APRIL 8, 2020

It is hard to fathom how quickly our lives have changed. On Wednesday, February 19, the S&P 500 closed at an all-time high. On the following Monday, financial markets suddenly began to recognize that what started in China could have a devastating impact on global economies. Over the following weeks, the world seemed to shrink at an unprecedented rate as we all became acutely aware of global connectivity and interdependence.

Just as all nations have suffered outbreaks of the novel coronavirus (albeit at differing rates of speed and severity), all financial markets have felt its impact. While there have been a handful of beneficiaries of the current economic environment, most financial assets have dropped in value dramatically or seen some form of market disruption. Global equities, most commodities and lower quality bonds (high yield corporate and municipals, emerging markets, and structured "products") have been hardest hit. Even high-quality bonds fell victim to a short-term trading liquidity crunch. Interest rates have fluctuated wildly.

Despite the extraordinary turmoil across markets, we do not believe that the global financial system will collapse. The Federal Reserve, along with other central banks, has acted swiftly and decisively to inject liquidity and assure access to capital. One key to weathering this storm is a functioning banking system with lenders willing and able to extend credit to cash-strapped businesses. The silver lining of the 2008 financial crisis is that banks were in far better condition at the beginning of 2020 than they were in 2007 and that central banks have a better understanding of the tools at their disposal. They will not repeat the mistakes of the last crisis (e.g. the Lehman bankruptcy and a slow, uneven response).

Government relief programs that benefit displaced workers as well as certain targeted industries, small businesses and not-for-profits will all be crucial. The task is enormous; first steps have been taken. Time will tell if they are adequate. We are optimists and believe that people, businesses, institutions and our government will all pull together to see each other through to the other side of this crisis.

As investors and stewards of our clients' capital, we must temper our optimism with a realistic assessment of the far-reaching damage to economic life. In the near term, at least, it is significant. As experienced as we are, none of us has ever factored the potential for such a dire environment into our investment decisions. Fortunately, we have started from as strong a position as possible. Very strong results across asset classes in 2019 meant that client accounts began with a high level of capital. We believe that our quality standards for equities as well as bonds assures us that we are invested in those companies and securities most likely to be able to meet their obligations. Even in the absence of any ability to predict such a severe downturn, our natural risk aversion has been an asset.

Like virtually every investor, we have seen market values decline, in some cases precipitously. Holding cash reserves and, where appropriate, allocations to fixed income have helped cushion the blow. We believe that our equity portfolios are a collection of businesses in a strong position

to navigate this harsh terrain. We believe that most of our holdings will retain their investment potential. However, some will be less attractive long-term holdings as investors recalibrate risk to include the possibility of future pandemics and an extended recession. Likewise, others will become more attractive as their business durability becomes more widely recognized.

In reflection of this, we have made more portfolio moves than usual over the past weeks. We have trimmed or exited positions, generally, for the following reasons: that future investor sentiment is likely to be less generous or, conversely, unrealistically hopeful that companies will benefit from the current environment. Finally, we have selectively harvested losses to offset gains for taxable clients.

None of these was intended to time markets by raising cash. One bright spot has been that the swift and, in some cases, indiscriminate decline has provided a handful of very attractive opportunities. Great businesses that always seemed too expensive have fallen to reasonable valuations. We have tried to take advantage of market turmoil to trade up to even higher quality businesses and to improve the long-term prospects of our holdings.

We have been less active in bond portfolios. Due to certain market dynamics (which could be the subject of an entire paper), even high-quality bonds became difficult to trade. Having an extremely high level of confidence that our bond holdings would continue to pay interest and principal when due, we saw no reason to try to sell into a market in which there were no buyers. Indeed, this is the very reason that we insist on achieving exposure to the fixed income market by building portfolios of individual bonds rather than investing in mutual funds. Given recent experience, we stand by that perspective.

As is often the case, what is bad for sellers is good for buyers. In cases where clients held bonds that matured or extra cash, we have opportunistically taken advantage of other investors (in some instances the very mutual funds we avoid) needing to unload bonds at any price.

While the trading in bond markets has stabilized somewhat (especially in the high-grade sector), there continue to be opportunities for small and nimble investors, even for those, like us, with high standards of credit quality. We will do our best to capture above-market yields as long as the market allows.

Just as important is what we will not be doing. In fixed income, we will not increase risk exposure in an attempt to take advantage of borrower distress. No doubt others will be tempted. Some will succeed; many will not. As we search for stock ideas, we will not pay up for companies benefitting chiefly from the spread of Covid-19. The virus will pass. Some behaviors adopted during the lockdown will persist; many will not. We will think about how the business and investing landscapes may be altered, but we will maintain a strong valuation discipline while weighing potential investments.

We cannot predict timing, but we know that at some point the virus will cease to be a global threat and that economic life will begin to be restored. Some aspects may be permanently altered, but most will be recognizable as the same or as slight variations of what existed before the outbreak. Economic growth will continue at some point and at some rate. We are confident that

thoughtfully constructed portfolios of stocks and, where appropriate, bonds will continue to be the most effective way to preserve capital and increase spending power.

Like most of the country, all of us at Spears Abacus are working remotely and have been for nearly a month. We are experiencing the benefits of being part of a small cohesive team that has prepared adequately for the unforeseeable. As we speak to friends, former colleagues and business partners at the largest financial firms, we see many struggling to function smoothly. Their large bureaucracies have proven to be the enemy of efficient crisis management.

Our technology infrastructure, most of it long in place, has worked flawlessly. We have adapted new tools quickly. We continue to look for ways to help us meet the challenge of transitioning from one office to fifteen, many with a perpetual 'bring your kids to work' day. So far, we have not missed a beat and have been able to respond to client requests, follow markets and make informed investment decisions throughout.

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