

Introduction:

We want to wish all the best to you and your colleagues, friends, and families during a challenging and unsettling time. The coronavirus or COVID-19 or “the virus” has turned the world upside down. No one is immune to its impact but we continue to be amazed at how it is bringing out the best in some people. Since everybody is working from their home and “sheltering in-place”, we hope our newsletter can be a nice distraction from this environment. As we like to say, feel free to use our research as the all-natural cure for insomnia....

At Manole Capital, we focus all our time on FINTECH, or doing bottoms up, fundamental research on financial and technology companies. In our normal quarterly newsletters, we provide some macro commentary on interest rates, inflation, Fed actions, and touch on some items impacting the FINTECH industry. There is so much going on right now, that we broke our newsletter into 2 separate components. Part 1 focuses on the macro issues, unemployment, Fed actions, and our attempt to frame the economic and financial damage this virus is causing.

In Part 2 ½ (an ode to Naked Gun 2 ½), we highlight our thoughts on risk, being prepared for volatility and we have sprinkled in a few tidbits about some of the long-term ramifications, both positive and negative, for our FINTECH stocks.

The New Normal?

Our response to this virus was most likely similar to a lot of yours. Just 5 to 6 weeks ago, we believed that COVID-19 was being blown out of proportion and it was driving people to somewhat odd choices. We started off sensibly, listening to the CDC’s Dr Messonnier in mid-January who said, “This is not something that American families generally need to worry about” and “this is a very, very low risk to the US.” We were shocked to see the video of two ladies fighting in a grocery supermarket over toilet paper.

Fast forward to today and COVID-19 is a global pandemic, having killed over 200,000 people, unlike anything the world has experienced in a century. The news media has shown countless acts of heroism by the healthcare industry, which is well portrayed in this cartoon. This is a crisis that is testing much of the world and clearly the healthcare industry, scientists and first responders are all responding like true champions. Don’t forget the excellent work being done by grocery store employees and pharmacy workers too.

We are lucky to be able to work and manage assets seamlessly from our home office. In our business, we simply need a good internet connection and good cell phone reception. As we write this newsletter, safely keeping 6 feet from anybody, our puppy is wondering when he’ll get his 4th walk of the day.

How We Got Here:

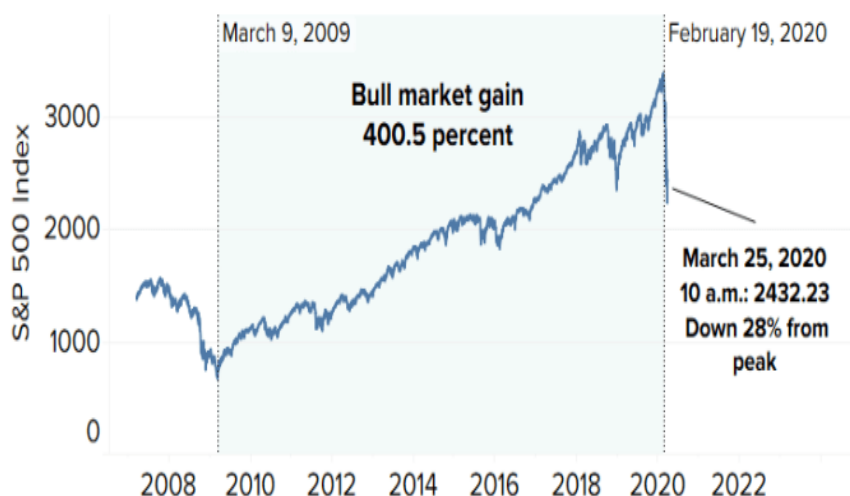
Since 1929, in US Presidential election years, the S&P 500 has averaged a +7.4% gain and traded higher 66% of the time. In 2019, the S&P 500 rose roughly 31% with multiple expansion, rather than profit growth, driving those equity gains. A Morgan Stanley research note detailed that nearly 90% of S&P 500, MSCI emerging and developed markets equity gains last year were driven by higher valuations, as opposed to company’s generating higher profits and free cash flow. 2020 started out in a similar way. China reported its first death from COVID-

19 on January 10th, but this was clearly not a focus on the investment community; the US stock market continued to march higher.

The bull market, the longest in history at 11-years old, showed no signs of slowing just two months ago. From March of 2009 to mid-February 2020, the S&P 500 gained over 400%. We will identify the peak of the overall market on February 19th, when the S&P 500 hit its 13th all-time record of 2020. However, in 4 short weeks, it all came crashing down.

From Bull to Bear:

S&P 500 bear market



It only took 16 trading days for this hibernating bear to wake up and end over a decade-long bull market. We have just experienced the fastest ever decline (over 25%) from an all-time record to a bear market.

The volatility has also been unprecedented, with the S&P 500 averaging over a 5.0% swing each day in the month of March. By comparison, the prior record level of volatility was experienced in November of 1929, where the market had an average daily move of 3.9%.

SOURCE: FactSet



So What Stage Are We In?

We have reached the stage of this crisis where investors have digested weeks of market volatility and are looking ahead to the next phase. How bad will the economic damage end up being? How long until the curve starts to flatten in earnest? And what does that mean for various markets? We are fond of analyzing the past for clues about the future. In prior periods of uncertainty and stress, the market's typically will go through 3 distinct phases.

