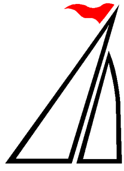
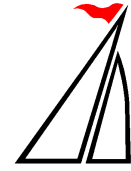


WINDWARD CAPITAL

Risk Averse Asset Management



2020 Third Quarter Review

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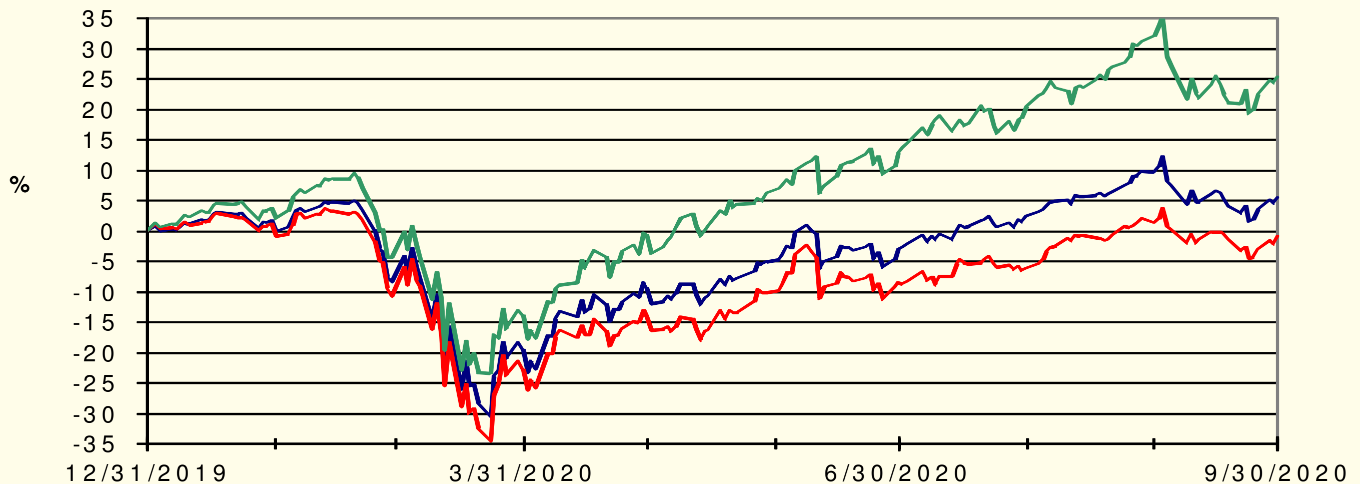

Better Angels

"With malice toward none; with charity for all; with firmness in the right, as God gives us to see the right, let us strive on to finish the work we are in; to bind up the nation's wounds; to care for him who shall have borne the battle, and for his widow, and his orphan; to do all which may achieve and cherish a just, and a lasting peace, among ourselves, and with all nations."

—Abraham Lincoln (1809 - 1865)
Second Inaugural Address (1865)

The major U.S. equity market indices continued their advance off of the March lows during the Third Quarter of 2020, with the Standard & Poor's 500 Index (S&P 500), Dow Jones Industrial Average (DJIA), and NASDAQ Composite Index (NASDAQ) returning +8.93%, +8.22%, and +11.23%, respectively, for the period. As a result, for 2020 Year-to-Date, the S&P 500, DJIA, and NASDAQ have returned +5.57%, –0.91%, and +25.40%, respectively—a dramatic recovery from the approximately 30-36% declines experienced from February's highs to the depth of the March lows. In fact, both the S&P 500 and NASDAQ reached new, historic highs during the Third Quarter.

These positive financial market trends appear to be primarily related to recognition of a bottoming of the U.S. economy and optimism regarding the future outlook. The bullish sentiment among investors is predicated on strong monetary and fiscal policy support amid significant uncertainties regarding the extent and speed of the economic recovery. As a result, despite the dramatic recovery in the equity markets, we anticipate ongoing volatility as financial market participants

wrestle with what we believe will be an uneven global macroeconomic recovery due to the lingering effects of the coronavirus pandemic and a potentially uncoordinated political and societal response to its mitigation.

