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March 18th Client Teleconference

Barbara Turley:

Good afternoon and thank you for dialing into the conference call for our Commerce Trust company clients. My name is Barbara Turley and I am director of investment research at Commerce Trust. As you all know, we are living through a highly unusual time with a coronavirus pandemic. Before we start on today's agenda, we would first like to say that we hope you and your families are healthy and safely navigating the seemingly daily disruptions in our lives as we combat this virus. Many of you have received our communications via email since the market downturn started earlier this month, but we also wanted to reach out today in this teleconference so that you could hear directly from our top investment leaders. As we have stated in earlier communications and we want to reiterate this, the daily administration of your financial matters with Commerce Trust Company is still functioning very much as you would have experienced before the Corona virus impact and we intend to keep putting all our resources into providing the investment services you are accustomed to receiving from us.

So now let's turn to the situation at hand. I am joined by our two speakers, one of whom is Scott Colbert who is our Chief Economist and Director of Fixed Income Management. Also joining us is Joe Williams who is our Director of Investment Strategy. At one time or another you may have heard Scott or Joe on national or local news broadcast. Scott is going to set the context of the broad economic landscape and then Joe is going to follow with some comments about how the fact markets have weathered crises in the past and where the market may be headed. Some of our listeners have sent in questions in response to our invitation and Joe and Scott will attempt to answer some of those questions before this call is concluded. Before we begin, I do need to say that this presentation is designed to provide investment information exclusively for Commerce Trust Company clients. It is intended to provide general information only and that information is subject to change and reflects the opinions of the speakers and not necessarily that of Commerce Bancshares Inc and we always urge you to consult with your independent legal and tax advisors as appropriate. Now with that, Scott, could you lead us off this afternoon?

Scott Colbert:

Well thank you Barbara. I'm going to try and talk about two things. What are those two things? Number one, where is the economy as we sit here today and where is it headed? We'll call that one thing, in my words, the economic outlook. And then secondly, what's going on within the fixed income side of the markets. As the manager of about $22 billion of, the folks on this lines, you know, money and, you know what's going on in the market, then we'll hand it off to Joe, which we'll move to the equity side and talk about our top down asset allocations and what they're doing to mitigate some of the problems on the equity side. And I'll address some of those on the fixed income side. So, let's, let's get the easy stuff out of the way. We are currently both in a global recession and if not statistically yet, because generally a recession, they, border the recessions by quarters.

If we haven't slipped into it yet, which we have on March one, we will statistically, certainly by April one, be in a recession in this country. , global recessions are typically defined as growth, less than two and a half percent. We went into the year with growth at about 3%, but with China and of course the largest contributor to growth at the margin, taking it on the chin first with the coronavirus. That and the compounding effects of everything has certainly pulled us into something less than two and a half percent world growth, we're probably looking at something like 2% world growth if we're lucky, maybe even as much as one and a half percent global growth by the time we're through with the year. But most of us, of course, are much more focused on the United States. And it's here where we made it through two months.

The initial impact of the virus is happening right now. And of course, statistically it will show up in the next quarter. We can't imagine that you can recover so quickly that we won't have a second quarter. You know, starting July one through September 30th, but we are optimistic that a lot of this can be put behind us in two relatively quick quarters. And we'll talk about why. So, you know, without a doubt, we've got a lot of wood to chop and a recessionary blow to offset. Is there any good news to be found? Well, the first good news is that we went into the year with really quite a tailwind, interest rates. And you've probably forgotten about all this because our focus is solely on CNN and the virus. But you know, we went into the year, the fed had already reduced rates three times last year and in fact the entire interest rate curve in the United States was down about 75 basis points.

And that afforded us several things. Number one, the entire corporate bond market with the economy, improving interest rates, declining, saw credit spreads compressing, and the average corporation in America has taken huge advantage of this both terming out their debt. The average corporate bond has about a 12-year maturity and lowered the cost of that debt. The average yield that the average investment grade company in this country was paying going into the year was only about 2.9% to borrow money and all that money by the way is locked in. So it's not like there should be, you know, an impending crisis short of those that are having, you know, literally are having, you know, a dramatic a draw down in liquidity, given their given their cash flow situation. Secondly, of course this helped the housing market and the housing market was really finally getting some legs after having kind of suffered slowly but steadily improvement over this entire 10 year, 10-and-a-half-year recovery.

