SECOND QUARTER,
JUNE 30, 2020

DEIGHAN WEALTH ADVISORS

Objective, unbiased *advice*

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First and foremost, we would like to express our deepest condolences to those readers who have lost family members and friends to COVID-19. We cannot imagine your heartbreak, and our thoughts and prayers are with you. Second, to those readers who have lost their jobs or are otherwise struggling as a result of the pandemic, know that you are not alone. These are financially unstable times, and we're here – whether that's to help you plan a way forward or whether that's simply to chat and get things off your mind. Third, we would like to extend our sincerest thanks to those readers working on the front lines throughout this crisis. Whether you're a health care professional, a police officer, a firefighter, a retail employee, or a public volunteer, we're all getting through this because of your hard work and personal sacrifice. Thank you.

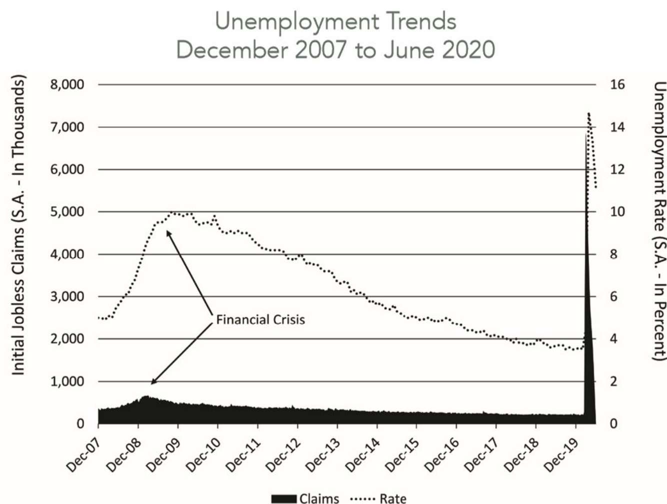
MARKET COMMENTARY

The second quarter of 2020 will be remembered for a very long time. It will be remembered for the myriad little ways life has been disrupted by stay-at-home orders and social distancing, from masks, to hand sanitizer, to waiting in line, to Zoom fatigue. It will be remembered by those who have lost their careers and businesses as a period marked by fear, uncertainty, and financial distress. It will be remembered for George Floyd and for Black Lives Matter, and it will be remembered as a time of intense social strife fueled by systemic inequality and injustice. Most of all, however, the second quarter of 2020 will be remembered for the lives lost. COVID-19's human cost has been incalculable, and this mark will be upon us for a generation. Children have lost parents, and parents have lost children. As a people, we have lost a wealth of talent, ideas, creativity, and spirit, and society is now poorer as a result. Over half a million people worldwide have died so far, one quarter of them Americans. More than ten million people have been infected across the globe, and only half have recovered. Here in the U.S., infections have again started to rise, and we now have over 1.8 million confirmed, active cases. To date, more than 2.6 million Americans have been infected. For most of us, the past few months have been a time without precedent in living memory.

This incredible human cost has come with a steep economic price. In March and April, businesses around the country were required to close as the result of stay-at-home and shelter-in-place orders. These orders, though they helped to slow the spread of the virus, pushed the U.S. economy into a historically deep recession. 17.8 million people are presently out of work, and the unemployment rate sits at 11.1%, down from a high of 14.7% in April. By comparison, the unemployment rate peaked at 10.6% during the Great Recession, also known as the Global Financial Crisis.

As of July 2nd, the Atlanta Fed's GDPNow estimates that GDP contracted 35.2% in the second quarter, and the New York Fed's Nowcast estimates that GDP declined 15.09%. Because GDP is reported with a significant lag, an advance estimate from the Bureau of Economic Analysis won't be available until July 30th, and the final estimate won't be available until the end of the third quarter. Suffice it to say, however, that the economy most likely contracted sharply in the second quarter, following a decline of 5.0% in the first quarter. These declines rival or exceed the worst economic contractions in U.S. history. For context, the economy contracted 13% in 1932, during the Great Depression era. The largest previously recorded, single-quarter decline in U.S. GDP came in the first three

months of 1958, when the economy contracted 10%. During the Financial Crisis, the worst single-quarter GDP decline was 8.4%, which came in the fourth quarter of 2008.



