



April 7, 2020

*"A Quick One, While Corona's Away"*

Dear Readers:

We hope you, your friends and loved ones are safe and staying safe in these difficult times.

There has never been a better time to write a capital markets letter. In that statement there is both opportunity and treachery. Q1 2020 was *slightly* more interesting than the average quarter. The danger here is that our letter becomes gratuitously long and expands on information that is covered more effectively by smarter, more eloquent people. Thus, we embrace our punchy roots, which dictate that we cover what we sort of know and try our best to provide context, humor and appreciation for our readers.

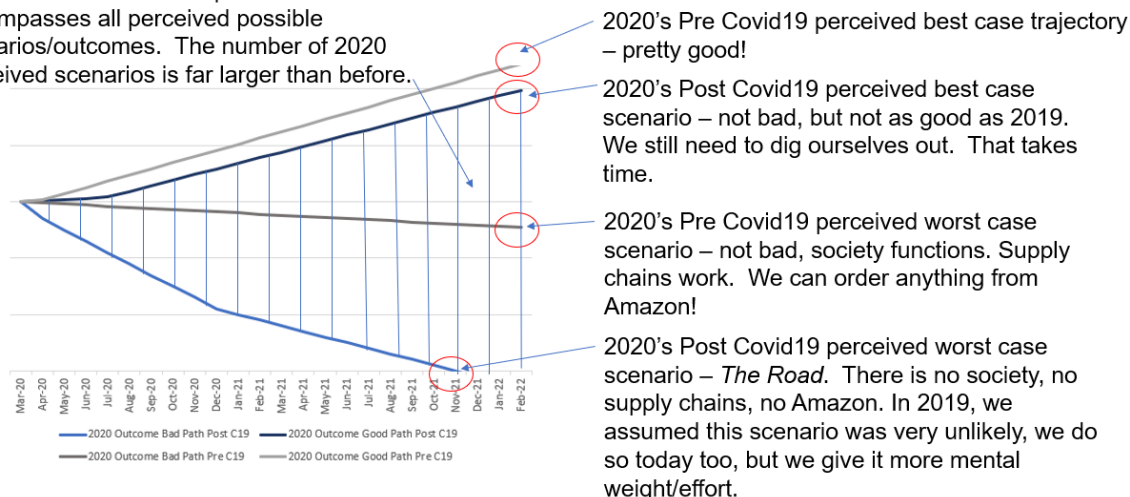
We are all lost and the mental dexterity to hold all these competing ideas is exhausting. Kevin notes that George Orwell described this as "doublethink...the power of holding two contradictory beliefs in one's mind simultaneously, and accepting both of them."  
- [George Orwell](#)

It is good for us to bring in Orwell. Including him makes us appear smarter. We even footnoted him! 2020, and dare we admit it, humanity, is all about doublethink. This is having your cake and eating it too or in today's parlance "having your hand sanitizer and using it too." Doublethink is also the framework of where things stand today. Imagine a cone of dispersal, like the one below. We start in one spot, on one day, and then our paths start along an x-axis of time. The area between these two paths represents possible scenarios. The further apart the paths, the more possibilities. Let's call one path "Good Path," everything ends up perfectly. In this scenario, governments, citizens, and health professionals come together and show COVID-19 who's boss.

Let's contrast "Good Path" with "Bad Path." "Bad Path" is a Cormac McCarthy's novel: FUBAR, with people trying to eat/kill you. As always, assume neither path is likely to pass, everything's in between, but emotionally, we are all (markets included) calibrating to the possibility of each of these paths simultaneously. Twelve weeks ago, our perceived "Bad Path" was far more benign, maybe one of Karl Ove's *My Struggle* books: yes, life has tedium and ennui, but society supports, economies advance. Our new "Bad Path" has worsened markedly: it's the apocalypse. Even our current "Good Path" has diminished. (Now it's Karl dealing with his deceased grandmother's belongings.)



The area between the respective lines encompasses all perceived possible scenarios/outcomes. The number of 2020 perceived scenarios is far larger than before.



It's the increased divergence between the outcomes that requires mental dexterity and compounds our emotional exhaustion. We know from movies that Zombie apocalypses are stressful. It is exhausting if you couple this with the stress of staying at home, with the sadness of the deaths we've seen, will continue to see, and with the horrific unemployment we see and will continue to see. The markets have, in six weeks, expressed their equivocation over which path we will take.

While, the broader swath of scenarios always existed, it is only now, with our doomsday creativity enhanced, that we lend credence to *The Road* scenario. This is why there is no toilet paper on grocers' shelves and why gun sales have hit levels not seen since the last Zombie apocalypse: [Obama's re-election](#). The preppers feel [vindicated](#)!

Bill Ackman, an opportunist if there ever was one, effectively held both viewpoints in one sitting during his now infamous CNBC [interview](#) on March 18th.

### **Equity Markets:**

The first quarter of 2020 for equities as measured by the S&P 500 had three distinct acts of varying length.



