Frank A. Childress
Chief Investment Officer
Registered Investment Advisor
Since 1993

CHILDRESS
INVESTMENT
MANAGEMENT

888 E. Saddlehorn Road
Sedona, AZ 86351

425-985-2621

Website:
childressinvestment.com

Email:
childressinvtmgt@msn.com

Frank A. Childress DBA
CHILDRESS INVESTMENT MANAGEMENT
QUARTERLY ECONOMIC REPORT
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The financial markets put in a strong performance during the 2nd quarter of 2020. After a drop of –35% in the S&P 500 index from the middle of February to the bottom on April 23rd, the market rallied to within 10% of the high made in February before the Corona Virus outbreak.

Significant events of this quarter were:

- ***The U.S. economy fell –4.8% during the first quarter of 2020.***
- ***FED dramatically cut short term interest rates to 0% due to Covid shutdowns.***
- ***20 million jobs were lost in April. This was the biggest monthly job loss in the history of our country.***
- ***U.S. Government has provided $2.7 Trillion in Aid to businesses and consumers due to the Covid crisis.***

The second quarter of 2020 witnessed a historical drop in both jobs and our economy due to the Covid shutdowns. Our economy lost 20.5 million jobs in April, and then gained 2.5 million jobs in May and 4.8 million in June. The total jobs lost during the second quarter was still a staggering 13.2 million. The hardest hit industries were Leisure/Hospitality at -28% job losses, retail at -8.1%, Government at -6.3% and manufacturing at -6.0%. (Source: U.S. Labor department).

The unemployment rate in April rose to 14.7% in the U.S. It has dropped to 11.1% at the end of June due to a recovery in jobs during May and June. Unemployment in the African American community is at –16.8%, which is very troubling. This has led to social unrest in their communities on top of the issues with police brutality and discrimination. In the 1930's when we had the Great Depression there was heightened social unrest and in Europe with their high unemployment, there has been continued social unrest, especially in France. Of note, there will be continued layoffs in the airline industry starting in October and there are many furloughed employees in the leisure/hospitality industry that have yet to find out if they will be brought back by their employers

A very good measure of the state of our job market is the weekly unemployment claims. At the end of June there were 20.5 million people receiving unemployment. This number has held steady since the beginning of May and is a reduction from the 25 million claims during April. I will be watching these weekly claims very closely to monitor our economy in the coming months. Of importance, the enhanced unemployment benefit of $600 per week is set to end on August 1st. The Senate Democrats want this program to continue but Republicans do not. Due to this extra benefit many unemployed workers have not taken a reduction in income from their regular job wages. This is a very expensive program for the Government to fund and this will end in 2020 due to the Federal financial burden of funding this program. **Look for our economy to slow when this enhanced program ends.**

On March 15th, the FED cut interest rates to 0%. This was a dramatic move on their part and reflects the severity of the economic downturn caused by the Corona Virus. This action is designed to stimulate the economy with lower borrowing costs. The FED has stated it will keep rates at 0% through 2021. For income investors and retired people this is a negative as bonds will pay lower interest rates. Money market funds will be going to 0% in tandem with their move.

From March to the end of May the FED pumped $2.9 trillion dollars into the banking system. They were also given the power by the Treasury department to lend $4 trillion to the private sector. This gives them the capacity to make loans to companies that are capital depleted due to the downturn. These are historic events in the history of the FED and again illustrate the severity of the economic downturn.

One of the hardest hit industries due to Covid was the airline industry. This industry predicts that there will be 3 to 5 years of depressed demand for air travel. They also believe there will be a permanent reduction in business travel due to the improvements in video conferencing. Boeing has announced and started a layoff of 13,000 employees and will shed 10% of their workforce of 160,000 employees globally in the next year. Suppliers employing one million workers globally for Boeing are also implementing layoffs.

The airline industry predicts layoffs of 105,000 employees starting on October 1st. ***This is one forth of all their employees.*** The airlines had to delay layoffs due to taking Payroll Protection money from the Federal Government in April. Delta took $2.7 Billion under this program and will take another Federal loan for $4.6 Billion later this year. Delta does not have to pay back the Payroll Protection money but will have to pay back any Government loans at low interest rates. Delta lost $534 million in the first quarter and will lose much more in the second quarter, which saw the full effect of Covid. The unfortunate situation is that air travel cannot come back until the virus is under control. With a vaccine coming at the earliest in about a year, there may be a major bankruptcy in this industry next year.

A troubling budget/economic issue developing is all the money the Federal Government is spending to both stimulate the economy and prop up industries in trouble. *The Congressional Budge Office (CBO) is predicting a $3.7 Trillion federal budget deficit for the year 2020*. This is money our government will have to borrow via selling U.S. Government bonds. This will take us to a debt level equal to 101% of our country's annual Gross Domestic Product. Economists have long used the 100% debt to GDP of a country as a red flag of when to watch a country's debt to see if borrowing has gotten out of control. As with an individual or company, when debt gets out of hand your income winds up going to paying interest and not allowing for profits or investment.

