FIRST QUARTER,
MARCH 31, 2020

DEIGHAN WEALTH ADVISORS

Objective, unbiased *advice*

MARKET COMMENTARY

In 1697, Willem de Vlamingh led a team of Dutch explorers to Western Australia. It was there that the weathered old sea captain encountered a black swan. This was a significant discovery, because, until then, westerners had thought that black swans didn't exist. Upon seeing the swan, de Vlamingh had an epiphany. "Of course," he thought. "Other animals come in a variety of colors and shapes and sizes, so clearly swans must too." Hence, the term "black swan" became a metaphor for any unprecedented or unexpected historical event that, in retrospect, seems obvious and bound to have happened. The 2008 financial crisis was a significant black swan event, for example.

Black swans present two main problems. First and foremost, they come out of nowhere. In finance, we call this "tail risk." The term is easy to remember because swans have tails, but that's not why we call it tail risk. Rather, tail risk is a statistical concept that seeks to quantify the risk in the extreme left tail of a probability distribution of investment returns. A tail, or black swan, event is something that has a low probability of occurring (generally 0.3% or less), but that would have a significantly large, negative impact on investment returns should it occur. The risk posed by such events cannot be ignored, because the damage can be great. However, since these events occur rarely and randomly, investors have limited tools to protect against them. One cannot hedge a portfolio indefinitely to protect against some unknown, far-off tail event; the costs are too high. Therefore, an investor's best defense is diversification. A well-diversified portfolio should be able to withstand a variety of tail events, much like a building engineered to withstand an earthquake. That's why we spend so much time discussing asset allocation with clients.

The second problem, then, is that black swans are relatively easy to explain in retrospect, and this can lead to hindsight bias. Hindsight bias is the tendency, after an event has occurred, to see it as predictable despite having little or no basis for predicting it. This can cause an investor to overestimate his own abilities and to discount future risks, thinking he'll be able to predict the next crisis. This bias is particularly damaging when that same investor takes on too much risk and doesn't properly diversify, thinking he'll be able to time the market before the next crisis hits. If you've ever met with us, you know how strongly we try to dissuade clients from this type of thinking.

There can be no doubt that COVID-19 is a black swan of historic proportion. Last quarter, we wrote about a moderate risk of recession, the need to be wary of elevated equity prices, and the potential for significant chop in markets – all reasonable concerns. At the time, COVID-19 appeared to be relatively well contained in China and a handful of other Asian countries, and it was generally accepted that we were dealing with another SARS or MERS type of outbreak. For much of the first quarter, markets shrugged off the virus. The focus was on earnings, impeachment, and the presidential election. In fact, the Dow Jones Industrial Average closed at an all-time high on February 12th. That was just seven weeks ago! Today, as we sit isolated in our homes, we know the virus is highly contagious. It can rip through communities like wildfire, making this pandemic ferocious in its speed and unrelenting in its scope and impact. Our hearts go out to the individuals and families dealing with this horrible illness, and our sincerest thanks go out to the courageous men and women working on the front lines in healthcare, in retail, in shipping and logistics, in government, and in all other essential capacities.

Because information is evolving so rapidly, it's hard to know just how severe and protracted the situation will become. As a nation, we've been hampered in our ability to track and prevent the spread of infection, in part due to a shortage of testing. You can't get a handle on the scope of a problem if you can't test for it, and it's hard to see how social distancing measures can be reduced until testing kits are made widely available. This has been exacerbated by a disjointed federal response, with states and municipalities left fending for themselves. We've been operating under a patchwork of orders and guidelines from state and local leaders, some more strict than others. As a result, our fear is that too little is being done to flatten the curve, potentially leaving us with a worst of both worlds scenario.

On the one hand, we've already shut down huge swaths of the economy, which has led to record unemployment and significant economic pain. In just two weeks, there have been nearly ten million jobless claims. For context, previously no more than 695,000 people had ever filed for unemployment in a single week since the U.S. started tracking in 1967. On the other hand, many people still refuse to socially distance, and some states have been late in issuing social distancing orders. Therefore, while much of the economy has come to a full stop, pockets of the country continue to take unnecessary risks.