US Equity Returns						
Index	Act 1: 12/31 to 2/19	Act 2: 2/20 to 3/23	Act 3: 3/24 to 3/31	Q1 2020	3/31 Closing Price	Last time we closed at/below that price (before this quarter)
S&P 500	4.81%	-33.92%	15.52%	-20.00%	2,584.59	January 2019
NASDAQ	9.41%	-30.12%	12.24%	-14.18%	7,700.10	June 2019
Dow Jones	2.84%	-36.65%	17.89%	-23.20%	21,917.16	August 2017
Russell 2000	1.44%	-40.78%	15.03%	-30.89%	1,153.10	July 2016

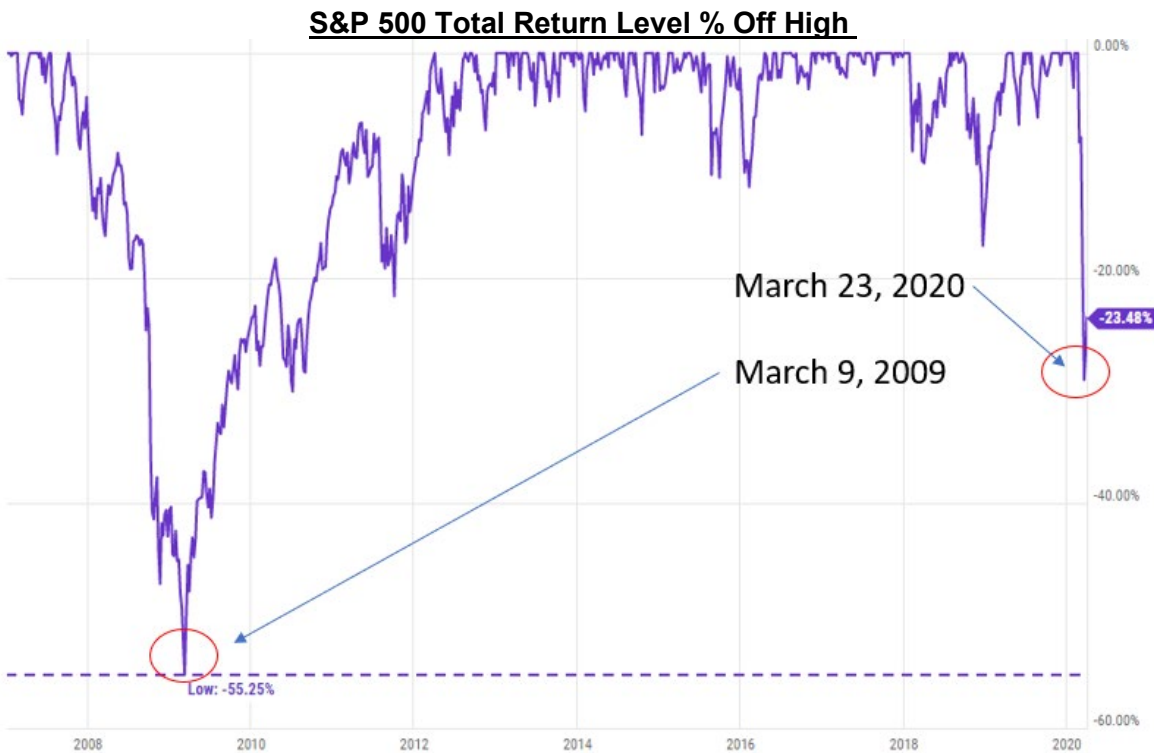
Source: Yahoo Finance

Act 1) January 1st to February 19th, a continuation of 2019 with a slow grind higher, adding 5% of gains to the longest bull market in history. We were on the pre COVID-19 “Good Path.”

Act 2) February 20th to March 23rd, the market falls off a cliff, losing 34% in just 23 trading days as the investing world acknowledges that we may all be in McCarthy’s *The Road* (Post COVID-19 “Bad Path”). The speed of this drop was remarkable and unequaled historically. This drop will be a statistical playground and reminder for market participants for decades to come.

Act 3) March 24th to March 31st, risk-seeking investors rejoice at the momentum reversal over the last six trading sessions of the quarter where markets bounced 16% higher off the March 23rd lows. In this scenario, investors reject *The Road* “Bad Path” and accept that society appears to function and that collectively we are choosing to share ventilators versus hoarding them.

Despite the broad rejection of the McCarthy path at the end of Q1, we remain 23.5% off the February 19th highs. Most equity indices remain in bear market territory (20% or more off their highs). These drawdowns have not matched the Global Financial Crisis (down 55%) in size (yet) but have been more pronounced over a shorter timeframe (see: Act 2).



In 2008, commentators became really interested in introducing letters, affixed to cartesian planes to describe recoveries. Would the markets recover in a shape that's like a V, a fast recovery from the bottom, or a U (a recovery with a longer, flatline bottom). Lots of people are asking this question now and adding new letters. The term for this is alphabet soup and no one knows what will happen. It's nice that many believe the markets recover: you cannot fully believe *The Road* scenario while trying to plot the shape of the recovery. We are quick to note that in 2008, the S&P 500 "bounced" by 9%-19% six times between September and December 2008, only to bottom in March 2009. This is not to say we are bears, we are not. We are doublethinkers, like Orwell said we would be. We acknowledge fully that the 2020 Federal Reserve has taken powerful steps in two weeks that took it five months to do in 2008. Effectively, 2008 gave the Fed a powerful playbook of how to use structures like TARP and TALF, which it is already using now. Jerome Powell, Trump's Fed Chair and perennial whipping boy, deserves a nice [tweet](#) for once.



