KANOS
CAPITAL MANAGEMENT, LLC

First Quarter 2020 Investor Letter

Portfolio Comments

During the past quarter, most Kanos portfolios slightly outperformed indices, buoyed by our bond and gold positions. Treasury bond positions rose sharply during the quarter, led by the long-term Treasury ETF, TLT. Our gold bullion ETFs also gained during the quarter, as did one of our large precious metal miners, Newmont Mining. We cut some of our more speculative technology exposure early in the decline, limiting portfolio damage. We also put on some hedges in the portfolio, which increased in value as the market fell. However, most other positions we held declined during the quarter as the world economies were halted by governments. Our large multinationals declined the least (falling between 10-20%) and our pharmaceuticals/healthcare stocks also fell less than the averages. However, the quickness and wide-ranging damage to the nation and economy led to declines in many of our holdings. Our yield investments fell as mortgage repayment and financial company solvency worries dropped their stock prices. All things concerned with energy were essentially cut in half, including our small holdings of supermajors and pipelines. Finally, our precious metals miners had a mixed performance, with large companies holding their value much better than smaller companies.

Looking forward, our portfolios have already bounced back strongly, as gold hit new eight-year highs and miners moved to multi-year highs. Energy, financials, materials and utilities have bounced back the strongest so far this quarter, helping Kanos portfolios. Healthcare, technology and staples have also advanced. Treasuries have held up well, despite heavy issuance to pay for the stimulus programs. We will go through the prospects in the US markets in the Equity and Bond sections below.

Market Analysis - Looking Forward

My my my! The past seven weeks have been packed with market-moving news and economic bombshells as the Covid-19 virus sweeps around the world. We have been working at a feverish pace, following news and adjusting our points of view, modifying the portfolios as necessary, while trying to avoid mistakes. Our portfolios, as referenced above, have held up well, and we thought it would be useful to go through our holdings by sector to give you an update on portfolio components. First, we will talk about economies and their conditions as the world nears maximum Covid-19 exposure.

Economy

Covid-19 is obviously the major story worldwide, affecting billions of people and causing economic shutdowns around the world as people try to ward off the spread through social distancing. The US economy, the strongest in the world through February, has been affected as severely as most other developed nations. As we write, the latest unemployment claims number has been released: 4.4 million

1217 South Shepherd
Suite 200
Houston, Texas 77019
www.kanoscapital.com

new claims were recorded, bringing the last five-week total to approximately 26.5 million jobless, or more than 15% of the working population – by far the worst in 50+ years. With a minimum amount of savings per capita and huge government support programs underway (slowly supplying cash to individuals and small businesses), the US economy has come to a screeching halt. Initial GDP "growth" estimates for the second quarter of 2020 center around a 30-35% decrease in GDP. These are certainly (at least technically) recessionary or depressionary statistics, even though they have happened so quickly.

Businesses have also been hit hard by Covid quarantines, with only those deemed "essential" able to operate centrally, with the others forced to send workers home to operate from their houses, if possible. This has led to the shuttering of many small businesses, the powerhouse of America's economy. In addition, almost all travel and leisure businesses, including all sports games, gambling and conventions being cancelled, further hurting the economy. Even essential businesses like restaurants have been forced to close dining rooms and serve takeout only, hampering their operations and financial viability. The closing of school campuses, and the move of school to online teaching, is questionable in its effectiveness, and robs students of comradery, sports, and in some cases, regular meals. The presence of parents and students at home literally 24-hours per day has cut down on productivity in both business and scholastics. Home-restricted living has also reduced discretionary purchasing, further hurting US economic activity.

The US Government and the US Federal Reserve have implemented a large number of stimulus programs to try to preserve individual, business and corporate balance sheets to help businesses get through the government-ordered shutdowns of businesses that have caused such big problems throughout the economic chain. The Fed's programs include:

- "Real" quantitative easing ("QE5"): first consisting of $500 billion for buying longer-dated Treasuries and $200 million for mortgage-backed securities, eventually increased to unlimited amounts devoted to buying, starting at $75 billion of Treasuries PER DAY and $50 billion of MBSs PER DAY
- As much as $500 billion in repos offered daily, sometimes twice daily
- US dollar swap lines with ECB, BOJ, Bank of England and Bank of Canada, eventually expanded to include 10 more central banks
- A separate repo facility for foreign central banks
- TALF (Term-Asset Backed Securities Loan Facility) – for buying mortgage debt securities
- Money Market Fund Liquidity Facility – for guaranteeing money market funds
- Commercial Paper Loan Facility – for buying commercial paper
- Primary Dealer Credit Facility – making sure primary dealers have adequate liquidity
- Primary Markets Corporate Credit Facility – to buy new issues from corporate clients and buying investment grade bond ETFs
- Secondary Market Corporate Credit Facility – to buy bonds in existence issued by corporates
- PPP Lending Facility – to buy Paycheck Protection Loans made to businesses by banks
- Main Street Lending Program – for small- to mid-sized businesses too big for PPP
- Municipal Liquidity Facility – to purchase notes from cities that have lost tax revenue from Covid

These programs are trying to support parts of the economy that were stopped in their tracks when the shutdowns happened. However, even before Covid hit the world, economies in Europe and South America were borderline recessionary and Asian economies were slowing. The US economy peaked in the 3Q 2018 and had been gradually slowing, supported by nearly inexhaustible consumer spending, but the sequestering of most Americans (discussed above) has stopped even the US economy in its tracks. Many of the programs (those at the bottom of the above list) are to try to keep businesses, from small to large, from failing and losing their workers; the government (and many in financial markets) expects the economy and most businesses to restart during the late spring/early summer.

The monetary stimulus programs (those in the top part of the above list) effectively stopped many dislocations in financial markets where uncertainty had stopped counterparties from trading with each other and caused credit concerns as assets dropped in value. Fed support of programs allowed some collateral to regain most of its value, thus stopping lenders from moving on seizing assets as prices dropped significantly. Importantly, the Fed's unlimited QE helped cushion the drop in the stock market, helping prices to find at least an interim bottom. However, the amount of money created, which is over $2.4 trillion through QE alone through late April, is unprecedented in amount and quickness of deployment. This massive stimulus, which many in government, regulatory authorities and corporate management felt had to be deployed, is a serious concern, what happens when the crisis passes, and these massive sums are scheduled to be withdrawn? More troubling is the opposite question: what happens when the crisis passes, and the stimulus is not withdrawn? The QE monetary stimulus deployed in the wake of 2008/2009 led to the emergence of an asset bubble that pushed up values in stocks, bonds, real estate and many other assets to the second-most overvalued in history. This stimulus is many multiples of that, just through late April….

