Q&A: How a New Federal Law Aids the Economy

Key takeaways

- On March 27, 2020, Congress passed and the president signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provides economic support intended to be quickly available to workers and businesses.
- The law is innovative in targeting aid as quickly as possible to individuals and businesses, and for how it works with the Federal Reserve to support the U.S. financial system.

What it may mean for investors

- Whether the CARES Act is sufficient to end the selloff still depends upon the pace of infections. We continue to believe that some equity market consolidation is likely, including the possibility that the S&P 500 Index may retest its recent lows.

What is the detail behind the direct payments to households?

The Act sets aside approximately $269 billion for direct payments to individuals. Taxpayers with annual income of up to $75,000 ($150,000 for married couples in 2019 are eligible to receive a one-time direct deposit of up to $1,200 ($2,400 for married couples), plus $500 per child (under the age of 18). Treasury Secretary Mnuchin said Wednesday, March 25 that the government will make direct deposits within three weeks, and that there is no need to complete a form or sign up to receive a payment if the taxpayer has been paying taxes or received Social Security payments since 2018.

---

2 The Internal Revenue Service has a website with more information, https://www.irs.gov/coronavirus.
How are retirement plans affected?

In order to prevent investors from being forced to sell financial instruments while equity market prices are falling, the Act suspends the requirement for 2020 required minimum distributions (RMDs) for everyone. The suspension includes distributions for those who turned 70½ in 2019 and otherwise would have had to take a minimum distribution before April 1, 2020. Likewise, those who took a required distribution within the last 60 days can roll over their distribution to the same or a different IRA within 60 days of that distribution and not pay the income tax on the distribution, as long as the investor did not make an IRA withdrawal within 365 days preceding the distribution.3

The Act also provides for investors regardless of age to take retirement-plan distributions of up to $100,000 without the usual 10% early withdrawal tax for those younger than 59½. What’s more, distributions taken in 2020 can be reported as income evenly over 2020, 2021, and 2022, or can be repaid within those three years to avoid income tax. These provisions apply to qualified individuals, defined as people who:

(i) are diagnosed with the coronavirus; or
(ii) have a spouse or a dependent with the virus; or
(iii) experience financial hardship as a result of quarantine, furlough, lay-off, or reduced hours at work; or
(iv) are unable to work due to lack of childcare; or
(v) own and operate a business that suffers closing or reduced hours.

Finally, the Act increases the loan limit from 401(k) accounts from $50,000 to $100,000.

Our perspective is that suspending RMDs gives investors choices. In general, we believe it is a positive not to have to take a distribution while equity market prices are low and, instead, spread out distributions into the future, when we could see higher financial market prices. Still, investors who do not have much taxable income may want to study whether it makes sense for them to take the distribution this year to take advantage of the lower tax bracket. Investors may also want to consider whether this year is a good opportunity for a Roth IRA conversion. We favor avoiding withdrawals at this point, unless an investor has no other adequate source of funds. Otherwise, our strongest preference is to keep the IRA on a course to grow towards the investor’s long-term goals.

How are unemployment benefits extended?

The Act includes roughly $250 billion to extend unemployment benefits – not only the period and amount of payments but also the eligibility. The states run the unemployment insurance, but the CARES Act provides federal funding through December 31 for an additional $600 per week for an extra four months. The program also extends coverage to those who ordinarily would not qualify for state unemployment, including the self-employed, independent contractors, and gig workers.4

How does the Act support small businesses in maintaining payrolls?

The Paycheck Protection Program is one of the largest sections of the Act and offers an estimated $349 billion in government-guaranteed loans to small businesses that have fewer than 500 employees, select types of businesses with fewer than 1,500 employees, 501(c)(3) non-profits with fewer than 500 workers, and some 501(c)(19) veteran organizations.5

Loans made through this program are capped at $10 million, and cannot exceed 4% in interest cost, but do not require collateral. The program also expands the existing network of over 800 lenders who can extend credit to

4 Gig workers are independent contractors who enter into formal agreements with companies that use their services on an as-needed or on-demand basis.

© 2020 Wells Fargo Investment Institute. All rights reserved.
eligible businesses, and allows borrowers to defer fees, principal, and interest for 6-12 months. In general, as long as a borrowing firm continues normal payroll payments (with caps for compensation exceeding $100,000/year) during the eight weeks after the loan is made, then the borrower can receive forgiveness in the amount of mortgage interest, rent payments, and utility payments.

Other benefits include tax credits and delayed tax payments connected to COVID-19 sales losses, as well as expanded eligibility for the Small Business Administration’s Economic Injury Disaster Loans. The CARES Act significantly expands this disaster loan eligibility and may provide emergency grant cash advances that may qualify for forgiveness if used for paid leave, payroll maintenance, meeting higher supply chain costs, and other qualified expenses.

