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March 12th Call Recording- Coronavirus and the Stock Markets

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Darcy O'Brien: [00:00:00] Hello and thank you for joining us for this afternoon's discussion, Coronavirus and the Stock Markets: People, Economy, and your Portfolio. My name is Darcy O'Brien and I am the Chief Marketing Officer at Simon Quick, and I will be moderating today's discussion, given the recent market turmoil and media coverage regarding the coronavirus.

We have received a number of questions from our clients, and we thought that this would be a good platform for us to have a more communal discussion. Please note that there will not be a visual component to this webinar. However, as a participant, you can submit questions through the Q and A function on Zoom.

You may also submit questions by emailing me at dobrien@simonquickadvisors.com. Now, before I dive into the questions, please note the following disclaimers. This presentation is for information and discussion purposes only. Please remember that past performance may not be indicative of future results, and there is no guarantee that the concepts and ideas discussed during the presentation will be profitable or proved successful.

And now I would like to welcome our Chief Investment Officer, Chris Moore and our Head of Investment Research, Wayne Yi to ask them some of the burning questions we have received from clients. Since they received so many questions, we've organized them by topic, and we'll touch on as many of the key points as possible.

The first category of questions is under valuations and opportunity. Chris, why has the market sold off as much as it has?

Chris Moore: [00:01:46] 2019 was it terrific year for equity markets, both domestically and overseas, with equity indices really across the globe generating returns anywhere from 25 to 30%.

Heading into this year, the market was certainly overdue for some downside volatility. Since last year's market move was really a straight up move for equities for the entire calendar year. After a volatile fourth quarter in 2018 and heading into this year, the market was at some say, priced to perfection with expectations going forward for 2020.

What happened really, was the surprise, kind of the unknown event of the Coronavirus impacting investors in such a way that now we are questioning economic growth here in the U.S. you know, whether this is going to impact one quarter or two quarters of GDP growth, there is this fear that the impact to the economy across industries, not just travel, leisure, hospitality, but really across the board will be impacted as behavioral changes to STEM and potential spread of the virus cause consumers to spend less do less.

And ultimately, that slows GDP growth. So, markets are responding quite negatively to that out of fear of how long will this last, will this be 30 days, 60 days, 90 days, will last through the end of the year? And how long will it take before markets ultimately recover? And the second component that is contributing to this market sell off is the fact that the Coronavirus impacts everyone. It impacts the psychology of all of us, our daily lives, because everyone is talking about it. Everyone is planning for how to prepare, should it impact their lives or their family or their friends. And it is that component combined with the economic component that is driving stocks lower because it is a de-risking event for investors.

And we have seen that really over the last two and a half weeks. And it has been far and fast.

Darcy O'Brien: [00:04:27] Thank you, Chris. And as a follow on to that question, is this the bottom? And when is it the right time to buy?

Chris Moore: [00:04:35] We are not going to try to call the bottom. That is a loser's game, despite our kind of behavioral needs to try to do so. It is easier said than done. We may have hit bottom today, or we may be another 5 to 10% from here before we hit bottom.

A lot of that is driven by how long this will go on. And at what point will we see, you know, potential action to make us feel more comfortable adding risk? What we do know is that during prior outbreaks the impact on markets were generally quick and severe to the downside followed by a recovery, generally speaking three to six months later.

While we do not know how long a downturn will be or how severe it will be, we're confident that, you know, stock prices where they are today are certainly cheaper and, are more attractive from a risk reward basis. As a component of your portfolio one year out, three years out and definitely five years out from now.

We view equities as a long-term growth component of portfolios, and, want to find times like this, where we can be increasing exposure. So, we've been as a firm, underweight equities coming into this. Now it looks like bear market decline of 20%. After today, we have been underweight equities. We moved to that position in the second half of last year.

And has been reducing exposure for client portfolios throughout all of the second half of last year. So, coming into this, we had an underweight position we've since adjusted that to incorporate what we knew is a more, attractive entry point. I have been using a quote from Warren buffet over the last couple of days, “be fearful when others are greedy and greedy, when others are fearful”.

So, we are taking this as an opportunity to be buyers of equities when it makes sense for each client's kind of specific goals and objectives.