As we have discussed previously, the economic effect of the coronavirus pandemic is different from that of previous financial crises: this is, at its essence, a health crisis, not a credit crisis. The current global macroeconomic downturn is not due to an endogenous event: this is an exogenous shock that has resulted in a conscious effort on the part of governmental authorities to artificially freeze parts of the economy as a medical intervention in order to slow down the spread of the coronavirus. That strategy should be viewed positively because responsive and appropriate monetary and fiscal policies can alleviate the negative economic side effects of this "treatment" until health authorities are successful in their coronavirus mitigation efforts.

Although the depth and duration of the pandemic's impact on the world economy remains unknowable and may differ on a country-by-country basis, we remain confident that global health authorities will eventually succeed in controlling the spread of the coronavirus, and that the monetary and fiscal policy measures currently being implemented will mitigate a significant amount of the economic impact. Certainly, the tragic loss of life will continue for some time, and businesses—from small to large—will be disrupted to varying degrees over both the short and the long term: corporate bankruptcies, restructurings, and consolidation appear inevitable for some.

It should be remembered, however, that financial markets are "discounting mechanisms" and, as such, will eventually look ahead toward an economic recovery—the shape of which remains indeterminate at this time but is, in our opinion, currently in progress. Relieving the disruptions in the credit markets and restoring the flow of credit to households and businesses are essential to the resumption of sustainable economic growth. In addition, it is important for the government to help fill the gap created by the drop in consumer spending and temporary business shutdowns. Finally, and most importantly, the negative health impacts of the coronavirus must be mitigated. These policies—monetary, fiscal, and health—represent the three legs of a stool that is necessary for supporting the U.S. economy's return to prosperity reasonably quickly.

We believe that the risk associated with any hiccups in the recovery and any resultant financial market volatility is mitigated in *Windward* portfolios—especially over the long run—to a large degree by the fact that we are invested in "high quality," dominant, financially-strong, leading companies with best-in-class managements, high incremental returns on invested capital, and business models with sustainable competitive advantages. As a result, we believe that, on the whole, the businesses in our portfolios will survive this crisis and ultimately prosper. Consequently, we have not raised cash or made any changes to the investments held in *Windward*'s portfolio strategies.

Although increased uncertainty associated with the outcome of the upcoming U.S. Presidential and Congressional elections could create additional market volatility in the months ahead, at the moment we are unable to confidently make any definitive assertions regarding the impact of these elections on the geopolitical and global macroeconomic outlook, much less the financial markets. As you know, as investors, we remain politically agnostic in evaluating the economic and corporate impacts of public policy. That is the reason why we would prefer to analyze the actual legislative mandates and policies that are enacted and determine their corporate beneficiaries before considering major changes to the current investments in *Windward*'s portfolio strategies. We will continue to monitor domestic and international political and economic developments as they unfold.

Unfinished Business

It has been just eight months since the pandemic first gained a foothold in the United States, bringing with it the sharpest economic downturn on record—as well as the most forceful fiscal and monetary policy response in living memory. As the coronavirus spread across the globe, the U.S. economy was in its 128th month of ex-

pansion—the longest in recorded history—and was generally in a strong position: moderate growth continued at a slightly above-trend pace, labor market conditions were strong across a range of measures, the unemployment rate was running at 50-year lows, and Personal Consumption Expenditures (PCE) inflation was running just below +2%.

Most economic forecasters expected the expansion and its benefits to continue—and with good reason: there was no economy-threatening asset bubble to pop and no unsustainable boom to bust. While nonfinancial business leverage appeared to be elevated, leverage in the household sector was moderate. The banking system was strong, with robust levels of capital and liquidity. The COVID-19 recession was unusual in that it was not triggered by a buildup of financial or economic imbalances. Instead, the pandemic shock was essentially a case of a natural disaster hitting a healthy economy.

