

PERFORMANCE*

	FMR Performance		Russell 1000	Dow Jones	S&P 500
	Taxable	Retirement	Value	Industrial	Dividends **
2020 Q1	-23.20%	-19.10%	-20.61%	-23.20%	-19.60%
2020 Q2	16.86%	16.14%	21.25%	17.77%	20.54%
2020 H1	-10.23%	-6.03%	-3.74%	-9.55%	-3.08%

The aggregate Five Mile River account performance grew 16.68% in the second quarter of 2020, versus the S&P 500 20.54%, the best quarterly gain for this index since 1998. FMR is down 9.11% year to date, compared to the S&P 500's decline of 3.08%, and the Dow's decline of 9.55%. Since inception in 2003 FMR's annual average gain is 8.33%, versus the S&P's average yearly gain of 11.71%.

The longest economic expansion in U.S. history ended in February of this year, as coronavirus and the associated lockdown froze many parts of the economy. However, economic improvements in retail spending, payrolls, industrial production and consumer sentiment in April, May and June suggest that this "recession" most likely ended in either April or May thereby registering the shortest recession in U.S. history. This reversal of economic activity was made possible by the policy steps taken by the Federal Reserve providing \$3.2 trillion in direct lending facilities, and over \$2 trillion of fiscal stimulus from the U.S. Government (The CARES Act). The Federal Reserve created **NINE** different lending programs since March growing its balance sheet by the \$3.2 trillion mentioned above. The Federal Reserve's actions have been to purchase and thereby support government bonds and corporate investment grade bonds and high yield bonds, even Exchange Traded Funds (ETF's), which had the initial effect of stabilizing bonds and also stocks. What started as a historic S&P 500 decline of 33.93% in only twenty-four trading days (February 19th to March 23rd) was reversed by these unprecedented fiscal and monetary policies causing the S&P 500 to rebound 38.58% from the March lows.

The path forward for the U.S. economy and the stock market will now be determined by the spread of the virus. Two of the more significant unknowns regarding COVID-19 are: one, will there be another wave of the virus and two, what will be the timing of viable treatments and vaccines? Future full lockdowns are probably off the table and are being displaced by social distancing, masks, hygiene practices, and individual states' lockdown of specific facilities. Volatility in the stock market will continue until there is greater clarity on these questions and many of the other unknowns associated with the virus. The government has created "Operation Warp Speed," a program providing funding and various incentives to accelerate the delivery of a vaccine by year-end. This is a herculean task because on average it typically takes FIVE years from development to commercial introduction for a vaccine to be approved by the FDA.

This race for a cure has now created over 100 potential vaccines in “the clinic.” While many hold significant promise in efficacy, lengthy but necessary clinical trials testing safety could delay the introduction of a new vaccine until 2021.

Pfizer is a good example of clinical success with their messenger RNA vaccine that produced two to three times the antibodies of a recovered virus patient. Their chief scientist was interviewed, stating that their product could be on the market before year-end depending on its safety profile. Interim data from a number of successful vaccine candidates point to the potential for year-end approvals. The pundits are saying they believe that the ultimate vaccine will probably be a combination of different drug candidates.

Because of the economic uncertainty and the number of unknowns created by the virus there are relatively few hard conclusions that one can make about future economic and stock market forecasts. We do know that the amount of money created by the Federal Reserve, called monetary aggregates (M1), has increased 34% in just three months! This compares with the very healthy 16% growth in M1 for the full year following the 2008/2009 Great Recession. A significant difference from the Great Recession is the current money creation is going directly into consumers’ pockets. The Great Recession monetary stimulus did not go to consumers, instead it went to the major banks to stabilize their capital reserves which were depleted from the housing debacle. This explains why the current explosion in money growth along with the government’s PPP program have translated into recent strength in retail spending, and the hope for a “V” shaped economic recovery. The Federal Reserve’s massive liquidity injections, along with the reduction in interest rates, have also helped the corporate sector which has taken advantage of this liquidity opportunity in the last four months to raise a record \$8.4 trillion in bond and stock issuance.