Darcy O'Brien: [00:07:01] Thank you, Chris. And the next question I was going to address to Wayne, if Simon Quick is recommending a target weight to equities now, what would make change at this point, if there's an even further pull back, is there a potential to go to overweight?

What valuation levels or milestones would you want to see before advising clients to 'back up the truck'?

Wayne Yi: [00:07:25] Yeah, I want to reiterate a lot of the points that Chris just laid out in the sense that, last year, if you really think about the performance that drove the markets last year, it was really on the hope and expectations that, the earnings continue to grow, that there was some kind of trade deal in place.

And, there was not a lot of earnings growth, per say in the actual year. So that was one of the motivations, why we had moved to a modest underweight recommendation. That had changed. Yeah, I think about kind of fundamental, now this is kind of all backward looking. It's not forward-looking, but just kind of thinking about that, where we ended the year, we had a trade deal in place, macro fundamentals were solid and consistent, earnings were beating to the upside, so you had good forward momentum Cyclicals are finally getting a bid. So, there was good momentum from a fundamental basis, that was supporting markets. So, looking at that and then seeing the Corona impact, kind of really hit markets really hard.

That was a dramatic move. And we saw that big move down at the end of February and now we are just seeing that continue to play through. When technicals move that quickly or when market action reacts to that quickly, just kind of step back and think about where the earnings profile of potential is.

Corona will impact earnings. It will cause a slowdown in terms of kind of global growth, and U.S. growth into the second and third quarters. But over the long-term and that's kind of how we invest, we think that there will be a recovery on the back of that.

And we think these multiples and valuations are pretty attractive to. Goldman just came out with a piece this morning and before today's start, they are calling for a 15% decline in the S&P in three months. Now that is a big, dramatic number. It is a big call, but they're also saying by the end of the year, the market will be up 11% from this point.

So, being short term and just think about that three-month decline, like no one can really call that that well. But as you go a little bit longer term and think about kind of going through the business cycle and up 11% from today, that is a solid number for the S&P now. I am not putting weight on either of those numbers, but I just want to comment that there's a lot of volatility in terms of market reaction.

So, we're trying to look beyond that and right now the risk reward is better balanced from an equity perspective to the up and to the down. And that is what caused us to say: Hey, we don't want to be underweight anymore. We think there is starting to be opportunity here to add, and if the markets continue to sell off and it outpaces the earnings declines. Then those could be opportunities to buy even more attractive multiples and valuations. We won't be able to call the bottom anyone could, but, we put a high level of focus on what's going on the fundamental corporate level, in addition to what kind of support the fed and the administration is doing.

I think a fed policy is very kind of accommodated and supportive and proactive here. And now the white house, we are seeing a lot of action or steps to kind of bolster the economy in the midst of this. So those are the elements that we are looking at.

Darcy O'Brien: [00:10:45] The next category is fundamentals and macro.

How long do you think this will go on? Are there bigger problems we could be surprised by? Or is this all just fear?

Chris Moore: [00:10:53] That's the million dollar question and everyone is trying to determine how long the market route we'll go on, how long the spread of the virus will continue, and for how long the economy will be impacted. And the way we are thinking about it, for one is the market is a leading indicator for the economy.

It generally sells off in advance of the real economic weakness. So, this recent decline is certainly a proactive, de-risking from investors in response to what is expected within the economy. As it relates to how long we think this could last, I was reading something last night about what's called bar's law, which is an epidemic which basically indicates that epidemic outbreaks follow a bell curve pattern where the pattern includes a sharp increase in cases at the beginning of the cycle, and then it peaks and then it declines and returns to a baseline. And that pattern basically exists because all of us individuals modify our behaviors to avoid getting sick.

And those who do get sick, seek medical attention. And ultimately, you know, that leads to kind of a decline in the spread. There have been some kind of predictions around, you know, based on the rate of which had happened in China, how will that really impact the U.S. and for how much longer will we see, you know, the virus continue to peak and spread, and then ultimately decline.

The guess at this point, from what I've read is it's anywhere from, you know, April or May, to as long as June or July before we see that are our peak cases and then declining through June and July. So, what we are thinking about kind of, how does that ultimately impact the economy, I think it's a function of how quickly behaviors change and how dramatically behaviors change.