But those concerns are for a day a few months in the future. Right now, the question is how the US economy is going to react once the Stay At Home orders start to be relaxed. How quickly does the economy rev back to where it was operating in January 2020? As the equity studies below will show, the stock market is pricing in a relatively robust and rapid return to Jan 2020 levels by the end of the year. We believe it will take longer. Why? Here are a few reasons:

1) The virus will not be completely eradicated and most people feeling at risk of infection will continue to shelter-in-place or limit public contact to prevent contracting the virus;
2) The habits of social distancing will not be so easy to shed especially when facing large groups of people. Thus, we think sporting events, concerts, theater and movie viewings, etc. will see smaller crowds than in the past as people continue to do versions of distancing to keep practicing precautions;
3) Supply chains in some cases have broken or been strained, meaning there will be limited amounts (or even shortages until chains are re-established) of materials, meaning stores and even restaurants may not have full inventories/menus of products, cutting down on potential sales.
4) At least some residual working-from-home may continue, cutting down on commuting and its expenses, further hurting the restaurant/retail sales around people's workplaces; and
5) Any new outbreaks or hot spot eruptions could result in some re-quarantining which would again cut down on economic activity in the area in which quarantine was re-established.

Another thought about how the economy will recover comes from Bloomberg.com's John Authers 4/5/2020 article, When Plagues Pass, Labor Gets Upper Hand. The main point of the article is that after a plague there are fewer skilled workers, meaning labor generally gets paid more afterwards. He makes another salient point which applies more generally to the Covid-19 crisis we are facing:

> "When the academics looked at real natural interest rates after pandemics and compared them with the impact of wars, they found they had exactly opposite effects…Their finding was clear-cut. Wars lead to higher real interest rates, which imply greater economic activity that needs to be controlled. Pandemics are followed by lower real rates, implying sluggish economic activity…
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> "The intuition behind this is that there is no shortage of capital that needs to be replaced, as there would be after a war. Further, there is probably a tendency to save rather than invest. When the economy takes a huge hit, many feel the need to save more — and hence consume less, meaning slower economic growth.
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> "There are also important psychological differences. After a war, traumatic though it was, the winners have the satisfaction of victory, while the losers can bring great intensity to rebuilding and salvaging national honor. The second half of the 20th century, and the economic rise of countries such as Germany, Japan and South Korea, shows the possibilities.
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> "After a pandemic, people have literally had the fear of God put in them, and there is no great sense of victory at the end. Often survivors feel guilty. Thus consumption and investment patterns can be influenced by post-traumatic stress disorder. To quote the investment analyst Peter Atwater, of Financial Insyghts: 'We don't recover from trauma; we adapt to it. We learn to live with its scars and to move forward amid the pain.'" [Emphasis ours – KS]

In Europe, Covid-19 hit an already near recessionary economic situation. Italy, as everyone knows, has been the worst hit region after China began its recovery from the virus. Germany, which was technically already in recession, has been incredibly effective (and lucky) in its corralling the virus and avoided large breakouts, which means Europe's largest economy is ready to gear up rapidly, although demand for products is unknown worldwide as most countries have travel restrictions which presumably leads to less efficient importing/exporting. The United Kingdom has seen rapid economic slowing to the point that not only has the Bank of England (BOE) restarted quantitative easing, it has instituted direct payments to the UK Government for bonds – direct monetization of UK government debt (currently prohibited by law in the US for the Fed). Europe is expected to be able to open up economically slightly earlier than the US, but to what kind of environment? We are skeptical of Europe's ability to sustain any real economic pickup, and we are not planning any investments there currently.

In Asia, things are much different. China, Singapore and South Korea, have fought through the Covid-19 infection (Singapore and South Korea most successfully); however, all are finding a new wave of

infections occurring, leading to new concerns about how to continue to build economic activity without re-igniting widespread outbreaks.

China has quarantined a couple of cities (on the northern border with Russia) to try to contain any re-infection wave. China's reported March economic statistics, in the form of Purchasing Manager Index reports (PMIs) show a rapid bounce back to pre-Covid levels, although more measurable economic indicators like railway volumes, traffic congestion, subway ridership and property sales are still far off prior year levels. How are PMIs so high so quickly? China injected Total Social Financing credit of 5.15 trillion yuan ($732 billion) in March compared to 855 billion yuan ($122 billion) in February. Total social financing includes loans, non-bank loans/financing and bond sales. This is on the order of what the Fed did in the US, although this is after China had supposedly emerged from the virus quarantines (except for Wuhan, which emerged in April). China supposedly has restarted the majority of its industries and they are gearing up for full production, whatever that means in the post-Covid world. All the amounts of credit injected into the Chinese economy exceeded estimates, so economic activity is expected to gear up quickly.

Other emerging markets are still suffering from the virus. India, the second largest country in the world, is thinking about reopening some industry but is still reporting relatively low Covid infections in a country not equipped to institute social distancing. African countries are fighting outbreaks with already overwhelmed health care infrastructures and little "safety net" emergency supplies or stimulus from already overwhelmed governments. Much of South America is also locked down, with Peru having a bad outbreak and trouble fighting it effectively. We have avoided emerging markets investments because we thought they would suffer the most in a financial downturn. Little did we know a medical emergency would hit first, then causing an economic catastrophe.

Equities

The arrival of the Covid-19 crisis from Asia coupled with a very highly valued market resulted in an understandable -35% drop in major indices as investors re-evaluated current and future economic conditions, with incomplete and sometimes inaccurate data on which to base expectations. Once more-believable infection and morbidity data from Europe was analyzed, Wall Street quickly applied projected disease peaks to the US and calculated when expected economic activity would pick up. This led to more conviction about a true economic pickup, and these projections are the main impetus behind the market rally that began on March 23rd.

In addition, and not to be discounted, the shutdown of the US economy (which occurred on a rolling basis but in scale in mid-March) caused the Fed to spring into action quickly, lowering interest rates to near-zero and adding quantitative easing (QE5) on a scale never seen. QE5 consisted of purchases of $75 billion of Treasuries **PER DAY** and $50 billion of mortgage-backed government-guaranteed bonds **PER DAY** (beginning in late March). The rate of purchases have since been scaled back, but this led to $125 billion per day in cash in March and resulted in a Fed balance sheet that has ballooned to over $6.5 trillion, meaning more than $2.6 trillion has been created by the Fed in the past eight months, and more and more of this monetary stimulus seems to be the prime mover of the US stock market.

Thus, we continue to hold a large amount of stocks because we think: 1) the Fed stimuli, coupled with the US Government's fiscal stimuli, will help support stocks, 2) there are still some attractive situations we think will provide us with relative strength, interesting long-term prospects and some yield, and 3) most other investments are unattractive: a) government bond yields are miniscule and may be near the top as governments offer a large amount of new bonds to finance Covid-induced deficits, b) corporate bonds yield very little and are near their tops, especially since they are now supported by Fed stimulus programs, c) real estate has benefitted from low interest rates but is now going through a rent/mortgage cash flow crisis with bad as well as good resolution potentials, d) commodities are going to suffer as economic damage continues and recovery comes slowly and e) cash will suffer because it pays little to nothing and will suffer from the inflation that is being caused by excessive money creation and the promise of more in the future (from both monetary and fiscal stimulus programs).