But we really went in, mortgage rates were down, home loan rates were down about a 75 to 90 basis points and of course housing appreciation was up. This helped translate with the economy doing well, bonds, doing well, housing, doing well, stocks having a record, not record but near record year last year to 11 additional trillion dollars of wealth that we didn't have the year before. Now the bad news of course is we've managed to wipe that out in about 25 days, but at least we had it to give back and we didn't start from a weaker foundation. We start from the wealthiest foundation we ever have now stepping into the breach in addition to help cushion the blow, of course are our policymakers and what they, what they can do. The first policy action of course is coming from via monetary policy and the federal reserve, what have they done?

Well they've, you know, cut rates twice prior to the meeting that they were hoping to wait for, which just occurred. So, prior to their meeting they were essentially forced by the downdraft and the and the sudden downshift in the economy to cut rates twice and essentially take short term rates to zero. In fact, Landers Carnal sitting next to me, our Chief Investment Officer, and he mentioned to me today that the T bill went negative in terms of interest rates for the first time ever. I didn't catch that. But you know, you're looking at essentially 0% rates. In fact, if you want to think about it this way, a bank like Commerce or Bank of America, JP Morgan can go to the Fed's window and borrow unlimited amounts of money right now at 25 basis points. And we would earn with excess money that we have sitting around at the fed 10 basis points.

So you can see how basically the cash markets have gone to zero. So, the feds cut rates, they've introduced an unlimited amount of liquidity for the banking and brokerage system, via the fed window, the lowering of rates and some additional policy that they've implemented. They've geared up their QE while it's a $700 billion response, and that's hard for people to put into context. During the financial crisis, the fed basically implemented three waves of quantitative easing, essentially about a trillion dollars each trillion, trillion, trillion. I think there's more quantitative easing, coming, and essentially it's the fed printing money to buy bonds, both treasury bonds and mortgage backed securities to keep interest rates low out along the curve and to create fluidity and liquidity in a market that is a little and has been somewhat disruptive. And then they've reduced the discount window as well and then some, some nichier programs that help commercial paper issuers and things like that.

That's almost too much pool. Now. Probably more importantly though than then offering this liquidity of course is what can the government from a fiscal point of view do. And the good news is with interest rates as low as they are, the government largely has almost unlimited borrowing capacity to provide fiscal stimulus of some kind. They of course have already passed the eight and a half billion dollar emergency bill. , they've released 40 plus billion dollars of FEMA type monies into the economy. They just passed I think plus or minus a minute the $100 billion package the proposal that would extend unemployment, doubled in Medicare benefits that are going to all the States who participate in that program, created the free testing things like that. And now we're waiting for the bigger package, which by the way, at 850 billion to a trillion dollars is bigger than the Obamacare package of $787 billion during the entire financial crisis that came 14 months after the crisis started.

And we are basically, you know, we are 21 days or 25 days into this. So, you know, policy will have, a positive effect. It certain mitigating whatever disaster you're feeling right now and it works with a lag, but it is certainly helping us. It's, it's not hurting us. Now how far will we contract? Nobody knows. But I will say this, and this isn't meant to panic anybody, but the numbers are going to be staggering if you think about it. What would I tell you that the economy might contract 10% in the second quarter? What does that really mean? Well, that's over an entire year, that 10% and so that's really only a nominal two and a half percent contraction. So, to get the to the big 10% number, which would be an unprecedented quarterly number, would just simply mean that we spent 97 and a half cents on the dollar for every dollar we spent versus the first quarter.

And if you'd told me we still are spending 97 and a half cents on the dollar compared to a full dollar. I would be surprised if we even can do that, right? So, the number is going to be big and it's going to be ugly and it's going to be negative, but in the same case, when will it end? And that's where nobody really knows. I think Joe is more on the pessimistic side because he recognizes the complications that this causes the problems to businesses, the credit results. I'm a little more on the optimistic side thinking that the market is likely to find a bottom when the number of new coronavirus cases stops accelerating. And so, I guess when will that be? We only have three examples to look for in this. Number one is China, in the provinces X to buy, because they're, they got a handle on it.

They know Hubei was bad and so they really got a lockdown on that fast and China got control of that problem outside the original problem in 30 days. Well, we're 21 days into this, we're not, well actually basically we're not even that really, but we're not going to make it in 30 days. Right. It took China inside Hubei 50 days with draconian measures and we haven't moved to draconian measures, but we've certainly moved to measures that we've never seen in the United States. And so, I don't think it's unbelievable that it's somewhere past 50 days, but perhaps not too much longer than that because we are tracking better than almost everywhere else. Short of South Korea, they got a handle on it like X, China, the outside China regions where we're, where South Korea really got a handle on this within 30 days as well.

