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Second Quarter 2020 Review & Outlook
by Whitney Brown

INVESTMENT OUTLOOK

- Stocks stage powerful rally in second quarter.
- Mega-cap tech stocks lead markets higher.
- Investors eye virus progress as economies reopen.
- Economy and markets supported by monetary and fiscal stimulus.

Equity markets enjoyed a phenomenal rebound in the second quarter. The widely followed major market indexes all gained by double-digit percentages for the three months. The Dow Jones Industrial Average was the slow poke rising 18% while the NASDAQ Composite galloped ahead by 31%. For the year to date, the NASDAQ stands alone as the only major equity index to retake its pre-COVID high. The NASDAQ is sporting a 12% gain for the year through June 30 while the S&P 500 is down 4%. The small cap Russell 2000 is off 13%, as is the developed international MSCI EAFE. Clearly, U.S. stocks on the whole have fared better than international equities, while growth-oriented sectors have continued to dominate the more economically cyclical value sectors.

The NASDAQ's remarkable surge in the wake of the global pandemic, a deep recession, and record unemployment is largely attributable to the success of a handful of mega-cap tech stocks: Facebook, Amazon, Netflix, Microsoft, Apple, and Google (Alphabet). Because of their enormous market capitalizations this group of so-called FANMAG stocks dominates the market-cap weighted NASDAQ Composite Index. Apple, Microsoft, Amazon, and Alphabet each weigh in with market caps in excess of $1 trillion. The market cap on these six stocks alone exceeds 20% of the market cap of the entire S&P 500 Composite.

Market Measures	2nd QTR	YTD
S & P 500 (price)	20.0%	-4.0%
Dow Jones Industrial Average	17.8%	-9.5%
NASDAQ Composite	30.6%	12.1%
Russell 2000	25.0%	-13.6%
MSCI EAFE	13.9%	-12.8%
Barclays Capital Inter Gov't/Credit Bond Index	2.8%	5.3%
	6/30/20	6/30/19
10-Year U.S. Treasury Bond Yield	0.67%	2.01%
Three-month U.S. Treasury Bill Yield	0.14%	2.10%

These stocks have for various reasons proven to be winners in the pandemic economy and in pre-COVID times had consistently demonstrated high rates of sales, free cash flows, and earnings growth. In some ways investors now view these stocks as defensive plays for uncertain times due to the essential nature of their products and services as well as their strong financial metrics.

Since early June, the rally off the March 23 panic low has paused with markets mostly moving sideways by alternating up weeks with down ones. The stock market called the economic recovery well before there was economic data to support the case. Now, as U.S. states and other countries attempt reopening at varying paces and with varying degrees of success, investors may be adopting a wait-and-see approach.

Second quarter earnings announcements will unfold in the coming weeks even as many areas in the U.S. and abroad contend with a troubling resurgence of COVID-19. Already, some states that pushed to reopen sooner are being forced to delay and even reverse their progress as virus case counts surge. Importantly, the virus will be with us for a while. Availability of an effective treatment for widespread use is months away, and, at best, a vaccine would not be ready until the end of the year. How people and their governments contend with balancing the need to revive their economies against restrictive measures to control the spread of the virus will impact investor sentiment.

Sizing up the second half of the year, there is much to be concerned about such as the persistence of the virus and how the U.S. presidential election shapes up. Given the recession and the President's low polling numbers, the most

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IRS Remedies for 2020 RMDs by Bob Martin

It is not often that we can tell the Internal Revenue Service thank you, but a recent notice issued by the IRS on June 23, 2020 may prompt some to do so. Recall that on March 27 President Trump signed into measure a law (under the CARES Act) that suspended Required Minimum Distributions (RMDs) from tax deferred 401(k) accounts and individual retirement accounts. Many retirees taking RMDs do so automatically each month to ensure they meet the requirement and avoid paying the hefty 50% penalty. Others use the RMD to make donations to qualified charities. So when the law when into effect, some RMDers had already taken some if not all of their RMD out. The original law allowed for the distribution to be reversed but only under the 60-day rollover rule. The June 23 notice helped to clarify that people who took RMDs in January or anytime thereafter can redeposit their RMDs to accommodate the CARES Act RMD suspension for 2020.

How do we return the money?

The method approved by the IRS today is a rollover. The RMD deposit can be treated as rollover if accomplished before August 31, 2020. When returning the RMD, you can re-deposit the money in the distributing IRA/401(k) or place in another tax-deferred account.

The notice reads: "In the case of the IRA owner or beneficiary who has already received a distribution of an amount that would have been an RMD in 2020 but for section 2203 of the CARES Act or section 114 of the SECURE Act, the recipient may repay the distribution to the distributing IRA, even if the repayment is made more than 60 days after the distribution, provided the repayment is made no later than August 31, 2020."

