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March 18th 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 live call weathering the coronavirus market downturn. My name is Darcy O'Brien. I'm the chief marketing officer at Simon quick, and I will be moderating today's discussion. Given the increased market volatility, Chris Moore and our head of investment research.

Wayne Yi and I, are going to host weekly market update calls for the foreseeable future until the markets stabilized. Please note that there will not be a visual component to this call. However, as a participant, you can submit questions through the Q&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.

Now I will dive into our questions. The first one comes in from Tom. For some clients, when our financial and investment plan was put into place, we were riding high and there were no black swans in the distance. Since that time, the markets and the world had been turned on their head. Have we, as a firm, shifted our conversations from stay the course and keep your head down to let's use this as a buying opportunity?

Chris Moore: [00:01:46] Thanks Darcy, I'll take that one. This is Chris. And so it's a good question. And certainly in just the last week, since we hosted our last call a lot has changed and, volatility in markets has continued to be extreme and the situation is certainly one that is on everyone's minds. As we look at kind of where we are within the market today, one of the things that we're looking at is what changes have we been making to portfolios leading up to this and how do we plan to make further changes and really capitalize on potential opportunities here?

The first thing I would highlight it is over the last two quarters we've been making a conscious effort to increase the quality of our exposure within portfolios, in particular, within equities, we had shifted more towards higher quality docs and companies that we thought would be more inclined to weather a severe downturn. Within fixed income, we had shifted from, you know, leverage loan exposure, or lower corporate credit exposure to, more

treasury exposure, municipal exposure, where we felt like the, potential decline would be most offset by appreciation and the less risky assets. So those were things we've been doing up until this point.

Certainly in hindsight, we wish we had done a lot more, but leading up to today's call in many client portfolios, we've continued this shift even more dramatically. We suspect to be doing the same in the next couple of days in a more dramatic fashion and for clients that we have not connected with already, we will be in touch with a plan for how we intend to do that.

The second thing that we're looking at is more specifically, where do we want to be investing to capitalize on what's happening in the market today, so that when we do come out of this, we're maximizing the return potential with a risk return trade off that's highly attractive.

One of the ways we're doing that is looking at distress strategies, where can we be allocating capital within the distress universe that will capitalize on likely defaults and further bankruptcies within certain sectors, in particular over the next three to six months, that could be in both public markets and private markets.

The other thing that we're looking at right now is which companies will investors want more exposure to, or put more investment dollars behind after this decline, likely some of those candidates will be healthcare biotech medical device companies, where it's likely that everyone will want to put more dollars towards those industries with the hope that we're better prepared for the next, potential public health issue of this degree. And the second item that we're looking towards is technology companies, specifically those that are, software service oriented that would benefit the working from home or educating your children from home or any other remote related function. All of us in every industry are certainly thinking about how are we using technology to stay connected with our team and our clients in such a way that it's efficient and seamless.

So we think those are industries that will benefit going forward. So technology healthcare, biotech in particular are sectors that will be putting more capital towards in the coming weeks.

Darcy O'Brien: [00:05:47] Thank you, Chris. Our next question comes in from Bob and he says, in addition to discussing our ability to raise cash, I would like your advice on where to put cash right now. Secondly, if fixed income is a potential source of cash to redeploy at some point, I would be interested in to hear your perspective on how our fixed income allocations are performing in this market.

Wayne Yi: [00:06:13] Sure. This is Wayne. And I'll take that one.

I would say there's two ways to take the first part of that question. And it's like, where do you put cash right now? And then the question is where do you deploy capital to take advantage of what's available in the markets? I would say Chris touched on those elements, but, the other question is if you are trying to be defensive and I think reading into some of

the questions around fixed income, is fixed income the right place to hold your cash, or are there other areas or segments of fixed income that might make more sense right now?

And I don't know. I don't know how closely people are following the markets and kind of let's call it the financing markets, but in periods of dislocation, there is uncertainty across the board in the sense that treasuries are the safe haven people flock to treasuries. And then even high quality, lower risk opportunities are viewed as a potentially risky and you see risk kind of move out from that perspective.

