Update on Coronavirus and Global Markets:
Where Do We Go from Here?

March 20, 2020

Dear Clients and Friends:

While we are all doing our part to adapt to "social distancing," the economy and the markets continued their slide this week. As we discussed on our conference call last Friday (available on our website for those who missed it), we have to assume that forthcoming first-quarter data about the spread of COVID-19 and the economy will get worse. As investors struggle to estimate the depth of the impact of COVID-19 on our communities and our economy, markets have responded with intra-day market swings in the order of 1,000+ points.

Fiscal Policy Response

We did not spend much time on the conference call last week speculating on the fiscal and monetary responses out of Washington. Today we have more clarity on both.

This week the president signed a bill that will provide economic relief to workers to the tune of $100 billion. Additionally, Congress is working on a plan that could be passed as early as next week with headlines claiming up to $1 trillion (and whispers of more aid to come) of economic relief to family, friends, and neighbors working in industries impacted most including restaurants, hospitality, airlines and manufacturing. There is no appetite in Washington to see weekly and monthly payroll numbers dip into the 100s of thousands without an economic backstop that is likely to include checks at first—and possibly followed by tax holidays later. Private institutions are stepping up too, waving payment deadlines for utility bills, rent, credit facilities, and extending health insurance for furloughed workers.

The next phase will target specific industries – many of them mentioned above. Efforts will be made to provide guarantees and liquidity to assist small, privately held businesses, as well as large, publicly held businesses to stay afloat during this uncertain time.

It will be a real challenge for the small restaurateur who operates 10 locations to remain solvent and staffed when no one is leaving their home. Small business owners will need to make real-time decisions regarding staffing and closures

On the other end of the spectrum is a business like Boeing, which serves an imperative role in the U.S. and global economy. No one has a desire to see Boeing and its 17,000 suppliers go out of business. Similarly, the tens of thousands of workers across the travel and hospitality industry from airlines to hotels are not businesses that our economy can afford to see fail.

We suspect that we will learn the details of these lifelines in the coming days, but potential outcomes could include protective debt measures that result in the federal government taking stakes in the equity of some of the most vulnerable industries, providing loan guarantees on outstanding lines of credit, or possibly the issuance of warrants that would allow the government to enter and exit an equity position down the road. It's worth noting that, while necessary, some of these measures would likely be extremely dilutive to current equity owners.

Monetary Policy Response

Long-time clients will recall our analogy that the markets are the plumbing of the U.S. and global economy. Most of the time, markets are relatively benign: Water moves where it is *supposed* to move to various faucets throughout the home via the water lines at a comfortable temperature and then back down through drains of the system. Occasionally, instead of a minor clog in the system (think Flash Crash of 2010), uncertainty elevates dramatically, liquidity tightens up, and the pipes get gummed up throughout the system. During these periods risk assets fall, and market participants expect those sorts of hiccups. However, other parts of the market that are supposed to be more stable (the bond market) tighten up too, and there can be wide variances between the price at which something is quoted to buy or sell from where the expectation of its real (or recent) value lies. We refer to this as a "market dislocation," which is what we experienced this week in the Treasury, Municipal and Corporate credit markets.

With rates already at zero, the water pressure in our pipes was already quite high. Then the Federal Reserve, together with other global central banks, stepped into the bathtub on the second floor with a firehose pointed down the drain. Liquidity is the medicine they hope will work like a "snake" to flush the entire financial system and ensure smooth operations on the other end of this global crisis.

Our expectation is that, over time, these actions will buy time for markets to settle and begin to operate smoothly again. In the meantime, pricing variances—or dislocations—will continue to provide opportunities in the credit markets not seen since the financial crisis. We have already begun to take advantage of these dislocations to purchase short-term bonds at attractive prices that have not otherwise been available in years.

FBB Positioning

As we sort through the current volatility, we continue to weigh risk and reward for both stocks and bonds. We entered the current bear market with a bit more exposure to defensive stocks and cash. Some of our long term defensive holdings are seeing rising demand in the current crisis, including Clorox (bleach and disinfectants), Amazon (grocery deliveries to the home), Danaher (working to get high speed COVID-19 testing deployed), and Google (using technology to track the virus).

Each step of the way, we have reviewed the potential for market moves, while also assessing which companies might perform better or worse than the overall market. Our process during this market downturn began with a review and sale of low-conviction stocks that we felt were either expensive or overly exposed to cyclicality of the economy at large. We will also continue to look for opportunities to add high-quality, defensive securities such as Berkshire Hathaway.

This week we sold our holdings of international stocks, both in developed and emerging markets, as well as our emerging market bond funds. Our investment view was that, at current prices, we see more downside for international markets as countries in Europe and elsewhere are dealing with their own challenges related to the virus and whose banks are not as well capitalized as ours in the U.S.

Looking ahead, we will continue to gradually increase our equity exposure. At this point, we feel that equity markets are pricing in a full recession, and we are starting to see opportunities to purchase individual equities at reasonable prices. Where appropriate, we are considering additions to our portfolios in e-commerce, which we believe will continue to experience high demand into the future, and property casualty insurers, which tend to generate consistent results even in an economic downturn.

In conclusion, we see great challenges and opportunities in the midst of this market dislocation. We continue to look for investments where near-term investor concerns may mask high-quality businesses trading at discounted levels. Although we are being patient, we believe the current market conditions will continue to provide buying opportunities that will reward long-term investors. Again, we appreciate your confidence and trust in the FBB team, and we encourage you to reach out to your portfolio manager if you have additional questions pertaining to your specific asset allocation and financial situation.

Sincerely yours,

FBB Capital Partners' Investment Committee