## S&P 500 “bounced” by 9%-19% six times between Sep. and Dec. 2008

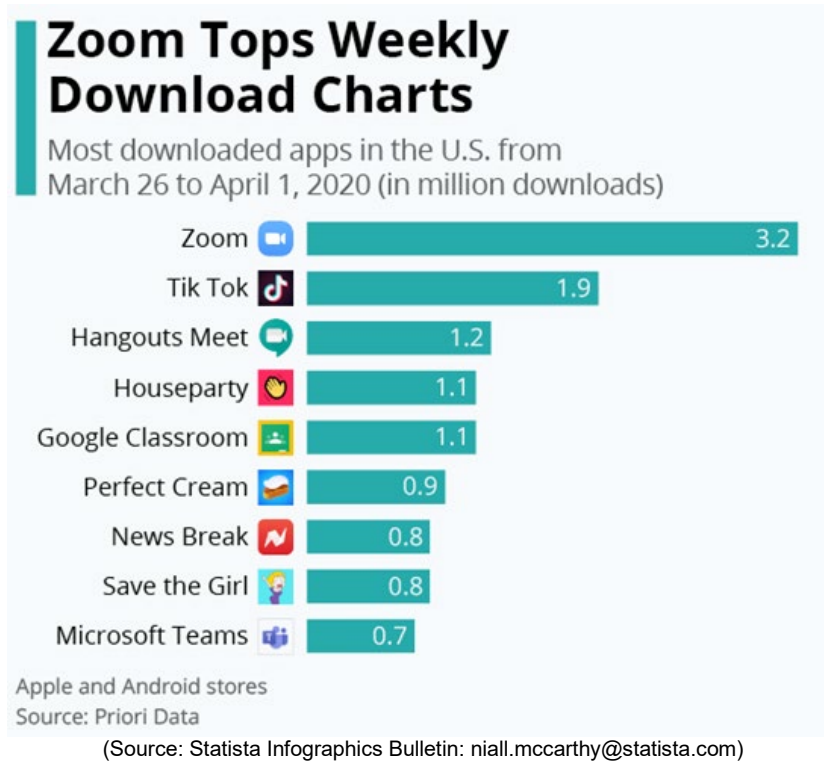


While we are always optimistic, we do not understand the playbook to how we turn the economy back on. Much like an internet comments section, we are experts at writing about things we do not understand, but we do think that society will be too scared to fully reengage until we advance on this virus. We assume the following: 1. COVID-19 is too broadly distributed to contain. 2. People will be too scared to move/act/live freely until we either develop herd immunity (global infection rates of at least 50% or greater) OR we have a vaccine (or therapeutics) to inoculate ourselves. The timeline for either of these scenarios seems to be twelve months at the very least. We do not know how we will integrate countries with higher levels of herd immunity with those that do not. Why would China, Taiwan, South Korea allow western visitors unless they require a time of quarantine? That time of quarantine hampers the ease of travel and physical connectivity that we took for granted. It impedes economic recovery and a return to normal activities.

We are unsure how the recovery plays out as the unknown unknowns remain high even in a post-COVID-19 world. For instance, will consumers quickly return to restaurants, to vacations, to movies/concerts? We think not. The knock-on effects of new consumer behavior will drive the new winners and losers in a no vaccine COVID-19 world. This behavior shift will accelerate the trend to move more of our daily life and interactions online. Nostalgia now includes: physical classrooms, posh board rooms, giving a friend a hug, and fancy law firm offices. If our attorney kicks ass over the phone and email, does she need to be in a fancy office in [Century City](#)? COVID-19 (temporarily?) blows up the location,

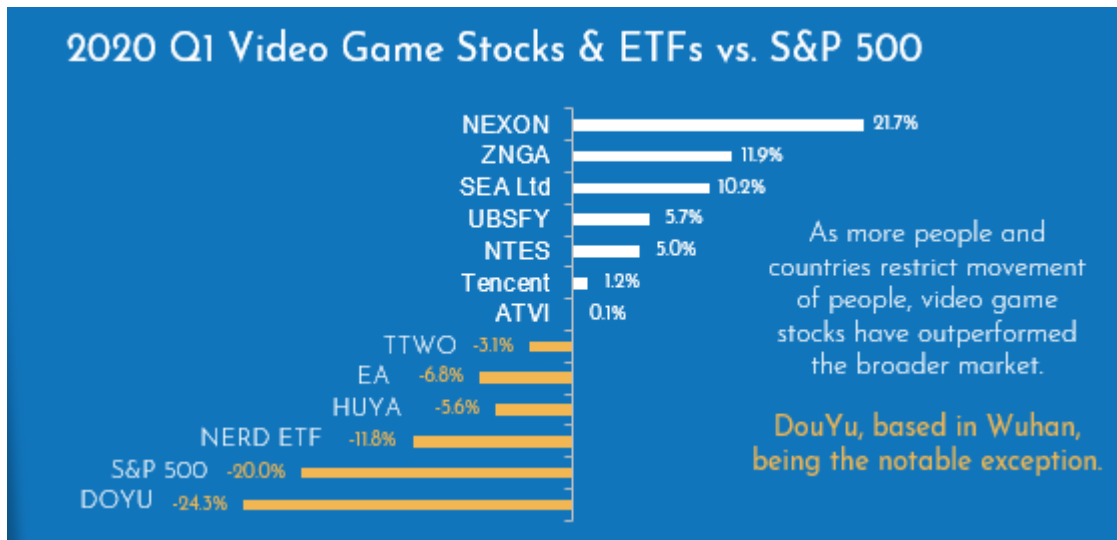


location, location playbook. Grandmothers are nearly crackerjack at FaceTime, Zoom and Hangouts. (Microsoft Teams is basically free but under penetrated.)

