Russians, Saudis & The Price Of Oil
March 9, 2020 Interim Commentary

1) **Russians, Saudis & Oil**: We woke up this morning to the Russians and Saudi's feuding over oil production. The result is that both parties are flooding the market with oil. This is a good thing/bad thing.

   The bad thing is that it puts immense pressure on oil commodities (oil was down more than 24% today) and oil related companies (even stalwart companies like Exxon were down double digits).

   However, this lowers energy costs which lowers the cost of gasoline, electricity, paint, plastic, carpet, and at least 70 other major products. Being as 70% of Gross Domestic Product comes from consumer spending, lower oil costs is like giving an immediate tax credit to every American family.

2) **Employment**: Further helping GDP, employers added 273,000 jobs in February and had upward revisions of 87,000 for previous two months. As such, the unemployment rate is 3.5%. ***People are working. When they work, they spend. This makes the economy turn.***

3) **Too Much Leverage**: Many companies in the energy sector are highly leveraged (have borrowed lots of money). This puts individual companies at risk for financial troubles when the underlying commodity under which they operate drops precipitously. It is quite possible that many of these heavily leveraged companies may go into a restructuring or go out of business entirely.

   Fortunately, we own no (zero) companies that directly invest in energy. Furthermore, most of the businesses we do own will benefit from lower energy costs.

4) **Measuring Leverage**: Prior to 2008/2009, we thought we were pretty careful with debt to equity ratios. The Great Recession taught us that our metrics were conservative, but not conservative enough.

As such, we refined and enhanced our proprietary "Obligation Ratio." ***We did this long ago and have functioned with this mandate as a guiding principle. This has allowed us to be well prepared for the current volatility and associated challenges***.

This allows us to see how well a business can "self-fund" their expenses without the help of self-serving investment bankers. Our proprietary metric is far more conservative than anything we see being used by other investment firms. ***This gives our investments the best opportunities to withstand significant and unforeseen shocks***.

5) **<u>Client Liquidity</u>**: In addition to being extremely cautious when we assess the obligation ratios of our investments, we are quite confident that our clients have put themselves in a position of success. ***They have done so by carrying very little debt and having enough liquidity to carry them through six to nine months of living expenses***. This allows our clients to be insulated against shorter term bumps and focus on the long term opportunities.

6) **<u>Travel/Leisure Industry</u>**: We have also seen the travel industry hit particularly hard—due to fears over the coronavirus. Although we have ownership in rails, we have no (zero) exposure to auto manufacturers, airplane manufacturers, airlines, cruise lines or casinos. We have limited exposure to cruises via our ownership in Disney.

   Even in the case of Disney, we believe that declines in cruises and visits to the Magic Kingdom will be offset by the massive entertainment catalog available via Disney Streaming. Long-term, Disney will recover and return to consistency.

   We have also used this as an ***opportunity to invest in "capital light" businesses like Booking Holdings*** (the old Priceline.com). Although depressed for today, the travel industry is not going away long-term. The fact that this is capital light (requires very little cash to get up and running or to maintain), further distinguishes its competitive advantages over other options.

7) **<u>The Coronavirus</u>**: We continue to find the coronavirus to be a bit curious. The following is from Whitney Tilson's daily blog:

In the last six months seasonal influenza (the regular flu) affected 32 million Americans, with 310,000 going to the hospital and killing 18,000.

The U.S. Centers for Disease Control and Prevention estimates that since 2010 the flu is responsible for between 12,000 and 61,000 deaths annually in the U.S. Globally, the World Health Organization estimates that the flu kills 290,000 to 650,000 people per year.

In comparison, there are just over 114,000 confirmed coronavirus cases worldwide and fewer than 4,000 deaths. In the U.S., there are just over 600 confirmed cases of coronavirus, and 22 deaths (13 from a single nursing home in Washington).

China, the epicenter of the pandemic, accounts for 72% of cases and 80% of deaths to date. New coronavirus cases in China peaked more a month ago and are falling.

Starting this month, the Northern Hemisphere, including the 12 countries that account for 97% of coronavirus cases, starts heating up. Warm and moist weather kills almost all respiratory viruses, which is why the flu dies out in America every year by May at the latest, and likely why Australia has fewer than 100 cases and South America and Africa have almost none.

We don't want to downplay the seriousness of any illness. However, we continue to believe the coronavirus is being promoted by the news media well beyond its true level of severity.

8) **Stock Market Volatility**: Very little of the stock market volatility is driven by individuals. Instead, it is driven by computers. This causes significant volume in stock trading and very erratic movements. For the first time since the current circuit breakers were implemented, they trigger a stoppage in trading.

   We know these computers are hyper-focused on short-term trading with little consideration for the long game. ***As such, the easiest way to win is to not play the short-term game and instead focus on long-term goals***.

We heard from several clients today—we appreciate the emails, texts and calls. **Please do not be shy about sharing your concerns or questions….that is why you**

<u>pay us. We are here to make disciplined and informed decisions in times of uncertainty</u>.

We look forward to hearing from you.

Warren, Tammy, Jon, Nate, Joseph and Dave