SPRING 2020 | VOL. 27 | NO. 2
QUARTERLY PERSPECTIVE

DVI
DAVID VAUGHAN INVESTMENTS

THE CORONAVIRUS CRISIS

Will Williams *Chairman, President & CEO*

A Healthcare Crisis

What was viewed by most in the U.S. as China's problem, became very real to all of us on January 20th when the first confirmed case in the United States of Coronavirus Disease 2019 (COVID-19) was identified in Snohomish County, Washington. By February 19th, the day the S&P 500 Index peaked at a record high of 3393.52, the case number had increased to 13. Italy, which was emerging as a hotspot in Europe, had fewer than 20 cases at that time. Nearly a month later, confirmed cases had jumped to over 15,000 in the U.S., and on March 11th, the World Health Organization announced that the Public Health Emergency was now a full-blown Pandemic. In the early days of April, data from the Center for Systems Science and Engineering at Johns Hopkins University recorded 245,573 COVID-19 cases in the United States, 115,242 cases in Italy and over one million confirmed cases worldwide. What was originally viewed as limited in scope, soon became more than just a health crisis, but was now an emerging economic crisis as well. In absence of an adequate number of testing kits or an effective vaccine, social distancing has emerged as the single best way of slowing the growth of the virus. The latest statistics provided by the New York Times suggests that nearly 300 million people in 38 states, the District of Columbia and Puerto Rico are being urged to stay home. The consequence of this appropriate response is economic stagnation for most of the impacted regions.

Velocity of Decline

Going into 2020, I would say most Street analysts were somewhat sanguine about the prospects for improved corporate earnings after flattish results on that front in 2019. Earnings Per Share (EPS) for the S&P 500 Index was $163 in 2019 and consensus as late as January of this year still called for EPS of $177 for 2020 or an 8% annual growth rate. With the announcement of travel bans and later shelter-in-place orders, the Street began to recognize the significant economic repercussions of the lockdown. The resulting stock market decline beginning on February 20th was the fastest in recorded history. In a mere 15 trading days, the peak to trough decline was over twenty percent, and we had achieved the technical definition of a Bear market.

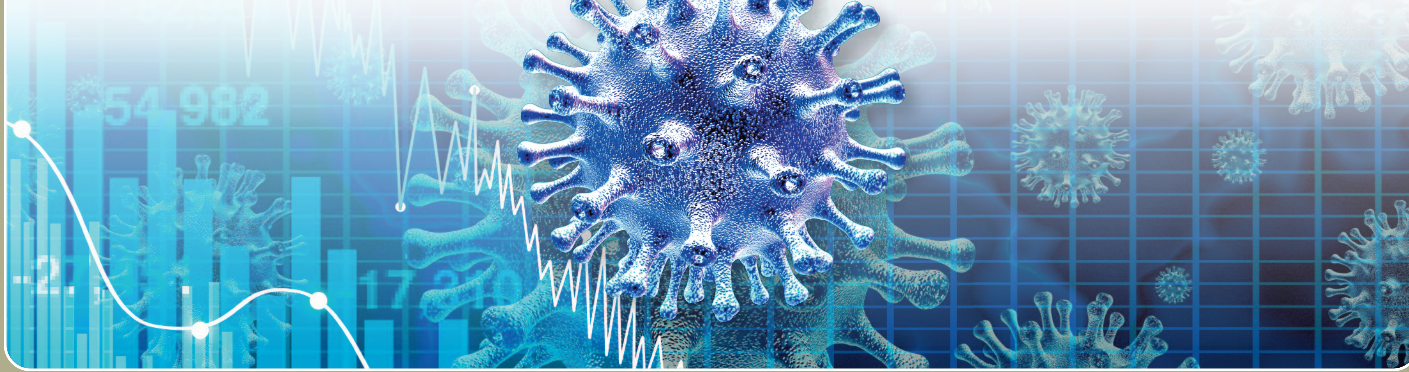
Bear Markets – Not One-Size-Fits-All

The U.S. stock market has experienced 13 Bear Markets since 1926 in all sizes, shapes and colors. Economists use the terms Event Driven, Cyclical and Structural, to describe the nature of the triggering event that was the catalyst behind each market decline of 20% or more.

Structural Bear Market: Generally triggered by financial bubbles, they tend to last the longest and are the most severe in terms of the magnitude of decline. The 2008-2009 Mortgage Related Crisis would be the most recent example with a market decline of 57% and a recovery time of nearly 4 years back to the prior market peak.

Cyclical Bear Market: The economic cycle is the culprit behind Cyclical Bear Markets, as they always coincide with an economic recession. Commodity shocks such as oil price spikes, or a significant increase in short-term interest rates tend to cause economic declines that negatively impact corporate earnings. The 1973-1974 OPEC OIL Embargo would be a classic example with a 48% market decline and nearly a 6-year time period to recover market losses.

Continued on page 4



Brian Christensen, CFA
Senior Vice President & CIO

WHAT AILS OIL?

With oil prices trading at 18-year lows, the businesses of oil exploration, drilling, refining and marketing, and storage and transportation are all under significant distress.