We saw this in '08. We're seeing this right now. It says, municipals are moving wider, investment grade corporates, high quality investment grade, moving wider. Things that are short duration are still moving wider versus treasury. So, What's driving this. I tell a lot of this is coming from just a lot of get door to technicals.

You could throw it to trades being unhedged or unwound. But in this period, you are seeing a lot of short term dislocations in markets. And some of the actions that the fed is taking in terms of making sure that there's liquidity in the system is used to manage this. Now we're not calling a another '08 financial crisis where the banks are going under, but the fed knows what happened in '08. It is reacting quickly and being early to make sure that there are no concerns around the financial system. And we feel like that will assuage some of the kind of pressures and concerns that we're seeing in the market. But what have we experienced over the past couple of weeks? We just went from a one and a quarter, 150 on fed funds to zero.

And that was a big move. Even the treasury index is only up about 80 bps or about half of that return. The Barclays investment grade index is down on the month. Things like that. They're not typical and that's not a typical relationship you expect.

So we do view it as a short term technical that the fed is addressing. But we do think that fixed income, is an appropriate place to be invested in. Particularly as a counterbalance to equities, and that would be the source of capital deployment as we recycled into equity opportunities.

Now we do think that as the fed has gone to zero, there's less opportunity for obviously there's no yield there. But, going to zero does allow for, the capital rotation away as markets stabilize from the funding perspective.

Darcy O'Brien: [00:09:49] Thank you, Wayne. Our next question comes in from Jay. The US 10 year yield and US 30 year bond yield were halved in one week. According to JP Morgan bank through synthetic derivative, derivatives are short 1.2 trillion, the equivalent on us. 10 year bonds. This is not a smell of fear, but a smell of somebody big blowing up like LTCM or Lehman.

Is this the Canary in the coal mine?

Wayne Yi: [00:10:19] I'll take that as well. Cause it, it goes a little bit to the question that came prior to that, but, I think the fed moved aggressively, because there is a lot of new

uncertainty out there. I can't recall the last time when, major cities where the streets were just empty and everyone just sheltering in their homes.

And in the uncertainty, the fed is trying to show that they're backing the financial system they're backing companies. They're making sure that the needs of capital markets and the general economy will be maintained at its core to, work through the next quarter or two.

Is there a Canary?

I don't know. So I think banks are in a much better place today than they were in '08. When you kind of look at shock scenarios, even with increasing default expectations and lower recoveries, banks are better postured weather through that. I do think some of the reactions on markets were based by the fed getting cutting rates immediately.

And then also providing liquidity to, whether it's banks or insurance companies to slowly and more gradually unwind any potential trades. They have their treasuries or have historically been used to hedge other parts of fixed income exposures, with treasuries tightening those that creature short book to underperform and allowing for other institutions to kind of manage through that, I think is really the reason why the fed moves as aggressively and actively, not just from a rates perspective, but also from a commercial funding and repo perspective.

So I think that's the rationale, the reasoning on why they've done it.

Darcy O'Brien: [00:12:37] Thank you, Wayne. Our next question comes in from Nancy. How do you explain the extreme volatility in markets and when do you expect it to end?

Chris Moore: [00:12:48] I'll take that one. And, the latter half of the question, when do we expect it to end? I'll start with, that's anyone's guests, quite frankly. The markets are really waiting for continued support from Congress from administration, from the fed. They want fiscal initiatives to support the economy and provide ultimately support for markets as well. The volatility that we're seeing today is at unheard of levels the last time, quite frankly, volatility was this high was, in 1998 with the collapse of long term capital management.

It was an extraordinary period. And like then, today we're seeing a variety of technical factors that are contributing to the market volatility. We touched on this a little bit last week, but, compared to kind of a pre-2008 period, there are no longer proprietary trading desks on wall street that are creating liquidity for the markets.