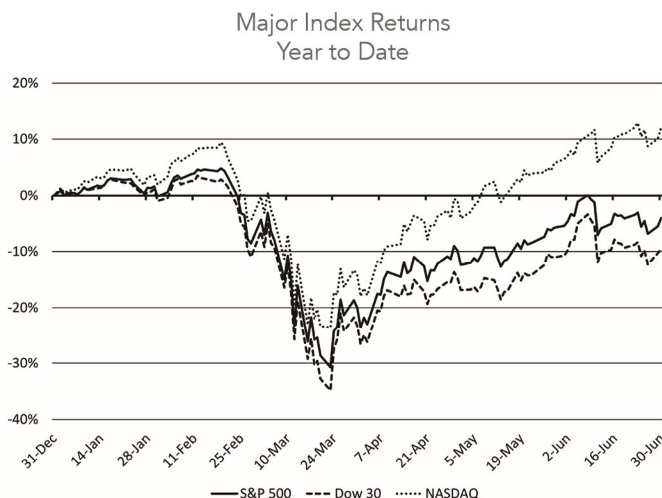
In late February and early March, when the scope of the problem first came into focus, financial markets panicked. No other word really comes close to what happened. Diversification was of little help as investors of all stripes ran for the exits and correlations between various asset classes approached 1.0. Credit markets froze, and high-quality corporate bonds and other debt instruments dropped in price alongside equities. Stocks markets whipsawed with daily price changes in excess of 10%, and good investments were indiscriminately sold alongside bad investments. All-in, the S&P 500 Index declined 34% from February 19th to March 23rd, a period of time that also saw intermediate-term, investment-grade bonds decline as much as 10%.

Back in 2008, the Federal Reserve was somewhat slow to act. This time around, however, the Fed acted quickly and decisively. On March 15th, it cut interest rates to essentially 0% and announced a new round of quantitative easing aimed at providing credit market liquidity. Over subsequent weeks, the Fed further announced the creation of several liquidity facilities targeting money market mutual funds, commercial paper markets, primary and secondary corporate debt markets, asset-backed securities markets, main street borrowers, and municipal borrowers. Though these facilities have taken time to come online, their announcement helped to illustrate the Fed's commitment to doing whatever necessary to restore confidence in financial markets and to help employers stay in business.

At the same time, Congress stepped in with the CARES Act, a multi-pronged fiscal approach that included direct payments to taxpayers as well as funding for various initiatives, such as the Paycheck Protection Program (PPP). Though not perfect in its rollout or application, the PPP helped to keep people on payrolls when they might have otherwise been furloughed or let go.

In response to these government actions, markets responded positively. Credit markets stabilized, and stock markets rallied significantly, climbing a wall of worry to end the second quarter within spitting distance of where everything started. The S&P 500 Index rose 19.95%, its best quarterly return since the index's inception in 1957, and the NASDAQ rallied an incredible 30.63%, rising to an all-time high on the backs of large technology companies. Such strong stock performance was welcome, if unexpected, and it reiterated the importance of remaining invested even during the darkest of times; one simply cannot know. The S&P 500 is now down just over 4% on the year, the NASDAQ is up about 12%, and the Dow Jones is down 9.5%.

Recognizing that prices were dislocated in late March and early April, we implemented a number of trades in client accounts that included the purchase of stocks, high yield bonds, and long-term bonds. While we didn't time the exact bottom, we came pretty darned close and were able to add value to portfolios. At present, thanks both to our incremental purchases and to the market rally, most clients are sitting with full or near-full equity allocations and portfolio values that are just a few percentage points underwater year-to-date. Given the immense challenges presented by COVID-19 and the historic market volatility in the first and second quarters, we are largely satisfied with this result.