These distributions apply to any defined contribution plan, including 401(k) or 403(b) plan, or an IRA. The waiver does not apply to defined-benefit plans. The relief also covers spouses and non-spouse beneficiaries with inherited 401(k)s or IRAs. It applies to people who turned 70 ½ in 2019 and delayed taking their first RMD until 2020.

How do we recoup the tax bill?

To provide an example, if you took a RMD on January 2 for $30,000 and asked your custodian to withhold $10,000 for taxes, you can return the $20,000 to a tax-deferred account and add another $10,000 from your own pocket to make up for the amount that was withheld. To recover the taxes, you can reduce your withholding or quarterly estimated payments or wait for a refund on your 2020 tax return. Alternatively, you can let the IRS keep the $10,000 tax payment and convert the $20,000 to a Roth IRA by August 31. Once in a Roth, the $20,000 can grow tax-free.

What if I made a Qualified Charitable Distribution?

Qualified charitable distributions can also be put back in the IRA. It would be up to you whether to ask for the donation back from the qualified recipient or to use other funds to roll back into the IRA. If the qualified recipient keeps the money and you roll other money back into the IRA, then the donation would be treated as a Schedule A deductible contribution. The August 31 deadline applies.

Overall, the June 23 release is good news for many; if you can afford to put your RMD back, it may make sense to do so. As with any decision with tax implications, however, it is wise to consult your accountant or tax advisor. And this decision should work in concert with your overall financial planning objectives. We welcome any opportunity to discuss these matters further.

Bon Voyage Jonathon

After being recruited by Stebbins Hubard to join Dominion Trust Company in 1982 and moving to Roanoke from his home state of Florida, Jonathon Grace has decided to enter the retirement phase of his life journey this fall after 27 years with DHFB. He plans to refocus his efforts towards travel, family, and his health and fitness, along with his spouse, Gary Richardson.

We were blessed to have Jonathon join DHFB in 1993 as our Operations Manager, after his stint with Dominion/First Union ended. Of course, in a small office, each employee must become a "Jack of all Trades," if you will, and carry several responsibilities.

In addition to Operations Manager, Jonathon assumed the mantle of Chief Compliance Officer, dealing with the ever-changing regulatory environment. He also became responsible for Human Resources, all things software and security related, monitored our mutual fund selection process, as well as formatting and producing our quarterly newsletters. He provided support to several large endowments by assisting them with audit and reconciliation needs.

He oversaw our successful conversion to the Charles Schwab platform, as DHFB moved to consolidate custodians. Most recently, he has been spearheading our conversion to a powerful Portfolio Management system called "Black Diamond" (look for more Black Diamond information in a future newsletter).

Jonathon, you will definitely be missed!

Record Levels of Cash on the Sidelines by John Hubard

Amidst the recent market sell-off in response to fears surrounding the coronavirus and its potential effect on the U.S. economy, investors piled into money-market funds – mutual funds that invest in cash-like securities such as short-term debt, Treasury bills, or commercial paper. As investors sold their stock and bond holdings in risk-off fashion, these money-market funds saw their assets under management jump by 20% (or $685 billion) in March. In April and May they drew $388 billion and $31 billion respectively, bringing total assets in money-market funds to a record $4.8 trillion. And this doesn't take into account the money that has poured into deposit accounts at banks (See charts below).

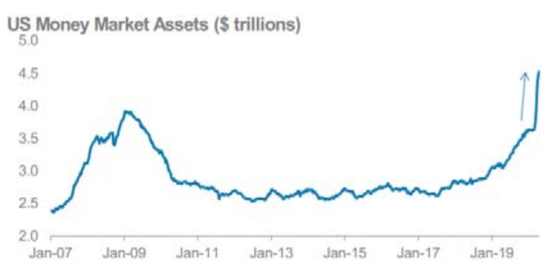
It is not unusual for investors to seek the safety of cash in turbulent times, but historically, this money came back into the stock market as a bottom formed and investors began to snap-up cheap, undervalued issues. What is perplexing is that in spite of the stock market staging an extraordinary recovery to pull within shouting distance of all-time highs, this cash has not returned to the markets. What this means is that investors have not yet fully bought into the legitimacy of this seemingly unexplainable rally.

While experts argue over the principal reason for the massive amount of cash currently on the sidelines, one can quickly point to the massive stimulus introduced by the Federal Reserve in response to a market which found itself with no liquidity (no buyers) as herds sold any asset they could to raise cash. In addition, the U.S. Treasury issued $1,200 each to millions of working Americans, and portions of those funds have found their way onto the sidelines. There is simply a lot of money in the system today after recent monetary and fiscal interventions.