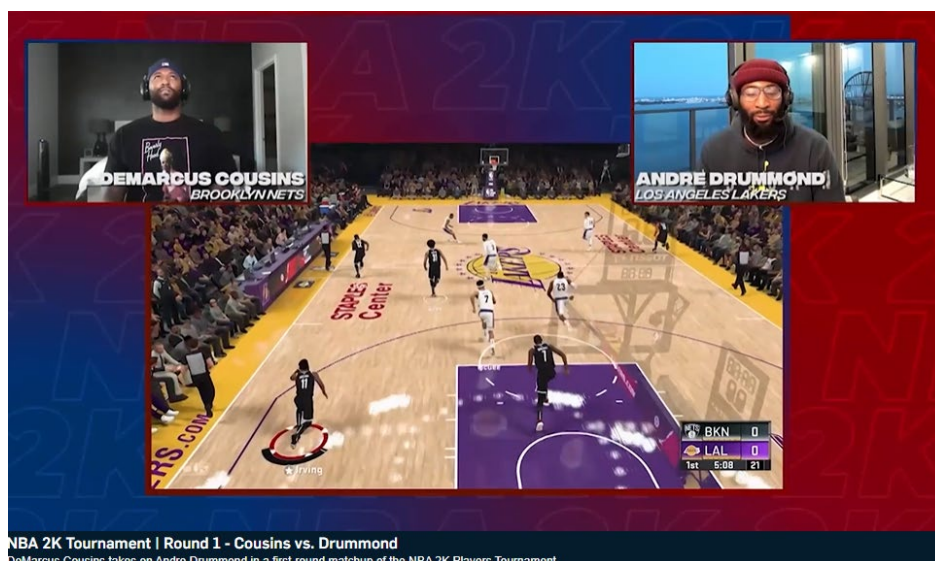


RPG is lucky. Most of our clients are video gamers. We ride or die with video game content, software and artistry. Massively Multi Online Role Playing Games (MMORPGs) have provided their users with a disease free way of interacting for decades. The networks and friendships developed in these games are [unequaled](#). (We jest, but one of our best ER sources met her husband in a famous WoW guild). Our online societies are rich, they will only get richer. This richness is reflected in the stock performance of these companies. It's reflected in the huge streaming [number from Twitch](#) (AMZN owned), Discord and Mixer (MSFT owned).





In the absence of physical team sports, ESPN turned to esports to provide a much needed break from monotony and 1984 college basketball reruns. They aired 12 hours of content: [Rocket League](#), [Madden NFL 20](#), and [NBA 2K](#). Take-Two Interactive (Ticker: TTWO) created the first-ever [NBA 2K Players Tournament](#), where real NBA players, including Kevin Durant, Trae Young, and 14 other NBA players compete to be crowned the NBA 2K20 champion. The ultimate winner will select a charity that will receive a \$100,000 donation on behalf of 2K to support coronavirus relief efforts. Here's a live action shot from the Cousins v Drummond match replete with a conversation about Cousins' newborn. (Demarcus, Congratulations we know you're reading!)





Our consistent pause comes from speaking with physician friends and frontline workers. We are lucky in that we have solid relationships with senior ER staff at UCLA and UCSF. They note that while California, currently appears to be avoiding the COVID-19 storm, it may only be a matter of time. The news from New York is tragic. The medical supply chain appears more fragile than we would have assumed. We all know ventilators are in short supply, but so are many, basic medical staples. Even the common place IV (saline) drips are in short order. To the medical novice, IV drips seem to be the lube that keeps patients stable. In finance, when the lube (cash) disappears, stability erodes.

We would be remiss to not discuss the incredible fiscal stimulus approved to help employees, employers, basically everyone. We applaud the speed with which Congress passed the CARES act. It was a nice moment of bipartisan action. We worry about implementation. As we write, we are curious to see clarity on affiliation rules for SBA loans (it's not clear that VC-backed companies qualify for these loans). We are also working on an application for the <https://www.onefiftyparker.org/> 150 Parker Avenue Preschool in San Francisco, where Ryan's on the board. Three weeks ago, 501c-3s could not apply for SBA loans, now they can. It's now a question of how. For ease of know-your-client rules, companies are supposed to apply through their existing bank. While some banks aren't participating in the SBA program, companies that bank with those banks are having trouble opening accounts at banks that do participate. For 150 Parker, Ryan got the application submitted Friday and has not heard a thing. As of yesterday, the Wells Fargo SBA website read as follows: "Given the exceptionally high volume of requests we have already received, we will not be able to accept any additional requests for a loan through the Paycheck Protection Program."

## Small Business Administration Paycheck Protection Program

---

We know that these are tough times, and we're committed to helping you get through this. We announced on April 5, 2020 that Wells Fargo is targeting to distribute a total of \$10 billion to small business customers under the requirements of the Paycheck Protection Program (PPP) and will focus on serving two segments: nonprofits and small businesses with fewer than 50 employees.

