How to Take Advantage of a Low Rate Environment and Market Correction
March 2020

On Tuesday March 3, 2020 the US Federal Reserve instituted its first emergency inter-meeting interest rate cut since the collapse of Lehman Brothers in the fall of 2008. This latest reduction brings the target Federal Funds rate to the range of 1.00%-1.25%, from the previous range of 1.50%-1.75%.

The Federal Reserve had previously instituted similar measures 8 times over the past 40 years, with notable events including the Russian financial crisis and collapse of Long Term Capital Management in 1998, the tech bubble bursting in 2001, the terrorist attacks of 9/11, the sub-prime mortgage crisis of 2007, and the collapse of Lehman Brothers in 2008.

Federal Reserve Emergency Rate Cut History		
March 3, 2020	-50 bps	Coronavirus
October 8, 2008	-50 bps	Lehman Brothers collapsed
January 22, 2008	-75 bps	US recession
August 17, 2007	-50 bps	Sub-prime mortgage crisis
September 17, 2001	-50 bps	9/11 terrorist attacks
April 18, 2001	-50 bps	Slumping economy
January 3, 2001	-50 bps	Tech bubble burst
October 15, 1998	-25 bps	Russian financial crisis, collapse of Long-Term Capital Mgmt

As responsible Balance Sheet stewards for your family, we believe it is important to not only understand the impact of these interest rate cuts on asset prices, but also on your liabilities, and on overall annual financial planning opportunities. As such, we have identified several strategies across both assets and liabilities that may be worth revisiting at this time in order to optimize your Balance Sheet and future cash flows.

Refinancing Existing Mortgages
Following the Federal Reserve's 0.5% emergency interest rate cut announced in March, the 10-year US Treasury rate has fallen to approximately 1%. As a result, the average interest rate on a 30-year fixed rate mortgage is 3.45%, according to Freddie Mac. A typical rule of thumb suggests that it is worth considering a refinance when you can reduce your interest rate by 1% or greater. At this time, the futures markets are predicting an additional 0.25% interest rate cut in April. We encourage you to reach out to us if you would like a formal analysis to demonstrate how many years it would take to begin to realize savings from a mortgage refinancing for your specific situation.

Fix Adjustable Rate Loans or Engage in an Interest Rate Swap for a Longer-Term Line of Credit
Similar to a mortgage refinancing, those with Adjustable Rate Mortgages (ARMs), or other adjustable rate liabilities may consider locking in a Fixed Interest Rate loan instead. For those that anticipate

needing credit for their business, choosing to engage in a Collateralized Line of Credit with a 5-yr, 7-yr or even 10-yr interest rate swap in order to lock in a long-term loan at rates below 3% may be prudent. At this time clients may be eligible for no-fee LIBOR based loans collateralized by their investment account through third party lenders.

Accelerate 2020 Capital Gains Budget and Tax Loss Harvest
The recent market pullback has created an opportunity for clients to accelerate their 2020 capital gains budget to the beginning of this year in order to take advantage of both lower prices (which lowers the realized gains) as well as a lower cost for reinvesting those gains in similar investments and asset classes. There is likely an imbalance of stocks and bonds in your portfolios, as equity prices have fallen, and bond prices have risen, and accelerating gains provides the tertiary benefit of enabling clients to bring their allocations back in line with their investment policy guidelines. We will reach out to you if there is an opportunity for such rebalancing and provide you with guidance on the expected capital gains implications of executing these trades.

Pre-funding Retirement Accounts
Clients that are continuing to earn active income from their business or employer may consider accelerating their contributions to their IRA, 401(k), and Health Savings Accounts (HSA) accounts. By prefunding the account in the first quarter of 2020, you are accelerating contributions that would otherwise be made throughout the year, with the purpose of purchasing assets at current depressed prices. This strategy assumes asset prices will rise by the end of the year after the coronavirus infection rate peaks in the Spring and then begins to decline. For information on annual contribution limits, feel free to call.

Conclusion
While lower interest rates will not solve for weak demand, they will likely encourage businesses to invest in rebuilding supply chains and help those firms that suffer a cash crunch from supply chain or demand disruptions. For equity investors, interest rate cuts are likely to put a floor on stock market valuations.

It is impossible to predict how the coronavirus will develop, and how markets will react to the news, yet what is clear is that there are strategies investors can take today across their balance sheet that will help them reduce expenses, and take advantage of depressed prices.

As always, we welcome any questions or concerns.

Brian Luster
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Collective Family Office

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