So that's where we're waiting. And in fact we, we manage money for almost every health care organization in the region and many outside the region, and I've talked to a lot of the folks there and in general the feeling is we are waiting for the storm to arrive, but it hasn't showed up yet. We're preparing, we have testing, we have extra beds. We pushed off elective surgeries and in fact in some cases where you're getting calls for liquidity to these hospitals because their revenues have fallen because they're pushing everybody out waiting for the influx of people that haven't showed up yet. What does a 50- to 60-day thing look like when we're only three weeks into it? Well, that would be a bottom sometime after April, but before mid-May. Secondly, you could look at it from a normal recessionary kind of point of view.

If the recession really started March 1st the average recession in this country is 11 months. I think this would be short because we know what the problem is and we will see the end of the recession when it begins to rollover. So, let's say it's less than 11 months, and stocks typically bottom four months before the end of the recession. So even if we go with 11 months, that's next January, subtract off four months from that and you're looking at the end of September. So, I would say from the most optimistic point of view, stocks and risk assets bottom sometime in May to sometime in September. Now while that's a wide range, that is a lot less than the average recession where when the average recession occurs, it takes 365 days from the stock market peak, which was less than a month ago to bottom on average. So, if there's a silver lining in all this projection, it's that while severe and sharp, the bottom is likely to be closer.

And we've seen these explosive rallies off the bottom when we finally get there. I think we're working there fairly quickly. Joe will tell you this is the most steep and severe downdraft we've ever seen in the financial markets. Nothing I mean it's basically an unprecedented freefall and so we're bound to get to the bottom, we believe a little quicker. Now, what does that mean for the bond market? Well, most of you know interest rates have gone down. At least that's what you read about or hear about on TV. And if you're lucky enough to have only own treasury bonds, absolutely cash has gone from one and a half percent, to soon be almost zero. T bills have gone a similar amount and as Landers mentioned earlier that they're actually negative. So, we're down, down, down on government securities. Mortgages, however, have not declined nearly as much.

They're only down about 25 basis points. So, if you're out there looking to refinance the flood of money coming into the refinancing pipeline has not afforded us the ability yet to refinance our houses in any huge material way at lower rates. Because the mortgage back pipeline is only so big, and people are flooding it right now. And so, mortgage issuers have backed away. But we think with the QE, the fact that the government is buying these mortgages will help drive that spread down and ought to offer some benefit. And of course, most of the bonds that people own in their portfolios are in the either in the municipal or the corporate space and they're actually, we've seen interest rates rise because while treasuries have gone down, credit spreads are clearly increased. For example, the average corporate bond is widen has basically widened about 160 basis points or 1.6% so while the average treasury bond might've fallen 50 basis points, the average corporate bond is actually more like 1% higher in yield today and it's not too dissimilar for municipal securities because of the perceived risks.

We do think that the municipal market as a relatively risk-free market in general will begin to turn and behave better, sooner than the corporate market and that leaves us finally in the high yield space, we had been allocating essentially for a balanced portfolio within fixed income and fixed income might be 35% of a portfolio. Essentially 8% of that portfolio would have been in what we call the higher yielding space. Those would be junk bonds for a pejorative, but, but high yield bonds, emerging market debt, preferred stocks and bank floating rate loans. We have taken action here and are reducing those positions to build a little bit of a cash cushion up on the fixed income side. Recognizing that is where the riskiest part of your portfolios lie. Same for the high yield municipals that you might have in your portfolio to just give us some ammunition and dry powder if you will to cushion the blow.

And then secondly to look for that bottom in the market to afford us the ability to rebalance. Now, there hasn't been any rebalancing done yet and Joe will address that. That's been a great positive because we haven't tried to catch that proverbial knife, but eventually we're gonna want to be nibbling, rebalancing, selling some of these bonds that haven't performed nearly as poorly. And in fact, if you want to take the Commerce Bond Fund as an example, the commerce bond fund as of last night, is down 1.35%. A lot better of course than the stock market down about 30% but nonetheless, a diversified bond fund with some corporates from governments, mortgages and asset backs, you can still see that the average bond fund really hasn't done much, but it sure provided a heck of a cushion relative to what we've seen on the stock side. So I'm a little more optimistic that we'll have more of a V-shaped financial market recovery, a very severe economic impact.