The 1st phase is **PANIC**. This often happens toward the end of an initial crash, like what happened in October of 1987 when the S&P 500 fell (33%) or August of 2011, when it declined swiftly by (18%). This is most likely what the market was experiencing in mid-March of 2020.

The 2nd phase is **RELIEF**. This usually is a multiple week reflex rally, where investors are relieved to see the falling stop. During the Financial Crisis, the S&P 500 had 6 week-long bounces, ranging from +9% to +19%, between September and December of 2008. The relief rallies in 1987 and 2011 recouped +30% and +40% of their losses,

from peak to panic low. Want another recent example? Dating back to the early 1930s, two of the top 10 weeks ever for the DJIA (Dow Jones Industrial Average) occurred the week of March 27th, 2020 and the week of April 9th, 2020. Just looking at recent stock market activity, the DJIA exited its bear market on March 26th and the S&P 500 escaped its bear market on April 8th. However, are these rallies the end of that period's pain? We do not believe so.

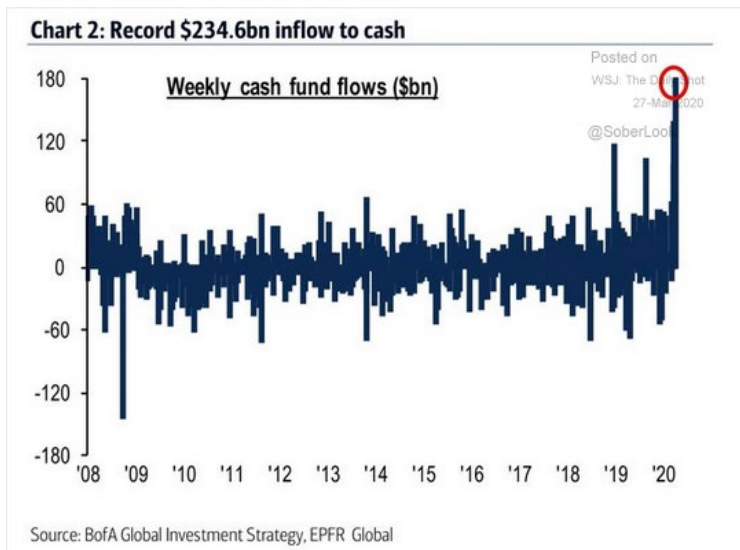
The 3rd phase is **DEMORALIZATION**. Nobody likes this phase, but it often re-appears. This phase is when the market re-tests that panic low, as investors begin to realize that weaker economic and corporate news is soon-to-be released. This is exactly what happened in December 1987 and October 2011. We are simply too early into this crisis to pinpoint where we are today.

Panic Is Not An Option:

There is an old adage in the stock market that goes like this. The stock market is the only place where people “crowd in” when the wares are most expensive and everybody is “getting rich”; and it the only place where they flee when there’s a sale. When it comes to panic trading, we liked Walt Bettinger (CEO of Schwab) recent quote on the subject. He said “We know from history, over time, our country perseveres and its markets rebound. The hopelessness of the financial crisis of 2008 was followed by a historic bull market, but the pivot went almost unnoticed by many investors until we were well into the turnaround. And so throughout this downturn, we are reminding our clients that panic is not an investment strategy and that trying to time the market is futile.” We couldn’t agree more.

Looking at this chart from Bank of America Merrill Lynch, we can see that cash flows spiked dramatically higher, as investors fled the equity markets for the safety of US dollars.

According to the Investment Company Institute or ICI, in the 10 months leading into the US stock market peak in October of 2007, investors poured \$84 billion into equity mutual funds. Then, from June 2008 to the market bottom in March of 2009, investors took \$233 billion out equity markets. Instead of beating yourself up for an inability to time the market, we advocate investing with a long-term perspective, analyze the current environment and look forward, but always remember to not panic.



Paycheck to Paycheck:

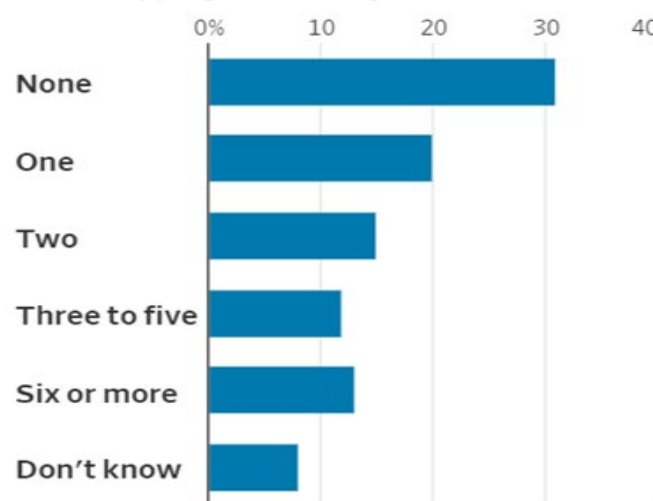
So only a couple months ago, things couldn't have been any better right? There was record high consumer confidence, a 50-year low in unemployment, record low interest rates and a 20-year high in household income. However, underneath the surface, was everything really solid?

