



## The Road Back: How Long? How Winding?

A world laid low by Covid-19 is reopening, for better or worse. Maybe those tightly packed protesters will give us some indication of how safe that will be. Meanwhile, major stock market averages have been signaling full speed ahead. At this writing the Standard & Poor's 500 Index has surged over 40% from its March 23<sup>rd</sup> low and is near its 2019 close. Nevertheless, economic and business prospects remain clouded by enormous uncertainty.

### Getting Back to Work

An economy's potential is generally thought to be a function of *growth in its labor force plus gains in productivity*. Major advanced economies have actually seen falling birth rates and weak labor force growth, a trend set to persist for at least another 20 years. But shifts in labor participation rates and immigration also play a role.

The U.S. participation rate – the percentage of those 16 or older who are employed or actively seeking work – had moved higher the last few years after a 15-year decline. The rate plunged with the lockdowns. Reopening will prompt a recovery, but a quick return to pre-crisis levels is unlikely given the businesses that have closed permanently or will be operating with reduced capacity.

Unlike China, Japan, and Europe, the U.S. has continued to see incremental growth in its working age population. The UN estimates that about half of that growth in recent years has come from immigration. Sustaining those numbers could be politically contentious in the wake of such heavy job losses.

### Productivity Under Review

This spring we have seen the power and adaptability of individuals and organizations with respect to

putting in a day's work and meeting customer needs in this digital era. All the disruption is accelerating workplace trends and new models of enterprise that predate the pandemic. But there are headwinds.

For some time and to varying degrees, productivity and service capacity may take a back seat to defining and maintaining *safety and separation* among workers, clients, vendors, etc. The concept of working and doing business "together" continues to evolve, but Covid-19 is a big new wrinkle. Online workflows and meetings are fairly easy. Fostering real teamwork, accountability, a sense of common purpose and shared success may be tougher.

Global supply chains and just-in-time inventory systems have long been touted as a boon to efficiency. But even before the pandemic, that view was being widely questioned with respect to national security, stability and diversity of supply, and income inequality.

### And a Looming Election

Thickening this stew are the vagaries of public policy and politics. For whatever reasons, the pandemic tended to strike hardest at states and municipalities that were already financially challenged. This all might be easier were it not an election year. But those who want elections to be about big issues are about to get their wish.

Who knows? *Maybe* a grand new definition of "going to work" will boost participation by those seeking more flexibility. *Maybe* we are on the crest of a new wave of innovation and re-imagining across all facets of our lives. *Maybe* it will rival the revolution triggered by the popular embrace of the Internet a quarter century ago. *Maybe...* ■

## So, How Are We Supposed to Pay for All This?

The federal government clearly has ventured (or should we say wandered?) out onto a new fiscal frontier. In 2009 the federal deficit hit a post-World-War-II record at 9.8% of gross domestic product (GDP), with stimulus spending and other stabilization measures to counter the global financial crisis. Fiscal 2020 is destined to make 2009 look like the "good old days." But before contemplating the nosebleed-red numbers to come, a little pre-pandemic context may be useful.

The first half of the government's fiscal 2020 (October 1<sup>st</sup> through March 31<sup>st</sup>) did not yet reflect the gathering Covid-19 storm. The picture was reasonably positive, or at least stable, with federal tax receipts up 6.7% from the same period a year earlier, including a 20% jump in corporate income taxes. However, spending also rose 6.7% on its larger base. Entitlements, defense, and net interest on the debt accounted for nearly 70% of total outlays.

Those first-half numbers augured a full-year 2020 deficit of around \$1.05 trillion, up modestly from 2019's deficit of \$984 billion (just under 5% of GDP). Now such projections are meaningless. Covid-19 stimulus checks, forgivable loans, huge unemployment claims, and a cratering of tax revenue figure to at least triple this year's pool of red ink and extend historic deficit spending well into the 2020s.

We are often told that the federal debt must eventually be paid off. However, the modern era has only taught us that it must be reliably serviced and continuously re-

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## Now Can We Expect Some Inflation?

With the world’s leading economies having been slowed to a crawl and global interest rates circling the zero bound, inflation might seem the least of our worries. On the other hand, major central banks and governments have thrown their fiscal and monetary spigots wide open. If inflation is ultimately the result of too much money chasing too few goods and services, what are the prospects for such an outcome?

Given the pandemic’s stunning reversal of economic fortune, central bankers have signaled a continuation of highly accommodative policy for the foreseeable future. The International Monetary Fund forecasts a \$9 trillion loss of global output over the next two years. Financial assets may already reflect the first phase of an inflation effect – stock prices propped up by the promise of ample liquidity despite lower prospective earnings and acute financial stress.

The resulting large output gap may depress headline inflation for the time being, allowing global central banks to keep feeding liquidity to the system. But shifts in a couple of key factors could help fan the inflation embers in the years ahead.