Unfortunately, instead of a relatively brief but manageable economic blackout followed by robust testing and case tracking (which might be supportive of a v-shaped recovery), we're potentially looking at months of rolling economic brownouts. Just as one part of the country starts to get its curve under control, another part of the country will be experiencing a flare up. Because it's so easy for people to move between states, and because states have no real ability to enforce their own borders, less healthy states are likely to export their problems to healthy states leading to second and third waves. In this rolling brownout scenario, social distancing restrictions, and the economic hardship they bring, cannot be quickly or permanently lifted. Relief and true economic recovery come only in the form of a vaccine, successful therapies, or eventual herd immunity, and the result is several months of economic malaise as opposed to several weeks.

Markets seem to be of two minds throughout all of this. Naturally, as investors started to understand that COVID-19 is a serious threat, markets sold off quickly. In the span of a month, major market indices dropped over 30%. Volatility spiked, with daily swings of 5% to 10% becoming commonplace, and the Dow finished with its worst first quarter showing in its 135 year history.

At the same time, investors have been remarkably bullish, as strange as that sounds in the midst of a bear market. From March 24th to March 26th, the Dow increased over 21% – its best three day run since 1931. Investors seem to have been placated by unprecedented easing from the Federal Reserve and over $6 trillion in fiscal and monetary stimulus, and they have started to price-in a best case scenario that assumes rapid economic recovery in the back half of the year.

Our view is that markets were frothy before COVID-19 hit the scene, and the March correction wasn't enough to flush out the bulls – perhaps because so little time has actually passed. In a survey of its institutional clients last week, RBC found that 58% of respondents were either "bullish" or "very bullish," up from 51% in December. Case in point – today, April 2nd, the S&P 500 Index ended up 2.28%, a day that saw 6.6 million jobless claims and the day that global infections crossed the one million mark.

This gives us pause. While we're encouraged that markets are showing resiliency during this uncertain time, markets could retest their lows. Bear markets generally move through three phases (denial, concern, and capitulation) with rallies occurring between each phase. It looks as though we jumped right past the denial phase into the concern phase, and now we're in the midst of the rally right before the capitulation phase. If so, this rally should become weaker and reverse, as a majority of investors throw in the towel and become fearful of further declines.

Of course, we hope this doesn't happen, but markets may be too optimistic given the potential for the rolling economic brownout scenario outlined above. If it becomes apparent that this will be anything other than a short-lived, v-shaped recovery, then markets will react negatively. We need to be prepared for this possibility.

That said, because we cannot know the future, we are doing our best to play both sides of the ball – a little offense and a lot of defense. We've used this recent period of calm as an opportunity to rebalance client accounts and to make opportunistic purchases, recognizing that this might be as good as valuations get. At the same time, we haven't put all excess capital to use, so we can take advantage of further buying opportunities should markets resume their downward trend. As steep as the correction has been, it has thus far been mild in comparison to the financial crisis and the dot-com bubble. With this in mind, we've kept portfolios well-diversified, and we've kept larger-than-normal cash allocations to help clients weather the financial storm.

Rest assured we are doing everything we can to monitor the situation and to stay healthy ourselves. We view it as a top priority to stay safe so we can do our best work for you. As you've seen from our communications, we're fully able to run the firm from remote locations, and our goal is to continue providing the same high level of service you've come to expect from us. We fervently hope conditions improve over the coming months and that our next market commentary is filled with a brighter outlook. At the same time, the present situation is concerning and unresolved, and it commands a sober, rather than rose-colored, response.

Until next time, we wish you and yours both health and safety. We're here for you, and we're only a phone call or email away.

PLANNING CORNER

CARES Act Provides Relief and Opportunity

The Coronavirus Aid, Relief and Economic Security (CARES) Act was enacted on March 27, 2020, as sweeping emergency legislation, sending $2 trillion to both citizens and businesses in an attempt to offset the economic impact of COVID-19 on the U.S. economy and taxpayers. In addition to increased unemployment benefits, almost $380B in loans and grants from the Small Business Administration, $100B for the healthcare industry, $78B to airlines and national security, and $454B to states, municipalities and other companies, the CARES Act contains a number of provisions designed to benefit individual Americans.