We have to remember that one person's spending is another person's income. That, in a single sentence, is what the \$87 trillion global economy is all about. This relationship, between spending and income, consumption and production, is the core of how a capitalist economy functions.

During this historic economic expansion, there was a hidden pain point that many missed, including us. We have seen studies that show that Americans are not wonderful savers. Statista Research shows that 45% of Americans have no savings and another 24% have less than \$1,000 stocked away. According to a 2019 Fed report, nearly 40% of Americans do not have enough cash on hand to cover an unexpected expense of only \$400. Clearly, not all Americans were prepared for a "rainy day".

This chart from the University of Chicago shows the number of paychecks the average American can miss, before dipping into their savings. Nearly ½ of those surveyed cannot afford to miss more than 1 paycheck before breaking into their savings. This isn't the solid footing that record high stock markets are built upon. It also isn't the environment that can easily handle and manage a crisis.

Number of paychecks workers can miss before dipping into savings



Note: Figures don't add to 100% due to missing responses

Source: NORC at the University of Chicago

Unemployment:

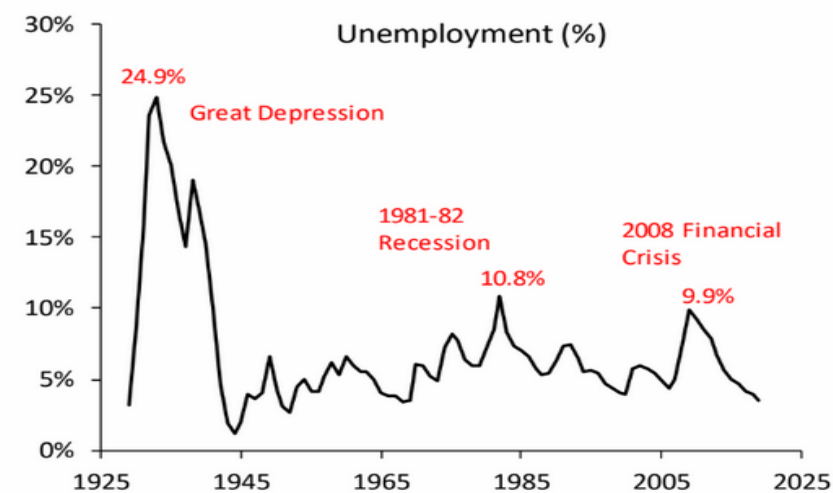
During the Financial Crisis in 2007 through 2009, it took nearly 18 months for the number of Americans receiving unemployment to reach 6.6 million people. Fueled by shutdowns across the country due to COVID-19, unemployment hit a new record of 7.5 million people - within a month. An astounding 24 million people have applied for unemployment benefits since mid-March. One of the problems with unemployment seems to be that websites are crashing and are not prepared for the tremendous volumes and activity they are experiencing. Phone lines have been inundated with inquiries and individuals desperately in need of support are unable to receive aid.

Consensus estimates now expect our economy to have a disastrous 2nd quarter and then sharply rebound (V-shaped) in the 3rd quarter. Well, the 2nd quarter is following that catastrophic estimate, in terms of unemployment. Job losses have been horrific and this is the fastest and largest jump in jobless claims ever. In March, more than ½ of the jobs lost were at restaurants and bars.

The nonpartisan CBO (Congressional Budget Office) said that the unemployment rate would exceed 10% in the 2nd quarter. This would be the second highest monthly unemployment rate on record, going back to 1948.

Nobel laureate economist Paul Krugman thinks the US unemployment rate could hit 20%. For perspective, that is twice the peak level of unemployment experienced during the Financial Crisis and near the Great Depression's level of 25%. The other prior peak? Late 1982, when unemployment hit 10.8%. How high will the unemployment rate get? The median estimate for Q2 is around 7%, which unfortunately seems too low to us.

Figure 3: Unemployment may surge near its highest levels since the end of the Great Depression



Source: BLS, Piper Sandler

Are we headed for a recession or depression? Will we quickly recover or will this environment linger? Before COVID, the US was arguably in one of its strongest economic positions ever. The simple response will be that we will naturally bounce back in record time as well. A recent *Wall Street Journal* study estimates that at least 25% of the US economy is offline due to this pandemic. That same study estimated that 29% of the US economy has “gone idle”. Quite simply, this has impacted every business and every region of our country. We will attempt to frame a few different scenarios and how COVID-19 is impacting certain industries.

Looking Forward:

Would we be surprised to see another 10% to 20% downside to equity markets? The answer is no. We expect to see weaker businesses struggle and won't be shocked to see default rates explode higher. We recently saw a quote from Scott Miner at Guggenheim and were struck by its directness. He said that “things that are cheap can still get cheaper” and “bottom fishing is the most expensive sport in the world.”

We believe that limiting business activity and limiting consumer spending will impact a wide range of industries, that will have a meaningful and negative impact on growth throughout 2020.

Here is an updated list of 2nd quarter GDP growth estimates from Schwab. Not only are all severely down, but the range varies significantly, from only (9%) to a low of down (40%). This shows how the market is truly “flying blind”, as economist can differ so noticeably on current quarter growth projections.