We are already seeing a lot of changes in behavior to date. And we expect on a going forward basis as the number of confirmed cases increases, we will see behavior change even more radically.

The short answer to the question is this will likely continue for another quarter. The second question was: are there bigger problems we could be surprised by, or is this just all fear?

This is generally what leads to kind of weaknesses being uncovered. Weaknesses elsewhere in the economy being uncovered, or in markets being uncovered. Events like this tends to create an environment for those points of weakness to show themselves, you know, over the weekend we had the energy situation and that impact on the price of energy and oil in particular.

And how is that impacting credit markets? I think there, there certainly could be bigger problems that we don't know and are not aware of, that could unfold or in 90 days, you know, we could work our way through this potentially with help from the administration or the fed. Or a cure, and this, this all turns out to be a much quicker recovery than maybe we are expecting.

Darcy O'Brien: [00:15:09] So Wayne, how does this compare to 2001 and 2008?

Wayne Yi: [00:15:16] Yeah, I think those are good periods in the market to think about the most recent recessions. And it's, I would say a little bit early in terms of saying how much this will echo those markets or not, but just kind of looking back at history, looking at not just those years recessions, but just recessions over time, kind of peak to trough type impacts that we've seen in, kind of earnings performance, on the S and P you could see those more than the 10 to 15, maybe up to the 20% area.

Then when you look at the peak to trough in terms of what the market reaction has been, the market reaction has been more in the 15 to mid-twenties type corrections. Now those are inclusive. If you thought about the median inclusive of the '01 and '08 recessions.

But when we think about it from a recency perspective, you think about kind of 50% correction, which is pretty dramatic. But if you just take a longer stream of history in terms of corrections and recessionary environments, you are looking at more in the 15- 20% type areas and kind of what we're experiencing right now.

We are just kind of right around there. So not to say that any one point in time is the right precedent, but it just this gives you some sense of what the potential bands of a recession and a correction are, and then eventually the recovery. Now that's just kind of the market reaction perspective.

Now, if you think about valuations here. 2000 was pretty dramatic from a PE perspective. You saw PEs at 27 times. Now the internet bubble was a huge driver of that, and there was a dramatic sell off in corrections from there. But then when you look at the '07 peak in PE, you're more than the 16 times level.

So where are we today? I mean, our most recent peak was roughly around 19 times. We are probably right around 15 times or so now. So, we're definitely coming down in terms of multiple making things a little bit cheaper. And in this environment, the Fed has been cutting

rates, so we are looking at 50 bits on fed funds versus looking at 4 or 5 or 6% on fed funds, back in those recessionary periods.

So, lower interest rates do support multiples to some extent. But we do think that there's good kind of proactive support here that should alleviate some of the concerns. It will be bought out from a market's perspective and from a fundamental perspective.

But on these numbers, it looks like things are looking a lot more attractive today, from an entry perspective.

Darcy O'Brien: [00:18:02] So Chris, does this bring us into a recession or are we already in one?

Chris Moore: [00:18:06] A recession is two quarters of negative GDP growth. At this point it is too early to know if we will, we will be in a recession or not.

And quite frankly, that is what the markets are trying to digest as well. We will definitely have weakness in March economic data, the first quarter GDP will be negatively impacted. It's likely not so extreme for the month of March that it offsets, January and February. The second quarter will be very challenging.

And from a lot of the data that I have read from the economists that are talking about potential impact and potential for a recession. Second quarter is certainly going to be the worst of the four quarters for the year. It will likely show a negative number. But the question really is kind of does this leak into the third quarter and by how much.

The bigger question truthfully is, does the, as I mentioned previously, does the Corona virus, kind of show other weaknesses or other cracks in the economy or the market, that maybe are bigger problems that we're not yet appreciating. And that will be something we will know in probably the next two weeks to four weeks.

Darcy O'Brien: [00:19:42] And Chris, what needs to happen before the markets see a rebound.

Chris Moore: [00:19:47] The markets need a lifeline and that could be in the form of monetary stimulus. It could be fiscal stimulus. You know, there has been discussions around payroll tax cuts or extending the April 15th tax filing deadline, which would help corporations from a cash flow perspective.

