EUBEL BRADY & SUTTMAN
ASSET MANAGEMENT

MARKET REPORT
FIRST QUARTER 2020

Key Takeaways

- COVID -19 stole the show.
- Stimulus programs lessened the impact.
- Volatility was the greatest since 2008.
- Valuations improved notably.
- Oil is down 65.9% year over year.
- We provide a stakeholder update, a few reasons for optimism and our thoughts on the future.

The Quarter in Review

The quarter was filled with uncertainty, volatility, misinformation, change, opportunity and sacrifice – all caused by an adversary that we cannot see, hear or smell – COVID-19. This letter is a bit longer than usual, but these are unusual times. We hope that you find the information on the following pages informative, helpful and balanced.

Total Return as of March 31, 2020

				Annualized		
	QTD	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**
S&P 500	-19.6%	-19.6%	-6.9%	5.1%	6.7%	10.5%
NASDAQ	-13.9%	-13.9%	0.8%	10.4%	10.8%	13.8%
Russell 3000						
Index	-20.9%	-20.9%	-9.1%	4.0%	5.8%	10.2%
Value	-27.3%	-27.3%	-18.0%	-2.7%	1.6%	7.5%
Growth	-14.9%	-14.9%	-0.4%	10.5%	9.7%	12.7%
Russell Mid Cap						
Index	-27.1%	-27.1%	-18.3%	-0.8%	1.9%	8.8%
Value	-31.7%	-31.7%	-24.1%	-6.0%	-0.8%	7.2%
Growth	-20.0%	-20.0%	-9.5%	6.5%	5.6%	10.9%
Russell 2000 (Small Cap)						
Index	-30.6%	-30.6%	-24.0%	-4.6%	-0.3%	6.9%
Value	-35.7%	-35.7%	-29.6%	-9.5%	-2.4%	4.8%
Growth	-25.8%	-25.8%	-18.6%	0.1%	1.7%	8.9%

Our economy, the largest in the world, was essentially paused during the latter part of March – a new concept. The magnitude of the stimulus and swiftness with which the Federal Reserve (the "Fed"), Treasury and Congress responded is incredible, unprecedented and necessary. The economic blow should be softened, but far from eliminated. Individuals ranging from entrepreneurs and healthcare professionals to service personnel across an array of industries have had their incomes impaired. For those individuals and anyone battling COVID-19 directly, our thoughts and prayers go out to them. These are tough times.

We are grateful for the extraordinary people in the healthcare, IT, grocery, farming, government and supply chain management industries who are working tirelessly, often in compromised conditions, to help their fellow citizens have a degree of normalcy. If you know one of these modern-day heroes, be sure to say thank you.

Regarding the investment landscape, it was a dynamic and thought-provoking quarter with the S&P 500 peaking at 3,386 on February 19, then sliding to an intra-quarter low of 2,237 on March 23 – shedding 1,149 points or 34% in just 23 trading days. **Equity and fixed-income markets became dislocated and we worked diligently to capitalize on opportunities.** Keep reading for more details …

Stimulus Programs

Historically, during times of economic crisis, the pace at which stimulus programs were implemented and the size of those programs were key factors in determining America's economic trajectory during the recovery. **Generally, quicker and bigger is better.** We highlight various stimulus programs implemented through quarter-end below to give you a sense of the current effort. **Collectively, the programs have been implemented faster and are larger than ever before.** We like the prospects for America emerging from this period stronger and better, albeit different.

As the lender of last resort, the Fed began supporting markets in mid-March:

- **March 15 –** The Fed began encouraging depository institutions to turn to the Discount Window for help and participated in coordinated central bank action with the Bank of Canada, Bank of England, Bank of Japan, European Central Bank and Swiss National Bank.

- **March 17** – The Fed announced the formation of a Primary Dealer Credit Facility (PDFC), a loan facility that will provide credit to primary dealers in exchange for a broad array of collateral with term funding up to 90 days. This program differs from the 2008 -2010 programs in that those programs were only available for overnight loans. Additionally, the Fed announced the formation of a Commercial Paper Funding Facility (CPFF) to support the smooth operation of critical commercial paper markets by serving as a backstop. Commercial paper markets finance an array of economic activity, including auto loans and mortgages, as well as operating capital for various companies. The Federal Reserve Bank of New York committed to lend to the facility which was structured as a special purpose vehicle to purchase commercial paper from eligible issuers.

- **March 18** – The Fed announced the establishment of a Money Market Mutual Fund Liquidity Facility (MMLF) to improve the liquidity and functioning of money markets, thereby helping money market funds meet investor redemption requests.

- **March 19** – The Fed announced coordinated central bank action with the Reserve Bank of Australia, Banco Central do Brasil, Danmarks Nationalbank (Denmark), Bank of Korea, Banco de Mexico, Norges Bank (Norway), Reserve Bank of New Zealand, Monetary Authority of Singapore and Sveriges Riksbank (Sweden) to support dollar liquidity in amounts ranging from $60 to $30 billion.