But since the problem is known and the problem will begin to fade away, eventually I think we'll have a gradual and slow recovery, but one that the financial markets will greatly anticipate and move faster, quicker than they ever have. Recognizing that the real root of the problem is simply the virus and not, I mean in general. So, with that, I'm going to hand it off to Joe to talk about the risk of your parts of your portfolio asset allocation. And then we're going to take what amounts do, I'm told lots and lots of questions.

Joe Williams:

All right, thanks Scott. We've all survived through the SARS and swine flu in 2000, 2009 but this coronavirus has we've seen something we've never seen before. Of all the economies around the world shutting down in less than a month when the equity market was at a record, high equity markets have declined 30% plus around the world, along with the Scott mentioned interest rates collapsing. The equity markets have priced in a lot of downside risks to the economy, but that is clearly a moving target on the downside. Equity averages are approaching the mean bear market, which is a little less than 35% and those are the ones that coincide with the recession, which we think we will be in. It has done it, as Scott said, in a record time, less than a month, 1929 bear market took two months. So, this is by far the fastest we've ever seen. So here we have the S and P down 32% or 31% so how bad can it get?

So, going back to 1900 we've had 36 bear markets, meaning declines of more than 20% and other than 1932 which was down 80% the next worst was one. We've all recently been through 2009 when the equity market was down 55% but then when we look at the next six worst bear markets, they all declined 45 to 50% Some pretty bad years in here. 1929, 1938, 1974, 1921 I don't remember too well that 1907 and 1903 periods. But those were the six worst bear markets and they were between 45 and 50%. So yes, the markets can head lower, but essentially if history is any guide, two-thirds of the damage has occurred already

With the economy grinding to a hold over the coming weeks and probably remaining so until mid-May, what will happen to earnings is a big question. Right now, initial projections are earnings declining at least 15 to 25%, but that's just a guess and it could be worse over the next two quarters. So right now, in this panic decline, there's going to a very high correlation of stocks. And when I say that, I mean everything is going down together, strong, weak companies. And just in the last two days though, we are starting to see some differentiation between the stronger companies and the weaker companies, which is important for this market start to stabilize. In this decline. Large cap stocks have been the strongest.

They been stronger than mid cap stocks and mid cap stocks have been stronger than small cap stocks. And that all goes back to the market's perception. A large company, like a Microsoft can certainly weather the storm much better than the small cap company that might not have the financial reserves for the steep recession short but steep. What we are going to be watching over the next couple of months as this panic selling hopefully subsides. We think it will in the equity market typically moves into a trading range as it probes and test the ultimate low, which sometimes is lower. Other times it's not. And what we're looking for is, is the number of stocks. Each time we go down hitting new lows, we'll begin to contract as the market does sort out between the winners and losers. And that's exactly what's happened what did happen back in 2009.

So, what do we do from here? First off, as Scott mentioned, we are once again reminded the benefits of a balanced portfolio with the fixed income portion of your account holding its value. Unfortunately, the equity portion has declined substantially. And now the question is when to rebalance, meaning when do we sell bonds to move back up to stocks of whatever the allocation is set to your account. We have so far taken the stance that we did in late 2008 and 2009 is that we would rather wait a bit to see how this plays out. We'll probably miss the low. We did. We waited until April of 2009, but we're going to be watching this over the next several weeks or months before we rebalance. Two of the equity themes we had at the beginning of the year remain intact. The first is overweight growth stocks. When I talk about growth stocks, think of technology, healthcare, consumer companies and overweight them to value stocks, which are typically energy, financial and industrials.

This theme has played out in the decline with large cap growth stocks down 10% less than value stocks. And we think that trend will continue. The other theme we had at the beginning of the year, and we've actually reduced farther is our international exposure versus domestic. Our long-term weight has been 70% domestic, 30% in the international. And we've been lowering that over the last, several months to now around 20. And we've actually lowered it again today. So here's the thought process behind that. Underweight to international, which continues to underperform. It underperformed last year. Domestic stock is underperforming another six to 7% this year. And it's because of the structural makeup of the S % P 500 versus the EAFE. Now EAFE is large cap stocks in Europe, Australia and the Far East and the structural makeup is very different. S&P 500's largest sector is 28% and that's technology stocks.

That's before the decline. Versus the EAFE tech weighting of only 8% the two biggest sectors of the international markets are financial stocks which are dealing with negative interest rates in Europe and industrials and a very small waiting in as a reset technology. So they really are at a disadvantage and that's one reason why we continued to remain underweight it and today we decided to even reduce that farther by reducing over the next several days our positions in the small cap international funds that we would own in your portfolio. We want to assure you that we are still actively managing equity and fixed income individual portfolios. We are trying to call out some of the weaker companies affected by the economic shutdown and redeploying the money in companies that should benefit. Now the one sector of the equity market we are reviewing carefully is the energy sector. Over the last month, we've seen oil demand of course collapse.

