



Musings from an Optimistic Realist...

Gregory A. Nejmech, CFA

Partner & President

April 22, 2020

The lives of the global citizenry have been disrupted, dismayed, changed meaningfully in ways big and small by the omnipotence of the pandemic. Like many, we've considered what the way forward may look like, and about the only conclusion we can assign high conviction to is we simply don't know what lies ahead with any degree of precision. **Today's uncertainty is tomorrow's unknown.**

Just as Buffett lauds us to be directionally right rather than precisely wrong, I thought I would share some perspectives from 40,000 feet.

I'd emphasize these are non-binary in nature...the world isn't a series of green and red signals, and I think indeed we'll transition from red (stop), pause on yellow (caution) for a long time before proceeding to green, and I'm not sure what the shade of green will be when the light turns.

Those **non-binary potential outcomes** will nonetheless be shaped by certain absolutes - **incontrovertible truths** that governments and citizens have had to adopt to survive:

Bailouts are more **pervasive** than any time in our lives, and arguably any time in economic history both absolute and relative to GDP;

Public and private debt levels and government deficits at every level will soar and remain **systemically high** for a generation (or three);

Health care systematic reform and preparedness will occupy greater economic and political capital, as will the security of, and pace with which, supply chains can satisfy hard to anticipate demand surges;

Questions of **equitable access** will be debated should an effective vaccine be developed;

The **S in ESG (Environmental, Social and Governance)** will be **accented**, with good corporate citizens who've shown compassion for employees, health care workers, delivery personnel, first responders valued more highly both in the minds of consumers and the minds of investors: **conscious capitalism may have (finally) arrived**;

Good corporate citizens offering a quality product/service/experience will devise systems and protocols for providing and certifying the cleanliness and infection immunization of their offerings, essentially making the "Good Housekeeping" seal of approval a **competitive differentiator**;

New measures of productivity will emerge: airline yields, hotel occupancies, public transit systems with mandated spaces between seats / rooms translate to lower denominators to calculate utilization rates;

Millennials have encountered **two tectonic economic disruptions** in the last dozen years – spanning the beginning of their adult working lives to the present...with the 08/09 Financial Crisis and the 19/20 Health Care Pandemic as bookends. An element of distrust with regard to institutional values and effectiveness has accompanied enormous financial strain on a demographic age cohort with mountains of student debt and, broadly, an inability to satisfy those obligations, with **secular implications** for consumption and social services;

Remote functionality will persist and create opportunities for continued technology innovation and platform stickiness while fostering demand for change to more **cost-effective delivery systems** in higher education, telemedicine, self-directed fitness/wellness, food delivery, personal connectivity, and on and on;

The **ideological battle** between globalization and nationalism, socialism and capitalism, parochialism and cultural inclusion, tolerance vs. intolerance, federalism and states' rights, coordinated solutions vs. unilateral dictates will grow **more vocal and political in nature**;

Active management may slow the inexorable rise of passive as investors will demand transparency and liquidity over opaque promises and lockups. Last Friday night, investors in the USO ETF (U.S. Oil Fund) went to bed believing they owned a stable energy basket. They woke Monday to a tax loss courtesy of a seriously devalued security that effectively subjected itself to a “long squeeze” as the ETF could not take delivery of the underlying commodity it had contracted to buy. Knowing what you own will usher a **return to investment simplification**;

Oil's severe dislocation - and the global nature of the commodity in the hands of certain politically fragile countries - has the potential to create destabilization in radically charged nations with consequences for seemingly politically stable jurisdictions;

Debt retirement will replace equity retirement in the financial algorithm of most companies;

Balance sheets, liquidity, debt ratings occupy top shelf in a more risk averse world, and balance sheet analysis is likely to be embraced as a long-lost friend to equity investors;

Conceptualization will matter more than financial precision in **determining investment outcomes**;

Leadership matters - now more than ever.

Best regards,

Greg

IMPORTANT DISCLOSURES

This piece represents our opinion as of 4/22/20 based on our understanding of market conditions and publicly available information; it is subject to change without notice and should not be used as a basis to make investment decisions or as a recommendation to invest in active management strategies or in any security. This piece has forward-looking statements that are by their nature uncertain and based on our assumptions; there is no assurance that forward-looking statements are accurate as actual results and future events can differ materially from our assumptions. Investing in securities involves significant risks, including the risk of loss of the original amount invested.

In response to the current coronavirus (COVID-19) global pandemic and in an effort to protect the safety and well-being of our team and the continuity of our critical business operations, our employees are working remotely and we suspended business travel and replaced in-person meetings with conference calls and video chats. We have tested our capacity to operate remotely and members of our team have worked from home in the past, and as of this moment, we believe we can perform critical services (making investment decisions, trading and settlement, and communicating with clients about the status of their accounts), assuming that current conditions do not worsen dramatically over the next few days, that our team and close family members do not fall ill infected with COVID-19, that there are no significant disruptions to our key service providers, and that our team continues to have internet connectivity and phone access from home. Given the rapidly evolving situation and the unknown impact of COVID-19, we cannot predict with certainty its effect to our business and client portfolios.

This document includes general information and has not been tailored for any specific recipient or recipients. Accordingly, the information in this document is not intended to cause HSMP to become a fiduciary within the meaning of Section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974, as amended, or Section 4975(e)(3)(B) of the Internal Revenue Code of 1986, as amended.

© Copyright 2020 HS Management Partners, LLC. All rights reserved.

This material shall not be reproduced without permission.