Private Wealth Partners, LLC

FIRST QUARTER 2020 REVIEW

Dear Client, April 8, 2020

As we mentioned in our fourth quarter 2019 review, our biggest economic concerns to start the new year were geopolitical conflict with Iran and a messy run-up to the 2020 presidential election. Most economists and money managers (ourselves included) maintained a constructive outlook that the global economy would post modest but solid growth in 2020, particularly as the U.S. and China made progress on a trade agreement and as central banks appeared positioned to maintain low interest rates.

Everything changed with the global spread of Covid-19, which has brought the global economy to a virtual standstill and created an aura of uncertainty about public health, job losses, and economic growth. The equity market re-priced the risk of a recession faster than it ever has in history—dropping -34% from a February 19 all-time high, before rallying +18% in response to aggressive fiscal and monetary action.

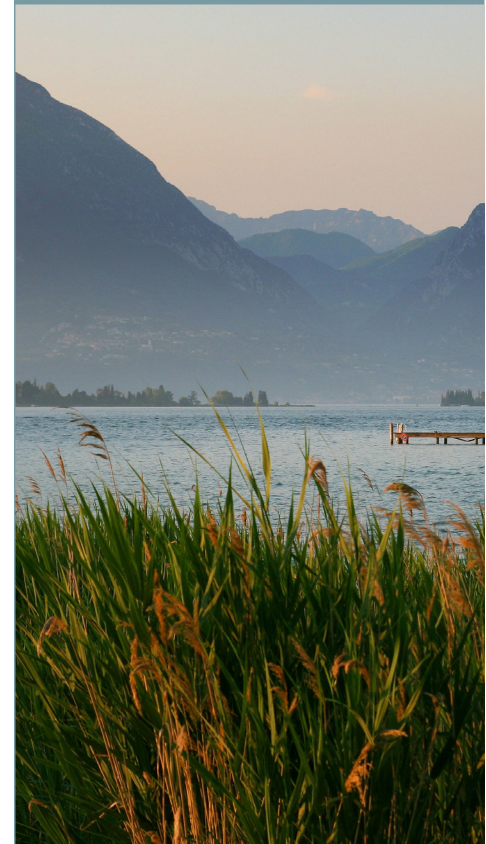
The S&P 500 finished down -19.6% for the quarter, but an investor's participation in the downside had everything to do with exposure: Energy (-50.5%), Financials (-31.9%), and Industrials (-27%) got clobbered, while Technology (-11.9%), Health Care (-12.7%), and Consumer Staples (-12.7%) outperformed on a relative basis. Some technology companies, like Amazon (which we own), even finished the quarter in positive territory.

THE EQUITY MARKET RE-PRICED RISK IN RECORD TIME

Source: Strategas Research

"Only when the tide goes out do you discover who's been swimming naked."

-WARREN BUFFETT



PRIVATE WEALTH PARTNERS, LLC

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As your investment manager, our objectives right now are three-fold:

