Market Commentary

April 1, 2020

Dear Clients/Friends:

First and foremost, we wish good health to you and your families in these unusual times. Even though the year has just begun, 2020 unfortunately will be remembered as the year of the COVID-19 Pandemic. Although most of the comments below address our thoughts on the current and future market/economic outlook, please know that our primary concern is the well-being of our entire community through these harrowing times.

Following a very strong fourth quarter and full year for 2019, financial markets started 2020 constructively with an outlook for another year of decent economic growth. The outlook changed dramatically in February and March, as COVID-19 moved from a localized virus in China to a global pandemic. As governments took the unprecedented action of rolling economic shutdowns in order to slow the spread, many businesses and industries ground to a halt by mid-March. The result has been profound and unlike any other time – ever.

As would be expected after such a series of unprecedented measures, market volatility levels spiked and nearly all asset classes became dislocated. The U.S. Federal Reserve has responded by taking aggressive actions to keep markets functioning – many of which were tested successfully in the 2008 Financial Crisis – and Congress passed a series of bills that are primarily designed to assist individuals and companies impacted by the economic shutdown. Additionally, more Congressional actions are anticipated in the coming weeks and months to further ease economic and financial market stress.

Broad equity indices experienced 30-40% declines until a bounce late in the quarter lessened the pain modestly. Mega cap and growth-oriented companies initially rebounded more quickly, but the lack of visibility continues to weigh unevenly on markets. The decline for the S&P 500 Index in the first quarter of 2020 was the worst quarterly result since 1987 and reflects expectations that U.S. economic activity (GDP) in the second quarter could be down 20% or more, before an expected sizable rebound later in the year and into 2021.

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<u>Steps We Took</u>

We did not react passively to the market disorder, as we made a number of moves prior to the market decline and during the quarter to improve short- and longer-term portfolio positioning.

We entered February modestly underweight equities, after initiating a few defensive investments in the prior months. While these moves proved too small in scale to protect portfolios from pandemic forces, we avoided many market segments that are likely to experience some of the greatest long-term fallout (retailers, office REITs, construction, airlines, and hotels).

That said, our holdings in banks and energy companies have been hit hard by the upheaval. In times of heightened uncertainty, occasionally some of our investment themes prove temporarily "off the mark", which we reevaluate to determine whether there is a permanent impairment involved or whether the security is subject to a temporary set-back. Our longer-term view is that these areas will recover, and possibly at a very dramatic rate once the economy begins to restart, but we decided to reduce some energy exposure due to near-term risks.

Some of the specific portfolio actions taken during the quarter include:

- Initiating equity investments with innovative and rapidly growing business models (Pinterest and Amazon) that are less impacted by or stand to benefit from the post pandemic economy.
- Reducing investments in cyclical companies with balance sheets that may limit capital allocation choices (XPO Logistics, Newell Rubbermaid, and Goodyear) even though our outlook for these companies remains positive longer-term.
- Starting investments in Gold and an ETF representing Gold Miners, as well as adding to Hedged Equity ETFs to provide equity upside while lessening downside risk over the intermediate term.
- Continuing to reduce energy related investments due to the combined impact of demand shock from COVID-19 and supply shock from Saudi Arabia dumping oil on the market. We also concentrated investments in energy companies with the strongest balance sheets that are best positioned for recovery after the economy restarts.
- Cutting exposure to developed international markets due to concern governments and companies located in these regions would not be able to act as proactively as their counterparts in the U.S.

Our new investments have generally been defensive in nature with attractive long-term appeal. At some point in the next few quarters, we believe better opportunities will present themselves to be more offensively minded.

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What History Has Taught Us about Crisis

Before getting to our outlook and additional steps we plan to take in the portfolio, let's first review what history has taught us from past crises and the likely near-term aftermath:

- In time, this pandemic will end. The best minds in the world are working emphatically to find a therapeutic solution and/or vaccine that will eventually render this virus to be similar to other viruses and not require future shutdowns.
- Economic disruption creates tremendous uncertainty regarding how quickly business can bounce back and what permanent consequences may result. Just as the market recovered in 2009 after dramatic overreactions in the 4th quarter 2008, markets will recover when current draconian scenarios do not come to fruition.
- Actions taken by the U.S. government to keep markets functioning and avoid an economic depression will help both investor and business sentiment recover.
- Volatile price action is more often than not a reflection of temporary inefficiencies driven by investor sentiment and group think. Today, this inefficiency is also coming in the form of computer-directed trading that emphasizes recent stock price movements rather than company fundamentals.
- New government policies, and possibly new government agencies, will be created to mitigate the next pandemic. More government funds will be spent over the coming years.

Looking Forward

Our investment strategies have historically been based on taking an analytical three- to five-year (or longer) outlook to determine where investment opportunities (and risks) are greatest, and to employ such investments, as appropriate, into a custom-tailored asset allocation strategy.

As we look forward to the second quarter and beyond, we believe the markets will shift from profound fear and uncertainty toward a more realistic perspective that the economy will begin to re-engage and forge ahead on the road to recovery. Additionally, recent actions taken by Congress and the Federal Reserve will provide further support to bridge our economy from one of temporary stagnation to an engine of prosperity for 2021 and beyond.

Portfolio themes that we are looking to take advantage of include:

- Certain trends in existence prior to the pandemic will accelerate in adoption (working remotely, online commerce, distributed entertainment, supply chains moving closer to final demand, etc.). Our investments in Amazon, Alibaba, Cisco and Microsoft are examples of firms whose services and technologies will enable these secular shifts.

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- New trends that may emerge, including the possibility of population migration away from cities, corporate office downsizing, changes in travel/leisure activities, and downscaling from discretionary and luxury goods toward necessities. Walmart stands out as one of our existing holdings that could benefit from these trends with its expansive rural/suburban footprint and focus on providing basic goods versus extravagant items.
- Innovations in technology and health care products will continue to enhance our lives in countless ways and be drivers for economic growth in the future. Our holdings in renewable energy provider NextEra Energy, Thermo Fisher and the Biotech and Healthcare ETFs should be prime beneficiaries of emerging technological and medical advances.

Although we are optimistic about economic growth over the medium and long term, we remain concerned that unemployment is likely to settle at higher levels than experienced in recent years, as companies will be forced to address profitability, particularly in industries that don't recover as quickly (retail, construction, hospitality, etc.). Some legacy businesses will need time to work through these issues and right size their operations, while other businesses will scale up employment to take advantage of emerging trends. As we move through this transition period, markets will recover accordingly.

We welcome the opportunity to discuss our perspectives. We will resume face-to-face meetings with you in the coming months once the health crisis subsides and restrictions are removed. In the meantime, we welcome your questions/comments via phone or email at your convenience.

Sincerely,

Alan Cole *Chris Engelman*

President Managing Director

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