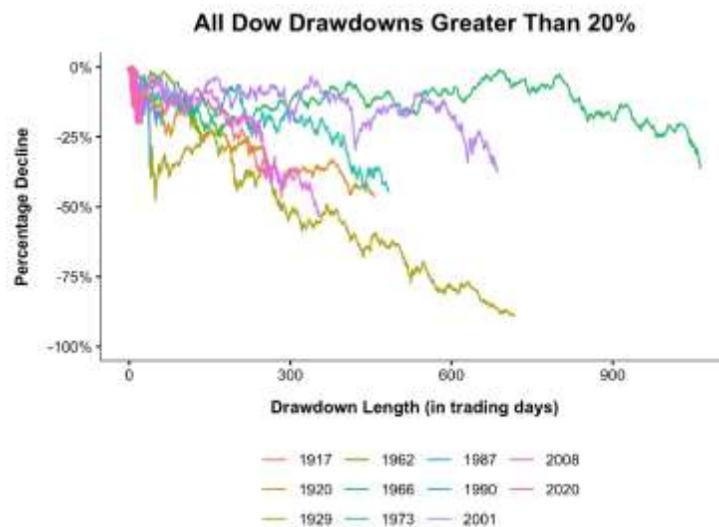




March 12, 2020

Dear Client,

Many prognosticators call a 20% drawdown from peak to trough in markets a bear market. The week that started March 9, 2020, exactly 11 years to the day from the Great Recession's bottom now officially marks the end of the bull market that began on that day and the start of a bear market. One fundamental reality of investing is that all bull markets eventually end. Unfortunately, a second truth holds that "markets go up on an escalator and down on an elevator." This 20% decline has been especially swift. According to Michael Batnick at Ritholtz Wealth Management, this is "the fastest bear market ever."¹



Source: Bloomberg

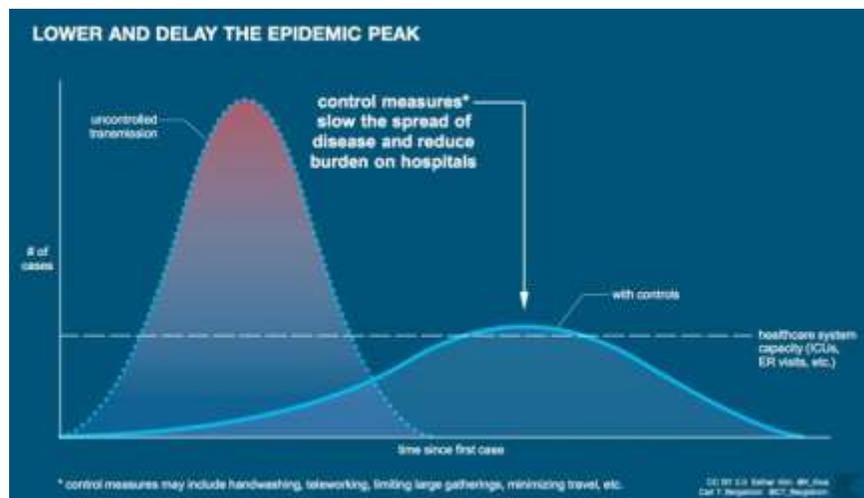
Bear markets are an inescapable element of investing. Bear markets are the cost of owning assets that over the long run return considerably more than inflation. Stated another way, the equity risk premium (the excess return in equities) exists because there are these moments in time where everything looks terrible and the pain of owning assets makes everyone question why they own anything in the first place. Typically, since World War II, stocks have entered bear market territory (a 20% drawdown from peak to trough) once every six years. We have gone 11 years without an official bear market though we experienced periods in 2011, 2015-16 and December of 2018 with the market retreating by 19% only to find support and not cross the bearish 20% threshold. What's the fundamental difference between those downturns and today? Very little aside for the swiftness and extra pain on paper.

¹ <https://theirrelevantinvestor.com/2020/03/09/the-fastest-bear-market-ever/>



One thing that has been especially tough to manage through all this is that before coronavirus set in, the market was making highs and companies that we follow were reporting meaningful accelerations in their business from the prior reporting period. The economy was on the brink of re-acceleration, right as the external shock hit. This is no ordinary shock like an earthquake or a hurricane where the pain is acute and the path to recovery hard but obvious. Instead, we have an uncertain amount of time until the acute phase is over. Leadership in this country has been slow to act and the window to set us up for the quicker path to recovery is rapidly closing. As we see it, if the leaders were to order all schools and gatherings closed and ended for the next month, we would be on our way to normal much quicker than if we let this virus get out of control. The market knows this and is expressing its concern at the lack of a steady hand delivering meaningful action to set us on the less damaging path.