Particularly troubling is how important the 2nd quarter is for most businesses. Spring is supposed to be about renewal and growth, but it will be remarkably different this year. Normal business cycles model in steady and predictable growth. In most cases, as weather improves, so too does business. From shopping to construction to real estate to restaurants. Growth during the summer is as predictable as humidity and mosquitos in Tampa. Not all of this necessary growth will arrive this spring and summer, due to this virus. Some businesses will be strong enough to survive. We hate to be harsh, but weaker companies simply cannot afford to miss a vital quarter or two of seasonal business. This will be a lingering worry for the global economy.

Firm	2Q2020 GDP estimate
Bloomberg Economics	-9.0%
UBS	-9.5%
Pantheon	-10.0%
Strategas	-10.0%
Cornerstone Macro	-11.0%
Oxford Economics	-11.9%
Citigroup	-12.0%
Credit Suisse	-12.0%
Bank of America Merrill Lynch	-12.0%
Deutsche Bank	-12.9%
IHS Markit	-13.0%
Wells Fargo	-14.7%
TSLombard	-17.7%
Evercore ISI	-20.0%
JPMorgan	-25.0%
Morgan Stanley	-30.1%
Goldman Sachs	-34.0%
Capital Economics	-40.0%

Source: Charles Schwab

V or U Shaped Recovery:

A positive scenario is a sharp and short hit to the economy, as we develop better testing, flatten the curve and come up with a cure or vaccine for COVID-19. It seems like the only hope for a V-shaped recovery is if our scientists and doctors discover and produce huge quantities of an effective treatment. The mobilization of the international medical research community has been remarkable, and we are thrilled to hear of some of their promising possibilities. Unfortunately, it seems unlikely that we will have a cure discovered in the next few months.

Over the last month or two, we have a new appreciation for a little known 79-year old age immunologist for the National Institute of Allergy and Infectious Diseases (NIAID). You too have probably enjoyed the candid answers and thoughtful responses from [Dr. Fauci](#). According to Dr. Fauci, the development and distribution of a vaccine is still 12 to 18 months away. It is positive that some infected people were able to recover or show no serious symptoms. This anti-body concept seems promising, but not enough is known as of now.

In the V-shaped recovery camp is President Trump and his whole administration. Just recently, Treasury Secretary Steven Mnuchin said, “You're going to see the economy really bounce back in July, August, September.” “You're seeing trillions of dollars that's making its way into the economy, and I think this is going to have a significant impact,” he added. “This is not the financial crisis [of 2008].” This bullish position is similar to the forecast issued by the CBO (Congressional Budget Office). It expects a sharp contraction in the 2nd quarter and then growth at an annual rate of 17% in the second half of 2020.

We are not in the market timing business (nobody is), and while we certainly are *hoping* for a quick recovery, we do not believe *hope* is a viable investment strategy. We recently saw an analysis that hinted at a different

take, instead of the typical U or V shaped recovery. Another possibility, one that seems plausible, is expecting a recovery similar to the Nike swoosh (see on right). A sharp fall, followed by a gradual recovery that will take us into 2021 and beyond. This type of elongated recovery seems more likely than a speedy upturn.

We are just trying to be realistic; trying to understand these myriad and perplexing signs and indicators, in an environment nobody has ever experienced before. This isn't similar to the tech bubble or even the Financial Crisis. This was an unbelievably quick and sudden shock to the economic system, that will impact the global economy and all types of businesses. It is hard to imagine a quick recovery, as the length of this economic shutdown is still unknown. How can a small business that went bankrupt come back? We understand the importance of flattening the curve and easing the burden on hospitals, but this inflection will not magically bring businesses back? The government and the Fed are both doing a tremendous job with stimulus measures but it appears that the money may not be reaching those in the most need, both individuals and businesses, quick enough.

The Great Re-Opening:

As we start the process of this "Great Re-opening", we acknowledge that each region of the country is currently in a different environment. Every state is essentially in a different boat, weathering this COVID-19 storm. Some, like Jerry Jones (owner of the Dallas Cowboys), are conducting the NFL draft from his \$250 million yacht. Others, are alone in a dingy, struggling to make ends meet. President Trump has provided administration plans, but is largely leaving it to governors to decide how and when to lift stay-at-home orders.

New York has taken the worse of the virus impact, with over 1/3rd of those infected and a quarter of our national fatalities. Other states, like Louisiana, New Jersey and Michigan have also experienced devastating outbreaks. On the flip side, states like Wyoming, Arkansas and Georgia have seen only modest impacts. Georgia governor Brian Kemp has taken a beating in the media for his late April re-opening plans. We were somewhat surprised to see tattoo parlors and bowling alleys as locations that needed to open quickly, but who are we to judge what is considered "essential". States must weigh their medical capacity and test capabilities before making these critical announcements.

There is no perfect policy and each governor and mayor will walk a tightrope of protecting the well-being of their citizens versus allowing those an opportunity to earn a living. We have to hope that our leaders are acting in the best interest of their constituents, while working off of insufficient information. Quite simply, regional differences are going to lead to different re-opening speeds. While all will be obvious in retrospect, our bias is for a phased roll-out for this "Great Re-opening" our economy. Crystal Watson is a senior scholar at John Hopkins Center for Health Security and she framed this dilemma well. She said, "We don't want to open things up, have a huge surge in cases and have to lock everything down again." We should be opening as soon as possible, as safely as possible. The last thing we want is to sacrifice safe for soon.