Whether it is more QE or other measures that the administration develops to support businesses. I heard something this morning about potential for supporting the shell producing, energy companies in the U S and they're certainly seeing weakness post the discussions over the weekend, but the market needs some form of help or hope in creating kind of support for cash cashflow for corporations in the U S and you know, that's both privately and publicly. We need that, we think we'll likely get another cut by the fed next week, but the truth is the fed rate cuts will not be enough to support kind of a weakening cash flow across the board, across all industries here for this quarter.

We need to get through this next quarter, the next 60 to 90 days. And I think, we will likely see something probably in the next week.

Darcy O'Brien: [00:21:21] Wayne pivoting to real estate. What would we expect the impact to be on the housing market?

Wayne Yi: [00:21:28] Yeah and the way we have been thinking about real estate is that it does provide some inflation protection as well as benefiting from tightening yields or tightening interest rates. While if we do see a slowdown in the economy, that will be deflationary and if you are trying to, sell a house, it's probably not going to be positive. If you are trying to build a house, I think that is going to be tougher as well because there might not be as much a demand, to buy houses. But if you own a house like refinancing with rates coming down, I think that is an interesting opportunity where you can kind of unlock liquidity, extract a better, a lower rate.

We're hearing that because of the day kind of refinances that have been coming in over the past couple of weeks or so that mortgage companies have been kind of artificially popping up interest rates just to manage the flow of refinancing. But as that gets settled and you let a mortgage rates reprice into where the 30-year treasury is.

You will continue to see more refinances come out and that will be positive for those that are staying in their houses and being able to take money out, being able to just have a lower cost of carry. So, it would be the most beneficial to them. But just even on the housing perspective, we do think that it will create a slowdown, but this is not like an '08 kind of housing crisis.

It is more just you would probably see an extension or a delay of new home purchases. Who knows, in this environment people might be thinking: Hey, there's more land, more space outside of the urban centers, so moving into a home could be more attractive when all this settles, so it could create another kind of interesting demand element from that perspective.

Darcy O'Brien: [00:23:29] Chris, moving onto our next category of questions. We received a couple of questions on energy. What does oil have to do with all of this?

Chris Moore: [00:23:38] Last week OPEC was in discussions to cut production in response to increase supplies, specifically as it relates to the shell producers here in the U.S. On the back of potential demand weakness from the coronavirus spreading across the globe.

Those negotiations specifically between Saudi Arabia and Russia turned south very quickly on Friday and into the weekend. And that led to no deal on extending and increasing cuts, through the end of the year. And in response to that, Saudi Arabia announced their plans to flood the market with cheap oil, decreasing the price and increasing the level of production that led to a massive drop in the price of oil over the weekend.

And especially into Monday. The last print I saw was it was down close to 50%, the price of oil on the year. So, what does this mean for the kind of economy and markets more

generally, this is another factor, another component in the fear around potential for the economy here in the U.S, and the stock market more generally.

The last time we had a precipitous fall in oil prices, that led to high yield market weakness in some of the energy companies that we are issuers of high yield. It led to many companies cutting production layoffs and not reinvesting, which all of that was negative for growth and at that point about two quarters, it had negative impact on the economy. Our concern here is that this leads to a bigger kind of credit event within high yield or even, the triple D sector of the investment grade corporate bond market. So, energy markets are being watched very carefully.

I think a lot of investors are hoping that, the Saudis and Russians come back to the negotiation table and come up with a plan to potentially cut and stabilize the price of oil. Cut production and stabilize the price of oil between now and the next couple weeks or so.

Darcy O'Brien: [00:26:23] And Chris, while we are on the subject, I'm seeing a question here from one of our callers.

Do we consider that we have got two black swans on our hands, the Coronavirus and oil prices plummeting?

Chris Moore: [00:26:36] It is fair to call the Coronavirus a black swan. We have had, you know, extreme volatility in oil prices previously and have weathered it. I think the length of the Coronavirus is impact and the potential for it to spread far beyond expectations would certainly put it in that black swan category.

If we kind of compare it to prior viral outbreaks, it may not get to that level. But we are certainly at a point in markets, which is why we have seen this 20% plus sell off, where there's definitely a risk off mentality. We've seen that in yields as well with the 10-year dropping too.