The Federal Reserve has said it will keep interest rates at the lower bound for the foreseeable future, likely through 2022. This means fixed income will remain unattractive, and investors will either need to settle for safety with little-to-no yield or be willing to take additional credit and duration risk – while still earning a historically low return in exchange for such risk. Although bond yields will be a drag on portfolios for years to come, we believe fixed income must continue to play a defensive role in portfolios, because stocks are also expensive. Despite all of the economic challenges we cited earlier, the S&P 500 trades near its pre-COVID highs and the NASDAQ trades above its pre-COVID highs. The forward price-to-earnings (P/E) ratio on the S&P 500 hasn't been this high since the glory days of the technology bubble, which concerns us. Various news reports over the past quarter have pointed to irrational exuberance in stocks, from Hertz stock appreciating wildly despite declaring bankruptcy, to Tesla overtaking Toyota as the world's largest automobile company by market capitalization, to any number of technology companies trading at sky-high valuations despite no earnings. A significant side effect of the Fed's policies has been an abundance of cheap money with nowhere to go but the stock market, and this has had an upward, distorting impact on equity prices. Don't get us wrong; all else equal, we're glad that stocks have recovered. However, when stocks trade at these levels, two major concerns present themselves.

First is the obvious risk of loss. When stocks are expensive, there is a greater probability of prices reverting downward. The more an investor overpays, the more he or she risks never seeing those prices again and impairing capital permanently (i.e. Cisco stock in March of 2000).

The second concern is that, even in the absence of some severe correction, high stock prices should translate into lower future annualized returns. In essence, an overly high price today is tantamount to the "pulling forward" of returns from future years. At the end of the day, a company is only worth so much, even after accounting for future growth. If tomorrow's value is pulled entirely into the present, then there is nowhere left for the price to go. From a planning perspective, investors should temper expectations for equity returns. Rather than expecting 8-10% per year, investors should instead start thinking in terms of 7%, 6%, or maybe even 5% returns from these levels on an annualized basis. Of course, even a 5% return on stocks trounces today's bond yields, and this fact is likely to keep money flowing into stocks, propping up values and perpetuating this phenomenon.

In our last newsletter, we wrote that our base case for the summer months was a series of rolling brownouts across the country, whereby states would deal with virus flareups at different times. This outlook, though a minority opinion at the time, has largely come true. The number of new U.S. cases is now outpacing April, when the virus first took off in Washington and New York. New cases have been averaging 40,000 per day, with 50% of all cases coming from Florida, California, Texas, and Arizona. It's difficult to see the virus abating and life returning to normal given the lack of coordinated policy, the lack of testing and tracing, and the general belief by large swaths of the population that masks and distancing measures are unnecessary. Assuming we continue on this trajectory, we expect a more prolonged downturn than necessary, and COVID-19 will continue to weigh on the economy and capital markets.

That said, it is impractical to keep the economy permanently closed, and we expect states to continue doing what they can to strike a balance between the need for individual safety and the need for people to earn an income. Despite the increasing number of infections, recent better-than-expected jobs numbers illustrate that we might be on the right track in finding that balance.

SOUNDBYTES

During these challenging times, we've continued to support our communities through our work on nonprofit boards. Within the past quarter:

Lucie Estabrook was elected president of the Wellspring board and joined the Bangor Land Trust board, where she was elected vice president;

Jennifer Eastman joined the Bangor Symphony Orchestra board, and the Mabel Wadsworth development committee, and;

Matt Skaves was elected vice chair of the Maine Seacoast Mission board.

For more information about these organizations, please visit their websites:

www.wellspringmaine.com
www.bangorlandtrust.org
www.bangorsymphony.org
www.mabelwadsworth.org
www.seacoastmission.org

The stock market's resilience, and indeed euphoria, throughout the second quarter tells us that investors shouldn't bet against massive monetary and fiscal stimulus. Therefore, our plan is to keep client accounts fully invested unless otherwise requested, while working diligently to find pockets of value and to take profits on overpriced holdings. We would caution readers that a rising stock market isn't necessarily a healthy stock market, and, given the somewhat outsized expectations baked into prices, today's market has the potential for continued volatility and perhaps even a significant pullback. If this occurs, our advice, as it was during the most volatile periods in February and March, is to ride out the volatility. If the market's gyrations have proven anything, it's that selling into a down market is a good way to lose money longer term.

As always, we welcome your phone calls and emails, so please reach out if you have any questions or concerns, and please keep us informed of life changes, especially cash needs. Until next time, we wish you and yours a safe, happy, and healthy summer.