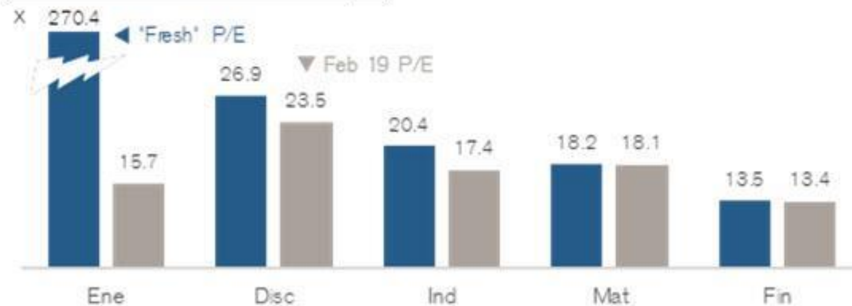
With those thoughts in mind, we thought it would be instructive to go through the sectors we own and why we find them attractive. We will use revised earnings as a backdrop to explain how they impact our decisions.

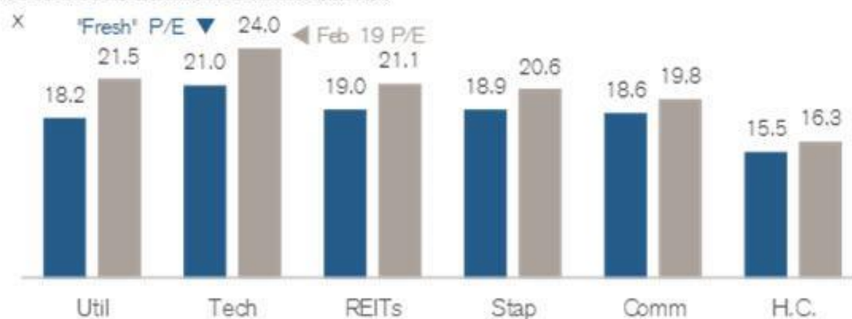
First, we need to think about the dynamics between earnings and stock prices. Most stocks are valued on the future earnings and resultant cash flows expected by their businesses. Since expected earnings can only be projected (and many consider their models to produce these projections as proprietary), we often fall back on recent earnings results and look at current earnings and the financial ratios as good approximations of what should be expected in the future. Thus, when stocks go down in price, and current and projected prospects aren't expected to change, the stock appears to be getting cheaper. However, when stocks go down and it is because projected future earnings are expected to drop, we have the possibility that stocks might get more expensive even though prices have come down. While somewhat counterintuitive, stocks may have gotten more expensive after the recent Covid panic. Jonathan Golub, the chief market strategist at Credit Suisse's US operations, put out in a note to clients in early April that showed the consensus (i.e. the average of all large Wall Street firms' earnings estimates) for Next Twelve Months (NTM) forward P/E ratio for each of the S&P 500 sectors, comparing them to the same ratios produced before the Covid panic hit Wall Street.

We have used Credit Suisse's graphs for illustration and conciseness reasons, and as you can see in the graphic following, five of the eleven S&P sectors have a higher forward P/E ratio than before the Covid panic, arguably showing these sectors are more expensive now than ever before. With the past and current forward P/E estimates as the backdrop, we are going to go through each of the sectors and opine about why we hold positions in the sector or why we do not.

First, we want to say that we still hold a large amount of stocks, and while we have a general "road map" for where we think stocks will go in the intermediate term, we don't know how the prospects for re-ramping the economy, the Fed's and governments' stimuli and changing virus/health concerns will affect prices in the shorter-term. Thus, we have participated in the bullish run that US stocks have experienced since the March 23 bottom. Some of our comment below sound bearish, but that is due to valuations in certain sectors, which does not mean we are out of the market, but just concentrated in some sectors, while underweight (sometimes severely) in other sectors.

Credit Suisse's Sector Study with Wall Street's Past and Current Next Twelve Months P/E Ratios





The following sectors show (in early April) higher NTM P/E valuations than pre-Covid:

Energy (Ene in the study): Energy is arguably a special case, because it was showing weakness before virus concerns swirled around the market and a vicious price war brought on by Saudi Arabia and Russia broke out. We will talk about it more extensively in our Energy section below, but the surplus of supply and waning demand that were seen prior to the Covid outbreak makes energy not very attractive. Having recognized this last year, **we have limited our investments in energy**, confining them to the supermajors we thought were best positioned (Royal Dutch Shell, Chevron and ExxonMobil) for financial strength, dividend payout and diversified operations that could benefit even with lower oil prices. They don't constitute large holdings in most portfolios. Obviously, the plunge to very low oil prices has hurt all energy stocks, including these. We plan to continue to hold these stocks due to their outperformance versus the rest of the sector, their very attractive dividends (which managements have said they would do all they could to maintain, showing so by cutting capital spending to pay them), and the belief that much of the world actually needs a healthy energy industry and higher oil prices to source dollars. We think there will be moves to boost energy prices (like we have seen from the Trump Administration lately), which we think will further boost our supermajor positions.

We also own in some portfolios some ETFs that contain pipelines and other MLP type investments. They have suffered in the latest downdraft more so than most investments as investors felt US pipelines and gathering systems would lose much of their value with lower energy prices. We believe the companies have been well aware of such a situation and have protected themselves through take-or-pay contracts and limited expansions, thereby addressing their exposure to huge revenue drops in the

inevitable boom-and-bust that happens frequently. We have kept these investments because we think investors overreacted and that cash flows will still generate some distribution income for holders in excess of dire expectations.

__Consumer Discretionary (Disc):__ As shown in the table above, Consumer Discretionary stocks have been expensive and are currently the most expensive at 26.9x normalized NTM earnings. They were already expensive, and we believe they are poor risk/reward holdings, so **we are underweight** or own none of these companies. Led by Amazon, these are home repair retailers, restaurants, travel companies, etc. which are expected to jump back to January 2020 levels (or better) quickly; we understand the logic but believe the reality will be smaller-than-expected revenues. Amazon, for example, is at all-time highs, while their business has been confined to low-margin essentials, hurting margins and non-essential supply chains. We think travel will also suffer; while we see cooped-up consumers wanting to travel, but we don't see them taking the longer, more expensive trips booked prior to the Covid-19 outbreak, only rebounding to low utilization rates and low profitability at best.

__Industrials (Ind):__ The Industrials as a whole have gotten more expensive as civilian transportation hopes (Boeing et al.) have risen when their earnings haven't; we don't think that will happen soon, so we have avoided those companies. We do have an **equal weighting in Industrials**, but it's because we have emphasized Defense companies and tried to avoid aerospace and equipment companies, which are the other major components. Our defense stocks, led by Lockheed Martin, have held up well during the virus carnage, as increased spending on defense has been contracted and is slated to continue for years. Raytheon, a long-time holding has merged with United Technologies, a big aerospace contractor, so it has been hurt by the travel slump hitting airlines. But by avoiding Boeing, General Electric, Caterpillar, etc., we have avoided some of the major drawdowns in this sector.