We have received forms from customers expressing interest in the PPP that we expect will fill the company's capacity to lend under the program, as Wells Fargo continues to operate under existing asset cap limitations. **Given the exceptionally high volume of requests we have already received, we will not be able to accept any additional requests for a loan through the Paycheck Protection Program.** We will review all expressions of interest submitted by customers via our online form through April 5 and provide updates in the coming days.

How is the CARES act supposed to work if the money is stuck in the system? 150 Parker can weather the storm for a while, many small businesses cannot. Prior to COVID-19, the SBA loan process was already painful, now, when we need it most, it's frozen. We would have expected this. Everyone's working remotely. Processes are mayhem. [This SBA freeze will extend the pain.](#)





In writing, we had been entranced by a narrative that 9/11 prompted a resurgence in US patriotism. That it sparked a jump in military recruitment. We are hopeful COVID-19 does the same for doctors, nurses, scientists and first responders. Science and expertise has been losing our nation's mindshare, we hope that ends. If nothing else this crisis has shown we need more researchers, more scientists, more medical professionals to guide us through this storm and the next (before we get off the soap box let us also acknowledge how underappreciated and underpaid our US teachers are). We hope the days of considering to underfund the CDC, NIH and other like institutions are behind us. In 2015, after speaking with Bill Gates about pandemics, [Ezra Klein wrote](#): "a pandemic disease is the most predictable catastrophe in the history of the human race, if only because it has happened to the human race so many, many times before."

While Klein and Gates are of course, right, COVID-19 is really just a pop quiz. The final exam is global warming; like COVID-19, it passed asymptotically for decades, and only now are we febrile. We know our lungs are next, it's just there is no ICU big enough.

### **Current Public Equity Playbook:**

**Large cap vs. small cap:** Large cap

**Growth vs. Value:** Overweight growth

**US vs. Europe/Japan vs. China:** Overweight US/China

**Developed vs. Emerging:** Overweight developed

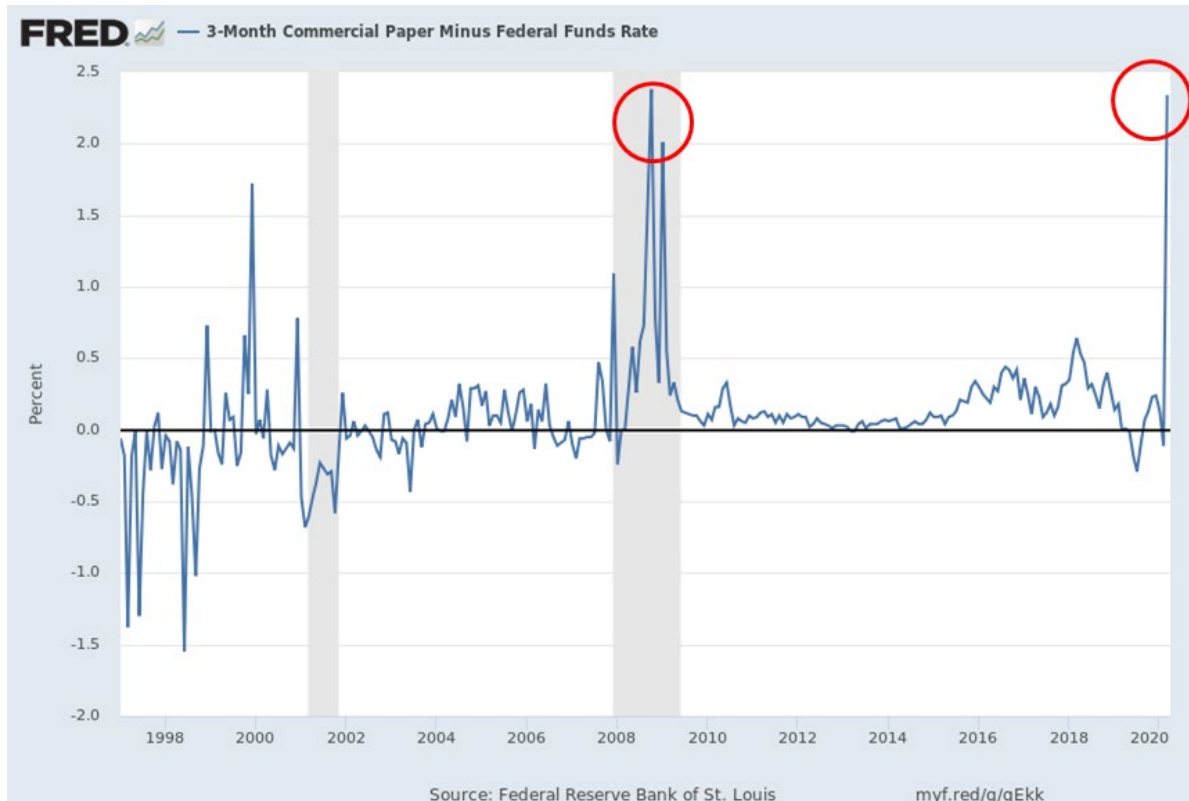
**Dollar cost averaging vs. lump sum:** Dollar cost averaging