And then a week and a half ago we had a price war erupt between Russia and Saudi Arabia and both are flooding the market with more oil. Now that has sent oil prices down over 60%. They hit the low $20 number today and it's causing immense strain on a lot of the weaker energy players that are in the shale region here in the United States. And even the larger cap oil companies are really taking a hit. We are reviewing trying to make sure to see if the dividends are at risk. We believe they are at risk, especially in the energy area. And so we are making sure, the companies that we do own, can make it through this price war that unfortunately could go for a couple of years. Now the benefit is though, your oil prices, gas prices are going to be declining. It's going to help the whole transportational sector once it gets up and running again.

So there are benefits for the consumer and the economy. Now, another question is, what are high quality companies? They're paying a good dividend worth down the road as the economy turns to normal. Dividend yields for the S&P are now three times greater than the 10-year treasury, and they're approaching 2.7%. We do not believe, well capitalized corporations will decrease their dividend rate just because of a six-month severe hit to earnings. And remember, as Scott was mentioning, stock market start to discount,] the economy and earnings six to 12 months in advance. So once we see the peaking in cases in the United States and hopefully the rest of the world over the next couple of months, I believe, you know, we could see a meaningful rally and we're just monitoring that on a daily basis of when we want to make any changes within the equity side. So, with that, Barbara, I'll turn it back over to you.

Barbara Turley:

Thank you, Joe and Scott. Now we'll try to answer some of the questions sent in by our listeners. And the first one, it didn't take long to rise to the top of the pile. Joe, I'll direct this one to you first since it appears to be top of mind for listeners and it concerns the stock markets. The question is this, why did Commerce Trust sell stocks before the main part of the downturn?

Joe Williams:

Well, that's always a good question. In retrospect. you know, we were monitoring, the situation and we saw the situation in Russia, I mean in China and we did feel that we could see the economy essentially closed for two weeks and then restart as we saw happen in China and that the stock market could deal with it. What changed. and we all underestimated was the complete shutdown of all world economies at the same time. And you know, in a period of a few weeks, you know, the whole decline now is, has been done of down 32%. And that's one reason, you know, I wanted to go back and look at where other bear markets and some of the worst declines we've had. You know, I would say we're probably 66% of the way there and yes, it can go down another 10 or 15%. But this is a virus that's moving through the economy and you know, it will pass through the system. There will be some vaccine developed over the next year and the economy will resume. So, you know, looking back, we should have, but it certainly occurred faster and harder than we've ever seen any other virus like this hit. All right. Add to that.

Scott Colbert:

You know, I mean clearly we saw what was happening overseas, , and we felt probably wrongly, somewhat protected by our oceans. The fact that so few cases were showing up here initially and the thought that, you know, you'd likely be able to quarantine or close this down faster than we really have. Secondly, because we are worried that of course if you over run the health care system, then there really is blood in the streets on a relative basis and draconian type estimates. We are pushing out or lengthening this cycle by doing what we're doing. So in order to not overwhelm the hospitals, we are extending that punch they took in China, which they got rid of. And within 60 days we are pushing it out and extending it. And so it's having a larger economic impact in terms of you know economic activity. Now the stock market of course has taken that to task and basically is discounting right now an average recession. We think it will be worse than average, but quicker than average. And so that's why we're still not rebalancing and not buying into the market. Simply put, we're not wanting to catch that proverbial falling knife just yet, but we think it's coming sooner rather than later and want to hold off and keep our dry powder for that rebalance down the road.

Barbara Turley:

All right, thank you. Our next question, concerns portfolio allocation. The question is what sort of portfolio allocation should I have now? Are there any safe havens? You know, cash, precious metals, bonds, treasury. I'll let both Joe and Scott respond to that.

Scott Colbert:

Maybe I'll start with the easiest part, which is, you know, obviously U S treasuries are somewhat of a safe Haven, although the 10 year treasury bottom and 54 basis points and it's bounced up 70 basis points from its bottom already, call it 65 basis points swing on a 10 year treasury with an eight year duration is four and a half percent. So, you know, you'd be looking at a loss if you bought that 10-year treasury. Cash is clearly the safest of havens in the sense, but we know that that's going to generate a non-inflation adjusted return. I do think that the treasury market will settle down and offers, I thought rather catchingly. Somebody said a risky no return. In other words, just you know, no return, something closer to inflation but at least no risk but, but no likely return. Gold hasn't proven to be a safe Haven as people have looked to sell whatever it was that was working. And then I'll let Joe pick it up from there. But short of cash, it's tough to see a lot of safe Haven opportunities at the moment. Joe?