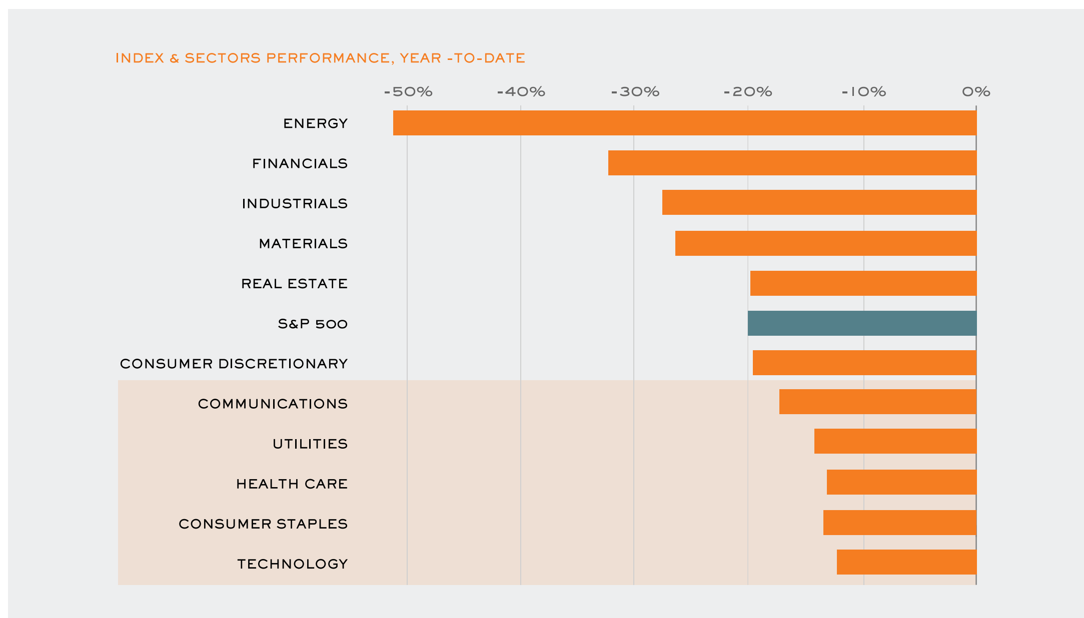
1. Make sure we try to limit our exposure to the most affected areas of the market;
2. Use volatility to our advantage. Rallies allow us to raise cash and pare back exposure to companies whose medium- to long-term outlooks have changed. Sell-offs enable us to establish or increase our positions in attractively-priced companies;
3. Make sure we're positioned to participate in the recovery when it eventually arrives—which it will.

When the impact of the global pandemic became clear in February, Private Wealth Partners immediately examined each portfolio equity holding in a "stress test"-like format. We looked for credit risk on company balance sheets and, in a broader sense, measured the portfolio's relative exposure to sectors we saw as highly vulnerable to 'full-stop, consumer stay-at-home' economic conditions—sectors such as energy, hospitality, retail, travel, consumer discretionary categories, small-cap stocks, and more.

Fortunately, we found very little credit risk in the portfolio and do not believe that any of our companies will need to access Fed loans or raise unreasonable amounts of cash to survive. Nearly all of our equity holdings are AAA-rated companies with strong balance sheets and strong business models, which should allow them to remain stable (or perhaps even thrive) during this economic downturn.

Looking at the chart below, *Private Wealth Partners has greater exposure to sectors that outperformed the S&P 500 for the quarter, and we have far less exposure to the sectors that performed poorly.*

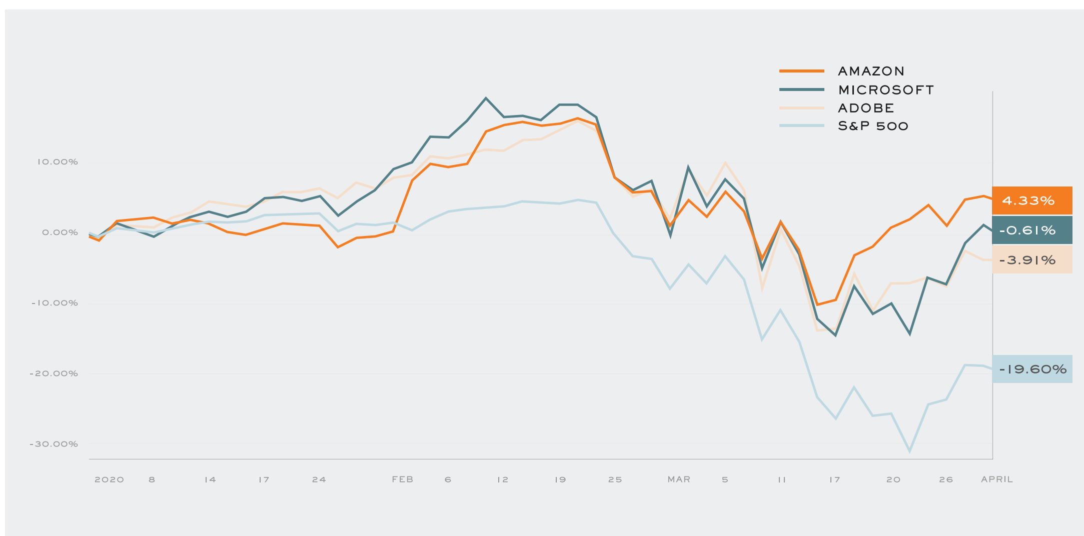
SOME SECTORS FARED BETTER THAN THE OVERALL STOCK MARKET