The Impact Is Felt Everywhere:

Discretionary spending will likely be one of the worst categories impacted from the coronavirus. As this chart shows, discretionary spending makes up a significant percentage of GDP in various countries like the UK, Spain, Italy and the US.

Concerts, festivals, sporting events and various **entertainment** options are often the lifeblood of certain communities. How are they supposed to manage through this crisis, when these activities are cancelled or postponed? Numerous festivals like South by Southwest in Austin Texas or Coachella in California have been cancelled.

So too has the Kentucky Derby and golf's legendary British Open. Some are able to re-schedule for later in the year, but most cannot. However sad it is for each event, the real damage is felt when analyzing the lingering impact it has on other nearby businesses. While each event is different, some estimate that each \$1 spent has the impact of \$50 to \$100 spent elsewhere, in surrounding communities (restaurants, bars, hotels, etc). Unfortunately, some smaller operators (i.e. Airbnb operators) are not prepared to miss their "busy season". Cineworld Group operates 787 movie theaters in 10 countries. It suspended its dividend, cut all capital expenditures and is holding talks with its landlords about restructure contracts. It can discuss options with banks, film studios and suppliers, but there is simply no revenue to help it sustain the fall-out from this pandemic. As huge sports fans, we struggle without hockey and basketball playoffs or the start of a new baseball season. Nobody knows when sports will return to our daily lives. Not Dr. Fauci, nor Dr Binx or even Dr J!

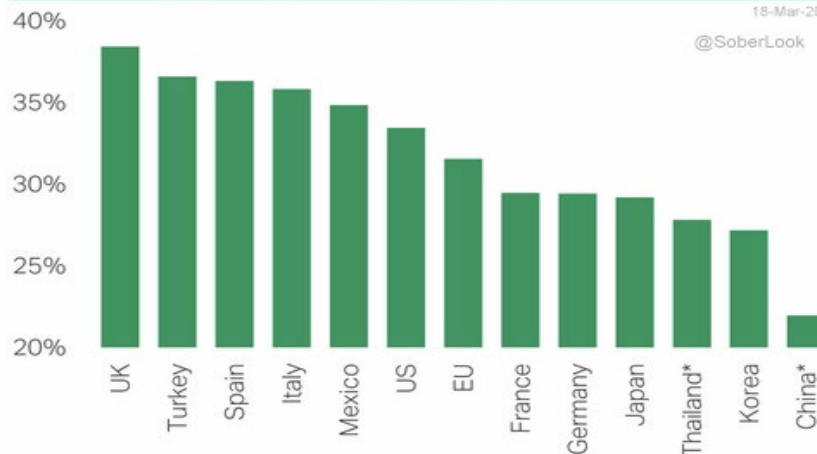
There are numerous examples of businesses making extraordinary efforts to stay afloat. There are 660,000 **restaurants** in the US, employing over 12 million people. The concentric circles around the restaurant industry are quite large. Restaurants that have not previously offered "take-out" or "to go" are adapting and selling food by any means necessary. For example, Panera Bread launched a grocery option (selling fruit, vegetables, etc) in under two weeks and it now accounts for 2% of firmwide sales. Darden Restaurants (owner / operator of brands Olive Garden, Long Horn Steakhouse, Capital Grille, Seasons 52, Bahama Breeze, Eddie V's, Yard House, Cheddar's) had comparable sales that were down (71%) for each of the last three weeklong periods. When the economy begins to re-open and becomes more stable, Darden will most likely re-hire their servers and staff. However, that small, local restaurant (that is not a publicly traded entity, with hundreds of locations and multiple brands), may not be so lucky.

Shock to discretionary spending

Discretionary household spending as % of GDP

Posted on
WSJ: The Daily Shot
18-Mar-2020

@SoberLook

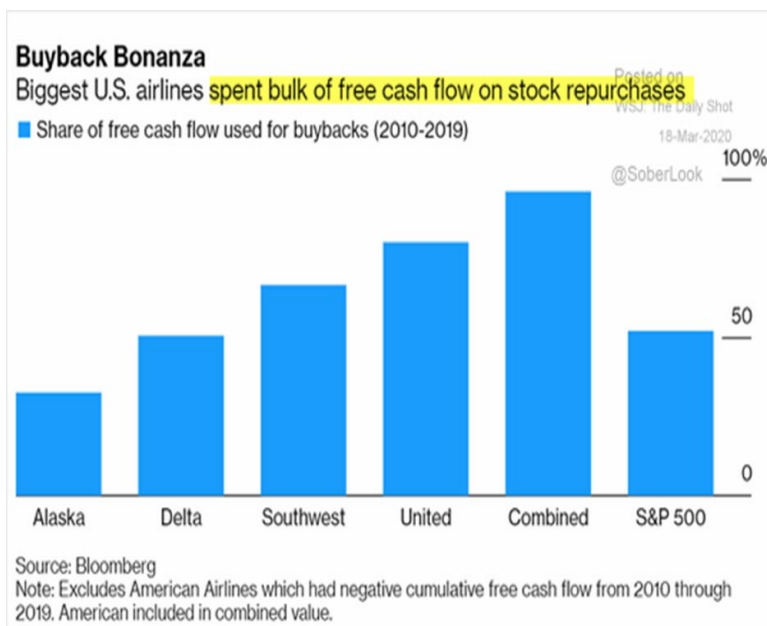


Source: OECD, TS Lombard.