China and South Korea have shown the world that aggressive testing and social-isolation provably work to stem the coronavirus' tide. It looks increasingly likely that this novel coronavirus will be endemic around the world from here on out, though there are considerable benefits to slowing its aggressive tide. If we can "flatten the curve" and decrease the case load at any one time, we can help our healthcare system avoid becoming overburdened like Italy. ²



According to noted Harvard epidemiologist Marc Lipsitch, once 60 percent of adults become infected, "the spread can stop permanently."³ There are two paths to getting to that permanent stop: the quick way or the slow way. The quick way would have the virus spreading like wildfire and overburdening our health system with considerable damage along the way. In contrast, the slow way would involve self-

² https://twitter.com/CT_Bergstrom/status/1236426968444235777

³ <https://www.spiegel.de/international/world/i-don-t-think-the-virus-can-be-stopped-anymore-a-03d404e6-762b-42fb-ac48-e4a8f03a2f2b>



isolation and about one to two months of really tough medicine for society to swallow in order to drive a more manageable case load for hospitals to treat patients who are more vulnerable to coronavirus. In the fast path, far more people will die, as is happening in Italy. In the slow path, far fewer people will die and we can get back to normal life much quicker.

Once the worst dangers of the virus are past (and it will happen one way or another), the return to normalcy will be swift. We own shares in companies that will certainly be impacted in a meaningful way. Disney, for example, will experience a steep drop in park visitors—they will likely have to shut their US parks as they did in China. With the suspension of the NBA season and other leagues likely to follow, Kambi will have fewer events on which to offer their services to their sports book customers. Revenues will certainly be hurt in the near-term. If you fast forward two years however, there is no path dependency on future revenues tied to today. **In other words, today's hit will not change the actual earnings power of the respective businesses two years forward.** People will eventually return to Disney's parks and Disney Plus might even stand to benefit with people in self-isolation signing up sooner than they otherwise might have. For Kambi, in two years, more states in the US will have legalized and regulated sports gaming. Sports games will go on and people will indulge in sports gaming, which is an entertaining accompaniment to the games themselves.

When we build a discounted cash flow analysis for any of the businesses we watch or invest in, one year itself is worth no more than 4% of the total value of a company. In other words, were we to write one year of a company's life to zero, as people are expecting right now, the overall hit to long-term value is much smaller than the amount of pain the market is pricing in today. That does not mean things cannot get worse before they get better; however, it does mean that when the environment returns to one in which people value the earnings power of a business, the recovery will be swift. Importantly, every company we own has the balance sheet to withstand a prolonged period of business contraction. All of these companies have little debt relative to their debt capacity, considerable actual cash liquidity, in addition to credit line access.

We place great emphasis on the management teams behind which we invest. In tough times, great management teams step up to create value in unforeseen ways. A company like IAC, who has remained highly liquid, will have incredible opportunities to deploy their large cash stash and add value that could not be modeled in a mere two weeks ago. ANGI Homeservices (which is majority owned by IAC) just this week authorized a repurchase equal to 25% of its public float—this will be massively accretive to long-term value. Twitter initiated a \$2 billion share repurchase program, the first in its history, and appointed some outstanding investment-minded board members. We know there are more tools in the playbooks of the management teams we have invested behind and we expect that somewhere down the line these companies come out of this bear market more, not less valuable than our initial assessment.



Today, March 12th, will be a bad day for markets. There was some hope that the President's evening address on the 11th would 1) finally take this issue seriously; 2) offer a plan for how we stop the spread of the coronavirus, given a proven playbook exists; and, 3) offer a plan for mitigating the harm for those who are economically vulnerable because of this unforeseen situation. There is some solace insofar as the President finally showed he understands the seriousness of the situation, but unfortunately, little was given on the most important issues related to point 2) above. The market has its way of forcing situations, as it did in late September 2008 when Congress voted down TARP.⁴ Given this President is as sensitive to the market as any in our recent history and given the gravity of the situation, we do expect leadership in this country to come together and deploy the right kind of plan to get us through this. There are five key points that need to be addressed: 1) this won't be easy; 2) we must deploy a roadmap to follow for what provably gets this virus under control 3) we must do whatever it takes to make sure we protect our community; 4) we will get through this together; and, 5) and with leadership and cooperation at all levels of our society things will be fine through this tumult as we get back to normal faster than you can imagine in the eye of the storm.

In six months, this insult will be a painful, though increasingly distant memory. Within two years, our companies will once again be valued on their earnings power and in the case of every company we own today, that earnings power will be considerably greater than at the start of this mess. We spent some time searching for historical analogies to today. Two come to mind as especially appropriate: natural disasters and General Strikes. Natural disasters, as we mentioned above, are far more acute and quick in the pain, though they offer a template for what recovery looks like. People, even those in pain, have an urge to get back to normal things in life and to do activities that are necessary and activities that create joy. General Strikes are relevant analogs for what it looks like when economies shut down for extended periods of time.