When there are retailer institutional sellers, those deaths are gone. The degree to which they're trading the books, for those banks is nonexistent. And, secondly, you have a number of computer driven trading strategies that are either in mutual fund structures, in some cases or hedge fund structures, some of which when incorporating kind of notional derivative exposure, are tens twenties, fifties, billions of dollars in exposure.

And those computer algorithms trade based on moves in the market. And in many cases, what that means is when risk increases within the equity market, those trading strategies

are pre-programmed to de-risk even further. So, in a period where equities are declining, those strategies are actually selling equities to de risk the overall risk of the portfolio.

So it's heightening volatility on a daily basis in an extreme fashion. The third component that's contributing to volatility is ETFs. ETFs have really ballooned post 2008 in popularity, with the S and P 500, the S P Y as the ticker being the largest of the group within equities. They now represent, in just the last two weeks, it spiked from about 25 to 30% of daily trading volume up to close to 40% of daily trading volume.

So what that means is the investment managers, the longterm holders of stocks that want to own stocks, or companies they like for the long term are maintaining those positions and not necessarily contributing significantly to the daily trading volume. This is a function of a lot of technical factors contributing to an already nervous market, where there is certainly a lot of fear for good reason, around the spread of the coronavirus across the globe and its potential impact on global growth. One thing I would just add to the comments I had made earlier to make it clear: We are not advising selling equities in this period.

We have been adding the equity exposure over the last two weeks. We first started when indices were down about 12% or so. We have continued to believe that for portfolios that can wait this out a one, two, three, five years or more will certainly benefit from adding equity risk. Now that being said, we also realize there are certainly potential for this to get worse, and we are not minimizing, the severity of the situation today.

And because of that, we're moving to increase quality, within portfolios, across the board. so that we want to own those assets, even if things do get worse so that we can own them, during a potentially worsening period. And then out of that, through the recovery as well.

Darcy O'Brien: [00:17:41] Thank you, Chris.

Our next question in the queue is from Marshall. Are you at all concerned about liquidity and fixed income ETFs or credit markets more generally?

Wayne Yi: [00:17:54] Yeah. I think those elements point to some of the earlier comments are made around fixed income and credit, but this is, ETFs are truly getting tested today, versus prior, because they're much more utilized by markets, by investors, and spreads.

I continue to tie in. So the unwind is dramatic. I would say, the riskier the credit quality, in smaller the asset or the market cap of the ETF, the more violent the discounts, have been expressed, even on highly liquid high quality fixed income, you see discounts anywhere between 1 to 5%.

Those who are levered on top, who levered ETFs, I think is where you see the most amount of pain, because you're getting hit, by, from the price discount to NAV in addition to the assets underperforming you're selling off. So that's where the risk lies, but we have not utilized them for that perspective.

We had stayed very close to high quality, investment grade, safer assets. And we think volatility kind of those parts of the market as well. We don't think it will persist over the long

term. We believe that it will, stay consistent and, and kind of normalize, as people kind of this new market dynamic.

Darcy O'Brien: [00:19:38] Thank you, Wayne. Chris, was that something you wanted to add or shall I move on to the next question?

Chris Moore: [00:19:47] No, you can move on. Thanks.

Darcy O'Brien: [00:19:49] Onto the next question. That's come in from Joanne. Were you surprised by bond changes and will they recover quicker than stocks?

Chris Moore: [00:20:04] Go ahead, Wayne. You take that one.

Wayne Yi: [00:20:07] bond changes. I think the recoveries committee rationalize quicker because you're just kind of moving through a technical effect in the sense that as I mentioned in primary, the first question, if you look back in '08 investment grade in a fed tightening environment, investment grade, we're not even talking about closed end funds or mutual funds.

We're talking about the index. With the fed tightening or lowering rates, the Barclays Agg was widening or this time was increasing and that was because people were just fearful, and just selling what they could not, because they actually thought that there was an inherent or deep kind of credit risk in that index or the constituents within that index.

I think we're seeing something like that right now. So I think it's that dislocation occurred that we're seeing currently, I believe that is, going to be relatively short term. And I think that can snap back pretty quickly. Now the Delta or the amount of money you can make in treating that I don't know, that's worth, trying to take advantage of. I don't think it's as material and it's more of a trader strategy as opposed to an investor strategy.