*TSL estimates

As the chart to the right shows, the **airline** industry spend the bulk of their free cash flow, over the last decade on stock repurchases. However, so too did over 50% of all S&P 500 companies. Some will ask if the airlines should have been better prepared, but most had enough cash on hand to survive three months without income. In normal situations, this would have been enough to navigate most crises, just not one that had air traffic falling over 70%. We have no answer for the bigger question of “Are these companies victims of this global pandemic or are they undeserving recipients of our taxpayer money?”

It is always easier to make these claims in hindsight, but the airlines have asked to be bailed out to the tune of \$50 billion. Our government has acted quickly and deemed these companies “essential” for saving. However, just like the US banks encountered a decade long hatred from Main Street, many airlines should expect a harsh response when consumers negatively react to flight delays and those annoying baggage fees.



During the Financial Crisis, much was made of how the US government bailed out the vital **auto** industry and its vast array of suppliers and downstream manufacturers. In March, the entire US auto industry essentially shutdown, with Ford, General Motors, Fiat Chrysler laying off 150,000 hourly employees. Nissan and Honda both furloughed their US factory workers without pay too. As these factories temporarily shut down, it will be quite a while before they begin producing those automobiles again. Then, once production ramps back up, what will demand look like?

Hospital operators are trying their best to acclimate to the largest disruption in their history. Most hospitals are structured for steady, predictable sales and profit streams. Many are now scrambling to meet the uncertain dynamic of not enough tests, not enough PPE (equipment), and the suspension of those profitable elective procedures. They will ultimately comeback, but how long will they be delayed? Speaking of those non-essential surgeries, it has noticeably impacted medical technology stocks like Stryker, Boston Scientific, Intuitive Surgical, etc. As hospitals re-trench and begin to adapt to short-term revenue hiccups, there are literally dozens of other businesses that get impacted in this concentric circle.

Real estate is another example, with a widespread impact. After spending billions building luxurious condo towers in New York City, how will these heavily levered developers be able to handle this shutdown? Many are battling sluggish demand, oversupply and a disappearance of those all-cash, foreign buyers. Will high-rise, city living be negatively impacted by the coronavirus pandemic? Some will claim that record low interest rates will spur demand, but we believe supply will exceed demand and force market prices lower.

Over the last several years, a record number of chains have filed for bankruptcy protection. Many **retailers** were already struggling to compete with eCommerce players like Amazon and now they are dealing with the coronavirus. Over the last year, many retailers were forced to shut down some of their underperforming store locations. Now, because of heavy debt burdens, these retailers are facing a balance sheet and cash flow problem. Since many do not generate free cash flow, especially during times of stress like today, they are in a difficult position. Over the next couple of years, JC Penney, Neiman Marcus and J Crew have \$2.8 billion, \$1.6 billion and \$1.4 billion of debt coming due. These retailers and others need to either re-finance this debt or else. Saving a retail chain with a business model in decline, even under normal circumstances, is quite challenging. Most retailers cannot shrink themselves back to health by simply closing underperforming locations. Many retailers struggle with a fundamental problem. If your business is no longer connecting with customers and you are no longer relevant, closing stores is unfortunately not the right answer. Chapter 11 bankruptcy is designed to save indebted companies. However, according to Fitch Ratings research, nearly half of those that filed for Chapter 11 over the last 15 years ultimately closed all their stores and went out of business for good.

Clearly, this virus is creating and revealing interesting dynamics, across various industries. This pandemic will likely speed the transition to a more digital world and should accelerate adoption of certain themes. How will the US and global economy evolve, grow, and potentially strengthen as a result of everything we have experienced? We know that working from home versus an office environment is rapidly changing. Children are doing online school, so education is undergoing a fundamental change. Many of us are using Zoom or Skype to remain connected with family and friends, so communications has evolved. Most of us are binge watching TV shows and movies and companies like Netflix, Amazon Prime, YouTube, Hulu and Disney Plus are working to fill that void. Instead of eating out at restaurants, some people are re-discovering their kitchen and having groceries and food delivered to our houses. These are just a few of the new experiences that fundamentally show how our economy is going digital. Can all businesses adapt to the changing needs of the American consumer? It requires significant investments to ensure customers can shop and connect in both the physical and online worlds. We will discuss this trend towards digital and eCommerce, in Part 2 ½ of this newsletter. In the meantime, let's take a quick look at what the government and Fed are up to.

Government Stimulus:

As we look forward, we envision those with strong balance sheets will be stronger, on the other side of this crisis. Those that are forced to accept bailouts or take on significant debt, will struggle. Those that fail to acclimate and change, won't survive, but those businesses that have shown an ability to adapt and invest in automation will ultimately thrive. Speaking of balance sheets, let's quickly address the government and Fed response.

While it did not happen immediately, nothing in Washington ever does, the Senate and House both approved the \$2 trillion CARES (Coronavirus Aid, Relief and Economic Security) Act in March. Just like TARP was controversial during the Financial Crisis, there are those that have major problems with this government attempt at providing economic relief.