__Materials (Mat):__ Most companies in the materials sector have some commodity component to them, which have seen their prospects downgraded, leading to earnings downgrades. That is why they appear more expensive than they were (worldwide economies were already slowing down), although they are not as expensive as they look (on a price/book basis they are only 1.8x, for example). **We are overweight here** with our precious metals positions (see the Precious Metals separate section below), but in the last few months, we thinned this position by selling our chemical companies after their business reorganization/ synergies did not prove to offset their outlooks of slowing sales (Dupont, Dow, etc.).

__Financials (Fin):__ We **continue to be bearish on financials** as we have seen interest rates move down steadily for the past few quarters. Investors have agreed with us as they have driven down Financials -32% in the first quarter, highlighted by a -21+% drop in March alone. We are not sure how financials are supposed to make much money if 1) their net interest margin (nim) is dropping due to falling interest rates (and their sources of funds don't get cheaper than 0%), 2) the capital markets are pretty dead except for underwriting investment grade debt (their most competitive and least profitable product in capital markets) and 3) their inability to trade extensively due to Dodd-Frank restrictions. They have been able to profit from Fed largesse by 1) selling bonds to the Fed and 2) issuing more loans, but if we are going into recession, businesses may continue to have loan problems past the time the Fed is stimulating (1Q 2020 earnings reports just out confirm this – large loan loss reserves were taken). Our allocation to financials has been through preferreds and owning mortgage REITs, companies that buy

and own mortgage debt, much as banks used to pre-2008. These suffered significantly during March's panic, as investors thought they would not receive payments and/or they might default on their debt. However, the Fed has set up stimulus programs to try to address mortgage problems (including buying more mortgages – providing much needed liquidity), and a large majority of these yield investments have recovered big chunks of their value, although they still trade at a big discount to net asset value (NAV), as payment concerns have already led to some dividend omissions.

The following sectors show (in early April) cheaper NTM P/E valuations than pre-Covid:

Utilities (Util): We **have liked utilities for a while** for their safety, yield and ability to adjust to financial conditions, as well as their all-US business models. Thus, we own utilities, either singly or in an ETF, in most portfolios. We are not surprised to see their cheaper valuations, as investors see governments forbidding utility cutoffs (for nonpayment) during the Covid shutdown, and we understand that stay-at-home programs have cut utility usage nationwide (at least temporarily), but we believe these are some of the steadiest businesses in the country and also will provide some inflation-protection with yield if all this money printing actually results in higher wages (and thus higher inflation).

Technology (Tech): We are actually a little surprised that technology valuations are indicated to have come down. Technology had a one-time sales binge last year that was predicated on China building out their semiconductor industry with Western components that will not be duplicated. There was a bump in some lower tech spending due to the Covid crisis as work-from-home led to a spike in personal computer equipment, networking and cloud computing spending, but again that is all one-time. We still own our Microsoft and some chip companies that were relatively inexpensive like Intel in some portfolios, but we have been and continue to be wary of high valuation stocks like Apple, Visa, Nvidia, etc. that have high valuations and expected earnings but show issues with their businesses. Thus, **we are underweight** (Tech has a very high 25%weighting in the S&P 500) but would revisit companies as stock prices come into line with more realistic earnings expectations.

Real Estate/REITs (REITs): We **own REITs in many portfolios** and believe that real estate could provide some diversification from stocks, but only in some sectors. Office and residential REITs with properties primarily on the coasts have been very expensive for years, and we have avoided them. We have tended toward industrial REITs and to a lesser extent apartment REITs. We have tried to avoid retail exposure. The REITs have lost value due to the uncertainty of rent payments for at least April and May, if not more; their multiples have probably dropped more than their earnings expectations.

Consumer Staples (Stap): Unsurprisingly, Staples were the second-best performing sector in both March and the first quarter as a whole behind healthcare. We did not own as many Staples as we have in the past because they were relatively expensive (their forward 20.6x P/E ratio is expensive compared to their single-digit sales growth rates); however, in recessions, their earnings hold up quite well, and with a drop in their forward valuations, decent yields and steady businesses, we **look to be adding Staples** to portfolios.

Communications (Comm): There is an interesting mix of companies classified as Communications. Long dominated by the telecom companies, it now contains Facebook, Alphabet (Google), Netflix,

video game makers as well as telecoms and cable companies. We have stayed away from Netflix and video game makers due to their high valuations and overhyped forward earning projections. We own Google in a number of portfolios but are worried about its reliance on ad spending – a stream which gets hit during recessions (we don't own Facebook for that reason; both have lagged recently due to ad sales concerns). We are fans of and own Verizon in most portfolios as a steady performer with a large exposure to 5G as it gets instituted. This sector is kind of a grab bag of different types of businesses and **we tend toward the steadier ones**. The worry over ad revenues has probably brought down valuations here, and yet, valuations are not yet compelling for the growth companies.

Healthcare (HC): Covid was an anathema to so many companies, but it helped out some healthcare companies. We **have overweighted healthcare** with concentrations in Pharmaceuticals, Diagnostics/Testing and Biotech. Healthcare has probably come down in valuation because a lot of speculative biotech companies have given up a lot of value. Most large pharmaceutical companies have underperformed the sector as investors zeroed in on companies with immediate help to the Covid crisis while visibility for where to invest capital was obscured. The crisis will probably end up generating more opportunities for many healthcare companies, but we are not surprised that valuations fell somewhat as the largest companies are mostly not materially involved currently in treating Covid.

Our sector study shows that we have avoided many of the overvalued sectors except where we own stocks in a subsector that has better prospects than the whole or where we own companies with dividends that will reward us for holding them through a trough in earnings (causing the overvaluation).

Interestingly, the still-high valuations in the market are being corroborated by another "factor:" the absence of activity by Warren Buffett. During the 2008/2009 Great Recession, Buffett was front and center, helping finance large slugs of capital for financing giants Goldman Sachs and General Electric among others, in which he thought his capital was a good risk/reward tradeoff in a time of great financial system uncertainty. Now, with a supposedly sound financial system (Buffett's company, Berkshire Hathaway, owns large ownership stakes in a number of banks, headlined by being the largest shareholder of Wells Fargo), Buffett is nowhere to be found, even when stocks were marked down -30% in price in late March. As Barron's said in their 4/10/2020 article titled, This Market Is Made for Warren Buffett. Why Has He Gone Quiet? "…aside from Apple, Berkshire has little exposure to technology, little to health care and too much to financials." So far, there has been no news on new investments – we should find out why on May 2nd when Berkshire holds its annual meeting, at which Buffett has historically not only laid out his past activities and strategies but has been open to questions from interested shareholders. All-in-all, his silence is deafening during this time of stock price weakness.

We, much like Buffett and his investment managers at Berkshire Hathaway, continue to look through sectors and individual companies for interesting ideas, for newly "on sale" companies that we have had our eyes on and the dynamics driving the markets in general. In addition, we continue to comb our portfolios, weeding out those companies with less attractive forward prospects or those suffering from more risk than we saw previously. We have set up our portfolios to weather storms, and while this hurricane has "buffeted" our portfolios (especially during March), we strongly believe they will hold up during further "stormy weather" (and have prospered in April during the recent run higher).