PLANNING CORNER

IRS Provides Additional Relief for 2020 IRA Required Minimum Distributions

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, enacted on March 27, provided relief in the form of waived IRA required minimum distributions (RMDs) for 2020. This was great news for IRA account holders since it meant that they could leave the RMD in their IRA, not pay tax on the distribution, and allow the money to continue to grow in their IRAs. In April, the IRS said that RMDs already received between February 1 and May 15 could be rolled back into IRAs by July 15, erasing the tax consequences of taking those distributions. However, the IRS did not provide relief at that time for inherited IRA holders, and for early birds who had taken their RMD prior to February 1, 2020.

In our last quarterly newsletter, and in our May 23 blog post video (both available at www.deighan.com), we talked about some of the provisions of the 2019 SECURE and 2020 CARES Acts as they pertain to IRAs and other defined contribution retirement accounts such as 401k, 403b, and 457 plans. At that time, we encouraged you to stay tuned as additional relief for IRA account holders and retirement plan participants might be on the way before year end. That additional relief arrived in late June!

New IRS rules issued on June 23 extend the rollover window – the deadline IRA account holders have to roll distributions back into their IRAs – to August 31. Additionally, RMD amounts taken in January 2020 are now eligible for inclusion in the new rollover rules. This is welcome relief especially for those who may have been pushed into a higher tax bracket, since IRA distributions are taxed at the account holder's ordinary income tax rate. And inherited IRA accounts have never been allowed to roll distributions back into their IRA, but the new rules include inherited IRAs. If you have inherited an IRA, you can benefit from this additional tax relief as well. Another provision of the rules applies to those who take substantially equal IRA distributions. The new IRS notice provides that the usual rule of allowing only one rollover per year per IRA account holder will not apply to this year's RMD.

While the new rules benefit those who would be subject to a higher bracket as a result of RMD income, IRA account holders that expect to be in a lower tax bracket this year may be better off hanging on to their RMD rather than returning it to the IRA since taking it out now might make more sense from a tax perspective if a higher tax bracket is expected next year.

If you have taken a distribution from your IRA this year and expect the extra income to bump you into a higher tax bracket, then consider reducing your taxable income by putting it back into your IRA before August 31. It could potentially save you from Medicare surcharges or tax on your Social Security. Please call us to discuss the logistics of rolling any RMD amounts taken in 2020 back to your IRA. We are also available to discuss other tax saving strategies such as Roth IRA conversions and charitable IRA rollovers. As always, we are here to help with all of your financial needs.

PORTFOLIO CHANGES

BUY – International Business Machines Corp. (IBM)
One of our goals this quarter was to find a technology company that stands to benefit from long-term trends, such as cloud computing, work-from-home, and artificial intelligence, without overpaying. IBM fits the bill. Shares are attractive compared to peers, as is the dividend yield (roughly 5.5%). Though IBM has struggled to get out of its own way for much of the last decade, we see significant catalysts in the form of a new CEO and the recent acquisition of open-source software provider, Red Hat.

BUY – Salesforce.com, Inc. (CRM)
Salesforce is another company that stands to benefit from long-term trends in cloud computing, work-from-home, and software-as-a-service. The firm is the market leader in customer relationship management (CRM) software, one of the fastest-growing segments of the enterprise software market according to Moody's. Salesforce has grown significantly over time, both organically and through the successful integration of acquisitions. Today, its offerings extend beyond CRM into areas such as service, marketing, client engagement, and data analytics.

BUY – Charles Schwab Corp. (SCHW)
Schwab is a leading discount broker, asset manager, and provider of custodial and support services to registered investment advisors. Its planned acquisition of TD Ameritrade, which was recently approved by both the Department of Justice and shareholders, should result in a company with significant scale and cost advantages. In an industry where fees have been driven downward, Schwab's size should allow it to continue growing revenues while remaining a customer-centered, low-cost leader. We initiated a position in anticipation of the upcoming merger and the competitive advantages it should bring, as well as the stock's attractive valuation and reasonable dividend yield.

BUY – Intercontinental Exchange, Inc. (ICE)
Intercontinental Exchange operates regulated exchanges, clearing houses, and listing venues, including the New York Stock Exchange (NYSE) and ICE Futures Europe. It operates markets for a variety of derivatives contracts and also provides data services in the areas of trading, investment, and risk management. The company has grown earnings per share for 14 consecutive years and enjoys significant levels of recurring revenue. In the short term, Intercontinental Exchange should benefit from continued market volatility, which drives trading volume and revenues. In the long term, the company should continue to benefit from the trend toward automated trading, as well as synergies from its data, index, and analytics offerings.