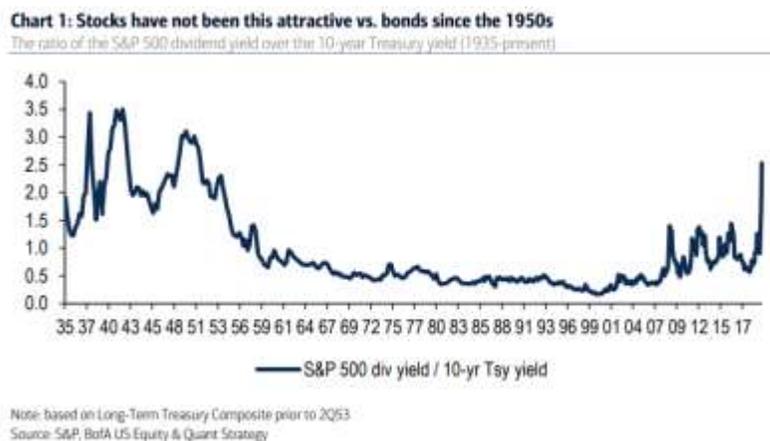
Two French examples from modern history are highly relevant. In May of 1968, France experienced a General Strike that saw two-thirds of the French population strike and thus skip work. This included nearly all key public and private sector workers. The chaos resulted in Charles de Gaulle fleeing the country, and the government was on the brink of collapse. There were riots and people were anxious about what the world would look like going forward. GDP continued growing with hardly a blip. Similarly, in 1995, France saw a General Strike of the entire public sector with virtually all of the country's transportation and other key services entirely shut down. Both of these enormous disruptions could have been expected to cause significant recessions; however, in neither case did GDP actually turn negative. In 1995, GDP was close to zero but a recession was avoided. Why is this so? We suspect that for many, amidst really tough circumstances, work offers an escape, despite the inability to do some of the everyday life things that we want to do. Neither are perfect analogies; however, both shed light on what the actual economic harm of

⁴ <https://money.cnn.com/2008/09/29/news/economy/bailout/>



major disruptions cause. A recession today might be unavoidable, but a recession caused by an external shock in a strong economy should cause less long-term harm than a recession caused by excesses in an economy that have to be wrung out. **In that crucial respect, this is not and will not be like 2008. The economic harm will be considerably less than in 2008-09 and the recovery will almost certainly be quicker.**

One other key point must be emphasized here: the entire Treasury curve heading out to 30 years is now at under 1%. We did not even get to these yields in the worst of the Great Recession, when deflation was truly on the table. Yes, this is an economic shock; however, deflation is not the risk we face here. Liquidity will be essential for small businesses in weathering this storm, but our balance sheets need not be pared down in the same way they were a decade ago. Further, the market is giving the government considerable firepower to draw on fiscal policy as a palliative here. Lastly, and perhaps most importantly for us, with rates over the long-term under 1%, and opportunity cost an important consideration, stocks as an asset class look increasingly compelling. Sure, stocks have volatility, but if your timeframe is long enough (and we all are in that camp), then the frustrations of the volatility are worth the extra yield that will be picked up over a decade. We have largely refrained from quoting Warren Buffett because of our emphasis on independent thought; however, doing so now is justified. Buffett often speaks in nuanced ways, though he was as close to emphatic as he gets in asserting that: "If something close to current rates should prevail over the coming decades and if corporate tax rates also remain near the low level businesses now enjoy, it is almost certain that equities will over time perform far better than long-term, fixed-rate debt instruments."⁵ Rates are even lower today than when he said this on February 22nd. Think about that! Now look at it in visual form:



⁵ <https://www.cnbc.com/2020/02/22/buffett-says-its-almost-certain-stocks-will-beat-bonds-over-long-term-if-rates-taxes-stay-low.html>



We talked about how frequently bear markets happen at the start of this letter. If we take that timeframe back to 1900 instead of post-WWII, they happen far more frequently— once every 3.5 years. How long do they last? The typical bear market lasts for 367 days-just over a year.⁶ We think that timeframe seems reasonable in this case, with the stages set for perhaps an even swifter recovery in this case. Balance sheets in our financial and household sectors are incredibly strong. This stands in stark contrast to 2008 where it took years to work off balance sheet excesses. If we as investors do our job appropriately, and we are working hard to do as much, we will find the best investment opportunities we have ever seen in our relatively young history.

We are happy to discuss this in further detail with you and encourage you to reach out directly.

Warm personal regards,

A handwritten signature in black ink, appearing to read 'Jason Gilbert'.

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⁶ <https://www.thebalance.com/u-s-stock-bear-markets-and-their-subsequent-recoveries-2388520>