Source: FactSet

Another focal point of our strategy is investing in "thematic growth" companies, which means looking for companies that are innovators and leaders in the modern economy (think 5G, cloud, e-commerce, drug development, etc.). The uniqueness of this economic downturn—which requires people to stay home and basically eliminates human interaction—actually bodes well for companies that are building and servicing the digital economy's infrastructure. Companies like Microsoft, Amazon, and Adobe have been outperforming on a relative basis. Demand for their products and services remains robust even as the economy contracts (see chart below). *These types of companies helped drive the technology sector's outperformance over the quarter.*

HEALTHY TECHNOLOGY COMPANIES ARE OUTPERFORMING ON THE WAY DOWN



Source: Bloomberg

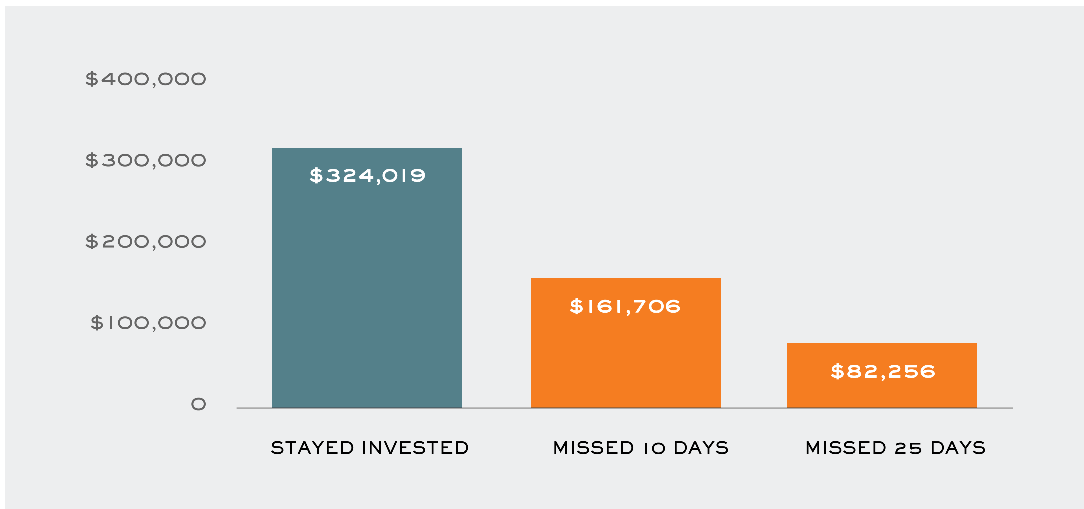
Looking ahead, one of our key objectives is to make sure we're positioned to fully participate in the recovery when it eventually arrives. No one can pinpoint Day 1 of the new economic expansion and bull market. But what we do know—and what has been consistent throughout history—is that the economic data and the 'news of the day' is likely to be dismal when that day does arrive. According to Strategas Research, markets bottom on average four months before a recession officially ends.

After the 2008 Great Recession, for example, "green shoots" did not start to appear in the economic data until Fall 2009. But by then, the new bull market was already at least six months old! If an investor thinks this recession could be over by September 2020, there's a good argument that now is the time to be in stocks—even though we know volatility is likely to persist. Goldman Sachs, for example, is projecting S&P 500 earnings per share to reach $170 by 2021. If the S&P 500 trades at 18 times 2021 earnings by the end of this year, it would suggest an S&P 500 level of 3,060—an approximately +17% jump from where we are now. With the 10-year U.S. Treasury yield at 0.67% as we write this letter, the choice today between stocks and bonds is actually not much of a choice at all.