I think the other day was just under 50 blips. So, this is a dramatic shift in risk tolerance for sure.

Darcy O'Brien: [00:27:45] Okay. We seem to have hit on a hot topic with oil. So, I am going to do a jump ball. Chris and Wayne, how does the current move in oil prices impact your view on MLP?

Wayne Yi: [00:28:04] Chris, you want me to take this?

Chris Moore: [00:28:07] Sure. Go ahead.

Wayne Yi: [00:28:09] So, just kind of pulling back a little bit and thinking about the energy exposure we've had in portfolios, we took out a lot of traditional energy exposure, probably it's been a couple of years now, where there was a nice recovery after the 15 kind of collapsed, but thereafter it's been a more cyclical only based, still a lot of restructuring in that space and just didn't seem as appetizing.

And it has been a smaller part of the overall market. So, we had reduced that part of the exposure. We did maintain exposure to MLPs our midstream pipelines because they exhibited a lot of characteristics that we did appreciate from a fundamental basis in the sense that they were less price sensitive, there was more of a volume story there.

There was an improving balance sheet and more rationalization in terms of, kind of corporate structures, as well as what we felt like was a slowly improving, an institutional holder base. But there has been fits and starts in those trades. Over the course time, we have been steadily kind of reducing that position, but with this pickup volatility, we did cut that exposure.

Part of that is risk mitigation in the sense that we don't want to let a smaller position, whip around a portfolio in a more dramatic fashion than we might otherwise expect. So, we reduced that exposure, and kind of the fundamental story here is that if the Italian oil does really go after U.S. producers and U.S. producers slow drilling or find it less economical to be drilling as actively.

That will funnel through into MLP. So, taking that element into account, taking into account the sudden spike in volatility in the sector, we thought it was prudent to pull back that exposure.

Darcy O'Brien: [00:30:20] Thank you, Wayne. I am keeping an eye on time here and we still have plenty of questions to get to.

So, before I move onto the next grouping of questions. Is there anything else you would like to add on our firm thesis on the energy sector more generally?

Wayne Yi: [00:30:37] Not from our side. I mean, anything just that, those comments about not having energy broadly, it was kind of limited to MLPs. This volatility did cause us to cut that exposure probably a little bit more than half.

Something that we are also mindful of is that energy as a sector has continually gotten smaller from an equity perspective. So, from an S and P perspective, you're looking at a low single digit's types of exposure in energy. It is more material and high yield, where I think it's back up to about 11% or so.

So, that is where it had aligned with some of the comments that Chris made that there is high yield risk here, and it funnels into the banks as well. Where the banks are in a significantly better position today than they were back in '08. They are much more de-risk with better equity capital structures.

But they are pressured by flat yield curves. They are pressured by a kind of slow down in the economies and on the margin, there is lending that is coming from the banks, whether it's to explorers or drillers directly or the inflated services around it.

So that is why, that, you know, the secondary effects have been weighing on markets and let's call it value indices because being punched by energy and by having financial exposure.

So, we have continually had to reduce that allocation.

Darcy O'Brien: [00:32:03] Thank you. Our next category is where to invest. Chris, for long-term money, what would be asset classes or funds that you would be most excited to be adding to client portfolios right now?

Chris Moore: [00:32:18] I think Wayne touched on it earlier. We are adding to kind of high-quality domestic equities, for long term-oriented investors, we do still think equities will be an important component of growth and appreciation within their portfolios.

So, we have been laser focused on quality as it relates to companies that have strong balance sheets, not capital intensive, low earnings variability. And the ability to potentially weather further declines in inequities or the economy should we see that?

So that's kind of the first category. And then the second category is we have been allocating to private market strategies in private equity and venture and growth equity. We continue to like those strategies. We think that this will actually be a good opportunity for many of those funds that have raised capital, but not yet called much.

The valuations in private markets will get more attractive here, maybe not as attractive on a relative basis as public markets because public markets have moved quite considerably. We do believe that many of those managers that are looking to put capital to work. in their funds will have the opportunity to buy cheaper amidst this decline and, especially over the next quarter or so.

Darcy O'Brien: [00:33:54] So Wayne, before we move on to the next category, is there anything you would like to comment on regarding, the underlying tilt and quality that we are expressing in portfolios?