### **Fixed Income:**

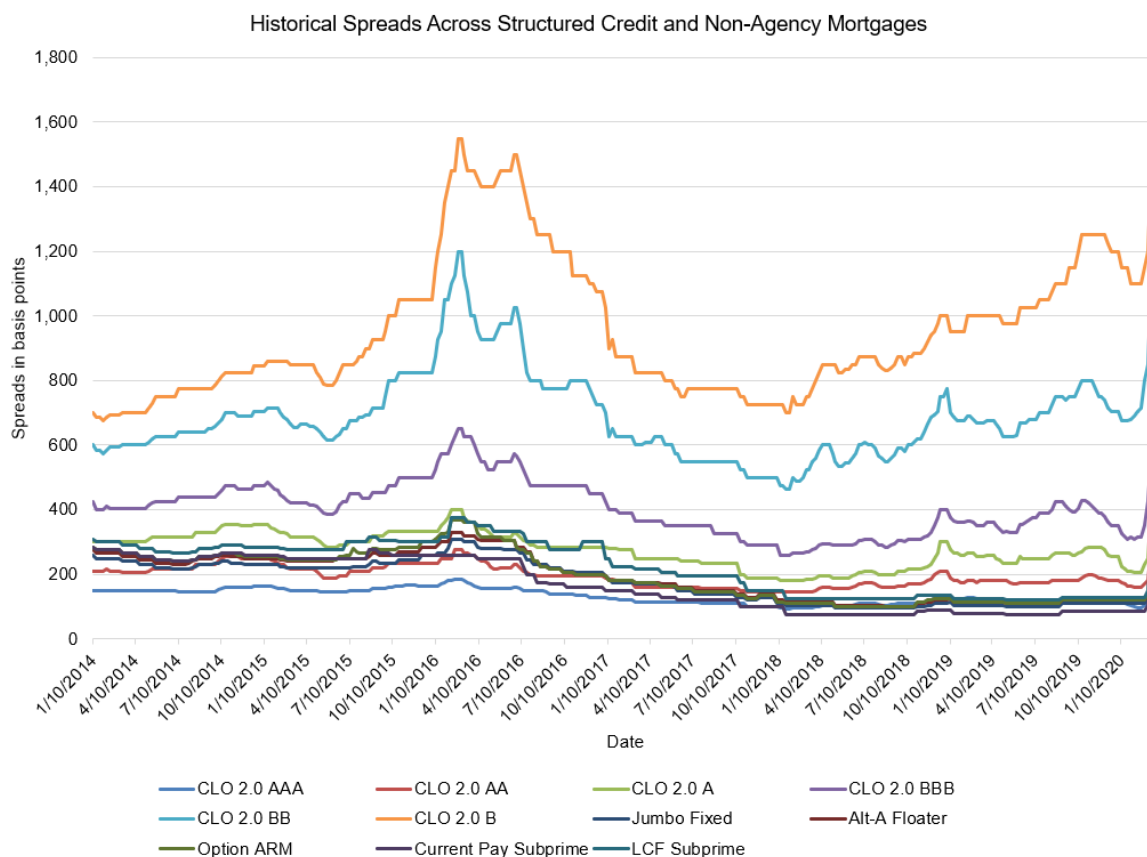
While much of the public square conversation has revolved around equities it is fixed income markets that provide a [canary in the coal mine](#) effect. This was also true in the 2008-2009 financial crisis. Our global economy is built on trust and access to credit (to fund short-term, medium-term, and long-term expansion). When one or both of those key ingredients is disrupted the world economy hits the proverbial brick wall. In mid-March, we saw liquidity drop across the fixed income markets (US Treasuries being a notable exception) as investors began to fully appreciate the growing impact of COVID-19. We are convinced that without the Fed's decisive action to take short term rates to ~0%, restart and expand their 2008-2009 monetary stimulus and open market operations that we would be headed for an economic depression (the probability of which is still greater than 0% but far less than where it was four weeks ago).



In the below chart, notice the steepness and timing of the commercial paper market spreads relative to the Fed Funds Rate in comparison to 2008, this recent move was as steep and it occurred in a period of just 2 weeks. The Fed's intervention, in our view, was required to stave off economic calamity not seen since the Great Depression (or worse). (Commercial paper is a short term corporate debt. It is a central ingredient in finance's IV drip.)



Today, there are still plenty of concerns in fixed income land: liquidity in structured credit remains below normal, high yield debt (particularly energy bonds), subprime non-agency mortgages, and even some municipal bond credits (e.g. bonds tied to airports, public transportation), to name a few, remain on shaky ground. As such, we have been inundated by fixed income managers who seek to play offense from this liquidity/price dislocation - this is similar to 2008-2010. Many of those strategies, we learned, had more room to fall before an eventual recovery. Is it better to be early or right? Time will tell, but as fiduciaries we would approach those types of investments with great caution even today. Any strategy that requires leverage to earn a reasonable rate of return should be met with even more caution as noted by some troubling signs coming from the credit hedge fund world (see: WSJ article [EJF Capital suspends redemptions](#)). As investors demand higher interest rates for riskier credits relative to US Treasuries we see the price of those riskier bonds fall dramatically. Illustrating this are the historical yield spreads across structured credit and non-agency mortgages which popped around the Ides of March, Et tu bonds, et tu?