Joe Williams:

You know, I do think, you know, on the stock, obviously there were no safe havens. Everything is, has declined in every market around the world. You know, I think ultimately as the market starts to differentiate now between these higher companies, higher quality companies, they will be the ones, you know, when you have a lot of the healthcare companies, they're yielding three to 4%, that those are gonna look awful attractive coming out of this. And the technology companies are gonna still be in business and will continue to do well. You know, I think we'll start to see that it hasn't made any difference so far, but from this period on, I think you will start seeing a clear differentiation of the winners and the losers. And you can just kind of look through the market today and even yesterday. Some of that leadership is starting to come out.

Barbara Turley:

And also for both of you, how is this period of time different from the great recession of 2007 to 2009?

Scott Colbert:

Well, I think the biggest differential is in a typical recession, things start to go bad. They compound upon themselves. You're not really sure what's, you know, looking back, you can say what started it, but then they just cascade and you're rolling down a hill and you really don't know when it's going to end until it finally just exhausts itself. And ends the great recession in 2007 and 2009 was our longest recession. It took 18 months and of course nearly brought the lifeblood of the economy, the banking system to its knees. Bank of America at $3 a share, and of course a number of banks going out of business. This time we enter it with a much stronger from a much stronger situation.

Banks while they're down a lot and you know, the bank stocks are clearly down a lot. They aren't trading like they're going out of business and I can tell you they've got more capital and lower charge off than they've ever had, and the fed has made available immediately and right away almost unlimited liquidity and lowered the reserve requirements. The fed and policy makers are asking the banking system this time to be the help and keep, get the economy through it compared to the last time where the, basically the levered banking system was the culprit and essentially the reason along with the subprime market and housing prices collapsing that forced us in the last recession. That's the biggest thing because I really think we can point to the, the virus is the problem. When the virus disappears, that will be the solution. What we don't know is the compounded knock on effects of what occurs while we work our way through it. How many people working at a Marriott that have just been laid off and slow to open up? Does it, does it harm? How long will it take Disney World to reopen? How many weeks will the auto manufacturers not bother to produce a car? Those, those are the kinds of things we still are working through. And as Joe will tell you in the equity market is telling you it's compounding worse than you know, originally anticipated. But we still think it'll be less draconian and quicker than the previous recession.

Joe Williams:

You know, we know in China, again, looking back wasn't that long ago that, you know, in February their auto sales dropped 80%. I mean, it was everything ground to a halt there. But I just saw coming into this meeting that, 90% of the Starbucks are now open again in China. So it, you know, this will pass. We don't have to worry about, you know, Lehman brothers going under, a Bear Stearns and the whole financial system melting down and that puts us in a much stronger place than we were in the 2008, 2009 time.

Scott Colbert:

You know, we could also probably say, let's face it with unemployment at the lowest rate level. That helped a lot because we have more people working than ever, even though this is going to impact employment quickly. Hopefully a lot of those people will be brought back and that was a plus. And, of course we were coming off the huge wealth effect from last year. We've largely only given that back compared to during the financial crisis where, you know, you went in with wealth that was lower. And of course, you know, a stock market that fell 50% while your house price on average was falling about 30% in this country. So it was, an awfully big hit from a wealth and economic standpoint in the last recession.

Barbara Turley:

How does the oil pricing war that Joe mentioned earlier, how does that complicate the bigger economic picture?

Scott Colbert:

Historically I'm told I've been very adamant about this. And we already went through one of these oil downdrafts in 2016, and we were very specific and said, This is not the start of a recession. Lower energy prices on average are still better for the country even though we're closer to energy independence, and even though we have this huge energy infrastructure that produces 12.5 million barrels of oil per day. It wasn't as big an advantage as it used to be, but it was still in general an advantage. This time the lower oil prices really aren't necessarily helping anybody, because when I look out the window the streets here in Clayton, there's not a lot of cars driving around. And so we're not really saving a lot of money because we're not even using the energy that has come to us so cheaply. So that's the big complication here is that no one's demanding the energy even though it's cheaper and cheaper.