But I do think that element would normalize quicker. The relationship between treasuries in investment grade, then what you might see in equities as people still try to parse through all the news and kind of reset valuations.

Darcy O'Brien: [00:21:47] Thank you, Wayne. The next question comes in from one of our anonymous attendees, looking out over the next one to three years in a very simple stock and bond world, do you have a reasonable range of potential returns for stocks and fixed income?

Chris Moore: [00:22:05] I can take that one. I think for stocks, one year from now, I feel highly confident that they are going to generate returns in excess of 10%. And I think in the average year for an investor, to say confidently, they'll get 10% in stocks.

That's probably a really solid return. Most people have a hurdle somewhere between five to 8%. The difference is in kind of an average discussion around putting on equity exposure, volatility is not where it is today. And, yeah, a gut wrenching thought for a lot of people to put money into equities today, seeing volatility as high as it's been over the last three weeks and having no, kind of comfort that that's going to stop anytime soon.

And, we completely appreciate that and want to encourage our investors to think much longer, think, a year, three years, five years or greater. If the opportunity for returns in stocks is 10% a year from now. That's a terrific opportunity. As long as you're willing to keep yourself in check as volatility picks up in the short term.

Cause it certainly could, as far as fixed income goes, you know, rates will remain low probably for the foreseeable future. And as long as rates are low, that is a good environment for fixed income. If there's no, you know, strong GDP growth leading to inflation, causing the fed to increase rates. The environment for bonds is generally good.

However, I think the range of returns earns within the fixed income universe could be very wide, because I think there are some lower credit quality bonds, whether it's loans or bonds, in high yield or investment grade, depending on the actor or the industry, they could be very severely impacted and the potential return there could be zero.

However, There are other bonds that will likely do quite well in this environment. And we'll continue to be looking for ways to allocate opportunistically. We have a number of non traditional credit and fixed income managers that we think know that universe really well and will likely find unique ways to capitalize on volatility and credit.

And, the distress that we were talking about earlier, most of those investments in kind of the 2008 period, those were distressed credit investments. It wasn't necessarily equity that was being purchased. It was distressed credit where the manager and the team had significant experiences.

And the ability to understand, what was driving performance on a going forward basis. So broadly speaking, answer the question directly, a fixed income will likely do fun. The upside potential there is significantly less, if you're in traditional fixed income, but you're not owning it today for the return, you're owning it for, protection against things, getting worse.

Darcy O'Brien: [00:25:43] Thank you, Chris. Our next question comes in from Kara. How will bailouts affect value? I.e. are you thinking of buying airlines or hotels as they're declining?

Chris Moore: [00:25:57] I can take that one too. No, we are not thinking of buying any of them. We likely would leave those decisions up to, truthfully, the distressed universe when some of the bankruptcies and potential bailouts, work their way through the system.

It's too early now for us to have any interest in airlines or cruise lines or hotel operators. We likely think that the shake out there is still ahead of us. And while we do expect, if not a bailout form of a rescue package for some of those, if not all of those industries, from the administration, we think it's too early to be buying into them, especially buying the equity.

But we do think there will be opportunity through sophisticated distress managers to be buying the debt, that will likely work out just fine.

Darcy O'Brien: [00:27:07] Thank you, Chris. The next question comes from Peter. Please help me understand the backup in tenure rates from 0.31 to 1.22%.

Wayne Yi: [00:27:22] I will address that. And I think if we're thinking about, just the price action that we saw, where I think on Monday, last one day we saw charges come in the hardest and kind of really grind in and on the back of a fed rate cuts. What we're seeing right now is that, to the comments I made earlier, there are trades that are being unwound.

If you think about the amount of fiscal spending that the administration is trying to pump through, that's going to definitely increase, the deficit. We're opening more lines. QE is now or quantitative easing is now back in play where, the government is pumping money into the system.