Wayne Yi: [00:34:07] Yeah, I would say part of the reason why we have been, kind of, confident in moving from an underweight to a market weight was also in the composition of our underlying equity managers and equities overall

In the sense that if it was just a more cyclical kind of bullish tilt, there is going to be a lot of volatility and that is not the type of exposure you want. Over the course of last year while being underweight equities, we have also been increasing our quality on the margin. It would essentially result in lower beta or lower sensitivity to the broader market volatility and to Chris's comments, what we're looking for when we say quality is that these are larger companies, that have more resilient balance sheets, meaning low leverage, high quality operating margins with recurring revenues and cash flows. Businesses that have a reason to exist and have moats around it. Those are kind of the factors that we really thought about allocating more to.

So, you do see that tilt that has been in our portfolio through all last year, as well as the continuation of that today. We have shied away from emerging markets, international, and small caps because on weaker, fundamental news, those are the areas fundamentally, which will continue to suffer.

So, that is where we have shied away from. Yeah, I think that the way we are positioning the portfolio, specifically in the equity allocation, gives us more conviction to move up from that underweight allocation that we have had.

Darcy O'Brien: [00:35:50] Thank you, Wayne. Moving on to our next topic, fixed income.

Wayne, with interest rates approaching zero, we're going to be in a place where we can only move in one direction, unless you believe we will see negative interest rates, which means we're assured to lose value in the future in traditional fixed income. Although we do not know timing. So, is it better to own fixed income or cash?

Wayne Yi: [00:36:19] Yeah, we have been in a low rate environment, for a long time now. And, while we've kind of gotten used to 2 and 3% type yield, like that is dramatically lower than the 5, 6, 8% type rates that we've had in the past. So, there wasn't a lot of kind of real return in fixed income, historically. So, we have had historically not been as excited about a traditional fixed income as an avenue for income.

Instead, we have been recommending a more credit oriented via the alternatives and hedge fund allocations to generate fixed income like returns. But today what you're seeing is that fixed income is not necessarily meant to be an income strategy or a yield strategy, rather it's meant to be the counterbalance to what's going on in the equity book and kind of the thought process of being able to increase your equity allocation today is because you're making a solid gains in your fixed income book, particularly if you're anything close to the Barclays AG in terms of credit, quality, and duration.

You are up several points on the year and being able to recycle some of that capital out and use that to fund equities, we think makes a lot of sense.

We do not rely on fixed income to be an income provider. But, the uncorrelated nature of it is what added value to the portfolios. Now, if you need cash, like fixed income today, it is not really a great cash substitute. But, it is that counterbalance that we do appreciate and negative rates a year ago, two years ago, we could have never imagined that the U.S. would even be in part of the consideration of having negative rates, but we've already seen this happen, outside of the U.S.

So, it's highly possible we could end up in a situation, if the markets got a lot more challenged, in the short term. I think that the fed and the administration is taking lots of steps to not that they need to have to go down that path, but I am pretty sure that is part of the conversation. There are other elements such as expansion or repo, just from a monetary perspective that also just kind of pumps liquidity into the system as well. All these are meant to kind of keep money in the capital markets.

But I guess I wouldn't say that we were not a camp dismissing negative rates and from here to there, we can see another point or so of rate declines that gets us there. And that would be a positive to fixed income.

Darcy O'Brien: [00:39:13] Thank you, Wayne. So, I'm going to change tacks here. I would like to make sure we have enough time to answer all the questions that have come in throughout this call.

So, I'm going to throw this one out to both Chris and Wayne. The virus broke out in China approximately five months ago. As investors, why weren't we warned at the potential harmful effects on market? What is being done now to stabilize markets?

Chris Moore: [00:39:39] I can take this one. I would say the early kind of Coronavirus indications came out in China in the December timeframe.

And I think from what I have read, it was not taken as seriously as it should have been at the time. Hence causing the spread to be quite dramatic early on. And as it was learned about on a global scale, really in January and definitely became on everyone's mind in February, there was a lot of work being done around, what would the impacts be to the economy, should the virus continues to spread at the rate that it was spreading at?