Source: Angel Oak Capital

### **Current Fixed Income Playbook:**

**Sovereign vs. Municipals vs. Corporate:** Overweight sovereign/munis, opportunistically add to high quality corporates on downturns

**Investment Grade vs. High-Yield:** Strong overweight to Investment Grade

**Structured Credit:** Opportunistically tilt to high quality structured credit and non-agency mortgage backed securities for more aggressive allocations

**Other Tactical Opportunities:** Municipal closed-end funds (it is not uncommon to see double digit dislocations in current price-to-NAV for closed end funds)

### **Commodities:**

The key ingredients for a collapse in oil prices: four parts global pandemic to one part oil supply shock from Russia and Saudi Arabia. Commodities sold off in Q1 with the energy



complex leading the way. As of today's writing oil trades below \$30/barrel. At these prices most oil shale producers in the US and Canada cannot turn a profit which has left investors, producers, and government officials to scramble and weigh the pros and cons of a potential energy sector [bailout](#) while at the same time potentially adding to the US Strategic Petroleum Reserve to take advantage of the current low [prices](#). None of this bodes well for the [clean energy](#) industry which is now facing a multi-front war of: reduced demand, fewer government subsidies, and a potential government subsidy to fossil fuel competitors.

If you're betting on an oil recovery via oil stocks you're betting on three things happening: 1) demand materially picks up as movement restrictions loosen across the globe 2) supplies are reduced by OPEC/Russia 3) Trump and the GOP bail out marginal US producers. All of which seem probable with #1 being a massive unknown for any prognosticator. For those traditional energy players that can successfully transition into this post-COVID-19 world we expect them to exhibit similar characteristics: large cap, diversified across upstream and downstream, and lots of cash on their books heading into March.

Commodity	Q1 2020 Performance
Heating oil	-50.20%
Low sulphur gas oil	-51.56%
Brent crude oil	-56.39%
WTI crude oil	-66.63%
Unleaded gas	-68.20%

Looking beyond energy we see a demand driven selloff among metals, softs, grain, and livestock. Gold, soybean meal, and wheat were the few positives in an otherwise difficult quarter for commodities. Gold investors (bugs) are likely to let you know how prescient they were in making their investment without also letting you know the last decade has produced annual returns of less than 4% (source: S&P GSCI Gold Index). Expect to see a lot more gold investment commercials on CNBC for the foreseeable future.

Commodity	Q1 2020 Performance
Gold	4.20%
Soybean meal	3.47%
Wheat	1.75%
Soybeans	-8.50%
Coffee	-9.68%
Corn	-13.20%
Zinc	-16.50%
Aluminum	-17.06%
Nickel	-18.62%
Sugar	-20.27%
Copper	-20.58%
Silver	-21.37%
Live Cattle	22.83%
Soybean oil	-23.23%
Cotton	-26.60%
Natural Gas	-27.69%
Lean hogs	-36.94%



The recent global downturn has caused the 1, 3, 5, and 10 year annualized returns to be negative as shown by the Bloomberg Commodity Total Return Index.

Index	Q1 2020	Annualized			
		1 Year	3 Years	5 Years	10 Years
Bloomberg Commodity Total Return Index	-23.29%	-22.31%	-8.61%	-7.76%	-6.74%

We have little interest today in trying to predict the direction or outcome of price movements in these commodities as the global demand curve continues to sort itself out. There will of course be risk-seeking investors willing to bet on these sorts of things and some will profit wildly by getting lucky on timing and use of low cost leverage - these winning investors will do their standard victory lap on CNBC while others will be forced liquidators never to be heard from again.

### **Commodities Playbook**

Strong Underweight across the board until we have more data around treating the virus and when potential restrictions will be lifted globally.

### **Where do we go from here?**

This is a rhetorical question as the real answer, even among the top medical and economic minds, is we have no #\$\$@\*%! idea because we simply do not have enough data. That said, we believe there will be an eventual full economic recovery (it is tough to be an ultra long-term investor (which we are) and bet against human ingenuity, perseverance, and capitalism). The strength and timing of such a recovery will be predicated on the fact that the quicker we all get back to our pre COVID-19 lives the more loss of life we are willing to accept - a chilling narrative even for the most ardent of American capitalists. The growing conversation of the “cure (staying home and shutting down large portions of the global economy) is worse than the disease” will become louder and from both American political parties the longer movement is restricted. If you ask small business owners who are on the brink, “when should we try to get back to normalcy” they likely have a much different answer than the ER doctor caring for COVID-19 victims. So far the medical professionals have been leading the conversation, when more economists and business owners get air time during pressers the conversation will shift and restrictions will lift.