And on top of that, what's exacerbating it is this effect of unwinding your hedges as well. So all that kind of coming to play, I think, has really caused a treasury, the safest asset, especially on the longer part of the curve, to really kind of push out and I don't think it's going to be that way.

I think the curve will definitely flatten and be lower, but I think there has been this kind of sudden move, to kind of reverse a lot of trades on top of fiscal expansion of fiscal spending. That's weighted on treasuries, right now. But if, and likely this recession does play, played through in the next quarter, people will return to, safe assets.

I agree if it's in that bunch, we'll move in that direction.

Darcy O'Brien: [00:29:13] Thank you, Wayne. The next question is from a one of our anonymous participants. What are your thoughts on investing into vault volatility with an ETF like VXX or the actual VIX for a three month period or until we get more clarity on stopping the virus?

Chris Moore: [00:29:33] This is Chris. I'll take that. It is a difficult trade to implement effectively. A lot of people lost money on that trade and in a way to nine, the VIX is typically a security that is traded daily. So it is not meant to be an instrument that you hold for a period of time. And it more often than not, costs investors, quite a bit of capital when they've tried to trade around volatility.

I think if you're looking to protect yourself against volatility, the best bet there is to either just hold cash or a traditional, super safe, fixed income instruments. Or use an option strategy. Where you're buying puts on an index, so you can capitalize should a volatility spike to the downside again.

Darcy O'Brien: [00:30:35] Thank you, Chris. Our next question comes in from Shresh. Why have money market funds lost value? Do you expect them to recover with everything that's said is trying to do?

Wayne Yi: [00:30:49] Yeah. That's an interesting question. So I think we tend to, Our firm's stance is to a stick any market funds that protect the dollar or stick to have maintained a $1 NAV so that you don't have any potential discount risk around that.

Now there are other ways to extract higher yield and money market funds that won't pay to the dollar, or to the $1 value. And a lot of that will be, tied towards a commercial paper.

And then the reason why you get a higher yield is because you're not taking the same kind of risk you're not taking, I still do high quality, but it's more a kind of let's think overnight risk.

And, I think part of the reason why when you hear is that the fed funds has been cut by 150 bps. But the extension of the overnight rate, the commercial, paper financing, that the treasury is doing. These are other elements that I would say a little bit more nuanced, and is done to really kind of bolstered the liquidity and the piping of the funding markets for banks, institutions, and other investors that is where I think you're probably seeing that effect. So I do think it will normalize or it should recover, but I think what we're seeing across fixed income from a technical effect, I think that's where you're seeing the pressure come in from.

Darcy O'Brien: [00:32:27].

Thank you, Wayne. The next question comes in from an anonymous attendee. Please comment on that dislocation within the muni market, and whether in times of heightened volatility, this sector still hold value in providing diversification and safety within an overall asset allocation.

Chris Moore: [00:32:50] I can take that.

The short answer is yes, it still does provide diversification and safety.

Munis do play an important role in asset allocation, especially for taxable investors. We have in the last week and having prior periods seen, munis behave, kind of counter-intuitively and that's really a function of, there are short periods where the market wants to de risk altogether and just own treasuries.

And, we've seen kind of a spike in yields and munis and liquidity drawing up to a degree. In the last week in response to that. The other factor I would just highlight too, is remember, everyone is working from home now. this includes major financial institutions in New York city. This includes everyone, that is trading bonds, stocks, et cetera. So it, there will be kind of a decrease in liquidity as it relates to that activity overall. it is certainly possible as a lot of firms were moving from their offices, their headquarters to work from home facilities. During that period, there was reduced volatility, or I'm sorry, reduced liquidity across many of the credit instruments, munis, maybe being one of those.

Darcy O'Brien: [00:34:29] Thank you, Chris. That is all the questions we have received for today. So at this point, we are going to begin wrapping up. As a reminder, we will be hosting these calls weekly as the market volatility continues. So please do continue to keep an eye on your inbox for updates. On the next call. We hope that you've enjoyed today's discussion.

If you have any additional questions that we were 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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