The shape of the economic recovery along with the November elections remain significant unknowns. Historically, the Consumer Confidence Index has been the best predictor for retail spending (66% of GDP). This index for June was just released and rose to 98.1%, up from 85.8% in May! It is still unclear whether this index, and its implied growth in consumer spending, will mollify the estimated 25% decline in second quarter GDP and the second quarter earnings decline of over 40%. The outcome of the November elections continues to be uncertain and potentially poses a concern for the economic recovery. The Senate race is the one to watch, more than the Presidency. The recently issued Democratic tax policy calls for raising corporate tax rates, increasing capital gains taxes, raising estate taxes, and increasing some individual taxes that could result in a 10% to 15% correction of the markets, according to Jeremy Siegel (Wharton School Finance Professor). Professor Siegel goes on to say on CNBC (6.30.20) that “. . . the market would welcome a Republican-maintained Senate even if there is a Biden Presidency.”

Stocks are unlikely to break out, up or down significantly until after the election. With the S&P 500 trading at 3,150 it is likely discounting S&P 500 earnings of at least \$175, or a PE of 18X. The S&P is not likely to see this level of earnings until the end of 2021, which suggests the market is fully valued and could take a year of earnings to grow into the market’s current valuation. More than half of the S&P 500 companies have withdrawn all forward guidance, which raises the chance of negative earnings surprises. It will likely take another quarter or two before corporate CEO’s have the confidence to make a forecast of 2021 earnings. While the appreciation of the markets from the March 23rd lows has been spectacular (+38.58%), the rise has been narrowly driven by the top FIVE names in the S&P 500 index (Apple, Amazon, Microsoft, Facebook, and Alphabet). This technology concentration has been profound as the market capitalization of these **FIVE** names is now equal to the market capitalization of the next **TWENTY** largest companies! These twenty include; The Home Depot, JP Morgan, Netflix, United Health, P&G, Mastercard, Visa, Verizon, PepsiCo, Disney, Merck, Intel, Pfizer, JNJ, and Walmart. Speculation has become rampant. Tesla has risen 150% in less than a month! After declaring bankruptcy, Hertz stock doubled in the following two weeks. Countless penny stocks have doubled and tripled. Las Vegas has restricted access and it feels as though that

money has arrived on Wall Street. That is not a bullish sign! Money market funds now exceed \$5.2 trillion and given the absolute low return on this money (less than 0.15%), it is no surprise that these funds are contributing to the strength in the indices and speculative ideas.

FMR is dedicated to investing in industry leaders that have long successful records of returning capital to shareholders. It is difficult to project how the tug of war between cash on the sidelines vs. the headline risks will resolve. In past FMR letters we explained the phenomenon whereby if you missed the twenty biggest daily gains in the market over the past twenty years, you would lose 3.7% for that twenty-year period and you would have not experienced the reported 10% + average yearly gain! For this reason, FMR has long argued that market timing is a fool's errand because it is important to continue to stay invested through uncertain times. Nevertheless, you will notice in your June statements that FMR is holding slightly elevated levels of cash as a buffer to market volatility.

IN SUMMARY

Even though the market has gotten ahead of its forecast earnings and seems to be discounting multiple unknowns, the stock market is still the most reliable and accurate Leading Economic Indicator, and therefore may be signaling a far better economy than what now appears visible.

We wish you all a healthy and prosperous summer. Please call with any questions.

Sincerely,



Lee



Todd



Martha

**The performance data included in this letter are not audited and have not been otherwise reviewed or verified by an outside party. While Five Mile River Investment Management, LLC endeavors to furnish accurate information, investors should not rely upon the accuracy or completeness of this information.*

***The S&P 500 Index is a market capitalized weighted index of 500 companies. It is a growth-biased index because the larger the capitalization of a company, the larger the weighting it contributes to the S&P 500 Index performance. The index referenced includes the dividends issued by these 500 companies. This index is used for a comparison for FMR accounts.*

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