- **March 20 –** The MMLF program was expanded to include municipal money market funds.

- **March 23** – Before U.S. markets opened, the Fed announced a salvo of initiatives to keep America going which included: purchasing an unlimited amount of Treasury and Agency mortgage backed securities (previously committed to purchasing at least $500 billion of Treasuries and $200 billion of mortgage backed securities); various programs totaling $300 billion in new financing; two new facilities

- to support credit to large employers, the Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance and the Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity for outstanding corporate bonds; establishment of a third facility, the Term Asset-Backed Loan Facility (TALF) to support the issuance of asset backed securities backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA) and other assets; once again, expanded the range of securities available to participate in the MMLF program, including municipal variable rate demand notes and bank certificates of deposit; expansion of the CPFF facility; and the intent to soon announce a Main Street Lending Program to small and medium sized businesses, supporting efforts of the SBA. **With this announcement, the Fed essentially pulled out all the stops.**

Although it takes Congress longer to act, legislation was passed swiftly and signed into law:

- **March 27 -** President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES"), providing an estimated $2 trillion of support for America. This bill built upon two prior, less substantial pieces of legislation. Additional information may be found at https://www.ebs-asset.com/Pages/Resources/COVID-19.aspx (Stimulus Summary).

The Fed did in hours recently what it took days to do back in 2008 and Congress did in weeks what took more than a year to do then. This swift response should pay dividends for America. After quarter-end, the Fed announced that it would provide up to $2.3 trillion in loans to support the economy - expanding many existing programs. Additional Congressional actions are possible as well. Policy makers are more likely to embrace inflationary rather than deflationary risks, in our view. Although there will almost certainly be leakage (funds not getting to intended targets), these efforts seem directionally correct.

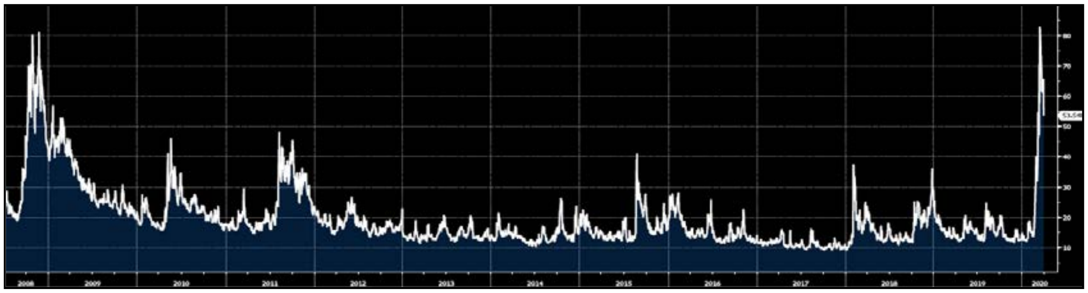
U.S. Equities

All 11 economic sectors declined during the quarter, contributing to the S&P 500's 19.6% retrenchment, including dividends. Energy (-50.5%) led the charge down the hill, followed by Financials (-31.9%) and Materials (-26.1%). Technology (-11.9%) was the least impacted, trailed by Health Care (-12.7%) and Consumer Staples (-12.7%). We had minimal exposure to energy related companies, so we were not meaningfully impacted by the dramatic decline. Our financial sector exposure was greater, and we absorbed that impact.

In many of our strategies, we are permitted to own small, mid and large-cap companies. We have had minimal small-cap exposure for several years, in part due to what we viewed as lofty valuations. This worked to our advantage during the quarter as small-caps, measured by the Russell 2000, had their worst first quarter ever. Of course, this means there are now more small-cap names eligible for review.

Volatility, after being largely subdued since 2008, came back with a vengeance. The accompanying Bloomberg chart of the VIX Index illustrates **recent levels greater than November 2008**, the last period of extreme volatility. Volatility creates opportunity and is the friend of the long-term investor. **Acting rationally and not rashly during these periods is a key element of long-term investment success.**

VIX Index (Chicago Board Options Exchange Volatility Index)



[80.86 – 11/20/2008] [82.69 – 3/16/2020]

Valuations, on a trailing and normalized basis, improved markedly during the quarter. Based on our internal analysis, the S&P 500 on a price-to-earnings metric **was more than 40% overvalued around its peak**. By quarter-end, it was trading **more in line with long-term averages which improves the prospects for future returns**. **How is this so?** Just like with a home, private business or commercial real estate – the lower your purchase price, relative to value, the better your future returns are likely to be. Using the S&P 500 as a proxy, historically, there has been a 40% to 50% correlation between P/E ratios and returns five and 10 years in the future – the lower the starting point, generally the better.

While many investors were worried about the short-term direction of the market (think levered hedge funds, large public mutual funds facing redemptions, etc.) **we were putting money to work with a long-term investment horizon**. Note in the accompanying table value-oriented companies' cheapness relative to their long-term averages – encouraging.