Stimulus Cash Payments. The U.S. Treasury will issue payments of $1,200 per individual as a rebate for the 2019 tax year. Individuals earning up to $75,000, heads of household earning up to $112,500 and joint filers earning up to $150,000 are eligible for the full payments. Those earning over the limits will receive payment reduced by $5 for every $100 over the limit. Payments cease at $99,000 per individual and $198,000 for joint filers. If the IRS holds direct deposit information for your bank account, you may see a deposit as soon as mid-April. Paper checks are expected to issue beginning in early May, and continue through mid-August. The IRS has directed that payments will be prioritized from low to high income.

Coronavirus-Related Distributions from IRAs. The CARES Act provides for distribution from IRAs up to $100,000 for those economically affected by the coronavirus. Individuals can withdraw up to $100,000 from their retirement account by self-certifying that they have been negatively affected by the coronavirus. Usually, withdrawals prior to age 59 ½ are subject to a 10% penalty, which is waived for these distributions. Normally, any distribution is included in taxable income in the year of distribution. Under the CARES Act, the taxable income of coronavirus-related distributions can be stretched over three years – 2020, 2021, and 2022. Whereas an individual typically has a 60 day window to replace any withdrawn funds and avoid the tax, the payback period has been extended to three years.

Waiver of 2020 RMD. The CARES Act waives 2020 required minimum distributions for IRAs, as well as 401(k), 403(b) and 457(b) plans. This waiver is not limited to those affected by COVID-19, and is available for any account holder who is: (a) 72 years of age or older in 2020; (b) 70 ½ in 2019 but did not take RMD in 2019 and planned to take delayed 2019 RMD by April 1, 2020; or (c) a beneficiary of an inherited IRA for decedents dying prior to 2020. If you have already received a 2020 RMD, you have a 60 day window to transfer it back if you wish to waive the distribution. Beyond the 60 day period, a waiver will be required. Beneficiaries of inherited IRAs who have already received RMD payments are not permitted to return funds.

Planning Opportunities. One potential planning opportunity arising from this emergency legislation is a Roth conversion. If you are anticipating income tax liability for 2020 that already includes your 2020 RMD, consider the option of converting that RMD amount to a Roth IRA, as opposed to waiving the distribution and leaving it in a taxable account. You will pay tax on the converted funds, but reinvest them for tax-free distribution at a later time. Remember, there is no RMD for Roth IRAs.

For those under 59 ½, excess funds could be withdrawn from the IRA to pay the tax on the converted funds, without the additional imposition of the normal 10% penalty.

If these opportunities are of interest to you, careful calculation should be done to determine the best tax outcome for you.

If you have any questions about how the CARES Act may affect you and your personal financial decisions or wish to speak with us about the unique planning opportunities this legislation offers, please contact us as soon as possible.

PORTFOLIO CHANGES

Added

Bristol-Myers Squibb (BMY)
We initiated a position in Bristol-Myers Squibb back in January. At the time, the company appeared attractively priced compared both to its intrinsic value and to its peers. BMY has a history of success in oncology, immunology, and cardiovascular drugs, and, in November, the company completed its acquisition of Celgene, making it a significantly larger company with a broad product portfolio. Today, shares trade at an even deeper discount and pay a dividend yield over 3%, making it a continued buying opportunity.

Boston Trust Walden Small Cap Fund (BOSOX)
Rest assured; we didn't purchase this fund solely for its ticker symbol. BOSOX is an actively managed, small cap mutual fund with an excellent track record. Manager Kenneth Scott has been at the helm since 2005, over which time the fund has outperformed its benchmark and 90% of peers. We added the fund to client portfolios to round out exposure, adding an active manager to an asset class where we previously had only passive management.

PGIM Jennison International Opportunities Fund (PWJZX)
PWJZX replaces Mutual European Fund (below) in our developed market international lineup. Managers Mark Baribeau and Thomas Davis have more than 60 years of combined investment experience, and they've managed the fund since its inception. They are supported by a deep bench, and the fund has outperformed 97% of peers over the past five years.