While the holdings leave plenty of dry powder for investors to deploy, the increase arrives amid fears that major stock market indexes are overextended. The general consensus among analysts seems to be that regardless of when, at some point, this cash will have to re-enter the system, whether that be through the payment of dividends and/or buyback programs, via capital expenditures by corporations, or through the purchase of securities and/or goods and services.

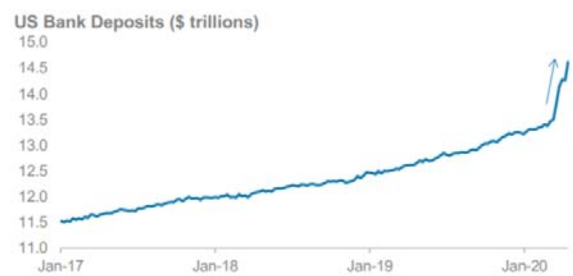
With the averages rising even without all of this parked cash, it seems pretty straightforward that any portion which enters the market will be *in addition to* the buying volume which has supported the recovery performance by stocks to this point. This is not to say that averages are immune from the seasonal slump which they have often experienced from July to September, but it does make it likely that large institutions will be there to support lower equity prices, providing the type of large-volume buying needed to stop any downtrend in its tracks.

ICI money market fund assets have risen substantially



Source: Bloomberg, Morgan Stanley Research

US bank deposits: A recent surge



Source: Bloomberg, Morgan Stanley Research

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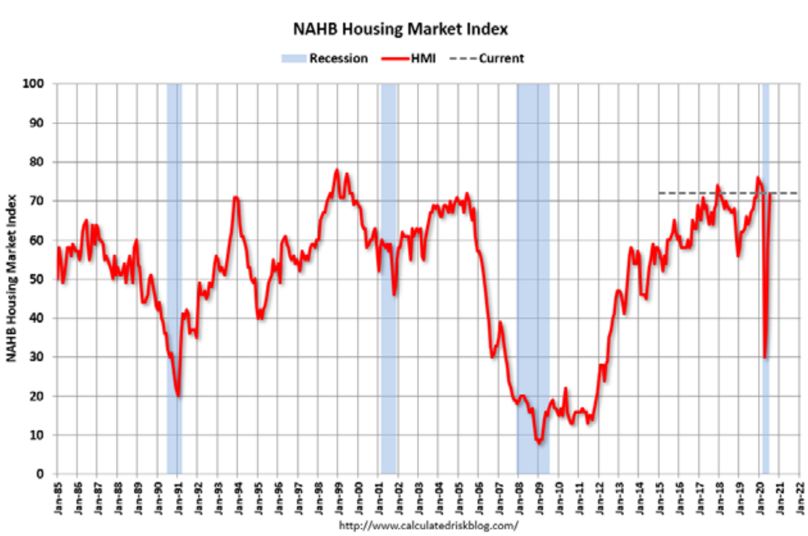
important implication of the election may hinge on which party ends up with control of the Senate. Yet, beyond the uncertainty there are several very important positives. First and foremost, the Federal Reserve, along with other central banks, have been early and aggressive in pumping liquidity into the economy. The Fed has also been unequivocal about its determination to provide unlimited support to the economy until it recovers from the effects of the pandemic.

Additionally, there is a good chance that Congress will work out a follow up stimulus bill with the White House before the election. Further, based on the latest reports, people appear to be returning to work faster than expected. Admittedly, we have far to go to get back to the low pre-COVID levels of unemployment. Last, from a technical market perspective the powerful equity rally off the March low bears the hallmarks of the beginning of a new cyclical bull market. Historically, when equities rallied 15% or more from a deep selloff, as they have, further gains tended to follow for up to two years. Recent strength in smaller capitalization stocks as well as traditional value sectors also helps build the cyclical bull case.

Housing during the Pandemic by John Hubard

In spite of increasing Covid-19 infections and small business shutdowns, American consumers' appetite for homes seems to be powering the current advance to a large degree. Historically low interest rates are attracting consumers with disposable income and a desire to relocate to make a move. This is in direct contradiction to what has typically occurred during downturns, where consumers sharply pulled back on their big ticket purchases while continuing to spend at service-sector businesses. In addition, the National Association of Homebuilders' housing market index reading for July jumped significantly higher. The index now stands at the solid, pre-pandemic reading in March, before the outbreak affected much of the nation.



While the housing market is clearly rebounding, make no mistake, challenges exist. For instance, lumber prices are at a two-year high, and builders are reporting rising costs for other building materials as well. While housing alone cannot support the US economy on its own, these large ticket items certainly have an outsized effect, and to be sure, signs of renewing strength are being seen in other areas such as automobiles.