Bonds

Treasury bonds have had one of the best investments runs in their recent history, as interest rates move toward zero across all maturities. As of our writing, 10-yr Treasuries trade at 0.59% and 30-yrs trade at 1.19%, both showing the flight to safety of investors and the lowered economic growth expectations that drive investors to buy bonds at such low yields. While we see the implications of economies coming back to life in the next few weeks as quarantines are relaxed, we still worry about the pace of expansions and the investment world reactions if Covid re-infections were to occur (as are currently happening, at least to a small extent, in China, South Korea, Singapore and other East Asian countries). Thus, we have held on to the vast majority of our holdings in Treasuries (mostly through ETFs), and we plan to do so at least into the summer. One countervailing argument for holding Treasuries is the vast need for the US Government to finance the much larger deficit spending that goes along with the new fiscal stimulus programs recently introduced. But with QE5 underway by the Fed and the current high demand for US Treasuries by institutions and investors worldwide, we think that Treasuries will continue to hold their current value for at least the next few weeks, if not much longer.

We are less sure of the future prospects for corporate bonds, although the “alphabet soup” of recent Fed/Gov’t financial support programs provides support for both investment grade corporate bonds and ETFs that hold them, and for some lower-rated corporate bonds that have lost their investment grade rating recently. We have sold most corporate bonds that were not at least A-rated. We would look to avoid lower grade bonds at this point, as many will face serious stress with the economic shutdown, limited or no fiscal stimulus help and slow-to-recover world economies.

We still hold some municipal bonds in some yield-oriented portfolios, and munis have been supported by their own fiscal stimulus program. While this stimulus helps with our opinion of munis short-term, we believe that many state and local economies were facing slowdowns pre-virus crisis, and the quarantines, which will certainly impact local tax receipts, cannot be anything but detrimental to muni budgets and therefore bond prospects. Growing pension liabilities due to underperforming stock markets and extremely low bond prices only add to the poor prospects for municipal and state budgets. Thus, we would limit ourselves to shorter-duration, insured munis and not look to put any new money to work in this sector (although we can imagine the US Government adding stimulus to munis).

We find international bond markets unattractive due to the complexity of budgetary concerns, currency fluctuations and the lack of dollars available in the world for paying back US dollar-denominated debts issued by other countries and primarily non-US multinational companies. In addition, monetary stimulus for years has caused many maturities of sovereign debt in both Europe and Asia to have negative nominal yields. We don’t anticipate investing in low- or negative-yield international investments anytime in the future.

Currencies

The US dollar has rallied throughout April as investors still look at the dollar as a safe haven and those needing dollars for trade or debt obligations continue to have to pay up for them. As we said last quarter, we observe the movements of currencies on a daily basis but currently don’t feel positions in

currencies or based on currency situations are particularly compelling at this point, mostly due to the risks of possible further devaluations and the unsettled situation of lifting quarantines and thus restarting economies on a wholesale basis. Meanwhile, the threat of a multinational currency accord, this time to weaken the dollar (which would help the worldwide financial system), is omnipresent, preventing us from currently betting on a further strengthening of the dollar.

Energy

Energy (as discussed above) is in flux, facing both a demand shock and uncertain supply reactions. As we go to press, OPEC plus Russia and other producers' agreement to limit supplies, slated to go into effect on May 1st, has seen widespread supply gluts before its implementation. The shocking emergence of negative nominal oil prices (essentially, oil producers paying users a fee to take their oil) shows the extreme oversupply currently, although oil futures prices for summer months are in the $20s/bbl, showing a better balance of supply/demand in the near future.

Due to the importance of energy to the world, the growing impetus around the world to restart economies and efforts by OPEC+ to limit supplies, we will maintain positions in supermajors and could add (to a small extent) interesting US independent producers in extremely attractive positions.

Commodities/Precious Metals

Commodities in general are usually very sensitive to changes in world economic activity. 2020 is no different, and the demand shocks caused by closed economies and quarantining of large populations around the world has caused the prices of most commodities to show weakness, highlighted by negative oil prices. However, agricultural commodity prices, as well as base metals prices, have shown continued sustained weakness and don't show much basing to give us hope that prices have reached bottoms. The precious metals, really gold in particular, are an exception to this, since gold is used as a store of value and as a form of money, much more sensitive to real interest rates and the amount of monetary stimulus worldwide(both of which signal gold attractiveness) than other commodities. Thus, we confine our discussion to precious metals in this letter.

The precious metals complex has been as interesting as the rest of the market. The Covid panic during March affected virtually every asset except for government bonds, with US Treasuries most prized of all. The US dollar was also in short supply and was hoarded. Both those factors led to selling, and precious metals and miners were not spared. Interestingly, the panic lows in gold were higher than gold's last low in November 2019; i.e. gold held lows much more recent than almost every sector in the US stock market (many stocks revisited 2016 lows). According to the chart below (this chart is updated from our last two letters), the series of bull flags that we have been tracking for the past couple of quarters resolved itself again bullishly, after which the gold market has just set a new eight-year high (signaling continued bullishness).

We said in our last letter: *"Just as we had expected (without knowing the timing, which is unknowable), we thought the "bull flag" would resolve itself higher, and it has. Gold has broken upward in price once again, pausing around the $1,550/oz level as late buyers look to buy into the rally, supplied by early bulls taking profits on positions taken at lower price levels."*

Now, with the Covid panic over (Wall Street analysts can "see" the path to a Covid-free US economic recovery), stocks have come back, helped in no small part by the Fed, which has layered on new stimulus programs to help restore struggling parts of the market, mostly through buying undervalued securities for cash. All that cash is now looking for a home, and gold and gold miners are a very under-owned sector. So, the gold complex is getting a growing share of this money. It is a natural place for investors to put money when cash is in abundance, interest rates are low (near zero everywhere) and stability is more of a concern than before. Recent action helps with our investment case: gold peaked in early March (pre-panic) at $1704/oz and then got pushed down when everything (but Treasuries) were sold. Since then, it based, advanced and pushed definitively to a new high.

Meanwhile, gold mining shares (best represented by the large gold miners ETF, Van Eck Gold Miners, symbol GDX) have underperformed versus gold since gold's peak in 2011, but they hit a bottom in 2015 (see graph below). Miners have rallied versus gold since the 2015/16 bottom but got trounced far worse than gold during the March virus panic. Even after a nice rally off the bottom, they are only back to the lower end of the recent range of miner valuation versus gold. Miners almost universally rallied strongly as gold set a new 8-year high, showing the extended bullishness into the mining shares but their continued long-term undervaluation versus gold, which we have seen translate into further gains in mining shares during April.