Heightened volatility may be unsettling, but it is important to remember that it works both ways (up and down). Over the last twenty years, 24 of the 25 worst trading days were within just one month of the 25 best trading days. We have been witnessing this statistic repeatedly over the last two months, with the market dropping -34% only to rebound +18% within a couple of weeks. As we went to print with this letter, for instance, the S&P 500 staged a +7% surge on a single day (Monday, April 6).

Blackrock puts this market behavior—and an investor's reality—into perspective: An individual who invested $100,000 in the S&P 500 over the 20-year period from January 1, 2000 to December 31, 2019—*meaning they participated fully in the devastation of the tech bubble and the Great Recession*—would have accumulated $324,019 by the end of the investment period. But if that same investor had missed just ten of the top-performing days during that period, they would only have accumulated $161,706. There can be a substantial opportunity costs to missing big market rallies over time.

BEING ON THE SIDELINES DURING VOLATILE PERIODS CAN BE COSTLY



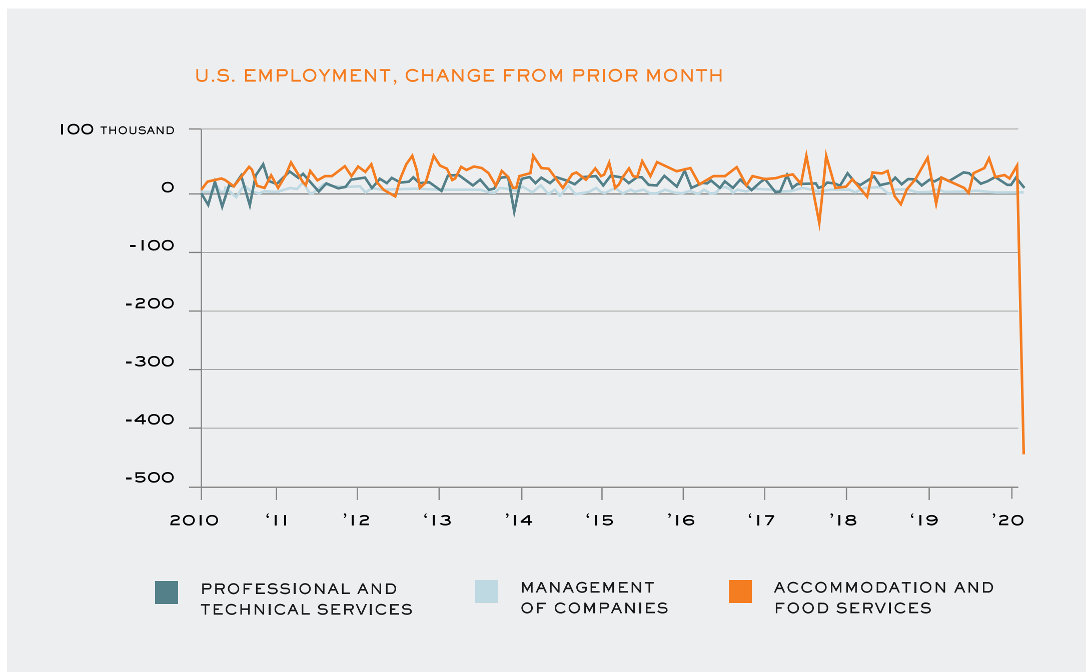
Source: Blackrock

THE U.S. ECONOMY

There is no question that the US economy is in a recession. The economic data trickling-in is bleak and will likely remain that way for the next couple of months at least. Oxford Economics predicts that by May, the US will have lost over 20 million jobs and have a double-digit unemployment rate. A small, but still relevant silver lining here is that this data includes employees being furloughed as a result of businesses closing temporarily while restrictions remain in place (as of March 30, three-quarters of Americans were living under state or local stay-at-home mandates or advisories).