A dozen years ago, with financial crisis looming, advanced economies had the advantage of a growing number of workers relative to those their labors must support. Now that ratio is falling, a trend that is expected to continue for some time. As retirees step away from the labor pool, they continue to consume a wide range of goods and services. That impending supply challenge relative to underlying demand could be inherently inflationary.

Economists also note a distinct difference in the growth of the money supply. In the wake of the global financial crisis, broad money supply growth collapsed, commensurate with locked credit channels, impaired balance sheets, counterparty risk, and dubious asset values. Today, broad measures of the money supply are posting strong growth. If that trend holds, the stimulus and li-

## Oil’s Well that Ends... Oh, Never Mind.

Was it a dream, or did oil prices actually go *negative* for a day or two in April? Well, sort of. In case you missed it, the price of the *futures contract* for May delivery of West Texas Intermediate (WTI) crude dove into negative territory the afternoon of April 20<sup>th</sup> for the first time in its 37-year trading history.

That anomaly didn’t last long, but it did crystallize the historic turmoil in the market for one of the world’s pivotal commodities. Saudi Arabia and Russia were playing a game of chicken, maintaining high levels of production despite sagging prices. Then came the pandemic.

Before much of the advanced world went into varying degrees of lock-down, global oil consumption

stood at 100 million barrels per day. Demand fell nearly 30% in April and is estimated to have remained at that depressed level through May.

By late April, a barrel of WTI traded down to the mid-teens, and Brent crude, the international benchmark, dipped just below \$20. That compared to five-year trailing average prices of \$55 and \$60, respectively. As shown in the accompanying table, Natural Resources has been among the past year’s worst performing fund categories.

In a world suddenly using 30% less oil than it was producing, storage capacity became a big issue. Much of the price collapse in that May WTI futures contract was driv-

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Investment Performance Review	TOTAL RETURN * (Dividends and capital gains reinvested.)			
	--- Annualized through June 5, 2020 ---			
Selected Mutual Fund Categories *	1 yr.	3 yr.	5 yr.	10 yr.
Large-Cap Stocks (Blend)	11.4 %	9.3 %	8.8 %	12.3 %
Mid-Cap Stocks (Blend)	2.9	4.4	4.7	10.3
Small-Cap Stocks (Blend) †	- 2.0	1.8	3.7	9.6
Foreign Stocks (Large Blend) †	2.1	0.9	2.1	5.7
Diversified Emerging Markets †	1.7	1.2	2.3	3.5
Specialty Natural Resources †	- 2.2	- 0.9	- 1.0	1.9
Specialty Real Estate †	- 3.7	3.2	5.0	9.6
Cons. Allocation (30-50% Equity)	5.4	4.1	4.1	6.1
Long-Term Bond	14.8	7.8	7.3	7.3
World Bond †	3.2	2.2	2.6	2.5
High Yield Taxable Bond †	1.6	2.6	3.6	5.8
Long-Term Municipal Bond	2.4	3.3	3.6	4.1

\* Source: Morningstar. **Past performance is NOT indicative of future results.**  
 † Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

quidity pushed by governments and central bankers is likelier to help fill the sails of inflation.

Meanwhile, financial markets appear to anticipate a robust recovery in demand and a relatively rapid restoration of jobs, businesses, and the trappings of “normal” life. Financial assets generally are not pricing in inflation fears, though it may

take some time to fill the output gap mentioned above.

Other than gold, most familiar inflation plays – commodities, industrials, materials stocks, etc. – have lagged such sectors as technology and healthcare, not to mention the significant returns for high-grade, long-term bonds. But for everything there is a season. ■

## Congress “Acts” Quickly to Show How Much It CARES

With the Pandemic gathering force and much of the nation hunkered down at home, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Public attention focused on the direct stimulus payments to individuals and those forgivable “paycheck protection” loans to businesses. However, the CARES Act also delivered a few presents for retirement savers that you may already be discussing with your advisors.

**Need money from your retirement account?** Distributions from an IRA or qualified retirement plan before age 59½ are usually subject to a 10% penalty. For 2020 that charge has been waived for amounts up to \$100,000 withdrawn for reasons related to COVID-19.\* The federal income tax on such distributions can be spread over as many as three tax years, and distributions can

be paid back into the account without reducing the annual contribution limits in those years.

**Want to keep it in your IRA longer?** The CARES Act declared a holiday for Required Minimum Distributions (RMD) otherwise due in 2020. The idea is to keep folks from *having* to draw on their retirement funds when values have taken a hit, which certainly was the situation in late March when the CARES Act was passed.

**Need to borrow from your plan account?** Plan sponsors may now allow participants who have been affected by the pandemic\* to borrow up to the lesser of \$100,000 or 100% of the account balance, essentially doubling previous limits. Starting dates for repayment also may be delayed.

**Want to add more to your re-**

**tirement accounts for 2019?** Consistent with the three-month push-back of the deadline for filing tax returns, 2019 IRA and HSA contributions, as well as employer contributions to retirement plans, can be made up to this July 15<sup>th</sup>.