BUY – ½ Position of Citigroup, Inc. (C)
Citi is one of the world's largest diversified banking companies. Its institutional arm provides a range of banking, sales, trading, foreign exchange, research, lending, investment banking, private banking, and cash management services to corporate, institutional, public sector, and high-net-worth clients. Its consumer banking arm provides retail banking, commercial banking, and credit card services to customers in North America, Latin America, and Asia. Shares trade at a significant discount to fair value and are supported by a dividend yield just over 4%. By adding a half position, we are slightly overweighting our banking exposure, as Citi joins JPMorgan Chase in client portfolios.

BUY – ½ Position of Walmart, Inc. (WMT)
Walmart, North America's largest retailer, is known for selling a wide variety of consumer goods at low prices. The company benefits from its leverage over suppliers as a major purchaser, which allows it to drive profits while undercutting competitors on price. Walmart operates 5,355 stores in the U.S. and 6,146 stores internationally, including Sam's Club stores. In recent years, it has built out its website to allow for same-day, in-store pickup, as well as a third-party marketplace. The company expects e-commerce sales to grow 30% in 2021 and has its sights set squarely on Amazon, who it views as a primary competitor. Our decision to add the stock to client portfolios was largely a defensive one; we view Walmart as a relatively stable store of value with modest growth opportunities, making an attractive holding during a pandemic. Walmart generates significant free cash flow and pays a reasonable dividend yield of roughly 1.8%. In addition, it is our opinion that Walmart has the logistical and technical expertise to challenge Amazon longer term.

SELL – Brookfield Asset Management, Inc. (BAM)
We first purchased Brookfield for clients in 2006. Since then, the stock has more than tripled in value. However, we decided it was time to exit the position to make way for other holdings in the financials sector. Brookfield has faced recent challenges growing funds from operations, and it has

significant exposure to commercial real estate, such as malls and office space. These properties are likely to be impacted both in the short term, due to COVID-19, and in the long term, as e-commerce grows and as companies move a portion of their workforces to the work-from-home model.

SELL – Schwab U.S. REIT ETF (SCHH)
We liquidated client positions in this REIT fund at various points throughout the quarter. The reasons were twofold. First, we made changes to our portfolio models, and those changes necessitated a reduction in real estate exposure. Second, for reasons similar to our sale of Brookfield, we see REITs facing challenges in a post-COVID world. Dollars raised from the sale of SCHH were used to fund some of the above purchases.

SELL – ½ Position of Amazon.com, Inc. (AMZN)
We continue to like Amazon as a long-term holding. However, in the short-term, we believe Amazon's price has gotten a little ahead of itself. The stock has been trading near all-time highs, and we decided to bank profits and redirect the proceeds into lower priced opportunities. The stock has increased fourfold since we first initiated the position. Therefore, the reduction brought shares back in-line with a normal position size, down from an overweight position size. Should Amazon shares correct significantly, we may consider adding back to client positions.

SELL – ½ Position of Chubb, Ltd. (CB)
Chubb is the world's largest publicly-traded property and casualty insurer, offering a variety of insurance products including general liability, homeowner's, auto, accident, worker's comp, specialty crop, and marine coverage. It is a well-run business with a combined ratio better than most peers. Our decision to reduce the position stemmed from near-term concerns over COVID-related payouts across numerous business lines, including travel, trade credit, accident, health, worker's comp, and business interruption. We wanted to reduce exposure to these short-term issues while remaining invested longer term.

WELCOME, ELLA STONE!

Deighan Wealth Advisors is pleased to welcome Ella Stone as our 2020 summer intern. Ella will be learning how to research investments and training on our Bloomberg terminal to increase her general knowledge in finance. Ella graduated this spring from the Hyde School in Bath, Maine, though she has grown up here in Bangor. She plans to attend Husson University in the fall, studying art and business (a perfect fit for our firm). In her free time, Ella enjoys painting in oil or acrylic, and spending time with her pets – a green-cheeked conrue parakeet named Luke, and a Chinese dwarf hamster named China. Ella loves hiking and camping in Maine, and crunchy peanut butter on pancakes. We love the vibrant energy Ella brings to our office!

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