One notable feature of the weak employment data is that a disproportionate number of lost jobs can be found in retail trade, hospitality, and food services (bars and restaurants). The implication here is that the lion's share of layoffs are in industries that will resume operations immediately when lockdowns and restrictions are lifted. This dynamic is much different than past recessions, when job losses hit nearly every sector and all levels of employment. Employment losses in 2001 spanned 25 months, while job losses in 2008-2009 lasted 27 months. This current recession appears to have registered a year's worth of job losses in just two months, but the duration of these job losses could also be entirely dependent on the length of the shutdown.

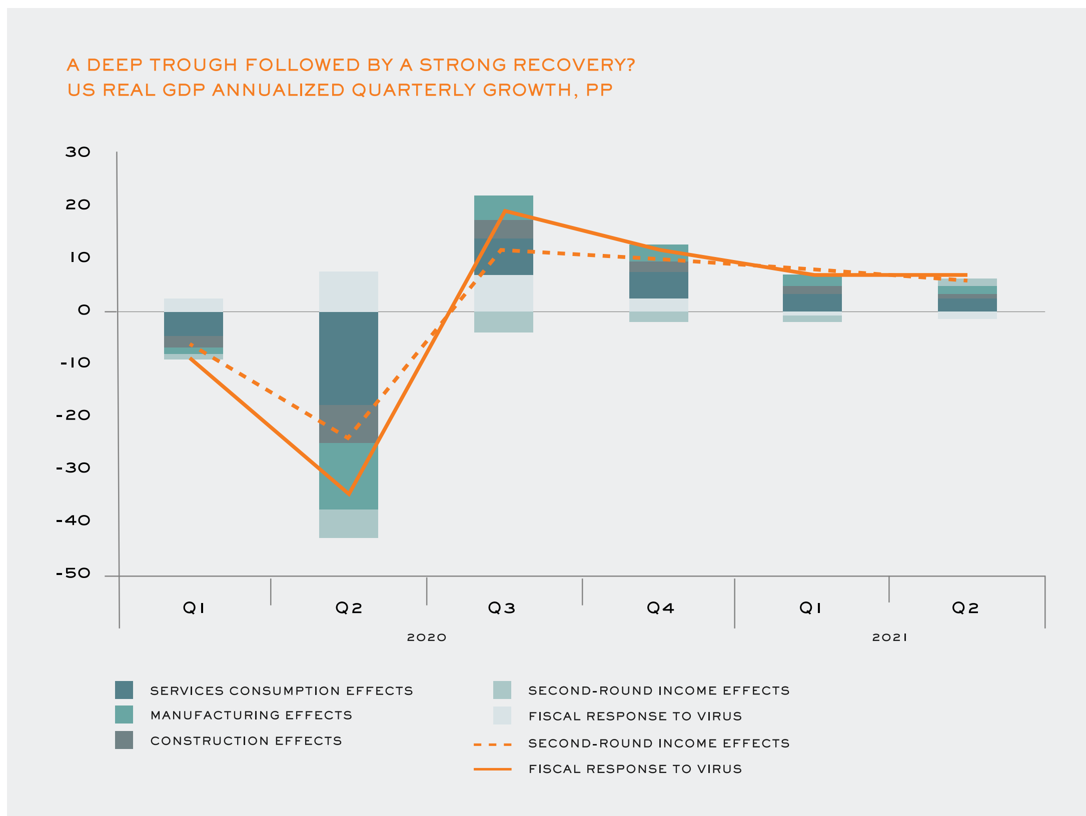
JOBLESS CLAIMS HAVE DISPROPORTIONATELY COME FROM ACCOMMODATION AND FOOD SERVICES



Source: Bureau of Labor Statistics

GDP forecasts for Q2 are dire across the board, and we understand how easy it can be to anchor to negative economic headlines. But if investors can manage to look out beyond the crisis, it seems possible the economy could experience a rebound in Q3 and Q4, aided by extraordinary fiscal and monetary stimulus. Goldman Sachs is forecasting Q3 GDP to rise at a19% annualized rate (see chart on next page).

