SYMONS® CAPITAL MANAGEMENT

QUARTERLY INVESTMENT LETTER
FIRST QUARTER 2020

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SEEKING GOOD RISK/REWARD OPPORTUNITIES THROUGHOUT FULL-MARKET CYCLES

THE BIG PICTURE

Our Chief Investment Officer, Colin Symons, CFA, published four blogs during the first quarter. His first blog for the second quarter was published on April 2. All of Colin's blogs can be found on our website, **www.symonscapital.com**, and you can sign up to receive them directly by email as they are published. Colin's April 2 blog reviews first quarter events in some detail, and then outlines where we may be headed. This *Quarterly Investment Letter* reviews the current investment world through a wider lens.

Last quarter we noted that 2019 was a remarkable year for financial markets — stocks were up 30% with no earnings growth. The first quarter of 2020 was equally remarkable, with stocks down as much as 30%, unprecedented worldwide economic disruptions, and obvious financial markets panic. Before we begin our usual discussion of Symons Capital's investment management work, we believe it makes sense to briefly consider whether some major mistakes have been made over past decades by our economic and political leaders. How did we get to the point of such fragile financial markets and mispricing of risk, and how do we get back to more resilient financial markets where financial and business risks fall on the risk-takers rather than on the taxpayers?

We think the critical, first step back to more resilient financial markets is the reinstatement of the 1933 Glass-Steagall Act, which separated commercial banking from investment banking, and which Congress repealed in 1999. Commercial banking provides the grease for the real economy — taking deposits, making loans, and providing basic credit facilities to businesses and individuals. Investment banking provides investment opportunities for those who want to risk their savings — underwriting securities, trading and investing in securities, being involved in a range of financial markets such as swaps, derivatives, leveraged hedge funds and the like. The 1999 repeal of Glass Steagall created massive moral hazard because it allowed investment banks to become members of the Fed and the FDIC, thereby having their risky activities backstopped by the American taxpayer. In 2008 the result was that we bailed out everyone, which made the moral hazard problem worse.

The Fed and the FDIC were not created to protect the banks. They were created to protect the commercial bank payments system and depositors, in order to keep the real economy working. Banks can and should fail. The Fed and the FDIC have the power to keep the bank deposit and loan system going. Those laws were not used in 2008-09. Rather, taxpayer funded bailouts saved the bankers. This is moral hazard, where taking more risk is not much of a risk when taxpayers are picking up the cost of any problems that arise. Bankers get the profits and taxpayers get the losses of investment banking risks.

The same concept holds true for corporations now seeking taxpayer bailouts. While we need the expertise of airline employees, that does not require protecting airlines' shareholders, bondholders and executive management. Chapter 11 of the federal Bankruptcy Code provides for reorganization of viable businesses. The Bankruptcy Code also provides for liquidation of zombie businesses.

In both cases the concept is simple — let the risk-takers take the risk.

THE ECONOMY AND INVESTMENT MARKETS

Symons Capital's Intelligent Risk Management investment discipline is not about being bullish or bearish. It is about finding attractive risk/reward opportunities in all economic and investment markets circumstances. Stock by stock, we determine whether to be aggressive or cautious so that, over time, we constantly seek to achieve the core goals of our investment discipline — provide protection of savings, build financial security, and reduce the possibility of life-changing catastrophic losses, as happened to many investors in 2000 and 2008. How do we try to do all of that?

The economy and investment markets are related. But their movements can be very different in the short term. Economic activity tends to change modestly and slowly, while investment markets can change dramatically and rapidly. The biggest drop in GDP since the Great Depression was a 5.6% decline in 2008-09. The current most popular guess for 2020 GDP decline is 15%. Covid-19 will definitely have an economic impact both short-term and long-term. The impact is likely to be asymmetric and noisy. It could be very tough for cruise ships for a good while. With a looming recession, it could affect a lot of buying patterns, starting with autos. Utilities should be broadly OK, but utilities with a lot of industrial customers could be impacted more. Over the next six months or so, we expect the massive government stimulus to favorably impact the pace of the short-term recovery. But that is not a complete long-term answer. There are a lot of complications out there.

Investment markets are far more volatile than the underlying economy. In contrast to the relatively modest rate of change in economic activity, in both 2000-02 and 2007-09 we had stock market drops in the 50% range. Why are stock market changes so much more dramatic than economic changes? The simple answer is that sharp market changes are largely driven by changes in investor psychology — from greed to fear, from risk-indifference to risk-aversion.

Investors are frequently indifferent to risk, and so are willing to pay high prices. But there are times when investors become averse to risk and so are willing to pay only lower prices that provide them with a better margin of safety. When investors' risk-aversion appears, downturns happen. What we saw in the first quarter was a significant increase in investors' aversion to risk. They suddenly were willing to pay only lower prices. Psychology is what drives most of the dramatic price drops.

Are the price drops justified? It depends. A sudden price drop usually does not mean that a large portion of the future value of a stock has disappeared. The long-term value of a stock is based on the projected long-term stream of cash flows from the company's business over several future decades, discounted to present value. Long-term value is not based on a one or two year decline in profits. For many businesses, such as consumer staples stocks, year-to-year cash flow streams typically change only modestly. Even in bad economic times, if the cash flow of a stock drops for a period, such a temporary decline in cash flow usually has only a modest effect on the total value of the cash flows from all future years. As a result, when we see a sudden across-the-market price drop, what has principally changed is investors' view of risk, rather than a permanent change in the stream of expected future cash flows. At the same time, it is common for investor psychology to remain risk-averse well past the bottom of an economic and market downturn because investors commonly view the future as a continuation of the recent past. That can represent an opportunity where investors remain risk averse while signs of economic recovery are appearing.