The main provisions of the bill are: 1x stimulus checks amounting to \$1,200 per adult and \$500 per child, \$250 billion to be spent on enhanced, expanded and extended unemployment benefits, \$500 billion in a fund to help distressed businesses, cities and states (\$50B for airlines, etc), \$349 billion in small business relief, largely in the form of “forgivable loans” (payroll, rent, utilities), \$150 billion in direct aid to state and municipal governments, \$221 billion in business tax breaks and \$340 billion in “other” spending, including \$117 billion for hospitals and veterans’ care.

The Fed:

Right before and then right after Congressional voting, the Fed fired a couple of bazooka shots at this microscopic virus. Just like the Financial Crisis, where Treasury Secretary Paulson worked closely with Fed Chairman Ben Bernanke, we are seeing the Fed and Treasury work in conjunction. The Fed needs to work with the Treasury without exposing itself to capital losses, as it is prohibited from doing so.

Shot #1:

The first Fed shot was a classic maneuver, its standard interest rate cut. After it cut its benchmark to zero, it went to another one of its typical moves, bond buying. It re-introduced its QE (quantitative easing) tactic and began with \$700 billion of ammunition for purchasing Treasuries and mortgage securities. This rate flattening technique is considered by many to be ineffective, but the Fed continued it anyhow. As the announcement was made, the market initially rallied, but ended the day much lower. The Fed’s balance sheet ballooned quickly from \$4.2 trillion to over \$6 trillion. It is now on a pace to more than double by midyear 2020, well above its prior peak of \$4.5 trillion.

Shot #2:

Then, the Fed introduced its “Main Street Lending Program”. This intends to pump \$600 billion into companies that are *too large* for the small business program, but are *too small* for traditional corporate debt markets. Once firms apply via a financial institution, those banks are authorized to release the funds. The bank can immediately sell 95% of the debt back to the Fed to offload its risk. Why 95%? Well, the Fed is forcing lenders that make “Main Street” loans to keep 5% of the risk. By forcing banks to keep some of the risk, it means these borrowers will have to abide by bank covenants, as well as the Fed’s terms. With its latest actions, the Fed is essentially backstopping all types of debt, from triple A to junk. This is a first and it seems like the Fed is wading further and further into capital markets territory. The bank earns a 1% origination fee, but this isn’t equivalent to the sheer amount of work it requires to get these businesses into compliance.

In our opinion, the biggest news out of the Fed, was the viewpoint that it officially “crossed the Rubicon”. It is estimated that the Fed has now put \$5 trillion to work and it is the lending and bond buyer of choice. This scale and activity is more than its entire balance sheet before the crisis. However, by rescuing weaker credits, as well as strong, the Fed is diving further into the risky asset pool. It is perceived by some, that the Fed’s most recent actions have once again explicitly benefitted Wall Street. What do we mean?

Problems with the “Main Street Lending Program”:

Let’s compare a widget manufacturer in the Midwest to a levered Wall Street shop. If you are that middle market business, you have years of prudent management of your business. These small to medium sized businesses are the backbone of the US economy and are typically conservatively managed. You haven’t taken on un-necessary debt and you run your business for the benefit of your family and your employees. If you decide to participate in the “Main Street Lending Program”, you now have a series of new rules to follow. The ban on buying back your stock and paying dividends probably aren’t a problem, but limits on your compensation might be. Let’s assume that you don’t mind any of these issues. How do you feel that these loans will last four years, without the ability to get out from under these terms? Also, for the duration of the loan, companies will not be able to lay off employees; won’t this make running this business all the more challenging? Maybe that doesn’t even bother you either. If that’s the case, you should sign up for a “Main Street” loan after the April 16th comment period and the hope to receive funding through your bank in mid-May. Can you last another 30 days of paying your payroll without any revenue? We certainly hope so.

I guess our problem is that a Wall Street firm that loads up with debt and puts those instruments into a CLO security, will face easier terms for liquidity relief than this similar private company in the Midwest. During the Financial Crisis, we learned that some Wall Street firms levered up, bought questionable assets and then packaged those loans into securities. I guess we are wondering why the Treasury is now backstopping these entities. Didn’t we learn that bailing out the risky activities of a select few has consequences?

The government and Fed have put forth a tremendous liquidity and spending package. The sheer size of the dollars is unparalleled. In a few short weeks, the Fed has already done more, at a faster pace, than it did during the 2008 crisis. According to former Fed Chairman Bernanke, “I think the Fed has been extremely proactive, and Jay Powell and his team have been working really hard and gotten ahead of this and shown they can set up a whole bunch of diverse programs that will help us keep the economy functioning during this shutdown period, so that when the all-clear is sounded, we will have a much better rebound than we otherwise would.”

During the Financial Crisis, central banks and various finance ministries took bold actions to address the consequences of the panic. The root cause of the problem was a lack of liquidity and capital. Central banks were able to quickly inject capital, where it was needed. This time, these central banks cannot solve our problems with unlimited funds. Tackling this problem is medical; it is finding a cure or vaccine for the pathogen. Until we get a handle on this virus, all these bankers can do is attempt to mitigate some of the economic and financial consequences from spiraling out of control. So far, it has proven to be a challenge. Our healthcare systems are under pressure and there is simply not enough testing, treatment, therapeutics, facilities, equipment, etc.