Given the healthy pre-coronavirus condition of the economy, in the early stages of the crisis it seemed plausible that, with a rapid, forceful, and sustained monetary, fiscal, and health policy response, many sectors of the economy would be able to bounce back strongly once the virus was under control. Conversely, it also seemed likely that certain sectors most affected by the pandemic—i.e., those relying on extensive in-person contact—would face a longer and more difficult path to recovery and that these sectors and people working in them would likely need targeted and sustained policy support.

As the pandemic emerged in the U.S., widespread economic shutdowns began in March. With many sectors shut down or operating well below capacity, real Gross Domestic Product (GDP) fell –31% in the Second Quarter (on an annualized basis). Employers slashed payrolls by 22 million, with those on temporary layoff rising by 17 million. Broader measures of labor market conditions, such as labor force participation and those working part time for economic reasons, showed further damage.

As discussed in detail in our *Windward Capital 2020 First Quarter Review*, the U.S. Federal Reserve (Fed) delivered a series of extraordinary policy moves and interventions to calm investors and to protect the economy from volatility and damage inflicted by the expanding coronavirus pandemic and its restrictions on activity. The Fed's steps have exceeded the scale, scope, and speed of the measures adopted during the 2008 Financial Crisis. It has announced one liquidity program after another, as central bankers around the world collectively worked to remove roadblocks interfering with the flow of credit to their economies.

In addition, U.S. fiscal policymakers utilized a bridge strategy to support the economy's eventual return to prosperity. To reach that positive outcome, the U.S. government has engaged in massive spending measures to ensure that those who lose their jobs do not experience personal catastrophe with long-lasting effects and that these individuals have jobs to return to—i.e., that businesses with sound long-term prospects do not collapse in the interim. (The unanimous passage of the CARES Act and three other bills passed with broad bipartisan support in March and April established wide-ranging programs that provided roughly $3 trillion in economic support overall—by far the largest and most innovative fiscal response to an economic crisis since the Great Depression.) Besides these direct effects, the goal was to minimize the magnitude of potential second and third order impacts resulting from the shutdowns.

These actions have so far supported a strong, but incomplete, recovery in demand and have—for now—substantially muted the normal recessionary dynamics that occur in a downturn. In a typical recession, there is a downward spiral in which layoffs lead to still lower demand, and subsequent additional layoffs. This dynamic was disrupted by the infusion of funds to households and businesses. Prompt and forceful policy actions were also likely responsible for reducing risk aversion in financial markets and business decisions more broadly.

While the combined effects of fiscal and monetary policy have aided the solid recovery of the labor market so far, there is still a long way to go. Payrolls have now recovered roughly half of the 22 million jobs lost. After rising to 14.7% in April, the unemployment rate

is back down to 7.9%, clearly a significant and rapid improvement. (A broader measure that better captures current labor market conditions—by adjusting for mistaken characterizations of job status, and for the decline in labor force participation since February—is running around 11%.)

The burdens of the downturn have not been evenly shared. The initial job losses fell most heavily on lower-wage workers in public-facing service industries—job categories in which minorities and women are overrepresented. In August, employment of those in the bottom quartile of the wage distribution was still 21% below its February level, while it was only 4% lower for other workers. Because the lowest 40% of households by income account for a smaller 22% of consumption, a drop in spending from this cohort is not an immediate blow to the economy. However, a potential wave of evictions, less fiscal relief, and slower labor recovery could dent spending and growth more broadly.

Although the overall recovery has progressed more quickly than generally expected, the economic outlook remains highly uncertain—in part because it depends on ultimately controlling the spread and effects of the virus, as discussed in detail in our *Windward Capital 2020 First* and *Second Quarter Review*s. There is a risk that the rapid initial gains from reopening may transition to a longer than expected road back to full recovery as some segments struggle with the pandemic's continued fallout. Indeed, the pace of economic improvement has recently moderated since the outsize gains of May and June, as is evident in the latest employment, income, and spending data. In the absence of additional fiscal aid, the increase in permanent job loss, as well as recent layoff announcements, is also worrying as it appears to be spreading across a variety of sectors, including State and local government employees.

