



COLBERT INVESTMENT MANAGEMENT

March 24, 2020

My first big market crisis was the 1987 Black Monday Crash, when stocks dropped 23% in one day. It was scary as hell. The worst was the 2008 Financial Crisis when business stopped suddenly and stocks went down 37% for the year. This crisis is different. Every crisis is different. I know from experience that I have a knack for navigating stressful situations, when stocks and bonds are misbehaving, when confusion reigns, when uncertainty abounds. I have been there many times before. Our stock portfolios got beaten up in 2002, and we recouped it all and more in 2003. Our stock portfolios got blasted in 2008, and we had our best year ever in 2009, followed by a stellar 2010, finishing higher than ever before. What I learned is to keep your head, focus on what I know, be decisive when warranted, do nothing when it's the best thing to do. Nobody ever knows exactly how much markets may go down. If you stay the course, you will not lose your money. You will make back the drop. And I am working constantly for us to come out of this ahead, just like before. No guarantees. Just my total determination. **The time to invest in stocks is now.**

Regarding our firm, our employees are permitted to work and support you from our regular office for now. In addition, if/when required by the authorities, we will be prepared -- as we have been since 2017 -- to work from other locations. Our custodian, Fidelity Investments, has already successfully entered this phase in various parts of the country. Therefore, its business as usual, fully operational for our clients, whatever may happen next.

N.B: Investing involves risk and past performance is not a predictor or a guarantee of future performance.

COVID-19 (corona virus disease - 2019)

Summary: COVID-19 is a health crisis that we will overcome. The economic penalty is not permanent. The U.S. government has lost one month (or more) of preparations by not planning decisively and failing to ramp up production of testing and other vital medical tools. Therefore, acting upon a possible Plan "A" (like South Korea did) can no longer be applied here. We must therefore move on to approach "B", which is to limit human contact as much as possible, and thus reduce contagion, especially for the most at-risk (asthmatic, heavy smokers, older people, etc.). This means closing a lot of businesses for a while. The social/economic goal is simple: slow to a crawl, then get up to walk, then start to jog.

Flatten the curve: China suppresses, Korea decisive, American muddle

China's cover up of the disease and its slow (though massive) reaction has resulted in public distrust everywhere. Countries like Taiwan and South Korea took the opposite approach: transparency combined with aggressive testing and isolation of the sick, with substantial medical tools on hand to handle the virus surge. These two countries' decision-making have minimized the medical and economic impact to their society.

The American government wasted precious time in not preparing properly and not acting decisively enough. We now lack many medical tools (like masks for medical staff and ventilators for critically sick patients). Having squandered the window of opportunity to emulate Korea's Plan "A", we must therefore go with a sort of Plan "B", which aims to reduce contagion in order to reduce the number of people within the 20% of patients that may become seriously ill from completely choking the hospital system. Letting the health system choke could cause a great number of otherwise preventable deaths to occur. To save lives, we must limit social contact, and thus shut down most businesses. We must flatten the growth curve of new Covid-19 cases.

Recession? Yes. Depression? No.

This shock to the business ecology is harmful to every company, some more than others. Medium-sized or bigger companies usually protect employees for a couple of weeks. It may be fatal to the weakest businesses, especially those with limited resources or excessive debts. Restaurants, bars, hotels, travel agents, much of which are small businesses, have or will fire most of their employees without pay. The American social safety net provides relatively little security to keep perfectly good employees viably afloat for 4 to 8 weeks (or even more). Because it's the government's chosen course of action to fight off the virus by using the "Plan B" described above, that stay-at-home policy causes forced hardship, which the government plans to address fully, within two weeks of this writing. The government plans to also give financial assistance, like loan guarantees, like perhaps cash to businesses directly in some cases, to pay employees, it's too early to tell exactly what. The main thing is that although businesses are facing tough times, the goal is to keep the whole economy afloat until we accomplish a flattening of the growth curve of new cases. With the hospital system stable by then, we can start to resume some normalcy in life. Even if some form of social distancing remains in place, many will be able to go back to work. And the government will be able to remove financial life-support as each sector regains its footing. **As a result, we may have an induced recession, but avoid an economic depression.**

And in this health crisis, there are seemingly many more questions than answers. But we do know some things, like how China has had no new cases for a few days now. We also can observe Italy which is a few weeks ahead of us with an early partial shutdown approach, converted recently into a near-total freeze: stay at home. We will learn what works, what doesn't. Many laboratories are working on viral medicines that may become available in the near future. And a vaccine is possibly 12 to 18 months away. **There is no reason to despair, we will get through this, and things will be better on the other side.**

Stock Markets. What is going on? What should you do?