From corporate bond point of view, about 2 to 3% of all corporate bonds have some type of energy exposure. The good news is it's kind of a 50-50 bifurcation there. You have the major integrative oil companies which essentially, let's face it, they can cut their dividends and save themselves anytime they want to. We know that BP has a 13% yield at Exxon and 8 or 9 or 10% yield. So they have the ability to weather through this. It's the pipelines that are levered, to begin with, that you're likely to see the economic contamination and compounding effect there. It's going to take a while for those rigs to decline. And it's going to take a while for OPAC and Russia to say, At 20$ a barrel we really didn't mean that. And so that just takes some time to work through. But that's certainly an added negative in this recession whereas the last recession you would have said, Lower energy prices, in general, were still positive.

Barbara Turley:

And Joe, here's a question for you. What do you see for international stocks, merging versus large? You spoke about international small earlier. What do you see in general for international stocks?

Joe Williams:

Well, as I said I do think they're at a structural disadvantage to the US markets, and that is not going to change. So I think they're going to be continued to be under pressure as far as their returns versus the US. What is somewhat surprising is merging markets, which we did go overweight six or seven months ago to that of the ETF, the large Europe, Australia, and the far East. We did feel growth was better. And you think with the whole coronavirus starting in China and the clamp to the Chinese market which is now rallied back, they would really be hit hard. But actually, yes they have been hit hard, but they're down 25% versus the ETF down nearly 30% as of last night. So, we're still sticking with our merging market exposure. We think longer term they still probably still have the best growth than the European or Japanese companies do. So, I doubt we're going to see any major change in that standpoint over the next 6 to 12 months.

Scott Colbert:

And while we're not looking really for any credit here, because we recognize most portfolios are down in a balanced fashion. They're down. We have underweighted those international stocks compared to what our typical strategic allocation is recognizing what Joe said here that US stocks seem to be a bit better position. It's been a modest help because the international markets, of course, have done in general worse than the US market through this downturn.

Barbara Turley:

We have a question here. How does Commerce approach constructing a balanced portfolio in a zero rate environment?

Scott Colbert:

Joe, you want to try that, or you want me to start?

Joe Williams:

You have the zero-rate part of it, so I'll let you start.

Scott Colbert:

It's an interesting question. I would say in a zero-rate environment not really any differently than we do in any other rate environment. We have never really targeted cash as an asset in and of itself recognizing that cash, in general, has no real return, and right now has a negative return. It does impact probably what we think is likely to be the steepness of the yield curve, and that's a positive. So the extent that cash is lower-yielding it is encouraging to think then that bonds can steepen up and offer some reasonable yields that they didn't used to offer. I will say that essentially fixed income hasn't gone away despite the fact that cash has. It makes a bond even more interesting. From an equity side, of course, we know that the riskless rate helps discount all stocks. I do think that this ultra-low interest rate environment that we were in is what helped propel equity valuations to all-time highs.

But when we look at a balanced portfolio we always think about it in terms of real returns. And the nominal returns to everything have come down as inflation has come down. But the real returns to both sectors of the market haven't been materially affected. So, it really hasn't effected that overall top-down allocation. We've been building pretty much the same portfolio trying to pull from all the different diversified sectors for a long time. And while we don't like low-interest rates because we know it generates less income, with also know though that on a relative basis nominal returns relative to inflation are still likely to be, in other words, your real return is still likely to be about the same.

Joe Williams:

I'll pop in. Let me make one correction to what Scott said. When he said, "Sending valuation to new all-time highs." Yes, valuations were expensive at the end of January, but they were nowhere close to the high that we saw back in the technology boom in late 1999 and 2000. And even they were below the highs that we saw in January of 2018. So while I can't say the market was cheap, but it certainly wasn't anywhere close to those highs.

Scott Colbert:

I misspoke. The stocks were nowhere near the crazy levels they were during the internet crisis. And frankly, while they were expensive, they were still cheap relative the where interest rates were. And it's why we still have full allocation to equities. We weren't overweight stocks, but we didn't go into the year underweight then either.

Joe Williams:

That's right. And stock are going to be your income producers in a zero-rate environment for at least the short-term. So at least I think that does make attractive a lot of people's international stock even go more than US stocks. So, I think that does give them support and valuations can trade at a higher level once we go through this little set back here over the next three to six months. As far as earnings go that valuation should trade in the more expensive range with interest rates at these levels.

Scott Colbert:

And it will certainly help us find a floor

Barbara Turley:

And how do both of you think the US presidential election might affect the recovery?