Since the economic expansion is still far from complete, U.S. Congress' reticence to provide additional near-term fiscal support is disconcerting. Too little support could lead to a weak recovery, creating unnecessary hardship for households and businesses. Over time, household insolvencies and business bankruptcies could rise, harming the productive capacity of the economy and holding back wage growth, thereby serving to limit the upside potential for the economy. By contrast, the risk of "excessive" stimulus seems minimal: even if fiscal policy actions ultimately prove to be greater than needed, these funds will not be wasted. In our view, the U.S. economic recovery will be stronger and move faster if monetary policy and fiscal policy continue to work side by side to provide ongoing support to the economy until its upward trajectory is more evidently sustainable.

Hidden Strength

Despite these headwinds, however, there are several factors that could serve as significant offsets and provide support to sustaining positive near-term U.S. economic momentum:

After briefly seizing up in March, financial markets have largely returned to normal functioning—albeit in the context of extensive ongoing policy support. Financial conditions are highly accommodative, and credit is available on reasonable terms for many—though not all—households and businesses. Interest-sensitive spending has been strong, as demonstrated by the surging housing and auto sectors.

Aid to businesses—in particular, via the Paycheck Protection Program—and the general boost to aggregate demand have so far partly forestalled an expected wave of bankruptcies. Business investment appears to be on a renewed upward trajectory, and new business formation similarly appears to be rebounding, pointing to some confidence in the future outlook. However, since it appears that many individuals may undergo extended periods of unemployment, and additional layoffs are being announced daily (particularly in the travel, leisure, and hospitality industries), there is likely to be a need for further support.

Most importantly, although the key provisions of the CARES Act have expired and Congress has yet to pass a subsequent support measure, there has been an overall improvement in household finances since the onset

of the pandemic. The fiscal aid given to households has supported necessary spending and contributed to a sharp increase in household saving, which is currently estimated at nearly $1 trillion. In addition, consumer credit has dropped roughly $100 billion from its peak this year, leaving room for households to borrow their way into additional spending, if necessary (or even if just desired). Goods consumption is now *above* its pre-pandemic level. Although services consumption remains low, it seems likely that much of this weakness is the byproduct of health concerns and social distancing, rather than reductions in income and wealth.

As confirmed by the U.S. Bureau of Economic Analysis' high frequency data, personal consumption has held up well after the expiration of expanded unemployment insurance benefits, indicating that savings from transfer payments continue to support economic activity. A recent Fed survey showed that households in July had surprisingly upbeat views of their current financial well-being, with 77% of adults either "doing okay" or "living comfortably," an improvement even over the reading immediately preceding the pandemic.

Although significant uncertainties remain—coronavirus-related economic headwinds, the timing and efficacy of vaccines, and the prospects for fiscal stimulus either in this Presidential term or the next—we believe that the above factors provide reason for optimism regarding the sustainability of near-term economic momentum. Indeed, under the right set of circumstances—e.g., further fiscal stimulus, instant-result COVID-19 test kits, a successful vaccine, etc.—the current $1 trillion in household savings could serve as kindling to fuel an advance in U.S. GDP over the next few years that may reach new, all-time highs.

Discretion Advised

As we have discussed with you over the years, the last decade has challenged the Fed's operating framework with issues such as: a falling natural rate of inflation, policy rates near the zero lower bound, a weakened relationship between unemployment and inflation, questionable estimates of the natural rate of unemployment, and a heightened awareness of the cost of unemployment. On August 27, after a more than year-long review of its monetary policy strategy, the Fed announced changes to the framework used for its policy actions.