\* For provisions that are especially targeted to individuals affected by the pandemic, the taxpayer, spouse, or a dependent must have been diagnosed with COVID-19, or the taxpayer must have suffered adverse economic effects due to quarantine, furlough, layoff, reduced work hours, or closure of a business operated by the taxpayer.

Other requirements, limits, or special benefits apply to single employer pensions or controlled groups of business entities with multiple plans. Be sure to review your situation and options with your tax and financial planning professionals. ■

## Flurry of Recent Changes Calls for Flexible Legacy Planning

Nothing like a good pandemic to get us thinking about our own mortality. Or maybe it’s all that time on our hands. Attorneys and advisors have noted a surge of client interest in getting estate plans in order. Recent legislation is also prompting reconsideration of tax and estate planning strategies. Here are a few dots that may need reconnecting.

**Less stretch for your IRA:** The Spring *Quarterly* covered the SECURE Act’s curtailment of the “stretch IRA,” limiting the appeal of leaving Individual Retirement Account assets to younger generations. Without rehashing those details, we reiterate the recommendation to review your IRA beneficiaries in consultation with your financial and estate planning professionals.

**Estate taxes can still bite:** The Tax Cut and Jobs Act of 2017 (TCJA) significantly raised the lifetime exemption from *federal* estate taxes. But many states impose a tax starting at much lower asset thresh-

olds. The state of Washington is a prime example, taxing estate assets above \$2.2 million at marginal rates from 10% to 20%. The strategic use of credit shelter trusts, qualified personal residence trusts, and other provisions may help mitigate or avoid those state levies.

**The DAF stretch:** Another big change in 2017’s TCJA was the near doubling of the standard deduction. That boosted the use of donor advised fund (DAF) accounts to help manage charitable giving more strategically, lump contributions into alternating tax years, etc.

Contributing to a DAF also removes assets from your estate, but most DAF sponsors let you specify successors to direct grants to charities after you are gone. Also your DAF can be named as a charitable IRA beneficiary, sparing those assets both estate and income tax liability and stretching your charitable legacy across generations.

**A nod to non-itemizers:** The

CARES Act (see accompanying article), passed in response to the pandemic, added a small incentive for charitable giving in 2020 for those who do not itemize deductions. That nod is an above-the-line charitable deduction, this year only, of up to \$300 without having to itemize. That may suit folks who find themselves making small gifts directly while managing more substantial giving through a DAF.

**That RMD holiday:** As noted in the accompanying article, the CARES Act cancels any 2020 obligations to take taxable distributions from IRAs or qualified plans. Taxpayers planning to discharge RMD obligations by directing distributions to charities may want to suspend that for 2020 in favor of grants from their DAF and/or the \$300 above-the-line deduction noted above.

Exactly how all this fits together may be different for each investor. But as Ferris Buhler famously said, “Life moves pretty fast...” ■

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financed. That has been made progressively easier by a multi-decade decline in interest rates. A year ago, the average coupon rate on Treasury debt outstanding was roughly 2.5%. These days the U.S. is issuing new debt and refinancing old at average rates well below 1.00%.

During the first half of fiscal 2020, as referenced above, *net interest* on the debt represented just 8.7%

of GDP, net interest was 12.5% of federal outlays.

As suggested in an accompanying article, it is possible that a return to higher inflation could play a role in easing the burden of the debt being assumed today. The last time U.S. debt as a percent of GDP was higher than today was at the end of World War II. From 1946 to 1955, the nominal amount of debt outstanding was only trimmed by about 10%. But a combination of

economic growth and an average annual inflation rate of 4.2% cut the *debt-to-GDP ratio* nearly in half.

A genuine crisis tied to U.S. indebtedness may come only when and if Treasury securities lose their allure as a liquid, safe haven in the eyes of the world's investors. Those who have been waiting – perhaps longing – for higher yields on their most conservative holdings may have to wait a while longer. Yes, this is a new frontier. ■

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**Oil's Well that Ends...**

en by capacity constraints at the main U.S. oil trading hub in Cushing, Oklahoma. Investors on the wrong side of the trade had to pay to avoid taking physical delivery of oil.

Storage capacity and costs remain a global issue with consumption still weak. Meanwhile, after some jawboning by President Trump, and with their own oil revenues suffering, Russia and Saudi Arabia have signed a cease-fire in their price war and agreed to meaningful production cuts.

Meanwhile, the U.S., China, India, and South Korea are adding to their strategic pe-

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roleum reserves, and about 3.5 million barrels per day of higher cost U.S. and Canadian production is expected to fall away in the face of current economics. Oil has rallied into the \$35-40 per barrel range at this writing, but the pace of a recovery in consumption is still uncertain.

Estimates are that \$35 versus \$55 oil translates into about \$730 billion of annual energy cost savings for the world's consumers. Those who *can* hit the road are enjoying a brisk tail wind of low gas prices. Maybe this is the summer to "see the USA in your Chevrolet," or even a Winnebago. ■