THE EQUUS REPORT

—BY BARNABY LEVIN

COVID-19

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In light of the growing threat from the COVID-19 Coronavirus – and the damage to our Energy complex that, I'm afraid, is occurring because of the ill-timed price war between Saudi Arabia and Russia and the price of Crude falling below most companies' and countries' cost of production[1] -- we want you to know what we have done to prepare for and, ultimately, take advantage of it.

So, let's **Start at the End**: Other than transmission (primarily of natural gas), we have had no exposure to oil for quite some time. And even more importantly, we have been *anticipating* that the fallout from this Virus – as with SARS, MERS and H1N1 before it -- might be greater than most were expecting so, more than a month ago, had already

1. eliminated all **Emerging Market** Indexes;
2. eliminated any **European** companies;
3. raised **a minimum of 10% in Cash** (and, in some cases, more); and
4. increased our holding in **the Prudent Bear Fund** (which goes up when the Market goes down) which, in the Strategic Equity Portfolio, now represents more than a 10% allocation

In other words, nearly 20% of your Assets are in Cash or Cash Equivalents as we go through what has become a global "lockdown," the likes of which we've never seen and which we will, undoubtedly, see more of before the Virus runs its course and puts the world into what, hopefully, only proves to be a *short* Recession.

Five years ago, in my article titled "The China Syndrome," I said that "developments in China have had a huge impact – both positive and, now, negative – and it is important we keep a close eye on what transpires there in the days and weeks ahead." Given that COVID-19 originated in and spread from the Wuhan Province in China, this (unfortunately) is as true as ever. But the *good* news is that both China and South Korea seem to have turned the corner and – rather than having to trust China's notoriously unreliable media – we can (and will) listen to Retailers like *Starbucks*, who say that business there is already beginning to return to normal[2] and, with their stock down more than 40% from its 2020 high, can see (from 144 Filings) that Insiders are now buying shares in size.

Regarding our decision to exit European and Emerging Market equities early on, we knew "when (relative to the Dollar) an Emerging Market currency is devalued, the impact it has on our *exports* takes ten to twelve months to take effect. But the impact it has on *that* country's *im*ports – as well as on all of their outstanding, dollar-denominated debt – is instantaneous and, at least in the short term, hurts

[1] and which, of course, they can't make up with 'Volume'…

[2] "The company now expects 95% of its China stores to be open in some form by the end of March" while, for context, "the virus began sparking widespread alarm and disrupting daily life in China in the second half of January." Bloomberg, Edward Ludlow, March 18, 2020, "Starbuck's Lessons in China May Help in U.S. Outbreak"

them far more than it does us."[3] Given our previously strong economy; the breadth, depth and dedication of our Healthcare system and workers; the innovative spirit and resources of the best Biotech companies in the world; and our early actions to restrict incoming flights from overseas, it seemed logical to assume that America should fare better than most. Regarding the latter, while philosophically admirable, open borders allowed unfettered access *to* the EU by "carriers" from places like China, Italy and Iran for longer than they should and, because of their demographics, now poses added risk of a bad outcome: the number of people over the age of 65 is, as a percent of their population, 20% in France; 22% in Italy; and 23% in Germany versus 16% here.[4] So again, when looking to reduce Risk and raise Cash, the decision of what to sell first seemed fairly straightforward to us.

But I'd like to return once more to the topic of ETFs, because I think it's really important for people to understand how Markets work and how -- after years of thinking how "easy" it was to simply invest in passive Indexes and buy the "dips" -- they have a darker side, with unintended consequences.

As far back as 20**15**,[5] in "The China Syndrome," I discussed how, due to the proliferation of ETFs, people were "throwing the baby out with the bathwater" and, today, think they're doing it again. In fact, because some of the similarities between then and now are so uncanny, I am attaching a Link to it in case you'd like to read it in its entirety:

The China Syndrome Equus Report

But as I said before, "my biggest concern is the one for which no one seems to have an answer – that is, the huge influence Exchange Traded Funds (ETFs) are having as, more and more, Hedge Funds are relying on ETFs to respond instantly to daily events; are momentum-driven: and use high degrees of leverage, subjecting them in the process to Margin Calls when markets fall and exacerbating that fall even further. And with ETFs – because they are broad-based 'baskets' of stock -- no one knows the full extent of the impact they can and will have on any given stock's behavior or performance, especially in ***Down*** markets." All we know is that most indexes are "Cap-weighted" (i.e. larger companies are a greater part of the index); that ETFs are the proverbial tail that wags the dog; that this tail has been getting bigger and bigger; and that human nature doesn't change. When people are afraid, they start to sell, ultimately without discrimination, until they reach a point of "*Capitulation*," the precondition of which is great suffering and pain, endured over a meaningful enough period of time that the circumstances become intolerable to the point where they simply give up, abandoning their long-held position and doing whatever it takes to end that pain.

