



Phases

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As COVID-19 morphed from a China provincial concern to a global pandemic, financial markets reeled with volatility. What commenced as a public health crisis quickly devolved to an economic one, and a long-term national security risk surfaced once pandemic ramifications became more widely appreciated.

The initial reaction was fear, captured in risk-off sentiment, and an equity market free-fall noteworthy by one of the shortest durations from bull to bear market in history. Hope took the next lap, with markets responding ebulliently to the intensity of vaccine research and the wellspring of monetary/fiscal support and global central bank altruism. Choppy seas one day, serenity the next, the markets have been understandably unpredictable in reaction to the “Once in a Lifetime” nature of the pandemic (see HS Management Partners’ CIO Harry Segalas thought piece of the same name dated March 30, 2020.)

We have internalized the waves of market disruption in phases, each unique, each requiring its own set of tools to navigate, each humbling in its wake. Like innings in a baseball game, we’ll take you from the opening pitch to the current at bat, not at all sure what inning we’re in; the one thing we can assure you is the first few stanzas have been action-packed.

The Initial Phase: The Bond Market as Risk Arbiter

My partners and I have witnessed at least a half dozen or so crises since beginning our investment careers in the Volcker era. Causation, remedies, and the scope of outcomes have each proven unique. Even so, the common thread among these disparate economic chapters is the consistency with which the bond market served as the most reliable arbiter of risk.

Equity markets occupy the lowest rung on the capital structure, accepting this position in exchange for the prospect of growth in principal value. As such, common stock investors focus on the income statement, sizing future earnings and cash flows as a guide to appreciation potential. Bond investors sit above equity investors on the capital structure food chain and are less concerned with growth and more concerned with stability, principal repayment, and a fixed return on capital. The balance sheet occupies the attention of fixed income investors.

As the crisis accelerated in early/mid-March, it was obvious that our traditional playbook – identifying quality businesses, growing the earnings/cash flow stream, being attentive to valuation – would prove difficult to follow given the elusiveness associated with determining profit projections and, therefore, valuation. The maxim that “all models are wrong...some are useful” certainly rang true as markets careened. The pandemic once again

demonstrated that financial problems typically originate on the statements of cash flow and the balance sheet, and eventually migrate to the income statement.

Recognizing earnings and cash flow estimates were like playing darts with our eyes closed, we embraced bond market basics: the change in receivables/inventories/payables; monthly cash burn rates; untapped liquidity available under existing credit facilities; maintenance vs. discretionary capital expenditures; forthcoming debt maturities; cash flow conservation should dividends and share buybacks be suspended; furloughed employee cost savings.

In some cases, the ability of companies to survive had to be discerned before any conversation surrounding longer term potential made sense. Substantive analysis of balance sheet and cash flow metrics, complemented by discussions with portfolio companies and bond market analysts, helped to restore our conviction and act accordingly. We have integrated balance sheet metrics more fully into the fabric of our investment process.

The Intermediate Phase: Credit Market Analysis Fosters Company Specific Conviction

As is often the case when the pendulum strikes fear from greed, equity selling was broad based. An analysis of client portfolios we conducted over that interval is worth highlighting.

From the S&P 500[®] Index peak (2/19/20) to the trough (3/23/20), we looked at a simple measure of liquidity and balance sheet strength, ranking our holdings from highest to lowest net cash positions. Not surprisingly, those companies with levered balance sheets and perceived liquidity challenges were generally punished most severely. By comparison, the action in the bonds of the underlying issuers was comparatively modest. Five-year CDS (collateralized debt swaps) naturally exhibited a slight uptick in presumed risk among all issuers, and spreads rose more so among more highly levered companies, though none approached anything resembling a red line.

The differential performance in equity prices was not at all mirrored in the bond market repose, which we believe corroborates and validates the independent balance sheet work we had done. As a result, we think we were able to identify real opportunities created by the equity vs. bond divergence of the same issuer, thereby heightening our conviction to initiate and/or add to positions that were hit hardest as equity participants rushed the exit.

As markets began to favorably respond to Federal Reserve initiatives, including the Fed serving as a support for sub-segments of the high yield and lower tiered investment grade market, liquidity concerns eased with the ability to extend maturities. Bulls forced bears into hibernation, and many of the stocks that had been subject to duress staged meaningful rebounds.

David Swenson, the famed Yale CIO, believes that to be successful at investing, one has to be comfortable being idiosyncratically uncomfortable. A prescient observation: armed with proper due diligence – and more than a little gumption – the prescription is to run toward what others have abandoned, while running from what the crowd adores. Uncomfortably idiosyncratic was our constant companion during the pivots of stress characteristic of the last several months.