IF THE VIRUS IS CONTAINED BY SUMMER, THE U.S. ECONOMY CAN MAKE A COMEBACK THIS YEAR



Source: Goldman Sachs

This type of economic crisis is unprecedented, but the fiscal and monetary responses to support the economy are also unprecedented. Alleviating the hardship from job losses and maintaining liquidity in the financial system are crucial, and for now the government and central bank responses look adequate. These policies also raise the odds that a powerful wave of pent-up demand could be unleashed once the virus is contained. So, while it's tempting to latch onto the steady stream of negative news, there are very real positive forces working against the headline risks:

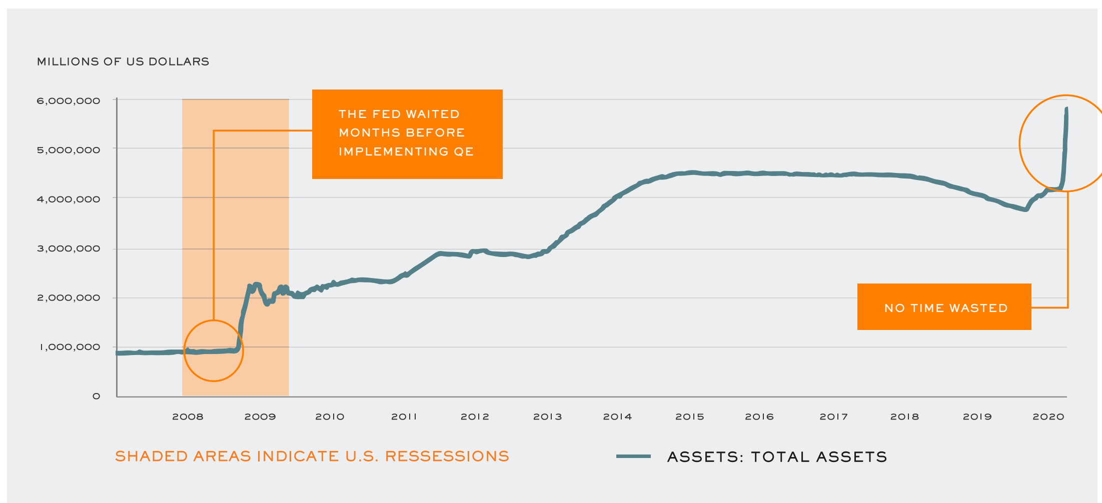
Fiscal Stimulus

- Total spending so far is around $2 trillion, which equates to 9.5% of GDP
- Most will be paid out in 2020
- Required Minimum Distributions (RMDs) are optional for 2020
- Early 401(k) withdrawals without penalty are permitted in certain cases
- Many households will soon receive 'helicopter money' via checks in the mail
- $500 billion in loans and business assistance programs for big companies
- Small businesses will have access to a separate $350 billion facility

Monetary Stimulus

- Unlimited QE program
- New facility to buy investment grade corporate bonds and bond ETFs
- Relaxing bank capital rules to encourage more lending
- Extra liquidity to aid money markets, commercial paper and muni debt
- The Fed is essentially becoming the "lender of last resort," extending loans directly to businesses large and small.