Oil prices retreated sharply on demand concerns amid the expectation for slowing global growth driven by the coronavirus epidemic. The rapid decline is a function of the oversupply issue that has hampered the industry. Entering 2020, North American oil production was at record levels lowering OPEC market share, and the degree of price shocks had been greatly diminished.

Against a background of collapsing global oil demand, OPEC members and Russia met on March 6th to review the market situation. The group's 2.1 million barrels a day production cuts were due to expire at the end of the March, and a new agreement was needed. Talks collapsed after the Kremlin refused to agree to what would have been the deepest supply cuts seen since the 2008 financial crisis, increasing cuts by 1.5 million barrels a day. By launching an oil price war, Russia and Saudi Arabia are now engaged in a high-stakes game of chicken. Until one of them blinks, the oil market will rebalance itself largely at the expense of U.S. oil producers. Meanwhile, consumers in the U.S. and other countries will enjoy lower prices. The impacts on OPEC as a cartel are yet to be determined, but its credibility and effectiveness hang in the balance.

In purely basic oil economics terms, Russia has a budget breakeven price of $40 per barrel this year: Saudi Arabia's is $84. Russia can easily produce over 11 million barrels per day of oil, while Saudi Arabia's average since 1973 is a little more than 8 million barrels per day. It is believed Russia can cope with oil prices as low as $25 per barrel from a budget and asset reserves perspective for up to 10 years. Saudi Arabia can manage 2 years at most.

The immediate outlook for the oil market will ultimately depend on how quickly governments move to contain the coronavirus outbreak, how successful their efforts are, and what lingering impact the global health crisis has on economic activity. A resolution to the Russia and Saudi Arabia spat would simply remove one element of uncertainty from the market.

DVI has long been an investor in major integrated oil companies. During the last oil price decline (2014 – 2015), we increased our investment in the industry, fully believing $30 per barrel oil would be short-lived. From the lows of early 2016 to mid-2018, we saw oil rise in price to the low $70's. Companies began to aggressively lower their cost structures and increase focus on shareholder returns. Stock prices rose.

Today, we remain believers in the long-term future of the major integrated oil companies. However, the underlying fundamentals are significantly more uncertain than prior market oil price lows. The exogenous factors of a health crisis and price war, when combined, cause us to question our position and look to lower risk in portfolios. To that end, we are actively taking steps to raise the quality of our oil company investments by focusing on companies with lower break-even oil production costs, stronger balance sheets, and abilities to maintain dividends. As a stock picker, it feels counterintuitive to reduce exposure when prices are low, yet our overriding priority will always be prudent risk management. Godspeed.

THE CARES ACT

Stimulus Offers Relief to Affected Individual Taxpayers

To help mitigate the financial and health crises related to the coronavirus (COVID-19), on Friday, March 27, 2020, President Trump signed into law the largest economic relief package in modern U.S. history. The $2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES Act) is intended to shore up the country on multiple fronts and includes several components aimed at individuals. Below, we have compiled an overview of the major components of this legislation. To read the full, in-depth article, please visit the "DVI Special Announcement" section on our website's home page at www.dviinc.com.

Penalty-Free Early Retirement Distributions

- Waives the 10% early distribution penalty for COVID-19-related withdrawals from IRAs, 401(k) plans and certain other retirement plans made on or after January 1, 2020, and through December 31, 2020.
- Eligible individuals can withdraw up to $100,000 penalty-free and can repay withdrawn funds within three years of the day after the distribution.

Waived Required Minimum Distribution Rules

- Waives the required minimum distribution (RMD) rules for certain defined contribution plans and IRAs for calendar year 2020.
- The waiver covers both 2019 RMDs required to be taken by April 1, 2020, and RMDs required for 2020.

Expanded Charitable Contribution Deductions

- Individual taxpayers can take advantage of a new above-the-line $300 deduction for cash contributions to qualified charities in 2020.
- Loosens the limitation on charitable deductions for cash contributions made to public charities in 2020, boosting it from 60% to 100% of adjusted gross income (AGI).

Small Business Paycheck Protection Program

- Provides small businesses with funds to pay up to 8 weeks of payroll costs including benefits.
- Funds are fully forgiven when used for payroll costs and/or interest on mortgages, rent and utilities.

Recovery Rebates

- The federal government will generally make direct payments of up to $1,200 to those who file their federal income tax returns as single filers or heads of households; married couples filing jointly can receive up to $2,400. Additional $500 payments will generally be made per qualifying child.
- The nontaxable rebates are subject to phaseouts based on AGI.

Expanded Unemployment Benefits

- Increases unemployment compensation benefits significantly. For those individuals who can't work as a direct result of COVID-19, the Act can provide an extra $600 per week for up to four months, over and above state unemployment benefits.

Student Loan Relief

- Employers can provide up to $5,250 annually toward employee student loan payments on a tax-free basis before January 1, 2021.
- The law also allows individuals to stop making payments on federal student loans through September 30, 2020, without incurring penalties or late fees.

