SARGENT

INVESTMENT GROUP

A LETTER TO OUR INVESTORS:

NAVIGATING THE MARKET DURING COVID-19

How to manage emotion and investments during unprecedented times

March 22, 2020

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Dear Investors,

It goes without saying that we have entered uncharted territory these last few weeks. Over the last fifty years we have had six different bear markets, instigated by factors like inflation, rising interest rates, a banking crisis, and reversals of inflated assets like technology and housing. What we have not seen is a crisis driven by an act of nature. In reaction to the COVID-19 virus we, as a country, as well as a global community, have taken dramatic measures in order to slow the spread of the disease. To this end, and for the first time in history, our government is implementing decisive steps designed to slow, if not completely halt, what was a very robust economy. At the same time, swift bipartisan action is being taken to promote longer term stability and growth. As if COVID-19 wasn't enough, tremendous additional pressure has been put on the markets by the collapse of energy prices as Saudi Arabia and Russia pursue a price war. These factors have combined to create a fear-based run on the markets which in turn has forced dramatic efforts to deleverage, further exacerbating the selling.

Clearly, COVID-19 and our corresponding attempt at social distancing will have a major impact not only on current economic activity, but on the profile of the economy's trajectory as well. Our country's Gross Domestic Product (GDP), which is the value of all goods and services produced by the economy, is expected to decline for a number of months (which began late February) as spending on goods and services (particularly services—restaurants, theaters, airlines, etc.) declines. In addition, a spike in spending for certain products (hand sanitizer, paper towels, nonperishable food, etc.) and disruptions in supply chains means that inventories at all levels will be reduced: Apple continues to sell its iPhones and Macs even though it is not receiving as much product from China, and households are purchasing certain items at a faster rate than they are being produced.

The above shows up directly in the math of GDP, because GDP is the sum of consumption, investment, government spending and net exports PLUS, importantly, the change in inventories. The change in inventories will likely be a large negative number in the calculation of GDP in the coming months, as described in the previous paragraph. That said, when demand begins to recover, the change in inventories will be the reverse, i.e. a significant positive number adding to GDP, as companies restore production not only to meet current demand but also to bring inventories back up to their normal levels. We highlight this as an example of why we may very well see a "snap back" in the markets once there is clarity on how we are going to deal with this virus and how long that may take.

It is during times like these that we must try to remain as unemotional as possible while evaluating investments and asset allocation. Over the last decade, the evolution of the structure of the markets has continued to progress with low interest rates fueling leverage and technology providing access to new market participants. In a low-volatility, slow-growth environment, these factors aren't particularly alarming, although when markets turn these factors can create an extreme reaction. The volatility index (VIX), also known as the fear index, peaked at approximately 60 during the 2008 financial crisis as the S&P fell over 50% from peak to trough. This past week the VIX traded well above 80 while the S&P has fallen approximately 30% from peak to trough. See the image on the next page as how volatility like this can often lead to opportunity.

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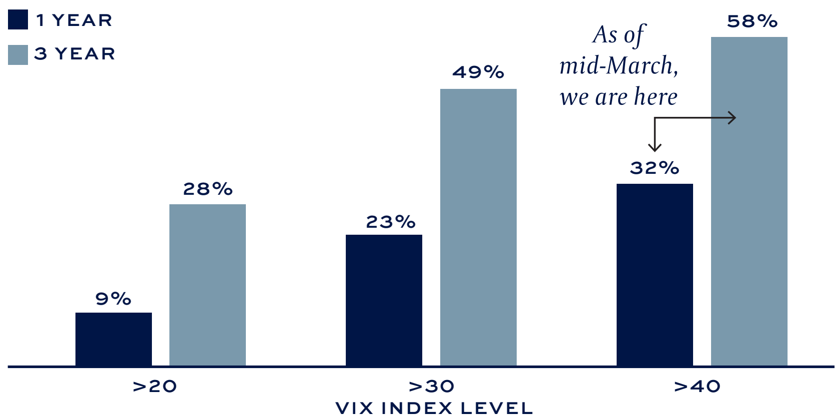
CAN YOU TAKE ADVANTAGE OF FEAR?

S&P 500 Total Return from various VIX Index Levels



Source: FactSet and Alger.
Note: Ensuing returns have been measured from the day the VIX hit each level.

Trying to time markets like this is nothing more than a guessing game and getting out of the markets completely may very well guarantee permanent impairment of one's capital. That is not to say the markets can't go lower, although it is clear that if one misses the few positive days during this sell-off, or the positive days that eventually begin the recovery, it may be harder to catch up. Once this market turns it is likely there will be a void of sellers, just as we have seen a void of buyers the last few weeks. Let's remember March of 2009 as the U.S. economy was hemorrhaging approximately 650,000 jobs a month and those of us on Wall Street were entirely focused on how much lower the markets could go. It was exactly at that moment the recovery in equities began and continued for the longest bull market in history. It is very apparent once again that the markets go down before the economy shows weakness, but it is worth remembering that markets also go up well before there are visible signs of economic recovery.

Operationally we would like you to know the robust backup systems we have had in place since the founding of the firm have been working flawlessly. In an attempt to do our part of social distancing we have postponed all client in person meetings. However, we continue to have in-depth conference calls with our fund managers, and are here by phone if you need us. We have also been cycling team members out of the office in order to limit contact. As a firm, our systems are designed in a manner that allow everyone to work remotely without sacrificing connectivity to the team or access to the markets. Times like these are stressful and uncomfortable for all of us. It is more important than ever that we remain disciplined in our approach to portfolio construction and focused on our longer term objectives. As a firm we are committed, available and here to serve you.

Chris

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Important Considerations:

The views and opinions expressed are for informational purposes only as of the date of writing and may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations to buy or sell securities. The information provided is taken from sources we believe to be reliable but it has not been independently verified. All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Past performance is not a guarantee of future results.

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