As a result of the U.S. Government taking on so much debt, look for taxes to increase in the coming years. At the local level this will be retail tax increases and property tax increases. On the Federal level income tax rates will be going up. This will slow down the economy as consumers have less money to spend. I hope we get this spending under control in the next year as borrowing and printing money is not the solution.

As a result of the huge economic impact of Covid on our economy there are new investment themes. Logically, all businesses that require face to face contact are really hurting: Travel, lodging, restaurants, retail stores, the airlines, the entertainment industry. Unfortunately, there are no short term solutions and thus the stocks of these industries have been hurt dramatically. Other industries hurt from the Covid economic fall have been the Energy stocks (due to less air travel and less driving) and the Bank stocks. These are all groups that will struggle until an effective vaccine is found.

In the interim, as we await a vaccine, all money flows into stocks are mainly going into technology and a few other groups that benefit from staying at home. Stay at home is benefiting grocers and food companies due to people eating more at home. Amazon is a great stay at home stock due to people not wanting to shop in public. Many technology companies that support working from home and video conferencing are doing very well. I think the tech stocks are now overvalued and when a vaccine arrives you may see a rotation back into the beaten down industries. Thus, the importance of diversification in portfolios.

Clients of Childress Investment have gotten through 2020 well. I have avoided all the industry groups discussed that are being sold due to a large drop in revenue. In March, when the stock market came under selling pressure, I reduced economically sensitive funds and stocks but held all tech investments. I also drastically reduced our exposure to high yield bonds as this is issued by companies with lower credit ratings.

If the virus were to abate or a vaccine becomes imminent, I will make adjustments by moving into these distressed groups that should rebound dramatically.

One sector that I am watching very closely is real estate. Commercial real estate has been hit very hard by Covid. Malls were closed and many tenants have not been making rent payments. Office buildings are also struggling and many businesses will reduce their office space permanently. Banks have exposures to this industry and thus losses on loans could be substantial and need to be monitored.

A positive for our economy has been residential real estate. Mortgage rates are extremely attractive at around 3% for a 30 year fixed rate loan. Home prices have held up extremely well considering the unemployment rate. These low rates are a major supporting factor and if residential real estate is able to hold pricing, it will aid in our economic recovery.

BULL CASE

The Bullish stock market case is as follows:

- FED has cut short-term rates to 0%.
- Strong balance sheets at many large corporations.
- Very strong tech cycle for many technology companies, which is producing strong earnings and sales.
- Stock valuations are attractive in many non-tech sectors.
- Massive economic stimulus by the Federal Government with enhanced jobless benefits and loans to distressed industries.

BEAR CASE

Bear Case:

- Covid Virus has proven hard to contain and vaccine is still not available.
- Trade issues with China.
- High unemployment in the U.S.
- Budget issues with State and local governments.
- Possible rise in taxes.
- Commercial real estate problems.

The bear case versus bull case is in the mildly bearish camp for the U.S. financial markets. We now face a host of economic and political problems, both domestically and internationally. The U.S. economy has fallen into a recession and determining the recovery is much more difficult than usual. In the current financial market, my continued focus will be on U.S. economic growth, Europe and the Chinese Trade negotiations.

We have lost momentum in consumer spending in the U.S., which is bearish for our economy. The residential real estate market is benefiting from a 30 year fixed rate mortgage that dropped from 4% to 3.0% in the past year! Home prices are a huge driver of consumer spending and if this market can hold pricing this portends well for our economy this year. If home prices come under pressure than an economic recovery will not be possible in the next year.

After the large increase in stock prices during the second quarter of 2020, this quarter should see a pullback in stock market prices in the U.S. Importantly, the financial markets have settled down since the FED assured investors they would be accommodative if the economy were to weaken further. I am now patiently waiting for economic developments, especially with Covid trends and developments for an effective vaccine.

Bonds were up during the quarter due to interest rates dropping after the FED cut rates. Corporate bonds still have appeal. In closing, the coming months will be more volatile for stocks than during the past ten years. This is due to the increased uncertainty caused by the Corona Virus and the resulting economic events occurring in the world.

ASSET ALLOCATION

The current client allocations are as follows:

- **Growth Accounts: 52% in U.S. stocks, 4% International stocks, 1% Gold, 28% in bonds and 15% in cash.**
- **Retirement accounts: 48% U.S. stocks, 3% International stocks, 1% Gold, 28% bonds and 20% cash.**
- **Conservative Accounts: 40% U.S stocks, 3% International Stocks, 37% bonds, and 20% cash.**

U.S. stock allocations were held steady during the period of April to June. Foreign stock holdings were held steady. I continue to favor U.S. company stocks over foreign stocks.

INVESTMENT REVIEW
OPENING AN ACCOUNT

If you have any comments or questions concerning this report, please contact Frank Childress at (425) 985-2621. Or via e-mail at: childressinvtmgt@msn.com. Feedback and comments are welcomed.

To arrange a review of your portfolio or to receive information to open a managed account, please contact us. If you know of someone whom would like to receive a complementary copy of this report, please let us know.

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