This, I'm afraid, is where things stand today but, *fortunately* – because we raised cash -- the toughest decision ***we*** are having to make each day is how best and how quickly to take *advantage* of the *panic* when putting that Cash back to work and, as Warren Buffett said, being "Greedy when others are Fearful." This includes our ladders of short-term, investment-grade bonds, issued by institutions like

[3] "The China Syndrome," Barnaby Levin, Hightower Advisors, September 3, 2015
[4] Central Intelligence Agency, "The Work Factbook" at **cia.gov/library/publications/the-world-factbook/geos**
[5] "The China Syndrome," Barnaby Levin, Hightower Advisors, September 3, 2015

JPMorgan and Goldman Sachs, where we are finding *incredible* yields for maturities as short as three months (which is about as far out as we're willing to go) as people are selling at any price.

Our focus has exclusively been on our core group of US, Global Gorillas -- all with Strong Balance Sheets and all of which have the ability, not only to withstand this temporary impact on their business, but take *advantage* of opportunities to acquire other companies and increase market share in the process.

Disney, of course, will be hurt as they close Theme Parks worldwide or lose subscribers for ESPN as events or entire Seasons are deferred or cancelled. Nor will these lost sales be recouped in coming quarters. On the other hand, with people working from home and their children home from school, they may *gain* and accelerate subscriptions for their new "Disney Plus" both here and abroad or by bringing Programming to market earlier to help both them and their subscribers bridge the gap. This should have long-term and lasting benefits.

Others, like **Apple** and **Tesla**, will be impacted by store closures but, because they both do a substantial amount of their business online, it remains to be seen how much business is actually "lost" or simply deferred, which should also be true of companies like **Salesforce** and **Nvidia**, which provide other companies important information and make them and the systems they use more powerful, productive and efficient, which is even more critical when their workforce is, if only temporarily, reduced.

Healthcare companies like **Gilead** and **Johnson & Johnson** are actually part of the *solution* and, so, should be sheltered from the impact on sales from people staying at home, while **Blackstone** (with more than $150 Billion in "dry powder") will be able to acquire companies across a broad spectrum of industries at more-compelling valuations. And, because so much of their Assets are locked up, they will be largely protected from "capital flight" or withdrawals, which is a risk other financial institutions, like Vanguard and Black*rock,* will face as people liquidate their holdings in ETFs and mutual funds.

And, finally, a company like **Amazon** could actually be a *Beneficiary* as people order *everything* and have it delivered same day or overnight in a world of "social distancing." This includes food from their Whole Food subsidiary; drugs from their new "PillPack by Amazon Pharmacy;" or their new "Just Walk Out," checkout-free technology, where customers pick up an item and are automatically billed as they leave the store and which Amazon just made available to any Retailer who wants it.

These are only a few examples but, I think, enough for now. But I *do* want to reassure you that this is an "unforced error" – meaning, it isn't a result of something (except, perhaps, for some Energy and Airline companies) that any particular company or person brought on themselves, either by choice or by something they did and it is, literally, a situation from which our country *will* "recover," perhaps stronger than ever. Yes, we will have taken on far more Debt (which, as you know, was already a huge problem) as we attempt to shatter this virus like a hammer – but as I've heard said, "if you're going to go through Hell, let's get through it as fast as we can" and we'll just have to deal with the Debt when it's over. Yet, when I see efforts like the recent series of Public-Private partnerships (including Google's online, coronavirus test or Retailers, like Walmart and Costco, allocating parts of their customer parking to set up drive-through test sites), where some of the best companies in our country are teaming with Government to solve and curtail this Virus – or the way in which we've slashed red tape for Agencies from the FDA to FEMA to speed things along – I am incredibly proud and encouraged. Our Nation is already beginning to do what we do best in times of crisis and, whether it's simply a matter of staying at home and working remotely – or fast-tracking test kits and vaccines – we *are* doing it, and (unlike China, where it originated) *voluntarily*. But, like China, we've already begun to bend or "flatten" the curve of the Virus's progress, as Dr. Fauci and Scott Gottlieb, former Head of the FDA, have been urging in daily Press Briefings and interviews. Nor, unlike 2008, are we faced with a *systemic* problem like we had then with our banks which, from all accounts, are better capitalized than ever and, therefore, I have no doubt that money will be made available to help people and companies get through this period. While no doubt a daunting ***challenge***, we can and will overcome as we have before.

I *do* hope that, in making these "loans," Congress takes a page from TARP and issues Senior Preferred Debt with *Warrants* (so there's upside and, as TARP did with the Banks, the Treasury could actually *make* money) and above-market rates of interest that are contingent on companies keeping people on their payroll. And, if they're publicly traded, I hope that, until the loans are repaid, they require those companies to suspend any stock buybacks and dividends, so the money only goes to the *workers* (who are *prevented* from working) and fixed overhead.

As to oil – while, as Rahm Emanuel once quipped about Congress, Russia might not *want* "a serious Crisis to go to waste" – it *does* seem that, one way or another, both Russia and Saudi Arabia will *have* to come to their senses before too much longer and defer, at least, their squabble until this far-more universal threat is resolved and, thereby, take some of the pressure off our overleveraged Energy industry. That would certainly help.

But in the meantime, please stay healthy. Be smart. Wash your hands (often) and *don't* touch your face! And, as always, if you have any questions or simply want to talk, please know that all of us at Hightower and **LK Wealth & Asset Management** stand ready to serve you in any way we can.