Among the more significant changes to its framework are:

- On maximum employment, the Fed emphasized that maximum employment is a broad-based and inclusive goal and reports that its policy decision will be informed by its "assessments of the shortfalls of employment from its maximum level." (The original document referred to "deviations from its maximum level.")
- On price stability, the Fed adjusted its strategy for achieving its longer-run inflation goal of 2% by noting that it "seeks to achieve inflation that averages 2% over time." To this end, the revised statement states that "following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time."
- The updates to the strategy statement explicitly acknowledge the challenges for monetary policy posed by a persistently low interest rate environment. Global monetary policy interest rates are more likely to be constrained by their effective lower-bound than in the past.

As a result, for all intents and purposes, the Fed essentially has decided that it will throw away the rule book and let inflation run higher and unemployment run lower before seeking to tighten financial conditions. To be clear, this change leaves the central bank pursuing an almost completely discretionary monetary policy.

Monetary policymakers have long been moving in the direction of more discretion. The old rules-based approach governing when to tighten and loosen monetary policy has fallen into disfavor as those rules were proven to be unreliable in times when economic conditions

swiftly changed. In retrospect, a reliance on guides such as the Taylor rule (which relates policy rates to output and inflation gaps) and the Phillips Curve (which relates inflation to unemployment rates) caused the Fed to over-predict inflation and set interest rates too high in 2018.

Even if the Fed could not rely on the old economic rules to guide policy, that guidance was still directed at sparking inflation toward its 2% target. First implemented in 2012, the target gave a sense of where the Fed wanted to go even if changing economic fundamentals made it less certain of how to get there. That has now changed, with Fed Chairman Jerome Powell signaling that the central bank will tolerate an inflation rate above its 2% target by an unspecified magnitude for an unspecified period of time before tightening monetary policy.

While the Fed has moved monetary policy in a dovish direction with these changes, it has also brought more uncertainty about the ultimate goal. Without a formula to define the "average," the Fed's interpretation of average is subject to change. We do not really know the Fed's goal for the inflation rate in either the near or medium term, nor do we know the timeline or what, if anything, the Fed is willing to do to achieve that goal. And while we know the Fed is willing to allow inflation to drift higher, we have no sense of how much higher and for how long. Will the Fed proactively try to spur inflation higher? Or does it intend an entirely passive strategy? Does the Fed intend to allow longer-term bond yields to continue their upward drift? Or will it become more proactive with regard to long-term asset purchases?

To be sure, this lurch toward discretionary monetary policy is not entirely unexpected. As the Fed learned during the last cycle, a shifting economic landscape means it cannot be constrained into a rigid policy path. Indeed, as we have discussed numerous times over the last several years, the global macroeconomic surfeit of supply and dearth of demand—now exacerbated by the worldwide coronavirus pandemic— further underscores the challenge of future economic growth with its concomitant deflationary risks that will result in an extended period of persistently low real interest rates.

At its September 15-16 Federal Open Market Committee (FOMC) meeting, the Fed reiterated its pledge to maintain a near-zero interest rate policy despite the economic gains of recent months. In addition, it enhanced its forward guidance to be consistent with the updated framework for its monetary policy strategy, committing to holding rates at near-zero until the economy is both at maximum employment and inflation is at 2%. As a result, the FOMC currently projects that it will maintain its short-term Federal Funds rate at 0.00-0.25% until 2023. This extended period of very low (and negative real) interest rates should persist even as economic activity accelerates.

This new policy framework—combined with the commitment to the zero lower bound—should prove positive for risk assets over the longer term because it means the Fed will be much less inclined to prematurely get in the way of economic gains relative to past recoveries. As long as inflation remains below 2%, the Fed will push back on any ideas that they will imminently tighten policy. And even inflation above 2% would not guarantee tighter policy if the Fed concluded that the overshoot was transitory. The implication for financial markets is that the Fed expects to hold monetary policy very easy for a very long time. In other words, do not doubt the Fed's resolve to keep policy accommodative.

It's Not Over

Extraordinary fiscal and monetary policy measures are necessary, but not sufficient, to return the economy to "normalcy." Ultimately, the way out of this health crisis will depend upon successful mitigation and/or control of the coronavirus. In our view, the economy's full potential cannot be realized as long as individuals remain concerned about their safety—and ensuring that safety will only come with measures that control the spread of the pandemic and empower people to preserve their health.

