April 2, 2020

Dear Clients and Friends:

We try at all times to focus on matters economic, as these tend to drive the various elements we use to make decisions on how to best employ the assets you have entrusted to us. Things like growth in GDP, inflation, and changes in interest rates we find endlessly fascinating, while others would rather talk about the weather or sports. We see ourselves as thinking for the long term, taking judicious risk for a given return, or in essence having a plan. But as the great Mike Tyson once said, "Everyone has a plan until you get punched in the face." Well, the world in 2020 got punched in the face. The onset of the coronavirus took the world by surprise, and the reaction has been stunning on many levels.

Let us state a couple of things before we get started. First is that we understand the unfathomable toll on humanity this crisis has taken and will take. We are not immune to these feelings, and we are as anxious and concerned as anyone. We remain hopeful and confident in the ingenuity of an entire world unleashed and committed to a single purpose. Yet our focus here is on matters economic, and we will limit our discussions to the risks and opportunities that this situation presents to us, working on your behalf. If that appears unseemly, then our apologies. Secondly, we will refrain from offering our opinion on the proper course of action or weighing in on how this is all likely to play out. Our focus will be on the reactions to the pandemic and how they have and will continue to affect our relatively narrow slice of the world.

As someone with many more days in the rearview mirror than in front of me, I often wonder if I have had my last truly memorable experience, if my future will be nothing but reminiscences of a bond operator. Then a month like March comes along, and I am reminded again why I love this profession so much. It was as if everything I had experienced over thirty plus years was compressed into one month. I won't replay the day-to-day volatility or recite the various policy actions taken; these are known events and represent history. Our focus is on the present, the near future, and finally the longer-term challenges that we, as investors, are likely to face when the immediate threat has been vanquished.

The actions taken by the Federal Reserve are breathtaking in scope and magnitude. On the fiscal side they are equally so. When combined, you get MMT or modern monetary theory - the idea that the federal government can run virtually unlimited deficits that will be financed by the Federal Reserve. The potential consequences of this we will discuss a bit later, but the immediate impact on our markets is clear. When Jerome Powell announced on a Monday morning in March the program of unlimited quantitative easing and the establishment of various facilities to buy and remove a massive amount of risk from the credit market, it was as if he had announced, "Attention Kmart shoppers, we have a Blue Light Special on risk assets." Of course Jay Powell is of an age where he would remember when that was a thing. For those who do not, I suggest Google. It is essentially a version of Mario Draghi's "whatever it takes." Then, as now, the message to investors is clear: buy risk, we got you covered. And that is what we did. Using our vast stores of liquidity, we have spent the last two weeks transforming Reams portfolios from those that shunned risk to those that embrace it. By the end of March, we had gone from significantly underweight credit to significantly overweight. We went from overweight government and agency quality assets to avoiding them. It may take a month or two, but make no mistake, the elevated risk premiums that exist today will likely be gone and may not return for quite a while.

As we move into the second quarter or the immediate future, the landscape we see is bleak, mostly a wasteland. Picture a dystopian scene from a movie or a novel…these are currently strangely popular…where shell-shocked investors pick through the mostly return-free detritus left behind from the tsunami of central bank liquidity. Investment grade credit offers, at least for now, a modest return made attractive only by the almost imperceptible relative yields available on most Treasury securities. Agency mortgages went from very attractive in mid-March to being, if not toxic to your fiscal health, certainly bereft of positive return potential. As stated, we believe for now that a portfolio of high quality mostly investment grade credit is the place to be, and the assets we manage have flowed accordingly into this space. We expect volatility and uncertainty to remain elevated for a time, but we anticipate the central banks will have their way and this uncertainty will revert to the previous environment, only worse - a period of low volatility and even lower risk premiums. Envision a world where investors search for an extra basis point like they do now for a roll of toilet paper. A world where all yields for a time compress to zero. It is this world we are prepared for and which, to us, seems a high probability outcome over the next 6- 12 months. But this too shall pass.

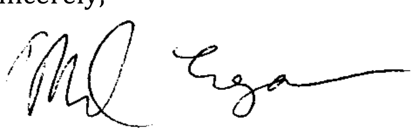
One day, and that day may never come, the price for today will need to be paid. The idea of MMT has gone from a theory to practice with nary a discussion. The deficit, including the recent coronavirus relief legislation, is expected to be at least $4 trillion and likely higher, which is more than 20% of what will be a smaller than last year GDP. This deficit will likely be financed by the Federal Reserve out of necessity. Are there consequences? I would like to think so. The idea that we can have government spend 20%, 30% or how about 40% of the economy as a deficit, have it financed by the Federal Reserve, and say it doesn't matter seems implausible.

So if there are consequences, what are they? We can only guess, and anyone who says otherwise is a fool, a liar or likely both. But if I were to guess, and that is all it would be, I would say the consequences will not be pleasant. As we move through the balance of 2020 and into 2021, the current situation will recede into the rear view, and the bill may come due. Higher inflation and interest rates would seem to be the likely consequence, but many thought that of the initial quantitative easing, which seems so long ago and so modest in scope. That was not the case then, and it may not be this time, although the magnitude is so much larger that we foresee a period of instability and perhaps substantial instability on the heels of the coming central bank induced torpor. But now is not the time to worry about such things, as the monumental Fed involvement will not only push the day of reckoning well into the future, but could also render the costs of resisting substantial.

It might sound terrible, I know, but we have enjoyed the month of March immensely from the perspective of what we do for you. The challenges have been, and continue to be, great. The daily volatility can be disturbing. Yet, we were positioned well going into this, we have followed our process, and while no one ever gets everything right, we believe we are very well positioned on your behalf.

We are happy to discuss the current environment, how we are positioned, and what we see as the challenges ahead in greater detail, any time at your convenience.

Sincerely,



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