Thus, you have gold hitting a new multi-year high, and you have gold miners off their relative bottom versus gold itself (they are also far better-run companies than when gold hit its highs in 2011-2012). They could obviously retrench in the near future, but we believe the rally is nowhere near being finished, and most in the investment world don't own gold or gold miners yet. Only one gold miner is in the S&P 500 (Newmont Mining) and its largest non-index holder only owns 2.5% of the company. <u>The entire worldwide gold-mining industry is estimated to be currently valued at $400 billion, which is about three days of what the Fed just put into the financial markets or about 1/3 the size of Microsoft or less than 1/2 of the market cap of Apple.</u> When these gold mining investments really work (and they are starting to work), the leverage of gold mining stocks coupled with their owning a large amount of gold reserves will lead to further appreciation in these stocks.

One more point: there have been questions in the financial press about the effect of Covid on gold miners. A number of miners (along with other large industries) have had mines shut down by authorities to try to curtail the spread of the virus. In times of slack demand, this could have a detrimental effect on miners' outlook and valuations, but <u>increased gold demand has instead led to indications of gold shortages.</u> One very visible aspect of a possible shortage is the premium that front-month futures contracts commanded in the past few weeks. As the Covid virus has affected economies worldwide, the large Swiss gold refineries (that form raw gold into purified bars) have been closed to prevent virus spread, and airlines, which are the primary means to move gold around the world, are operating on very reduced schedules, curtailing movement. Thus, gold for April delivery in New York's Comex futures contracts traded to a $70/oz premium as contract holders stood for delivery of 100-oz gold bars. This large premium shows the demand for gold now, and miner valuations have not suffered even though cash flows may be down this quarter due to government-mandated shutdowns.

Finally, another source of strong demand is the continued buying of gold by the world's central banks, as shown in the graph below from Gold Telegraph. After the Fed and ECB joined the Bank of Japan in

quantitative easing in 2009 (Fed) and 2011 (ECB), world central banks started upping their percentage of reserves devoted to gold. 2019 purchases were just under 2018; thus, these past two years show the most central bank net purchases in decades. This gold, once bought, is generally not sold unless large macroeconomic forces shift away from holding gold. The case for gold is strengthening currently, meaning continued central bank purchasing may help push gold prices higher, instead of just being countercyclical buying, like we've seen in the past several years.

CHART 2: CENTRAL BANKS SHIFT TO NET PURCHASE IN 2010

Tonnes
800.0
600.0
400.0
200.0
0.0
-200.0
-400.0
-600.0
-800.0
1995 1999 2003 2007 2011 2015 2019
Net Purchases Net sales

Source: Metals Focus, Refinitiv GFMS, World Gold Council

GoldTelegraph www.goldtelegraph.com

Kanos Quarterly Commentary

How We See The Future

We have been asked a few times in the past few weeks "how we see the future." This is obviously a very hard issue to tackle. However, we believe the exercise of going through our portfolio and using less hectic times to try to sort through possible scenarios for the future is helpful for growing our clients' capital. Thus, we are going to share our views of how we see some things moving ahead.

We will address the following major concerns we think the US and the world are facing:

1) How do we decide that the virus has been beaten and/or that the measures taken to defeat Covid can be relaxed?
2) When is the Covid threat low enough that we can restart large pieces of the economy?
3) How do small businesses cope with the issues of restarting, rehiring and surviving as the economy slowly regains its "steady state" activity?
4) When will supply chains be restored so that business inventories/store shelves can receive adequate supplies?
5) How fast does travel and leisure activities/industries rev up again?
6) When do monetary and fiscal stimulus programs start to get reduced?

And then, we will address our views on some longer-term issues:

1) How do we prepare for another round of Covid or another pandemic?
2) How do countries reopen their borders and to whom?
3) What changes for corporations and investors will the Covid crisis force?
4) What have governments learned about how to approach the future?
5) What parts of the economy could be permanently hurt by this crisis?

These are tough questions that really have no set answers. The evolution of human responses that will form the basis for restoring world economies and health systems are just being planned at this point, as virtually all resources are being used to fight the pandemic and to keep our economies and civilizations intact so we can return to some normalcy in the near future. Here are some of our thoughts about how these could evolve:

How do we decide that the virus has been beaten and/or that the measures taken to defeat Covid can be relaxed?

As the virus pandemic affected Asia and was first being seen in Europe and, to a lesser extent, the Americas, we at Kanos believe we must expand testing, first and foremost. Covid has proven to be a "tough cookie" for testing – with plenty of false readings, both positive and negative, and tests being administered have been in various forms. But bottom line: <u>medical authorities in each country (hopefully coordinating with other medical authorities worldwide) must decide on standardized, effective</u>

tests and increase the amount of testing on a grand scale. In addition, testing for antibodies that show people have had Covid and recovered must also be introduced on a grand scale. The tests must be sponsored by the government (administered for free) and available with minimal wait and with results given onsite (Maybe these could be rolled out in tents beside every Post Office). Once testing is done on a large scale, use of data analysis should be able to start to show both "zones of concern" where measures need to continue and areas where more numerous activities can be allowed to resume. Now that a lot of the social stigma, political implications and medical experience has evolved, the use of masks throughout the nation must continue, on a voluntary or (in some areas) mandatory basis, to lower the risk of infecting or re-infecting areas. **Bottom line: we think that widespread testing must be made available and the sooner, the better to get data to help judge where the threat is growing, or still a problem, or when the threat is easing.**

When is the Covid threat low enough that we can restart large pieces of the economy?

This is probably the thorniest question out there – when does one judge that sending people back to work is okay versus the threat of the virus cutting down people and threatening lives as well as livelihoods? We think testing would answer a lot about when the threat of infection/re-infection is falling, but absent widespread testing, we think the answer is opening businesses where the number of deaths is dropping, coupled with protective garb provided by businesses but tax incentivized by governments. The re-opening of the economy must happen quickly, as government assistance is very slow in arriving and people's financial safety nets are reaching empty. We must protect our most vulnerable, those who are older or have medical problems, so PPE (personal protective equipment) is important to try to make mandatory (even if improvised, if effective) in places supporting vulnerable populations. Compared to earlier responses, the simple task of using PPE which should limit both catching the virus and infecting someone if you have the virus will cut down dramatically on transmission. There will be hue and cry from a number of corners about it not being safe enough, but the trade-off between recession and depression might be dependent on when businesses can be restarted, and every week makes a difference. **Bottom line: we think that, absent test results, local and state governments must monitor public health, concentrating on when the number of deaths has peaked, to rollback much of the business prohibitions, with the proviso that PPE should be worn by workers and customers as needed, mandatorily in and around facilities of vulnerable populations.**

How do small businesses cope with the issues of restarting, rehiring and surviving as the economy slowly regains its "steady state" activity?

This is probably the hardest issue to solve; how do small businesses gear up (both literally and figuratively)? Governments are most concerned about preventing further spread of Covid; business leaders are also concerned about this, not only from a reputational basis (if customers are going to catch Covid at your business) but on an operational basis, too (if workers feel vulnerable, operations will suffer/cease and replacing sick workers will be difficult/impossible). Thus, small businesses need to show that they are: 1) a safe place to work (use of PPE and regular sanitation of common surfaces/areas) and 2) a safe place to buy/do business (customer availability of sanitation and use of appropriate combination of PPE/distancing to minimize possible transmission. We actually think people are more than ready to go back to work, and that business, to the extent that they can restock inventories/food

supplies for restaurants, will see former employees ready to go to work immediately if they feel protected. Government subsidies and grants will probably need to be extended for some more weeks but probably not past mid-summer. **Bottom line: giving small business the guidelines for operating, the availability of PPE and sanitizing supplies, and possibly some more weeks of stimulus support should allow small business to restart relatively quickly; social distancing concerns will be the real determinant here of whether business gets back anywhere near "normal".**

When will supply chains be restored so that business inventories/store shelves can receive adequate supplies?