Scientists have learned a lot about this coronavirus since the first cases were reported in the U.S. earlier this year.

For instance, they now know that airborne transmission is a far greater risk than contaminated surfaces, that the virus spreads through singing and shouting as much as through coughing, and that while any infected person is a potential vector, superspreading events are major drivers of the pandemic.

Experts have also identified the primary components of a successful mitigation strategy: test, to find out who is sick; trace, to find out who else may be sick; and isolate those who are suffering. Personal habits must accompany this: wearing face masks, hand washing, physical distancing, and avoiding crowds in enclosed spaces. Encouragingly, other countries (e.g., South Korea, Germany) have shown that the implementation of these mitigation measures—although complex and logistically involved—can successfully control the virus. In fact, the economies of these countries have already returned to a state of near-normalcy. It is therefore important to monitor the data from these countries on an ongoing basis in order to learn from their experiences.

It remains unclear, however, to what degree the U.S. will be able to enact similar measures (e.g., widespread testing and contact tracing, masking, etc.) given a variety of logistical, political, and societal constraints.

Science remains the most powerful tool that we possess to contain the pandemic. The "scientific method" (by definition) requires discipline, rigor, and intellectual honesty. As a result, it is critical to rely on scientific experts—not politically-motivated commentators, "snake oil" salesmen, or people who masquerade as scientists. We are neither epidemiologists nor virologists—and we do not profess any expertise in those areas. We defer to and are reliant upon the research of scientists and healthcare professionals to guide this discussion. Despite the recent setbacks in the U.S., we are optimistic that—given the unprecedented and extraordinary global scientific talent and financial resources being devoted to combating this coronavirus—their efforts will ultimately prove successful via the development of vaccines and/or therapeutics.

The unprecedented amount of capital and scientific effort being applied to the development of a vaccine is likely to produce at least one that will receive Emergency Use Authorization (EUA), which allows the FDA to make unapproved drugs available during a health crisis. However, the question still stands as to how large and frequent a dose will need to be administered to support an immune response, how effective (what level of protection) will the immunity be, how long immunity will last, and, most importantly, how long will it take for a vaccine to be widely produced and distributed in sufficient numbers to effectively vaccinate a population. Several companies have already begun to ramp up manufacturing capabilities to produce millions of doses in anticipation of EUA later this year. We must keep in mind that any production will first be allocated to those at the highest risk—healthcare workers, first responders, the elderly—before being made available for broader distribution.

A safe and effective vaccine could finally bring the pandemic under control, but its arrival will also test America's ability to resist the intuitive errors that have trapped it so far. Vaccination has long been portrayed as the ultimate biomedical silver bullet, separating an era when masks and social distancing mattered from a world where normality has returned. This is a false dichotomy, in our opinion. One-third of Americans already say they would refuse a vaccine, whether because of existing anti-vaccine attitudes or more reasonable concerns about a rushed development process. Those who get the shot are unlikely to be fully protected; the FDA is prepared to approve a vaccine that is at least 50% effective—a level comparable to current flu shots. Although an imperfect vaccine will still be useful, the risk is that the Federal government goes all-in on this one countermeasure without either addressing the systemic problems that made the U.S. so vulnerable or investing in the testing and tracing strategies that will still be necessary.

In the best-case scenario, a vaccine and better treatments will blunt COVID-19's severity, making it a much less dangerous and less disruptive disease. Over time, COVID-19 could become just another seasonal respiratory virus, like the four other coronaviruses that cause a sizable proportion of common colds: 229E, OC43, NL63, and HKU1. These "common cold" coronaviruses are so prevalent that we have likely all

had them at some time in our lives—perhaps even multiple times. Although they can cause serious outbreaks (especially in the elderly), they are usually mild enough to fly under the radar.