There are restrictions on businesses that receive the loans. These borrowers must maintain, as close as possible, at least 90% of their employment (as of March 24) through September 30. Also, these businesses may not issue dividends for a year after the loan is repaid.

Are there other tax provisions that are immediately available?

Yes. Congress made adjustments to deduction rules in existing tax law. Individual taxpayers who do not itemize may reduce taxable income by up to $300. For businesses, the provisions for deducting losses are more generous. These changes may be worth an additional $28 billion. It is difficult to estimate the total cost of these allowances at this time.

What does the ACT do for industries hit directly by the COVID-19 virus?

The Act provides $500 billion in business loans, loan guarantees, and other investments. Congress wanted a dedicated inspector general to oversee these funds. The allocations include $25 billion for passenger and $4 billion for cargo airlines, and up to $17 billion for businesses critical for national security. The provisions limit the terms of loans to not more than five years, and the loans cannot be forgiven. Such loans and guarantees require that a borrowing company not repurchase shares, pay dividends or make other capital distributions, and maintain employment close to current levels through September 2020. As well, the loan restricts executive total compensation for up to one year after loan repayment.

Do hospitals and local governments receive additional help?

The Act allocates over $130 billion for the health care system, including $100 billion for hospitals, and the balance to acquiring personal and protective equipment for health care professionals, testing supplies, workforce training, accelerated Medicare payments, among other health needs, including free COVID-19 testing across the country. State, local, and tribal governments qualify for another $150 billion, including disaster relief, transit programs, and educational institutions.

Does the CARES Act coordinate with Federal Reserve financial system support programs?

Yes. Of the $500 billion allocated to business lending, $454 billion is available after the previously mentioned programs for aviation and national security. That remainder supports Federal Reserve programs that provide lending to the financial system and to eligible states and municipalities, in order to increase liquidity in financial markets, including the municipal debt market. The Act also allows the Treasury Secretary to use the Treasury’s Exchange Stabilization Fund to establish a guarantee program for the U.S. money market mutual fund industry.

---

6 The program builds on the existing Small Business Administration’s 7(a) loan program that is already familiar to many businesses. For more details, please see www.SmallBusinessDisasterSupport.com for details.

7 For more information, please see “How to Apply for an SBA Disaster Relief Loan”, U.S. Chamber of Commerce, March 26, 2020.

8 Losses can now be extended back by five years, excess loss limitation rules for pass-through entities are suspended, and more of a business’ interest expense is deductible.

until December 31, 2020. The Federal Reserve has established a facility to purchase assets from U.S. money market mutual funds in order to maintain money market fund liquidity.

Conclusion

An overriding theme through all these provisions is direct assistance to those whose incomes or revenues are under pressure from the pandemic, and greater flexibility for how and where the Federal Reserve may shore up financial markets. The recent increase in legislative tempo has encouraged financial markets, insofar as the Act allows workers and businesses to bridge the next few months. Most of the provisions of the CARES Act expire between September and December 2020, however. If it takes beyond the third quarter to see a peak in the virus, Congress may need to return with another package.

Ultimately, we believe that the federal government will extend, as necessary, and the economy should rebound by late 2020. Even a strong rebound is possible, once more typical spending rates resume across the economy. Our 12-month outlook is for a rebound in economic growth, earnings growth, and valuations, which should support a broad recovery in equity prices. Yet, beyond the next two years, the implications of today’s strong fiscal and monetary response is likely to include a strong potential for higher tax rates and somewhat higher interest rates, depending upon how much additional economic aid ultimately is added to counter the economic fallout from the virus.
Risk Considerations

All investing involves risks including the possible loss of principal. Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

General Disclosures

Global Investment Strategy (GIS) is a division of Wells Fargo Investment Institute, Inc. (WFII). WFII is a registered investment adviser and wholly owned subsidiary of Wells Fargo Bank, N.A., a bank affiliate of Wells Fargo & Company.

The information in this report was prepared by Global Investment Strategy. Opinions represent GIS' opinion as of the date of this report and are for general information purposes only and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally. GIS does not undertake to advise you of any change in its opinions or the information contained in this report. Wells Fargo & Company affiliates may issue reports or have opinions that are inconsistent with, and reach different conclusions from, this report.

The information contained herein constitutes general information and is not directed to, designed for, or individually tailored to, any particular investor or potential investor. This report is not intended to be a client-specific suitability analysis or recommendation, an offer to participate in any investment, or a recommendation to buy, hold or sell securities. Do not use this report as the sole basis for investment decisions. Do not select an asset class or investment product based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon.

Wells Fargo Advisors is registered with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority, but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company. CAR 0320-04581