One additional aspect of understanding publicly traded investment markets is the benefits and emotional hazards of daily liquidity and pricing. Liquidity is important to investors' ability to adjust portfolios incrementally on a daily basis as the evidence changes, and the opportunities change. Markets with daily liquidity and pricing also bring volatility, which can in turn create greed-fear swings, and even panic. In addition to the risk/reward of liquidity, some investors use leverage to try to increase their reward returns. But in a down market leverage can make losses catastrophic — it can wipe out risk-indifferent investors due to margin calls and other adverse credit events. Even riskier is that some investment markets are illiquid but investors still use leverage, such as private equity and venture capital. Investors in illiquid markets have limited ability to adjust their portfolios, and the common use of leverage can really hurt the underlying investment. In illiquid markets, it is often hard to tell how much hurt there is until it is too late. Symons Capital has chosen to invest only in liquid markets and to never use leverage.

That is our wider lens view of how we analyze the economy and investment markets as we seek to protect savings and build financial security. In investment terms we are trying to gauge the probabilities of where the economy and markets may be six months or a year from now, not tomorrow. If you have an investment discipline, as we believe we do, you can avoid the emotional rollercoaster of feeling a sense of relief if the market is up today, or a sense of fear if the market is down tomorrow. At this point, our best judgment is that resolution of many economic uncertainties will take time, and some could take years. That is not a disaster. It only means there will be ups and downs, and so opportunities.

INVESTMENT STRATEGIES AND PORTFOLIO MANAGEMENT

We are very early in the economic and market reset process, and there is a lot to sort out. Since 2008 the Fed has built a no-risk financial paradise with their recurring market interventions having resulted in so many monetary, economic and price distortions. The first quarter saw an indiscriminate meltdown of prices for every financial asset, whether stocks, bonds, Treasurys or even gold, all in the panic rush to get cash.

We believe we were reasonably well prepared for the first quarter downturn, but we are not perfect. The first quarter panic was largely indiscriminate, with all financial assets dropping in unison. Now we are seeing increased daily up-and-down volatility. Opportunities have started to show up and we have done some selling and some buying. As Colin mentioned in his April 2 blog, in a volatile market some of this involves "whack-a-mole" investing. People decide they like tech? Prices jump and we'll sell it to them. People start running away from precious metals miners? Prices drop and we'll buy them. Some days it is hard to believe the price volatility we are seeing. Managing portfolios in this environment is not fun. But you can also get some awfully nice prices.

Will we get more opportunities going forward? We think so, but we have to be patient and nimble. Until the economy and market get sorted out more, we expect to see a lot of investors chasing the market both ways, and that's a recipe for continued volatility. We hope to take advantage of that.

More specifically, consumer staples continue to be generally attractive. People buy that stuff in all economic circumstances. Utilities also are OK, even if the general economic shutdown has reduced usage for a while. And many REITs still are attractive, starting with storage REITs. Going forward, we think precious metals are long-term attractive. Finally, the energy sector dropped a lot over the past 18 months, and we started buying some in the first quarter. That turned out to be too early, but we believe that integrated oil companies have long-term value. These sectors appear to be the right place for the uncertain environment we believe lies ahead. The overall theme is to buy quality companies where, if the world froze for a year, we would be comfortable with our holdings.

Looking farther out, at some point we expect the market will tilt away from the growth/momentum stocks that have done well for the past decade and move toward the value stocks. But it hasn't happened yet. Much of the continuing support for growth comes from the massive amount of funds that go into passive index investment vehicles, which currently have weightings tilted to the growth side. At some point we expect that, as risk indifference turns to risk aversion, specific analysis of each company's prospects will influence a tilt toward value and safety. We expect to see a range of market turns that we want to successfully navigate.

CONCLUSION

We have a worldwide medical crisis that is turning into a worldwide economic and financial markets crisis. The market impact can be amplified due to some of the highest stock valuations in history reverting to lower prices as investors become risk-averse. There's a balance between poor economic and financial news, and hope for the future. With all the recent big swings in the market, which we expect to continue, we want to manage that balance right. Market liquidity has been poor, which can cause enormous moves up and down. Everything has a season, and due to the dramatic price volatility this is starting to look like a season for being more of a trader, as we see some stocks moving from 52 week lows to 52 week highs in a month.

We believe our intelligent risk management approach to portfolio management is the most important part of Symons Capital's investment discipline. We seek to make consistently thoughtful decisions, and not be frozen in fear. While we will not always be right, we believe that evaluating risks and finding attractive opportunities is ultimately what clients pay us for. Investment management is not a pure science; it is a careful analysis of future probabilities and possibilities. At times it becomes messy and a bit stressful. Ultimately, if we can get through this period as we got through the 2000 and 2008 downturns, we will limit the psychological stress of clients and preserve purchasing power for the opportunities ahead.

Yours sincerely,

Ed Symons, JD	**Colin Symons, CFA**
Chairman & Founder	Chief Investment Officer

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