How are we thinking about its impact on portfolios and what were we doing to kind of protect portfolios? We have had an allocation to fixed income as Wayne highlighted on the previous question for precisely the hedging component, the unknowns, right?

The black swans that were talked about earlier, even though rates were really low, even though fixed incomes had this kind of terrific, run post 2008, rates could go lower and have gone lower and fixed income asset classes have appreciated accordingly. As Wayne also mentioned, there is only so much return you can get in cash. Right.

But if rates continue to move lower, you know, you will get a principal appreciation in your bonds above premium but to the degree where rates have moved now, we've seen fixed income generate nice returns for portfolios where everything equity related is down on a year to date basis.

So we like to think about kind of the overall risk profile of the portfolio in totality, relative to the goals and objectives of each individual client, and that determines the weightings for the equity and the fixed income and the alternative allocation and, you know, fixed income is never meant to be exciting, but it is in portfolios for precisely these events that are unknown and not predictable.

I do not know if Wayne has anything to add.

Wayne Yi: [00:42:15] Yeah, I agree with all those comments and the virus in itself, could we have seen it earlier, versus later? I think everyone, in every facet of a society is kind of figuring out how to contain, how to control, how to adjust for it.

And I would say that humans are highly adaptable and even from a sociological perspective, we will kind of manage to this. The way we interact from predication and greeting, then kind of gathering will adjust towards that and that will kind of play out in the economy.

We do take the view that this will be a temporary factor now, temporary being it won't be with us forever, but that we will be able to adjust for it and account for it and, kind of be able to move on living healthy, happy lives. So, I think that longer term view is where we really try to focus in on.

Darcy O'Brien: [00:43:39] Okay. The next question from one of our participants is to circle back on oil. Do you think that tariffs changed the Saudi's outlook on price?

Chris Moore: [00:43:48] I do not think the tariffs necessarily changed their outlook on price. I think it was the surprised rate of production by U.S.-based shale producers that. They viewed this as kind of an opportunity to respond to the negotiations with Russia while impacting U.S. production at the same time.

Darcy O'Brien: [00:44:12] How does the current market situation impact leveraged debt assets, such as Golub, Arowmark and CLO's?

Wayne Yi: [00:44:21] I'll talk a little bit about that. It has been a while now, but we have as a firm been pretty reluctant to buy into traditional corporate credit exposures, whether it's bonds or traditional leveraged loans, just because while everyone knows about the extension of Cub light loans, tightening spreads, less overall yield for riskier businesses. It just didn't resonate well from an attractive opportunity perspective. So, we had been very light from a kind of public markets perspective on that front. Now talking specifically about those managers and their strategies.

We think and view them as the best of the bunch. And we hold them to a pretty high standard in the sense that we have looked at a lot of direct lenders, didn't like their processes and controls, weren't as conservative, nor do they have any kind of underwriting competency in, restructuring capability when necessary.

There's a lot of direct lenders that came out these days that, that would not be able to go through a restructuring or a reorg. While, Golub, being a direct lender has built out that competency and we think they will weather and be able to do that. And they've been through multiple cycles to build, to show that they have been very competent in that perspective.

So, that is the only kind of direct lending exposure that we currently continue to use. There's a very high bar for us to expand on that. From an Aramark perspective, the history of Arrowmark is pretty interesting. We won't use this call to kind of go through it, but there is a high quality underwriting standard across levered vehicles, structured credit, whether it's regulatory relief transactions or CLO's or structure credit broadly, and having that more conservative mentality in the space without chasing returns when the moment is there, but rather being very disciplined, improves the volatility and impedes a sell off.

Those are the kind of the investment philosophies that we really gravitate towards. So, that is why we like them in that space. We are not going to say that these businesses are not going to be impacted at all from credit markets or a credit market deterioration. But we think they will be high quality performers in that space.

And a modest recession, we think they will be able to be very protective in. In a severe recession, we view them to be an outperformer in that space. And we'll still have the ability to pivot, in the midst of that.

I think Altum was the last comment maybe that was mentioned there. Altum being a direct CLO manager, they have been very conservative, and they brought down, their long exposures or their exposure to the market pretty dramatically and have built up a large cash position. CLO's and loans generally last year were not strong performers.

