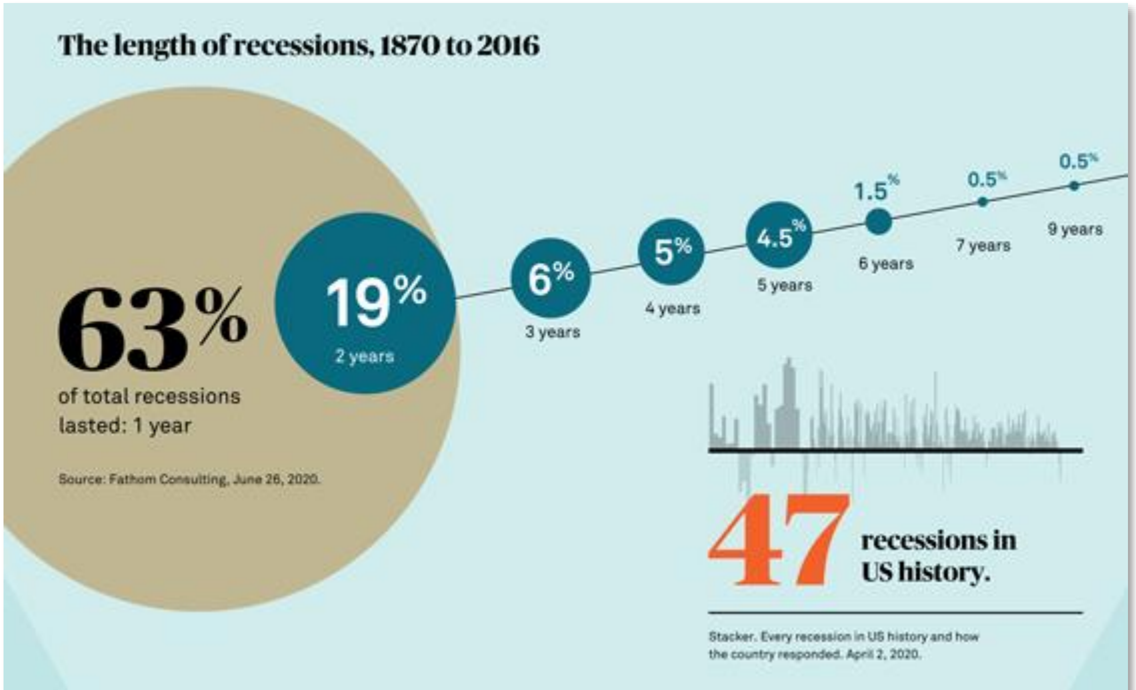
David

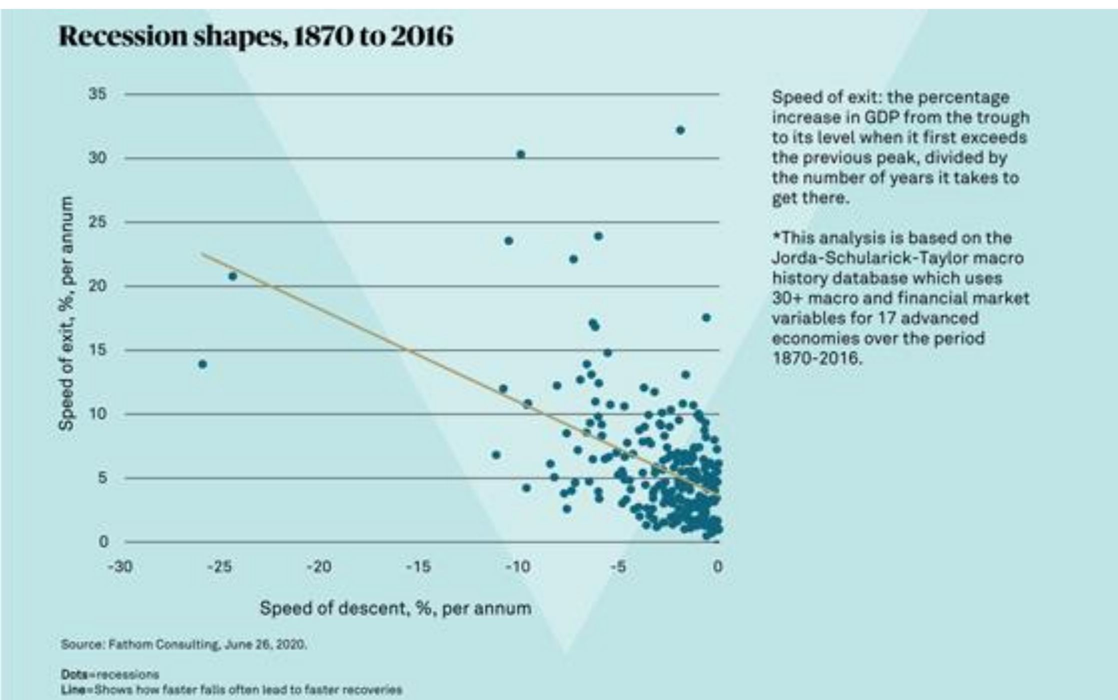
David A. Massart
President

A Picture Is Worth A Thousand Words

While deep recessions are historically not that uncommon, they tend to be followed by relatively swift recoveries. History suggests there is a relatively good chance of a positive 'V-shaped' recovery for the United States; however, those expecting a *completed* 'V-shaped' recovery may be disappointed.




The length of recessions, 1870 to 2016
63%
of total recessions
lasted: 1 year
Source: Fathom Consulting, June 26, 2020.
19%
2 years
6%
3 years
5%
4 years
4.5%
5 years
1.5%
6 years
0.5%
7 years
0.5%
9 years
47
recessions in
US history.
Stacker. Every recession in US history and how
the country responded. April 2, 2020.


Recession shapes, 1870 to 2016
35
30
25
20
15
10
5
0
Speed of exit, %, per annum
-30
-25
-20
-15
-10
-5
0
Speed of descent, %, per annum
Speed of exit: the percentage increase in GDP from the trough to its level when it first exceeds the previous peak, divided by the number of years it takes to get there.
*This analysis is based on the Jorda-Schularick-Taylor macro history database which uses 30+ macro and financial market variables for 17 advanced economies over the period 1870-2016.
Source: Fathom Consulting, June 26, 2020.
Dots=recessions
Line=Shows how faster falls often lead to faster recoveries