The Current Phase: Positioning for a New (Pandemic Influenced) Normal

At a high level, we've conceptualized our companies into three broad categories as we consider the way forward. These designations are largely qualitative with regard to business models, though from our view, quantitative proof points assuredly exist in the balance sheet and liquidity profiles associated with our holdings.

Category One: Companies whose business models were subject to minor disruption by the pandemic and, in reality, became more relevant as part of the solution; with what we see as outstanding balance sheets/liquidity positions; and less dependent on – and less likely to benefit from – a “V” shaped recovery.

Category Two: Businesses who were certainly affected by the pandemic, though held up reasonably well considering the severity of the shock; with what we consider very strong balance sheet/liquidity positions, albeit not quite as fortress as Category One companies; and who possess both defensive characteristics while also capable of playing offense in a more vigorous recovery.

Category Three: Businesses significantly impacted by the crisis, and whose earnings power has been deferred for some time; with what we deem needed balance sheet and liquidity support to bridge the precipitous drop in demand; and who arguably would have the most positive operating leverage to a robust economic rebound.

We have shifted between and among holdings and opportunities in these categories as Mr. Market has presented buy and sell opportunities. Generally, our work has wrought more of a skew to Category One and Two companies. The market recovery allowed us to nimbly redeploy proceeds from the rebound in more pro economically sensitive companies (Category 3) into more formidable franchises residing in the first two buckets, some of which lagged during the rally.

In the coming weeks, Harry will share in his quarterly letter the specific portfolio actions taken that align with the sequencing chronicled above.

And while we are very much bottoms up in our approach, we do believe that the macro matters. While the market seems to be embracing a “V”, those we respect in the industry see it as being more measured. We recently had an audience with Strategas’ Chief Economist, who sees it as more of a square root sign – a mini boom following a vertical drop – followed by moderate gains. The independent Congressional Budget Office (CBO) suggested economic activity could be approximately \$8 trillion lower over the coming decade, the equivalent of a 3% decline in activity; on a baseline of GDP growth in the range of 2.5% per annum, amortizing such a reduction per annum is meaningful.

While we can’t know what inning – phase – we’re in, we don’t much concern ourselves with that unknown. What we do know – what we can unequivocally commit to our clients – is we’re fully engaged in the game.

We want to once again extend our sincerest gratitude to the front-line health care workers, medical practitioners, grocery store employees, delivery personnel, *et al.* everywhere for your courageousness and compassion in the midst of the greatest public health crisis of our generation.

A happy and safe summer to all.

GIPS Disclosure
HS Management Partners, LLC
Concentrated Quality Growth Composite
Annual Disclosure Presentation

Year End	Firm	Composite		Performance Results					3-Year Annualized Std Deviation		
				Composite		S&P 500 [®]	Russell 1000 [®] Growth	Composite Dispersion (Std Dev)	Composite Gross	S&P 500 [®]	Russell 1000 [®] Growth
				Gross	Net						
1Q20	2,674	2,602	292	-24.29%	-24.42%	-19.60%	-14.10%	0.28	16.56	15.00	15.19
2019	3,566	3,478	280	38.12%	37.13%	31.49%	36.39%	1.13	11.29	11.93	13.07
2018	3,145	2,967	259	-4.42%	-5.07%	-4.38%	-1.51%	.28	10.04	10.80	12.12
2017	4,028	3,840	236	33.87%	33.06%	21.83%	30.21%	.46	9.61	9.92	10.54
2016	3,446	3,269	199	6.92%	6.25%	11.96%	7.08%	.10	10.72	10.59	11.15
2015	3,143	3,014	176	3.94%	3.32%	1.38%	5.67%	.81	11.03	10.48	10.70
2014	3,295	3,193	148	13.06%	12.39%	13.69%	13.05%	.26	9.85	8.98	9.59
2013	2,392	2,298	136	31.76%	31.04%	32.39%	33.48%	.09	12.26	11.94	12.18
2012	1,622	1,616	94	28.86%	28.16%	16.00%	15.26%	.15	13.82	15.09	15.66
2011	884	880	72	5.55%	5.00%	2.11%	2.64%	.11	15.81	18.70	17.76
2010	531	528	46	17.13%	16.44%	15.06%	16.71%	.28	19.54	21.85	22.11
2009	292	290	32	35.91%	35.06%	26.46%	37.21%	.33			
2008**	172	152	27	(34.49%)	(34.80%)	(37.00%)	(38.44%)	N.A.			
2007*	-	6	5 or fewer	16.84%	16.08%	4.83%	10.51%	N.A.			