Joe Williams:

From my standpoint, I'll tell you in about five months once we get through... I think that kind of off the table right now and we'll see as we go into September. I do think that Biden in there the market seemingly to win the nomination, that will at least calm the market over Bernie Sanders as far as what could happen. But this is going to be a very fluid situation, and we really don't know. Typically, an election year, this isn't the typical election year, whoever wins the election the markets have a tendency to move higher. But this isn't a normal election year. That's what I see.

Scott Colbert:

Well I would simply say that I think Trump seems to be much more amenable to working with a Democratic House to push things through. And so perhaps while this huge partisanship about almost everything and whoever wants to take responsibility for whatever recovery we have will be hugely partisan as well. There does seem to be at least some near-term agreement that he needs to move, the administration needs to act now and get something out. And so I don't think you're going to see quite as a strident Republican stance as is typical given Trump's interests, frankly, in being reelected and wanting to get the bad news behind him before November hits. They do say the average person makes up their mind by what? August, September. And so you got a small window here to decide which way this recession tips you. And it can't be positive really for the current administration until we get an all-clear sign.

Barbara Turley:

All right. Well, we have just about reached the end of our time allotment. Joe and Scott, do you have any parting thoughts for our listeners today?

Scott Colbert:

I guess we tried to bracket this by saying that the big help that will help the market's bottom and the recovery ensue is when the new rereported cases, and they're still significant and they're still accelerating, begin to decelerate. They call it the second derivative or basically the slump of that curve. We don't know when that's going to be, because the Italies, the Irans, the Germanies, and the Frances they're still in that upward cycle and we're trailing somewhere behind them, maybe a little better. But we still have our problems ahead of us. And we're just looking forward to that opportunity for when it moves. So, it's likely to be hopefully the most optimistic thing that we say is sooner than the severity is bracketed probably by that 55% downturn that we had for stocks during the great recession. We're down 30 plus now as we sit here today. So, there's still quite a bit of variability between the average recession, 35%, and the worst recession we've ever had at 50%. And that's still going to take some time to find that bottom.

Joe Williams:

I just want to reassure our clients that we are constantly reviewing your portfolios. We are looking at the risk. If you feel we have set [inaudible] your accounts, but if you feel that target is [inaudible], we are always willing to make any adjustments you want to make. We are trying to take a little bit of risk off the table by reducing in the high yield portion of the fixed income market and small international. And we're not rebalancing. That day will come sometime over the next several months, but it's not here yet.

Scott Colbert:

And your risk today is somewhat reduced in the sense that because we haven't taken any of the winners and rebalanced into the equities yet, your typical 60-40 portfolio today is much closer to 50-50. So, in that essence, we've already... The market has reduced the risk by one notch already waiting for us to go back to a fully risk portfolio. So, we're a little more defensive as we sit here today than we certainly were at the beginning of the year.

Barbara Turley:

All right. Thank you to both Joe and Scott for your thoughts today. And I want to hope that you, our listeners, found this call helpful. Now we realize we did not cover all of your questions. And some of the questions that you sent in were very, very specific about your particular situation. So we will strongly encourage you to contact your portfolio manager for further discussion about your situation or any other questions that were not able to be answered today. Also, we will post a recording of this call on our website at www.CommerceTrustCompany.com if you care to tune in again later. And I want to also say that your dedicated financial professionals here at Commerce Trust are working diligently to ensure your interactions with us run smoothly every day, even in the face of a national health crisis. So, you can feel confident in your decision to work with us since we have prepared for and weathered through many unusual situations in the past. We have more than 150 years of investment management experience, and our seasoned professionals have witnesses market cycles and economic crises of all sorts.

Barbara Turley:

So, rest assured that we have the systems and capital resources to navigate through this financial turbulence. Now while we cannot control the stock markets, we can and will continue to provide the knowledgeable and professional services you've come to expect from us. In times like this, it's important to stay calm and confident and keep a balanced perspective with any decision that's being made. And as always, we are grateful for your confidence in us. We deeply value our relationship with you.

At this point, I have some other important information. It's important for you to know that Commerce Trust Company is a division of Commerce Bank. And information and opinions provided hereby Commerce are available as of today, March 18th, 2020. So, our comments today are up-to-date as of today. Important material disclosures regarding the content of this call will follow.

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With that, we are finished with the agenda we had today. We will conclude our call by thanking you our clients, the listeners on this call, for your trust in us. Please be safe and healthy and have a great afternoon. Thank you.