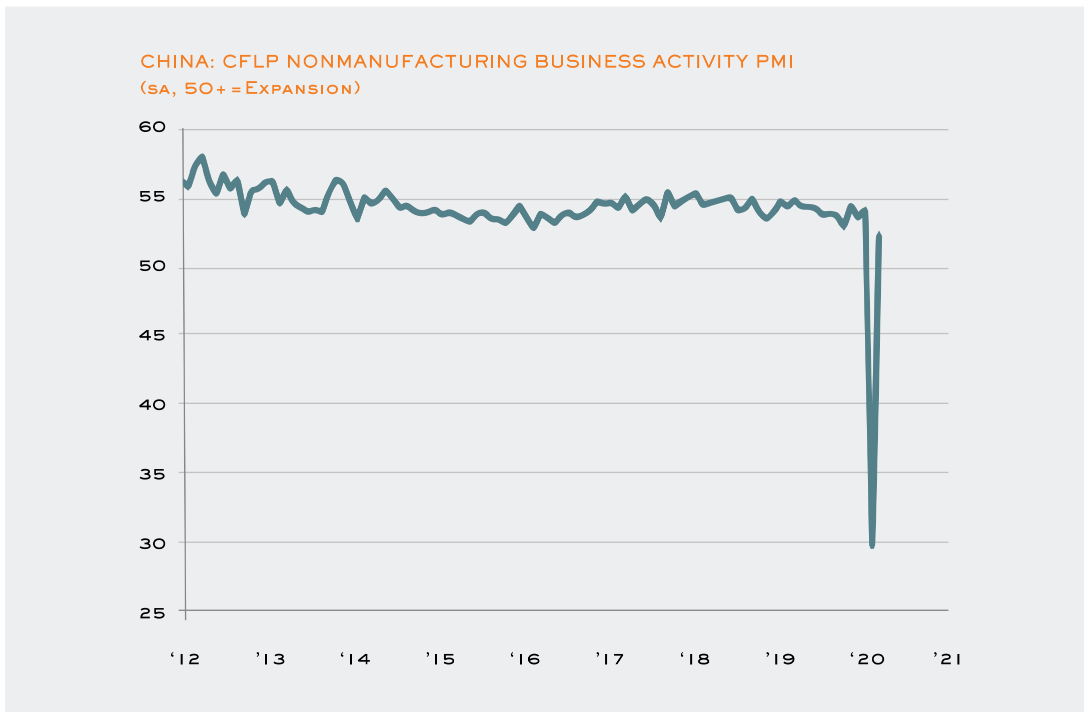
THE FED WASTED NO TIME EXPANDING THEIR BALANCE SHEET



Source: Federal Reserve Bank of St. Louis

Today, gauges of China's manufacturing activity are showing noticeable rebounds, and official reports show that traffic in Beijing is close to being back to normal during the workweek (Wuhan's traffic is also increasing, but not as much). Additionally, some 98% of major industrial companies across China have resumed operations, and nearly 90% of people are back on the job. Shopping malls in Wuhan – the original epicenter of the crisis – also reopened this week. These are positive developments that show the virus can be contained, but it's also true that China is resuming production in a world that currently lacks demand.

CHINA SHOWS HOW ECONOMIC ACTIVITY CAN RESUME ONCE THE CRISIS ABATES



Source: Strategas Research

CONCLUSION

The rapid spread of the Covid-19 global pandemic has been sudden and startling, and is affecting us all in different ways. Our thoughts particularly go out to people who have gotten sick, or who have friends or family members working on the front lines, providing essential services.

At Private Wealth Partners, we remain fully operational and will continue working vigilantly to navigate your investments through this challenging period. We believe, for now, that services will be the epicenter in the current economic crisis—causing acute damage to areas of the economy like retail, hospitality, travel, food service, energy, and the small business sector. *These are all areas where we currently have very little exposure*. We think the companies that will best withstand the economic shock are large, well-capitalized businesses and those whose services and products are still needed—and perhaps especially needed—during a crisis. We are confident in our current portfolio positioning.

We are in an unprecedented period in modern history, for which there is no playbook (it is being written now). We understand that bear markets are unpleasant, but they are also part of the normal ebb and flow of the economy, even if the events that cause them are unprecedented in nature. The economy and our country are resilient, and in a matter of time we will move past this crisis. For now, it's imperative that we remain patient and continue to make smart, thoughtful decisions.

If you have any concerns or questions whatsoever, please do not hesitate to reach out to us. We are all in this together, and will get through this together. Thank you for your continued confidence in Private Wealth Partners.

Sincerely,

Kenneth F. Siebel | Peter K. Maier | William F. Dagley
David P. Wong | Richard G. Kuchen | James Lenczowski
Jason M. Saxon | Chris Greene | Katrina Sutherland
Elyse Gottschalk | Vickie Marinovich

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