* Performance shown for 2007 is from April 1, 2007 through December 31, 2007.

** HS Management Partners, LLC charges its fees quarterly in arrears and therefore no significant fees were charged to client accounts in the first quarter of 2008. Had a modeled fee of 0.90% per annum been applied, the net of fee return for the first quarter of 2008 would be (10.82%).

N.A. - Information is not statistically meaningful due to an insufficient number of portfolios (3 or fewer) in the Composite for the entire year.

The HS Management Partners Concentrated Quality Growth Composite includes all fully discretionary, actively managed, fee paying accounts which employ our style of investing in 20-25 quality growth businesses. These accounts must have a market value exceeding \$500,000 at the time of initial inclusion in the Composite and have a market value exceeding \$300,000 to maintain inclusion.

Accounts that have contributions/withdrawals of greater than 10% of their market value (at the time of the cash flow) shall be excluded from Composite membership. Accounts that are not actively managed according to the intended strategy are excluded at the end of the last full day in which they last met the inclusion criteria. Accounts are reinstated into the Composite on the first day after the account again meets our inclusion criteria. Prior to April 1, 2009, our inclusion and exclusion criteria were applied on a monthly basis, rather than daily. Additional information regarding the treatment of significant cash flows is available upon request. Also available upon request are policies for valuing portfolios, calculating performance, and preparing compliant presentations.

For benchmark purposes, the Composite is compared to the S&P 500[®] and Russell 1000[®] Growth indices, however, the Composite may contain securities not represented in either or both indices. The HS Management Partners Concentrated Quality Growth Composite was created January 1, 2008. Prior to January 1, 2008 the accounts in the Composite were non-fee paying individual accounts managed by Harry Segalas in accordance with HS Management Partners' investment policies, becoming HS Management Partners accounts in December 2007. Prior to July 1, 2011, the HS Management Partners Concentrated Quality Growth Composite was known as the HS Management Partners Concentrated Growth Composite.

The Composite Dispersion presented is an asset-weighted standard deviation calculated using gross performance results for accounts included within the Composite for the entire period.

HS Management Partners, LLC claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS[®] standards. HS Management Partners, LLC has been independently verified for the period January 1, 2008 through March 31, 2020. Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS[®] standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS[®] standards. The Concentrated Quality Growth Composite has been examined for the period January 1, 2008 through March 31, 2020. The verification and performance examination reports are available upon request.

The performance track record from April 1, 2007 through December 31, 2007 has been examined by Ashland Partners & Company, LLP and meets the portability requirements of the GIPS[®] standards. A copy of their report is available upon request.

HS Management Partners, LLC is an independent SEC registered investment advisor (SEC registration does not imply a certain level of skill or training). The Firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, including those accounts no longer with the Firm. Past performance is not indicative of future results.

The U.S. Dollar is the currency used to express performance. When international ordinary shares or ADRs are held in portfolios in the Composite, performance is shown net of foreign withholding taxes. Returns are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using actual management fees. Prior to January 1, 2008, a representative fee of 0.90% annually was applied to the individual accounts in the Composite managed by Harry Segalas. Additional information regarding the policies for calculating and reporting returns is available upon request. Policies governing compliance with the GIPS[®] Standards were followed in establishing HS Management Partners' performance record and the accounts to be included therein. In that regard, certain individual accounts managed by Harry Segalas were excluded from the Composite because of material differences in the management style of those accounts and HS Management Partners' investment policies. The GIPS[®] standards were applied retroactively for the purposes of computing 2007 performance, and are being applied prospectively in a consistent manner.

Investment advisory fees are charged as a percentage of an account's assets under management. The annual fee schedule for accounts that are at least \$10 million under management is as follows: 0.90% on first \$25 million, 0.70% on next \$25 million and 0.50% on the balance. Accounts below \$10 million pay the greater of 1% or \$10,000. Actual investment advisory fees may deviate from the above fee schedule at the Firm's sole discretion. Please refer to our Form ADV for more information related to our fees.

IMPORTANT DISCLOSURES

When we use *HSMP*, *HS Management Partners*, or *Firm*, we mean HS Management Partners, LLC. This piece represents our opinion as of 6/5/20 based on our understanding of market conditions and publicly available information. It has forward-looking statements that are by their nature uncertain and based on our assumptions (such as when we refer to possible/future/estimated earnings, cash flows, earnings-per-share (EPS), growth rates, price-earnings ratios (P/E), market conditions, or portfolio/client portfolio outlook); there is no assurance that forward-looking statements are accurate as actual results and future events can differ materially from our assumptions. It is written from the perspective of our Composite holdings, performance and estimated metrics, and it does not refer to any specific group/client account (when we use *our portfolio(s)/your portfolio(s)* we mean client portfolios in general from our Composite perspective – please see below regarding differences between the Composite and actual client portfolios/ accounts). The information here is solely for illustration/discussion, is subject to change without notice, should not be construed as a recommendation to buy or sell any particular security, and should not be used as a base for making investment decisions. Investing in securities involves significant risks, including the risk of loss of the original amount invested.