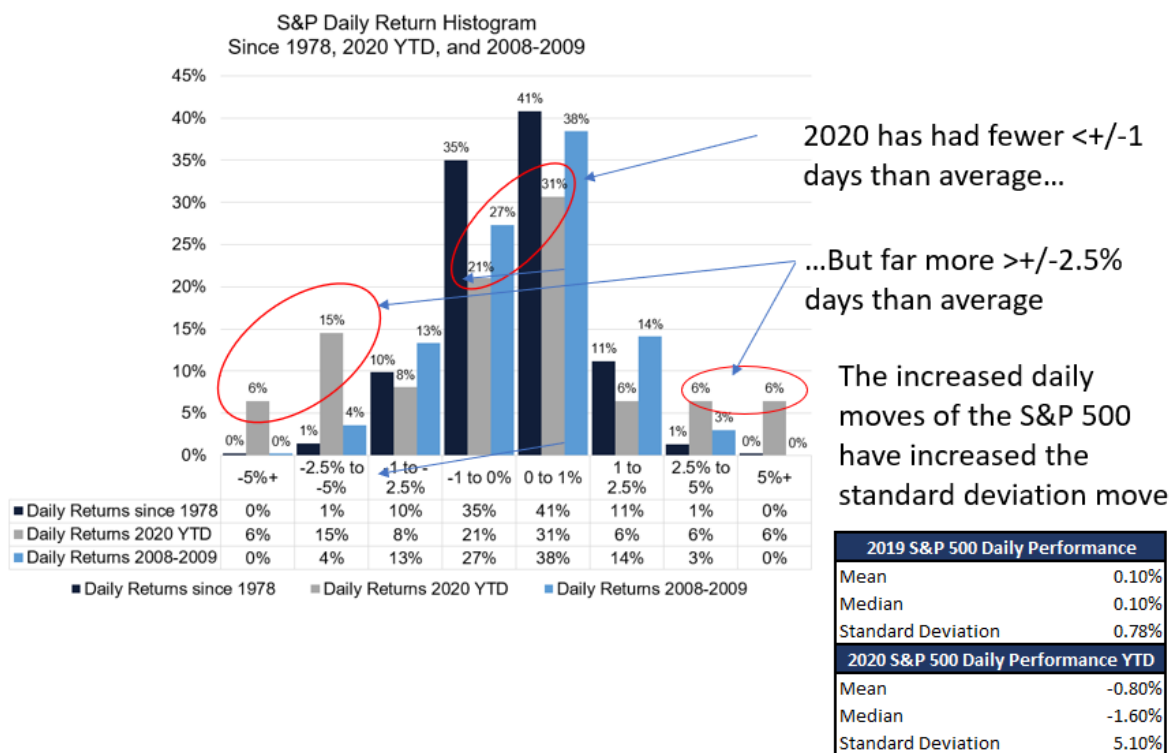
### **Appendix Slides:**

**What will it take to breakeven to 12/31/19 or 2/19/2020?**



Date	S&P 500 Adj Close	Daily Return	Balance \$1000 12/31/19	% To Breakeven to 12/31/19	% To Breakeven to 2/19/20
2/19/2020	3386.15	0.47%	\$1,048.09	-4.59%	0.00%
2/20/2020	3373.23	-0.38%	\$1,044.09	-4.22%	0.38%
2/21/2020	3337.75	-1.05%	\$1,033.11	-3.20%	1.45%
2/24/2020	3225.89	-3.35%	\$998.49	0.15%	4.97%
2/25/2020	3128.21	-3.03%	\$968.25	3.28%	8.25%
2/26/2020	3116.39	-0.38%	\$964.59	3.67%	8.66%
2/27/2020	2978.76	-4.42%	\$921.99	8.46%	13.68%
2/28/2020	2954.22	-0.82%	\$914.40	9.36%	14.62%
3/2/2020	3090.23	4.60%	\$956.50	4.55%	9.58%
3/3/2020	3003.37	-2.81%	\$929.61	7.57%	12.75%
3/4/2020	3130.12	4.22%	\$968.84	3.22%	8.18%
3/5/2020	3023.94	-3.39%	\$935.98	6.84%	11.98%
3/6/2020	2972.37	-1.71%	\$920.02	8.69%	13.92%
3/9/2020	2746.56	-7.60%	\$850.12	17.63%	23.29%
3/10/2020	2882.23	4.94%	\$892.12	12.09%	17.48%
3/11/2020	2741.38	-4.89%	\$848.52	17.85%	23.52%
3/12/2020	2480.64	-9.51%	\$767.81	30.24%	36.50%
3/13/2020	2711.02	9.29%	\$839.12	19.17%	24.90%
3/16/2020	2386.13	-11.98%	\$738.56	35.40%	41.91%
3/17/2020	2529.19	6.00%	\$782.84	27.74%	33.88%
3/18/2020	2398.10	-5.18%	\$742.27	34.72%	41.20%
3/19/2020	2409.39	0.47%	\$745.76	34.09%	40.54%
3/20/2020	2304.92	-4.34%	\$713.43	40.17%	46.91%
3/23/2020	2237.40	-2.93%	\$692.53	44.40%	51.34%
3/24/2020	2447.33	9.38%	\$757.50	32.01%	38.36%
3/25/2020	2475.56	1.15%	\$766.24	30.51%	36.78%
3/26/2020	2630.07	6.24%	\$814.07	22.84%	28.75%
3/27/2020	2541.47	-3.37%	\$786.64	27.12%	33.24%
3/30/2020	2626.65	3.35%	\$813.01	23.00%	28.92%
3/31/2020	2584.59	-1.60%	\$799.99	25.00%	31.01%





#### Legal Information and Disclosures

This memorandum expresses the views of the author as of the date indicated and such views are subject to change without notice. Resolute Partners Group LLC ("RPG") has no duty or obligation to update the information contained herein. Further, Resolute Partners Group LLC makes no representation, and it should not be assumed that past investment performance is an indication of future results. Moreover, wherever there is the potential for profit there is also the possibility of loss. This memorandum is being made available for educational purposes only and should not be used for any other purpose. The information contained herein does not constitute and should not be construed as an offering of advisory services or an offer to sell or solicitation to buy any securities or related financial instruments in any jurisdiction. Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third party sources. Resolute Partners Group LLC ("RPG") believes that the sources from which such information has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based.

This memorandum, including the information contained herein, may not be copied, reproduced, republished, or posted in whole or in part, in any form without the prior written consent of RPG.