One of the advantages of coming out of a recessionary environment (like now) is abundant supplies of raw materials readily available. We see supply chains for a number of materials starting back up quickly as the imperative of restarting economic activity is a priority for both governments and business. There are a number of industries (meatpacking, e.g.) that have been shut down due to Covid infections; disinfecting and having workers recuperate may take days/weeks, but the Fed's availability of financing, ready raw material supplies and a workforce confident in their safety can get domestic supply chains going quickly. There are going to be some problems with intercontinental supply chains as different economies will be opening up at different times and the time needed for manufacture as well as transportation could delay the availability of finished goods because to be finished, products must have ALL parts necessary, i.e. the absence or delay of one component can hold up availability. Having said that, with China being the first country/region to resume large scale economic activity, we think their need for increasing activity will spur the "supplier to the world" to make supplies available as soon as possible, cutting down on shortages and restoring most supply chains by the end of summer. **Bottom line: Economic shutdowns created recession-like conditions that can now allow availability of labor and materials to allow relatively quick restarts for domestic supply chains around the world, probably having economic activity back to "steady state" conditions by end of summer. This optimism does not necessarily extend to demand for products; that is dependent on consumers' financial state and confidence in the future.**

N.B. We strongly believe one lasting impact of the Covid crisis will be the diversification of supply chains by multinationals worldwide. This means that China will lose market share to newly important domestic industries worldwide (both developed and less developed countries) as well as closer, competitive international suppliers, such as Mexico, for the US and Eastern Europe, for Western Europe. This also comports with the virtual "cold war" with China that has followed the trade war and Covid crisis.

How fast does travel and leisure activities/industries rev up again?

We believe travel and leisure activities and industries will resume as quickly as governments let them resume business, but we see utilization levels coming back much more slowly, especially in regions either hard hit by Covid infections (where the populace will be "shell shocked") and economic activity will only come back slowly, especially travel and leisure, which people may shun because of paranoia of catching Covid. We also think industries not equipped for social distancing (the cruise industry comes immediately to mind, but also could include sporting events, theaters, music events and theme parks)

will come back more slowly, possibly impairing some of them (like some college sports, small audience professional sports like the WNBA, (the XFL folded last week)). Having said that, we also think people will use PPE to try to return to some normalcy and will restart airline travel remarkably fast. **Bottom line: we think that travel and leisure activities/industries will restart quickly when allowed by governments. We see some as returning to near normal activities relatively quickly (airlines) while others may not return to anywhere near prior levels for months or possibly years (cruises).**

When do monetary and fiscal stimulus programs start to get reduced?

While we hope politicians (and we are going to include central bankers with the politicians, since the former is so influenced by the latter these days) would realize they are spending public monies and thus should limit stimulus packages to when truly necessary, the already-existent threat of recession in Europe coupled with it being a Presidential election year in the US means that stimulus programs will probably last longer than needed for Covid crisis relief in order to "guarantee success." Thus, we see fiscal stimulus programs being extended to last throughout the summer, with US political parties fighting to try to get the upper hand for November's election. Also, the need for having more and better testing is paramount, and it will be on both the Federal government for planning and financing and state/local governments for implementing within (and in addition to) current healthcare systems. This will probably be permanent due to the nature of immediately available supplies when outbreaks occur.

The Fed and other central banks have "climbed to the top of slippery slopes" where they have provided so much support to many markets that withdrawing any large amount could cause upset/downdrafts in these markets. This Fed is very aware of their attempt to withdraw monetary stimulus through their "quantitative tightening" (QT) which ran during 2017-2018; in the fall of 2018, the stock market rebelled, dropping 20% in 4Q 2018. We see the Fed withdrawing their loan facilities for different classes of debt in the next couple of months, but we think they will make more permanent 1) swap lines for lending dollars to foreign central banks, 2) repo lines for domestic financing of banks and non-bank financial companies, and 3) yes, some continual QE5 buying of Treasuries and mortgage-backed securities to guarantee increased liquidity in the domestic (and world) banking system. **Bottom line: we expect some emergency loan facilities enacted by the Fed will be retired in the next couple of months, but we think the fiscal stimulus and the monetary stimulus in effect before the Covid crisis will be maintained indefinitely. With a much more fragile US economy post-Covid, any upset in financial market caused by Fed withdrawal could cause a stock market crash, which the Fed certainly does not want to have happen nor be blamed for.**

There are many longer-term implications of the Covid pandemic. Many have been expecting a pandemic to sweep the globe, but we don't think many actually did much to prepare.

How do we prepare for another round of Covid or another pandemic?

We think the best way of tackling a pandemic in the future will be through early and widespread testing, keeping track of virus outbreak areas and steering containment efforts and medical equipment and supplies more effectively. Obviously, we will need to have medical facilities, state and federal

governments and individuals stock up and keep a supply of PPE to be ready for the next outbreak. We are almost assured to have another, so having the near-instant availability of protective equipment, especially as supplies are low but being restocked, is paramount. We also think that setting up testing protocols and centers is also paramount – the sooner we can get these decided on, set up and running, the better we will respond to the next outbreak. **Bottom line: since we have a lot of experience battling Covid, we should be able to restock and build inventories of PPE and medical equipment to better protect ourselves during the next outbreak. Having effective and plentiful testing protocols, locations and supplies must be implemented as soon as possible. Obviously, a vaccine or effective medicines for fighting the outbreak are overarching goals, but neither of those will probably be available when the next round of Covid is expected to arrive this winter (or before).**

How do countries reopen their borders and to whom?

This is a tricky one, and it is not only unpredictable, it is probably ever changing. Governments will be trying to balance the risk of infection/re-infection (like China, Italy or even Singapore) versus trying to get tourism re-established and getting foreign spending to help struggling economies. **Bottom line: we expect borders to reopen in a haphazard fashion but then in a more wholesale manner as soon as some of the larger countries reopen. However, population density may mean some Asian countries, with higher densities, see more numerous openings and localized closings due to the easier chance of reinfection in dense Asian cities (also holds for India, for example).**

What changes for corporations and investors will the Covid crisis force?