We don’t claim to have any grand insights into which programs will be successful versus those that will fall flat. Our one takeaway is the bigger picture point that the US government is increasingly becoming interventionists. We have found that once these temporary measures and policies are introduced, they rarely get removed. When the Fed enacted rules and policies during the Financial Crisis, they were rarely removed and conditions were not allowed to normalize. Are these truly one off measures or are any of these actions permanent? It appears to us that fiscal and monetary policy are increasingly becoming even more intertwined. At some point

in the future, all of this money printing has to end up being inflationary, right? Like we experienced during World War 1 and 2, significant spending led to an era of big government, where more and more of our economy was controlled by public officials.

This year's budget deficit should hit \$3.8 trillion or 18.6% of our GDP, which is the highest since 1945 (per the Committee for a Responsible Federal Budget). This nonpartisan watchdog group predicts that the federal debt will reach 106% of GDP by 2022, matching an all-time record. The byproduct of these actions will ultimately lead to massive fiscal deficits, but that will be the topic for another day.

Conclusion:

In 2019, as the S&P 500 rose 31%, there was a clear demand for risk assets. In mid-February, that has been replaced with a demand for toilet paper. The oil market is facing the opposite problem. The demand for oil is falling, just as production moves higher. Clearly, Saudi Arabia and Russia picked an awful time to have a market share battle and it is adding another layer of complexity to this recent equity market meltdown.

If anyone tells you they know where the market will bottom, stop listening. The bull market was approaching its 11th anniversary and some thought tensions with Iran would be its downfall. Nope. Then, others believed it was the ramifications of the US and China trade war. Nope. Our raging bull market was fallen by a microscopic virus. While we all now know what specifically caused the end of this decade-long bull market, the bigger questions is trying to understand the duration of this pandemic and when life can return to a semblance of normality. Those are uncertain, but we hope that you can appreciate how we framed the discussion. We were expecting 2020 to be volatile, as the economy struggled for growth. President Trump was promoting the fact that stock markets were hitting all-time highs, as he sought re-election in November. Now, the election seems like an eternity away. The global focus is fighting the coronavirus and regaining our "normal" lives again.

If you are ready to read up on how COVID-19 is impacting the FINTECH industry, simply [click here](#). If you've had enough of Manole Capital's quarterly thoughts, we want to wish you all best.

With the help of caring and thoughtful neighbors and friends, we will find our way through this crisis. I look forward to speaking with you soon!



Warren Fisher, CFA
Founder & CEO
Manole Capital Management

Notable 1q'20 performance:

Best-performing sector:	Technology (12.3%), its largest drop since 4Q 2018
Worst-performing sector:	Energy (51.6%), its largest drop ever
Best-performing S&P 500 stock:	Legg Mason +36%
Worst-performing S&P 500 stock:	Apache (83.7%)
Best-performing DJIA stock:	Microsoft +0.01%
Worst-performing DJIA stock:	Boeing (54.2%)
Best-performing market worldwide:	Switzerland (13%), in USD
Worst-performing market worldwide:	Brazil (50.4%), in USD
Best-performing commodity:	Palladium +21.1%
Worst-performing commodity:	Gasoline (68.7%)
Fixed Income:	Bloomberg Barclays US Bond Index +3.1%
10 Year Treasury Yield:	-1.22 percentage points, its largest drop since 3q'11
CBOE Volatility Index (VIX):	+314%, its largest gain ever
Gold:	+3.6%
WTI Oil:	(66.5%), its largest drop ever

5 biggest Dow Jones Industrial Average drops (per Compound Capital Advisors):

- -1,175 February 5th, 2018
- -1,033 February 8th, 2018
- -1,032 February 24, 2020
- -832 October 10th, 2018
- -800 August 14th, 2019

Quotes:

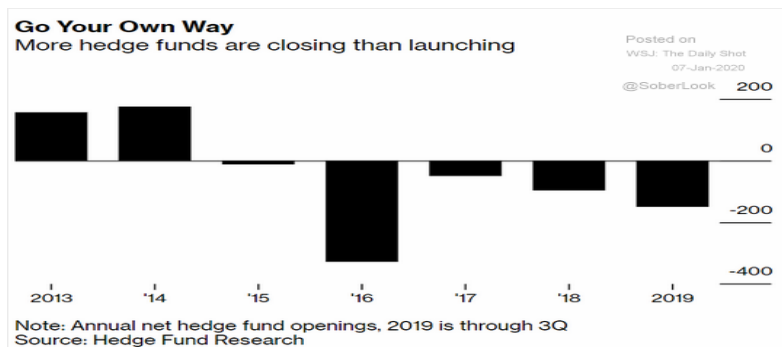
The populist leader of Tanzania (East Africa) is John Magufuli and he recently stated that the “coronavirus cannot survive in the body of the faithful.” Unlike other countries promoting social distancing prevention, Tanzania is leaving their churches and mosques open.

Oil usage:

China and Saudi Arabia picked an awful time to battle for market share in the crude oil sector. China is the world’s largest oil importer and consumes about 14 million barrels a day. To put that into perspective, China’s energy usage is equivalent to the combined needs of France, Germany, Italy, Spain, the UK, Japan and South Korea.

Hedge funds:

For the 5th consecutive year in 2019, more hedge funds closed than opened.



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