For all of the uncertainties that remain ahead for COVID-19, many experts agree that the virus will never be completely eradicated. A vaccine and therapeutics could mitigate severe cases and make the coronavirus easier to live with. As a result, although the virus itself is likely here to stay, this pandemic will eventually end.

Substance Over Form

We continue to believe that a U.S. economic recovery will not be "V-shaped"—it will be more like a dimmer switch—for reasons discussed in detail in our Windward *Capital 2020 First Quarter Review*. In addition, the three policy "legs" of the stool necessary for supporting the U.S. economy's return to prosperity reasonably quickly include monetary, fiscal, and health strategies. We remain extremely confident in the Fed's monetary policy capabilities and the potential for further actions. Although we are encouraged by the fiscal policy actions undertaken so far, we are somewhat less confident that Congress and the White House will enact further substantive fiscal policy measures soon—in addition to economic stimulus packages after the pandemic wanes (at least under the current Administration). With regard to health policy, we continue to be concerned that the U.S. has not aggressively enacted the mitigation measures recommended by healthcare experts and successfully implemented by many other countries (i.e., widespread testing and contact tracing/tracking); however, we are optimistic that, at some point, given the unprecedented global scope and scale of the intellectual capital being devoted to defeating the coronavirus, the scientific community will develop effective therapeutics or a vaccine. Until then, an ongoing resurgence of the virus in the coming months remains a potential risk that we will continue to monitor.

As detailed in our *2020 First Quarter Review*, on an overall basis, our investment strategy during the current pandemic crisis remains consistent with the investment strategy that we have followed in the past—essentially: to invest in high-quality businesses at the right valuations and hold them for as long as they remain high-quality businesses. In fact, the competitive strengths of these businesses could, perversely, *increase* as a result of this pandemic as lower-quality businesses fail to survive. As a result, this dynamic may drive the valuations of companies held in *Windward*'s portfolios dramatically higher than previously seen.

Similarly, crises usually accelerate real, pre-existing trends in society and technology—they do not create or destroy them. Subject to constraints, therefore, we believe that there is a deep underlying propensity for human habits to persist over time, and that, human nature being what it is, individuals will have a strong inclination to return to their former way of life as soon as reasonably practicable. As a result, we are not making changes in *Windward*'s strategies to invest in those companies that may be deriving benefits from near-term coronavirus trends (e.g., telecommuting, media streaming, etc.) because we believe that those trends will not persist. In addition, we are not investing in any speculative Healthcare companies involved in the potential discovery of a therapeutic/vaccine because we believe that the benefit to be derived from this discovery will primarily accrue to the existing businesses held in *Windward*'s portfolios. We believe that the long-term secular investment themes that we have previously identified remain intact.

If the U.S. economy has reached its nadir, then the most important issue for investors is not whether the stock market has "bottomed," but whether the recent equity market rally is sustainable. In other words, has the equity market correctly forecasted the timing of an economic recovery? If so, then the market could continue to advance. If not, then the market could re-test its previous lows.

Although the market is often prescient, its forecasting ability will be challenged due to the unusual nature of this downturn and the characteristics of financial market participants. In our opinion, attention should not

be focused on companies' earnings outlooks for the remainder of the year. It is obvious and well understood that there is tremendous uncertainty regarding the corporate earnings outlook, and that the variance in forecasts is much greater than normal. This is due, in part, to the extremely high degree of uncertainty about the economic recovery because of the unusual nature of the drivers of this downturn.

Compounding this uncertainty is the variability associated with the outcome of the upcoming U.S. Presidential and Congressional elections.

Offsetting these risks is the positive impact of unprecedented and extraordinary fiscal and monetary policy measures, combined with $1 trillion in U.S. household savings.

We believe that, at the March lows, the oversold nature of the markets served to highlight an extremely compelling risk-reward tradeoff, and helped to neutralize the overwhelming sense of negativity that prevailed with respect to the economic and earnings outlook. This sentiment shift should continue to drive the accumulation of stocks and help slow the magnitude, and speed, of future declines—and lend weight to rally efforts.