We typically build a concentrated portfolio with a hard cap on company names and with an aim to keeping clients' capital nearly fully invested. Our investment advice is limited to domestic and foreign equity securities of publicly traded companies. Client accounts generally hold 20-25 companies, although in certain circumstances they may hold more or less names. We do not maintain limits on industry or sector weightings, and while we do limit portfolio positions by company, clients' portfolios are likely to be significantly concentrated by sector, industry and/or geography, among other factors. While we believe that our investment strategy will produce desired returns, there can be no assurance that we will achieve our investment objectives. We encourage you to refer to our Firm Brochure (which is available on our website—www.hsmanage.com—or upon request at 212-888-0060) for some material risks applicable to our investment strategy and additional information regarding our Firm.

When we use *Composite*, we mean our HS Management Partners Concentrated Quality Growth Composite. The performance shown should not be taken as an indication of how the Composite or a client account will perform in the future; past performance is not indicative of and does not guarantee future results. HSMP claims compliance with the Global Investment Performance Standards (GIPS®). HS Management Partners, LLC is an independent SEC registered investment adviser (SEC registration does not imply any certain level of skill or training). The Composite includes all fully discretionary, actively managed, fee paying accounts which employ our style of investing in 20-25 quality growth businesses, including those accounts no longer with the Firm. Accounts must have a market value of greater than \$500,000 at the time of initial inclusion in the Composite and meet certain other criteria to maintain inclusion. The U.S. Dollar is the currency used to express performance. Composite performance is presented net of fees and includes the reinvestment of dividends and other earnings. The Composite is compared to the Russell 1000® Growth Index and the S&P 500® Index as benchmarks for market context only (we deem our strategy to be benchmark agnostic as we do not aim to mimic any market index). The Russell 1000 Growth Index is an unmanaged index which measures the performance of those Russell 1000® Index companies (largest 1,000 U.S. companies based on market capitalization) with higher price-to-book ratios and higher forecasted growth values. The S&P 500 Index is an unmanaged market capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Neither index bears fees and expenses and investors cannot invest directly in either of them. There are meaningful differences between the Composite and each index that should be considered when comparing performance, such as in terms of composition, concentration and volatility. For example: (1) the Composite can contain securities not represented in either or both indices and is much more concentrated than either index in terms of companies and sectors; (2) the average market capitalization of companies in the Composite will likely differ from that of either index; and (3) market or economic conditions may affect positively/negatively the Composite's performance but not the indices, which do not bear market risk. Although most discretionary client accounts are included in the Composite and dispersion is typically low over time, not all client accounts are in the Composite, and even for those in the Composite, there can be dispersion, particularly when viewed over narrow time periods. Client account holdings and performance can vary from the Composite or from other client accounts (even different accounts of the same client), and also from the representative portfolio, for several reasons, such as: client restrictions, account type and size, timing and market conditions at an account's inception and contributions/withdrawals, timing and terms of trades, actual client investment advisory fees (or the lack thereof), and client directed brokerage/commission recapture instructions. Furthermore, under our sole investment strategy (HSMP Concentrated Quality Growth Equity strategy) we provide investment advice on a discretionary basis (we make all the investment decisions and trade the accounts) and also on a non-discretionary basis in the form of model portfolios for use in multimanager products (we act as a non-discretionary sub-adviser and do not make the final investment decisions nor trade the accounts); therefore, certain information here (including holdings, performance, Composite, and investment strategy implementation) is not applicable to model portfolio clients as we have no control and do not monitor the implementation (complete, partial or not at all) of model portfolios, and the performance of model portfolio clients is not attributable to us.

In response to COVID-19 and in an effort to protect the safety 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, that our team and close family members do not fall ill, 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. Although our business continuity / disaster recovery plan aims to mitigate the impact of natural disasters or catastrophic events by maintaining critical business functions, while keeping the safety of our employees first, no plan can guarantee the continuity of our operations in the presence of these events. In particular, given the evolving situation and the unknown impact of COVID-19, we cannot predict with certainty its effect to our business and client portfolios.

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