And in the midst of that, they kind of recharged their portfolios so that there would be better opportunities for them to participate in. So once again, it just goes back to underwriting discipline, where the only way you could avoid or be profitable in a down market is to be negatively correlated.

And these strategies aren't necessarily negatively correlated, but the beta to markets is very low, the underwriting process is very sound and they have the ability to weather through periods of volatility to come out the other side and have high quality inflections when the markets do recover.

Darcy O'Brien: [00:48:23] Thank you Wayne. And just to be sensitive to time, we are about 10 minutes out from an hour. We are trying to keep the call to an hour. And at this time, I have two more questions for us to get to. The next one is will this be a good time to divert income to pay down principal on loans at 4 to 6% interest rates or would you recommend investing in good buys in the market?

Chris Moore: [00:48:46] I think the question is asking diverting cash to investments that are yielding 4 to 6%, with that in mind, you know, our view is to stick to high quality equities on a risk return basis, versus some of the loans that are yielding 4 to 6%.

We mentioned before some of our concerns around credit markets and high yield in particular. Some of the publicly traded leverage loans, could be in a position where they see further downside. If some of the credit concerns are realized, if we are looking at purely kind of a way to generate, return for each unit of risk.

We think that the high-quality equities are the way to go. That being said, I'm mentoring this question entirely in a vacuum and would normally take that in the context of your broader plan and strategy and how your portfolio is structured from a big picture basis, before making that recommendation.

Darcy O'Brien: [00:50:10] Okay, this next question comes from a self-proclaimed boomer says, I can understand that if your 20 through 50 years old, you stay in the market. You have time to find the bottom like everyone else, and then be better off two to five years from now when the market rises. But, what about us seniors who are close to retirement and do not have the time to recover from this route.

What's your opinion about pulling totally out of the market and placing everything in less risk averse situation, please advise?

Chris Moore: [00:50:45] The first question I would have is if you're already retired, what is your annual expense look like as a percentage of your total assets and how much longer into those assets have to support you.

But I think broadly answering the question we are against selling in panicked periods, like the one we are in right now. Because historically it is the absolute worst time to be selling. And we looked at some data the other day around kind of historical outbreaks of viruses on a global scale and you know, what the market reaction was and what the worst decline from peak to trough.

And if I remember the numbers correctly, I think in the prior instance, the worst decline was kind of a 12% decline or so. Here we're through 20. If you look at kind of all bare market declines, going back to 1929, and the decline of 1929 inclusion, 86% decline in the market. The average decline is 40%.

The recovery posts those periods is one 150%, so it's significant. We have done a lot of work on asset allocation and the impact of de-risking at the absolute wrong times and how that can really negatively impact your long-term plan. So, without knowing the specifics to you in your portfolio and your needs.

My first reaction is do not sell here. Hold wait this out and let's see how this plays out. Even if you know, retirement is in your very near future or today.

Darcy O'Brien: [00:52:48] Thank you, Chris. I think we have time for one more question. Chris, how do you think this environment now affects private equity market?

Chris Moore: [00:52:57] So I touched on a little bit before about how I do think that this will be an opportunity for the private equity funds and venture capital funds to put new money to work, because typically in periods of decline like this, private investments also get much cheaper. We think you will likely see some valuation decline within private marks for this quarter and likely the second quarter.

I would not be surprised if it is much less severe than you're seeing in public markets, just because public markets do have kind of the technical and emotional component in the valuation. Whereas the private market valuations are more fundamentally driven in many cases. I would say the more cyclical companies, those that are industrial or material, or energy related companies are going to be the hardest hit and could continue to be severely impacted if this weakness continues for an extended period of time.

So, in short, we still like the asset class. We still like the strategy. We do think it is a good way to generate return within client portfolios for the long term and hope to see many of our managers using this volatility as an opportunity to put money to work.

Darcy O'Brien: [00:54:31] Well, thank you Chris and I would like to take a moment to thank both Chris and Wayne for sharing their thoughts today.

And thank you to all of our participants for submitting their questions both before and after and during the call. We hope that you have enjoyed today's discussion. If you have any

additional questions that we're not able to address during the call, please do not hesitate to send them to me at dobrien@simonquickadvisors.com and we would be happy to address them offline.

Thank you again for joining us and have a great evening.

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