Three main changes come to mind for corporations: 1) supply chains will have to be diversified and at least 2-3 main channels will need to be used extensively (as opposed to one main with some backups), as a result of China being closed for Covid starting in mid-January for two months (which could happen again in the near future if Covid "phase II" becomes a larger problem there during 2020, 2) companies will (and probably will be required) to incorporate pandemic preparedness into their operating and disaster procedures, meaning the protocols established during the past few weeks might need to be used again in the near future (or, better procedures substituted, like having work-based workspace that is "adequately distanced," for example), and 3) companies will not be able to run as leanly, meaning they will have to keep more inventory on hand (to prevent pandemic supply chain disruptions) and more money on the balance sheet to weather rapid revenue declines like we saw in past weeks. This means that many operating ratios will look worse than in the past (like Return on Equity, an important statistic in corporate America, especially in private equity) which will, on the whole, make expenses higher and profitability lower. **Bottom line: Corporate America was unprepared for the pandemic, and companies will have to have plans for how to be better prepared in the future. Higher cash and inventory levels will probably need to happen to prevent future operations disruptions caused by pandemics. Higher operating costs due to less cost-effective supply chains and more pandemic preparedness will affect corporate bottom lines worldwide.**

What have governments learned about how to approach the future?

Governments have been the most "caught out" organizations by the pandemic. While SARS/MERS (to a limited extent) and H1N1/swine flu (to a greater extent) warned world governments that a pandemic could spread around the world and cause disruption, government preparedness for handling such an event was essentially non-existent. Thus, governments need to prepare for pandemics in the future, which could come as another round of Covid infections or (God forbid) another type of pandemic entirely. These preparations should include; 1) obviously, the buildup of stockpiles of PPE in US government warehouses regionally, and states will also have another stockpile (all of these stockpiles degrade over time, so this will be an ongoing process), and 2) permanent US government testing centers that are ready in days after a pandemic is identified to test a large amount of the population relatively quickly and efficiently. While both of these are obvious, they should also not be burdened with political considerations that will make them more expensive. The other thing governments probably don't understand yet is that economic activity, after an initial jump when "the great re-starts" begins regionally, is the economy will recover more slowly than most think, meaning that unemployment will stay stubbornly high. Government, both federal and state, need to take a page out of the Great Depression playbook and hire unemployed to work on infrastructure improvements, both industrial (roads, bridges, airports, electric grid, etc.) as well as more local (demolishing abandoned/blighted buildings, repurposing unused buildings for community clubhouses, parks, etc.) and establishing enterprise zones to attract more business back to city cores. However, governments need to rely on private industry to evolve both our current products but also future products to improve our preparedness and our responses to future outbreaks. Private industry innovation is important to help the nation (and the world) to react better. **Bottom line: Governments were caught completely unprepared; they need to prepare for the next pandemic and ramp up permanent testing infrastructure. In addition, governments at all levels need to utilize under- and unemployed to rebuild our infrastructure, cities and neighborhoods to help stimulate a better economic future. Governments also need to let private industry build up and improve our preparedness and reactions/cures to pandemics.**

What parts of the economy could be permanently hurt by this crisis?

There will be lots of winners and losers, but most companies will be permanently changed by this crisis. So many industries lost their ability to generate revenue, so the survivors will have to review their business models to survive another one of these events at some point in the future.

Losers will almost certainly include:

1) Brick and mortar retail – obviously, this category has been having trouble for a while. We think that there is definitely a place for walkup retail, especially for "right now" purchases, food purchases, anything customizable and even clothes (trying on clothes). However, general purveyors of goods may have even more trouble than before, going forward. **Action item: study on where personal touch is required and see if undervalued opportunities exist**
2) Cruise lines – these companies have had outbreaks of disease in the past and generally were able to overcome them with the public. However, it would seem that having the recent "floating petri dishes" where people could not get off their cruises (and the last one was stuck at sea until late April – really), that it would seem that these companies are going to have to change their

operations somehow to survive. Many people love cruises and will continue to book them; we fear that more horror stories will arise from cruise ships. **Action item: avoid cruise lines**

3) Hotels and resorts – people will want to travel, but the fear of catching Covid in unfamiliar places will probably hurt these companies for a while. It will require time to convince travelers that the places they visit will: 1) pose little threat to catching Covid and 2) show that measures are being taken to prevent infection or at least the spread of infection. **Action item: avoid hotel companies until we see how they adjust and whether travelers embrace them again with the virus not completely eradicated.**
4) Mortgage companies – the mortgage structure that was constructed after the 2008/2009 Financial Crisis relied on a number of poorly-capitalized companies levered like banks but without the financial backstops that banks enjoy today. Now the industry is struggling to survive, and the ability to finance the all-important housing industry hangs in the balance. What will probably happen is eventual privatization of Fannie Mae and Freddie Mac who (along with other companies large enough to compete) will be the storehouse for originated mortgages, to be packaged and sold to investment companies for income. This will in a sense revert to the pre-2008 model (absent banks holding mortgages), but it also leaves the question of what will happen to unconventional mortgages. **Action item: analyze Fannie and Freddie for investment potential**
5) Movie theater chains – these are already having problems, with some already talking about bankruptcy while others contemplating mergers, at least one of which was called off recently. **Avoid.**

Winners will almost certainly include:

1) Online retailers – people have had to turn to online. Certainly, Amazon is a winner, although it is very difficult to own if one wants to look at the fundamentals, present or future. Other online retailers may still be investible. **Action item: follow online situations for companies that succeeded under quarantines and are at reasonable valuations**
2) Testing companies – these companies will have to develop fast, accurate and relatively inexpensive testing, rolled out on a worldwide scale and be ready for new strains of Covid in coming years. **Action item: look for attractive investments in testing companies (we already own a couple in some portfolios)**
3) Security companies & sensing/monitoring manufacturers – this crisis has led governments to intrude further into citizens' lives, and it won't get any better soon. New sensing/scanning equipment for human body temperatures and probably other indicators will probably soon be part of screening at airports, sporting events and possibly even shopping malls. Unfortunately, this will make the whole TSA thing at airports seem minor. **Action item: look to see if any companies look attractive for this sector**

Other affected sectors could recover relatively quickly, including:

1) Airlines – while airlines have been virtually shut down (although not technically), we believe airlines will adjust rapidly to the new sanitary and screening procedures (they are already used to similar protocols), and the public will be ready to travel as soon as possible. People will use PPE and the airlines will insist on other procedures, and we see air travel resuming with above subsistence load factors fairly rapidly after "stay at home" measures are lifted in many areas of the US, of course including Florida and California. **Action item: none currently; state of airline**

industry as investments are undetermined at least into the near future. They will not have dividends and have taken government assistance; probably best to enjoy using them and not investing in them.

2) Theme parks – it is hard to believe that people won't flock back to the Disney and Universal theme parks, especially after many weeks of spring in which people could not travel at all. It is incumbent on these companies to make the parks sanitary and PPE-friendly, as well as the associated hotels and restaurants. **Action item: continue to evaluate Disney & Comcast for investment implications**

We still have a lot to ponder about the economy post-crisis. As we go to press, California's governor has set some pretty wide-ranging criteria that have to be fulfilled before he frees up the state from its quarantine, which could easily mean a June-July timeframe, an economy-killer in our estimation. We keep up to date on these thoughts and actions, and we will adjust portfolios as important post-Covid decisions influence our investments.

The Managers of Kanos Capital Management
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