Current P/E as % of 20-Year Average P/E

	Value	Blend	Growth
Large	89.7%	99.8%	106.3%
Mid	81.7%	90.0%	104.3%
Small	73.0%	95.1%	134.3%

Source: Guide to Markets 2Q 2020

Has the U.S. equity market bottomed? Although we have gotten this question several times in recent days, it is a very difficult one to answer. However, we did see more opportunities in March than at any point over the last couple of years and the Fed is working diligently to support capital markets. Our focus remains on purchasing individual companies trading at attractive prices relative to their intrinsic value. The larger the discount to intrinsic value the better – as a discount reduces the risk of a permanent loss of capital and increases future return potential. **As in all environments, price-to-value relationships guide our actions**.

Fixed Income & Commodities

Corporate bonds' total returns, as measured by the BofAML 1-to-10 Year Index, decreased 3.4% during the quarter. U.S. Treasuries and Agencies, as measured by a similar index, increased 5.2%. The yield curve was inverted, short-term yields greater than longer term yields, during January and February. This is an atypical scenario that often portends a recession in the coming months. As March unfolded, an initial action by the Fed was to lower the overnight rate (an accommodative move) which corrected the inversion.

Fixed-income markets became dislocated during mid-to-late March. Credit spreads widened across all credit and maturity ranges, but maturities inside the two-year mark widened the most. Many large bond investors experienced redemption requests, forcing them to sell what they could sell rather than what they wanted to sell. In other words, they were forced to sell investment grade bonds at discounted prices to raise cash because the market for lower quality issues essentially froze. Where appropriate, **we capitalized on this scenario** by rolling from very short-term instruments into investment grade bonds maturing in 2-3 years with better yields.

Commodities, as measured by the Bloomberg Commodity Index, decreased 23.0% during the quarter. Oil (WTI) priced at $20.48 on March 31, down 66.5% and 65.9% for the quarter and last year, respectively. The combination of oversupply, COVID-19 led demand destruction and a Saudi-Russia price war has decimated the energy space. Capital budgets are being slashed throughout the energy supply chain which should lead to less production. Lower production generally leads to higher prices, but not likely before bankruptcies and re-organizations skyrocket.

As an aside, according to TSA records, only 146,348 travelers went through its checkpoints on March 31 **–** down from 2,026,256 a year ago (-93% y/y).

Stakeholder Update

As a stakeholder in our business, we would like to provide you with a quick update:

- **Working Remotely** – As you know, beginning on March 16 the majority of our team began working from home with only five or six individuals remaining in the office. By March 23, we were down to only one or two in the office and were 100% remote a day or so later. We have always placed a high value on investing in our technology infrastructure and it paid dividends. The transition from office to home was virtually seamless and the few wrinkles that surfaced were resolved within a couple days. We owe a big "thanks" to our in-house IT team. We couldn't have done it without them.

- **Team Health** – All team members are healthy and have thus far avoided COVID-19. Initially, we held daily company-wide conference calls so all team members could hear the voice of leadership and one another. Then, we graduated to daily company-wide video conference calls. These are not only practical and helpful in keeping us all connected, they're occasionally entertaining too. As of this writing, we are down to company-wide video conference calls twice a week. Of course, each department connects for their weekly meetings just as if in the office and colleagues interact throughout the day as needed via conference or video conference calls.

- **Business Update –** All team members are working hard for you; our client base was stable during the period and our finances are secure. Making good investment decisions and taking care of clients during this turbulent period is our highest priority.

Reasons for Optimism

- **Temporary** – Although it may be difficult to see at present, the current COVID-19 situation is **temporary**.

- **Collaboration –** Scientists, with public and private support, are coming together around the world to improve testing and treatments, and to create a vaccine. While the movement of people around the globe has virtually stopped, the movement of data may have never been more open.

- **Better Prepared –** COVID -19 should make America better prepared for future, potentially more infectious and deadly pandemics.

Looking Ahead

Equity markets are large discounting machines and are generally looking 9-12 months down the road, typically accounting for economic and corporate data long before it is ever reported. In our view, this will be important to remember in the coming weeks and months as the data reported **(rearview mirror)** is going to be horrendous. There will be significant financial hardship on Mainstreet USA in the near-term, offset, to some degree, by stimulus efforts. There is no manual or checklist for restarting an economy, **so do not be surprised if it happens in fits and starts**.

We will manage through the current period, **adhering to our time-tested investment process** as we have for more than three decades. It is our belief that f**ocusing on normalized earnings, maintaining discipline and keeping a five to seven-year horizon in mind will be keys to success.** Although we increased equity exposure during March across all strategies for which it was appropriate, we generally still have dry powder to capitalize on additional opportunities as they arise.

Together, pulling for a common cause, America will triumph – reclaiming its hospitals, economy, mobility and way of life, but it'll take time. We believe patience, discipline and judgement are key: the patience to wait for the right opportunity; the discipline to say no to all the bad ones; and the judgement to know when to place the order.