Stock markets hate uncertainty. Stock markets are not good at evaluating the economic impact of a new virus. Therefore, the first wave of sellers usually represents those believe in the motto "sell first, ask questions later". These are often professionals, or day-traders, most of which are not successful. Individuals should not try that approach. In fact, a paper by Charles Schwab shows that, at best, less than 25% of traders are successful in timing the market ups and downs.

The next wave of sellers is those who are forced to sell. Imagine a big institutional fund that borrowed seven times (7x) their capital to invest in stocks, because the ride had been so good until recently. When markets tumble, they must sell, at any price. All this programmed and forced selling leads to pain for others who, fearing more pain to come, become sellers too. And the negative feedback loop continues until something changes. We rarely know in advance what that something is, but we generally know it when we see it. It's part of the intuition developed over three decades of experience.

History has shown that we had six major bear markets where investors lost an average of 39% by not selling. Some drops were as much as 50%. Surely avoiding those drops are desirable. But nobody knows when to buy again. **History further shows that after the big drops, the market has always recovered to go to new highs. Always.**

Consequently, if investors were given the choice between a course of action that works 25% of the time versus another that worked 100% of the time, they would surely choose the strategy with the better odds of success, right? Unfortunately, that's not how the human brain reacts in times of stress. Our completely natural aversion to loss makes us forget history, makes us ignore common sense. Sell before it gets worse the brain says. But who in their right mind would want to duplicate a strategy that works only 25% of the time versus one that has worked 100% of the time? That's total casino mentality.

Nobody knows if markets may go down 10% or 20% more. But if you don't need the money to live on immediately (and you have some good stocks), don't sell your stocks now. On the contrary, if you have some savings you are not planning to use, now is a good time to start putting it in stocks.

Airlines

The pandemic is having a harder impact on airlines than did the World Trade Center attacks, with the International Air Transport Association estimating a loss in passenger revenue of between US\$63 billion and US\$113 billion this year. In one example, Delta Airlines is projecting that their total revenues will go to about \$2.5 billion next quarter compared to \$12.5 billion in the same quarter last year. Delta is burning through \$50 million in cash every day now. Every day. The figures are staggering, but Delta has a relatively strong balance sheet, particularly compared to many other airlines. Delta probably would not survive intact for a year without revenue, but they can do it for a few months. Delta and other US airlines are about to receive US government support to make sure they survive to perform their important role in the economy.

As an investor, it's hard to figure out what will happen next in the stock market. But we can try to think ahead. For example, the whole the US airline industry will not make much money this year. How about next year though? Is it hard to imagine the industry being able to go back to making similar net profits as in 2019? If that's a plausible scenario, in less than 2 years, the average US airline stock could go back to trading at the same level as in January 2020. That average airline stock could almost double, or about 40% per year (compounded). There are risks involved here, and I am not recommending airline stocks or Delta as an investment, it's just a way to see through the huge cloud of uncertainty near-term. So the call one would have to make is whether or not these airlines will get through the next 6 months. If the answer is yes, then the painful 50% drop is tough for sure, but the potential gain when things come back to normal is substantial.

Charter

A much safer investment that we own and have discussed many times before is Charter Communications, a cable service provider. In this stay-at-home period our connection to the internet is more vital than ever. This is how most people work from home. This is also the best way for entertainment during our stay-at-home period. Cable companies are simply the best internet providers in the world. As a result, Charter's business remains solid, and it may even benefit from social lockdowns. Yet Charter's shares are down 20% this year. While it hurts that their stock price is down 20%, I don't worry about my Charter shares, I love them.

Conclusion

The economic aid which the American government will offer to cushion the unemployed should help face the temporary economic difficulty. Later on, when the peak of sick cases has passed, companies could resume to work, gradually. In more or less 6 months, if we do all of this relatively well, commerce should have largely resumed. Furthermore, stock markets should rebound strongly within a year or so.

In the meantime, we have to buckle up.

Sincerely yours,

A handwritten signature in blue ink, appearing to read 'K. Armand', with a stylized flourish at the end.

Karim Armand
President

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