Mortgage and Foreclosure Relief

- Homeowners with federally backed mortgages can request forbearance, regardless of their delinquency status and without incurring penalties, fees or interest.
- Further, except for vacant or abandoned property, servicers of federally backed mortgages can't initiate any foreclosure process, move for a foreclosure judgment or order of sale, or execute a foreclosure-related eviction or foreclosure sale for at least 60 days, starting March 18, 2020.

The Swiftly Changing Environment

- No one knows when the COVID-19 public health emergency will end, or for how long the economic repercussions will linger. We'll keep you informed on the latest developments and help you plan for a more stable financial future.

Will Williams
Chairman, President & CEO

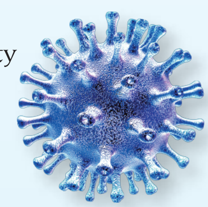
CONTINUED FROM PAGE 1

Event Driven: | Cyclical: | Structural:

		Market Peak	Market Trough	# of Months	% Drawdown	1 Year % Return Post- Trough	Recovery Time (m)	Recession	Recession Start Date
1	Crash of 1929	Sep-29	Jun-32	32	-86.00%	124.00%	266	X	Aug-29
2	Fed Aggressive Rate Tightening	Mar-37	Apr-42	61	-60.00%	59.00%	49	X	May-37
3	Post WWII - Demobilization	May-46	Jun-49	36	-30.00%	42.00%	27	X	Feb-45
4	Global Recession	Aug-56	Oct-57	14	-22.00%	31.00%	11	X	Aug-57
5	Cuban Missile Crisis	Dec-61	Jun-62	6	-28.00%	33.00%	14		
6	Financial Crisis Credit Crunch	Feb-66	Oct-66	7	-22.00%	33.00%	7		
7	Civil Unrest - Technology Crash	Nov-68	May-70	17	-36.00%	44.00%	21	X	Dec-69
8	OPEC Oil Embargo	Jan-73	Oct-74	20	-48.00%	38.00%	69	X	Nov-73
9	Volcker Fed Tightening	Nov-80	Aug-82	20	-27.00%	58.00%	3	X	Jul-81
10	'87 Crash - Portfolio Insurance	Aug-87	Dec-87	3	-34.00%	23.00%	20		
11	Technology Boom & Bust	Mar-00	Oct-02	30	-49.00%	34.00%	56	X	Mar-01
12	Mortgage Related Financial Crisis	Oct-07	Mar-09	17	-57.00%	68.00%	49	X	Dec-07
					-41.58%	48.92%	49		
13	Coronavirus Crisis / Oil Price Collapse	Feb-20	Mar-20	2	-35.00%			?	
		23 Trading Days							

Sources: JP Morgan Asset Management, Morgan Stanley Research, Fidelity Research, NBER

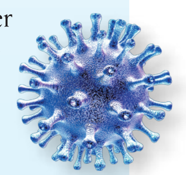
Event Driven Bear Market: Bear Markets of this type tend to come out of nowhere, as some unexpected development "shocks" the status quo and throws the market into a tailspin. These Bear Markets are the least severe both in terms of duration and severity of decline. In addition, more times than not, Event Driven Bear Markets are not associated with economic recessions.



Event Driven Bear Market

At this time, granted we are only 32 trading days into all of this, DVI is of the opinion that the current market environment will most likely be classified as an Event Driven Bear Market. The shock associated with COVID-19 has been the unexpected catalyst for the market decline. Unfortunately, a by-product of the shelter-in-place tactic is an economic recession that likely has already begun and will be in place through the fall of this year. So that, of course, is the anomaly in our current thinking. But then again, maybe this is not a traditional economic shock. If we are correct in our conclusion, it is the lesser of the three evils. We still are in a Bear Market, but the historical degree of loss and the recovery timeline are more attractive than the alternatives.

In recent weeks, the Federal Reserve, through monetary policy, and Congress via the CARES Act, have both been doing their part to provide economic stimulus and attempt to calm the markets. Some report that this economic bazooka will inject almost $4 trillion into our nation's economy. Unfortunately, much of this is outside of their control. Until we begin to see positive developments on the healthcare front, regardless of the extent of the lifeline offered to consumers and small businesses, the economy will continue to suffer. In recognition that a viable vaccine is 12-18 months away, what would positive news look like? Access to accurate testing would be a hugely positive development, as we simply have no idea as to who is infected, where they are located, and the number of people they have exposed to the virus. More comprehensive testing might also allow us to be more thoughtful and precise on shelter-in-place mandates versus the current more conservative approach. On the good news front, possible treatments such as Chloroquine and other FDA approved medications designed for other purposes might also lessen symptoms and therefore lessen fears.



Optimistic Yet Realistic

Despite our hope that the Coronavirus Crisis is short lived, typical Event Driven Bear markets have a shelf life of three to six months from market peak to market trough. In the meantime, DVI continues to focus on its high-quality investment strategies to weather the storm, taking appropriate actions to further increase the quality of our investment holdings. In addition, we our turning back to our 2008-2009 playbook and making sure we are executing tax and estate planning strategies that will benefit our clients in the years to come. There is much to do, but it is never lost upon us the great responsibility placed upon DVI by our clients to see them through to the other side. We hope and pray your families are safe and well. God Bless.

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