In our opinion, there are several factors relating to investor psychology that, qualitatively, should serve to support the market in the near-term:

- There seems to be less focus on trying to pick the absolute bottom for the market and more conviction in initiating, or adding to, core positions at lower cost bases.
- The violence of the recent rally reminded institutional investors how holding excessive cash can destroy performance when there is a shift in sentiment.
- There is a sense that it is less easy now to short stocks and be successful at it for an extended period of time.
- There appears to be a willingness to look past 2020 and into 2021, when the coronavirus mitigation efforts should, if properly enacted, produce more successes, the economy will be "re-opened," and corporate earnings growth will resume.

In terms of current overall global financial stability:

- Risk asset prices have rebounded following the precipitous fall early in the year, while benchmark interest rates have declined, leading to an overall easing of financial conditions.
- Swift and bold actions by central banks aimed at addressing severe market stress have boosted market sentiment, including in emerging markets, where asset purchases have been deployed in a number of countries for the first time, helping bring about the easing in financial conditions.
- Amid huge uncertainties, a potential disconnect between financial markets and the evolution of the real economy is starting to emerge—a vulnerability that could pose a threat to the recovery should investor risk appetite fade.
- Other financial system vulnerabilities may be revealed by the coronavirus pandemic. For example, high levels of debt may become unmanageable for some borrowers, and the losses resulting from insolvencies could test bank resilience in some countries.
- Some emerging and frontier market economies are facing refinancing risks, and market access has dried up for some countries.
- Fiscal and monetary policymakers, while continuing to support the real economy, need to closely monitor and remain vigilant regarding potential financial vulnerabilities in order to safeguard current financial stability.

As a result of these issues, the direction of the stock market will not be straight up from here, and we expect a volatile backdrop over the balance of the year. Serious fundamental economic and structural financial issues need to be resolved—and this will take time. More importantly, headway must be made on coronavirus mitigation—particularly in the United States.

Although the long-term societal and economic implications of the pandemic, if any, remain unclear, spe-

cific companies are taking advantage of the changes in their operating environment to create long-run opportunities for their businesses. Those leading companies whose superior business models are best positioned to withstand the current shocks to the system will emerge stronger as the economy recovers.

Our goal, as always, is to identify those companies and invest in them for your *Windward* portfolio. Our risk averse approach to managing your investments causes us to take a more measured and unemotional view of extremes in bullish or bearish sentiment and find ways to outperform the market with less volatility by focusing on specific companies' fundamentals. Our results over the course of various market cycles demonstrate our success.

We appreciate your support as we continue to navigate through this challenging period and invite you to call us should you have any questions or concerns.

Sources:
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U.S. Congress
U.S. Department of the Treasury
U.S. Federal Reserve
World Health Organization

HAS YOUR FINANCIAL CONDITION CHANGED?

Portfolio decisions are based on an individual's income requirements, tax bracket, time to retirement, risk tolerance, and other characteristics. If your financial condition has changed, or is about to change, please call us. We strive to prepare a portfolio that meets each investor's objectives, and the more information we have, the better the job we can do. If you have any questions regarding your portfolio, your asset allocation, or any investment within your portfolio, please let us know.

THE FUTURE IS NOW

As you may know, we post a weekly commentary on our website every Friday afternoon. We only mail some of these comments out when markets are particularly unsettled. Please be aware that these notes will continue to be available on-line, and we want to encourage you to sign up to receive a password for access to our secure web-site.

Our website provides the capability for clients to review their portfolios, their year-to-date realized capital gains, and income and expenses. Clients also have access to our weekend market comments. These reports are updated after 8:00pm each Friday, and are available to clients who have requested access. Clients may also request that their accountants and/or attorneys have access to the same information. We hope you will visit us at www.windwardcapital.com.

If you have interest in these capabilities, or if you would like to receive a copy of our Form ADV Part II or Form CRS free of charge, please email Steve Pene at: spene@windwardcapital.com, or call Mr. Pene at our main number: (310) 893-3000.

NOTES

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