Merger Fund (MERFX)
MERFX was recently added to both balanced and risk-averse accounts as a fixed income substitute for diversification purposes. It has a low correlation with traditional asset classes, and, in normal markets, its returns approximate those

SOUNDBYTES

We all enjoyed the Bangor Area Chamber of Commerce Annual Awards Dinner on January 24th.

Tyler Hoxie attended CFA Society Maine's "ESG Bootcamp" in February. A presentation about Environmental, Social and Governance (ESG) investing.

Jennifer Eastman and Jean Deighan helped to write exam questions for the Investment Advisor Examination (Series 65) administered by the North American Securities Administrators Association.

of short-term investments. The fund is among the best in its class and is led by two long-tenured managers, Roy Behren and Michael Shannon.

Baird Aggregate Bond Fund (BAGSX)
Voya Intermediate Bond Fund (IICIX)
Vanguard Intermediate-Term Bond ETF (BIV)
These three funds were added to our buy list to supplement individual bond portfolios. BIV provides broad market exposure at a rock-bottom cost, while BAGSX and IICIX are actively managed bond portfolios. Both of these latter two funds feature deep, long-tenured management teams and consistent track records at reasonable costs.

Baird Short-Term Bond Fund (BSBSX)
PIMCO Short-Term Fund (PSHAX)
Vanguard Short-Term Bond ETF (BSV)
As with the above intermediate bond funds, we added three short-term bond funds to supplement individual bond portfolios. Like BIV, BSV provides broad market exposure at a low cost. BSBSX is managed by the same team as BAGSX (above), and PSHAX is an actively managed fund with a long track record from a top-tier shop.

Vanguard Long-Term Corporate Bond ETF (VCLT)
BlackRock Strategic Income Opportunities Fund (BASIX)
BlackRock High Yield Bond Fund (BHYSX)
The COVID-19 market selloff hasn't been limited to just stocks; many corporate bonds have declined in value as well. As a result, we've initiated small positions in these three funds to gain exposure to higher-yielding bonds at lower prices. Both BASIX and BHYSX are actively managed funds that focus on lower-quality corporate bonds, while VCLT is a low-cost, broad-market ETF that invests in long-dated, high-quality corporate bonds. We may continue to add to these funds if prices continue to fall and spreads continue to widen.

Removed
Guggenheim Total Return Bond Fund (GIBLX)
This fund served us well, outperforming peers consistently while we held it. However, both the management team and the analyst team have undergone significant, recent turnover, shaking our confidence in the fund's ability to continue its strong performance.

Mutual European Fund (TEMIX)
TEMIX is a fund that we held for a long time, and for much of that time it delivered solid performance wrapped in a unique package. However, more recently the fund has failed to keep up with peers, and we've become less sanguine about Europe's near-term outlook. Therefore, we exited the fund in favor of PWJZX (above), which is a more broadly diversified developed markets manager with a strong track record.

Invesco S&P Global Water ETF (CGW)
CGW is a niche infrastructure play focused on water utilities and other water-related companies. The fund served its purpose and generated reasonable returns at a low cost, but we've moved away from this specific investment thesis. As a result, we've sold the fund.

WELCOME ALISON BERUBE!

The Deighan Wealth Advisors Team continues to grow with the recent addition of Alison Berube as Operations Associate. Alison is a 2019 Cum Laude graduate of the University of Maine with a double major in Finance and Financial Economics.

What interested you about joining DWA?
I have always been interested in financial literacy and teaching people the importance of handling money responsibly. I was introduced to DWA a few years ago and have enjoyed every interaction I have had here. They are genuinely kind and supportive people. I truly believe DWA's values coincide with my own and that they are the best at what they do. Being able to work with them, learn from them and help contribute to their success has been an incredible opportunity.

What do you find you like the best about your new position?
I enjoy the fact that I get an exposure to the world of financial planning every day and being able to learn new things has been exciting! I also enjoy interacting with my colleagues as they have been wonderful mentors and enjoyable to talk to.

What's your favorite flavor of ice cream?
Vanilla! With an added layer of hot fudge sundae that is!

Describe your perfect Maine day.
The perfect Maine day for me would be walking on the beach, mid 70s with a slight breeze. There's nothing like it!

We are excited to have Alison on board. Welcome to the team!

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