ALTA
CAPITAL MANAGEMENT
A member of Guardian Capital Group Limited

MARKET LETTER

July 2020

We have just witnessed one of the most extraordinary four months in the history of investing. The 11-year bull market came to an abrupt end when the S&P 500 fell from its February 19 high, down a precipitous 34% in about a month, the fastest such drop in history. From its March 23 trough, the market rose 39% to June 30. Market commentators described the market mood shifting from "widespread panic" mode to FOMO – fear of missing out – in mere trading days. As for the second quarter of 2020, the market posted a 20% gain, its strongest performance since the fourth quarter of 1998. After all that turbulence, as of quarter end, the S&P 500 now sits just 4% lower than where it started the year. If, like Rip Van Winkle, you just emerged from a long sleep, you'd be forgiven for thinking you hadn't missed much.

The cause of the downturn is now well known. A voluntary shutdown in many parts of the US brought the economy to a screeching halt in mid-March. As business activity slowly resumed in May and June, economic data registered big gains off a deep bottom, the economic equivalent of the Mariana Trench. After an astounding 20.5 million jobs lost in April, over 3 million new jobs were added in May and almost 5 million more in June, encouraging data points, but employment levels remain well off previous highs. Similarly, an 18% rise in retail sales demonstrates a quick resurgence that we all hoped for, but still leaves overall activity well below pre-pandemic levels. Economic forecasting is never certain but the view today is hazier than usual. What caused the sell-off, the pandemic, is still with us. The path forward depends on our success in containing it, the pace of reopening, and ensuing consumer and corporate behavior. To illustrate, a record number of companies have withdrawn forward earnings guidance, to the tune of about 40% of the S&P 500. More than ever, stock prices are fluctuating on rumor and innuendo as traders and investors, instead of digesting economic news and recalibrating forecasts, try to solve an epidemiological puzzle. In the meantime, the Fed has vowed to do "whatever it takes" and Congress has approved unprecedented stimulus payments to hopefully bridge the gap to a fundamental economic recovery. Thankfully, every day brings more knowledge about the virus, more evidence on how to contain its spread, the emergence of increasingly effective treatments, and the greater likelihood that a vaccine can be developed.

We, at Alta, are also navigating these uncharted waters, and our main observation is that the market during the second quarter appeared even more short-sighted than usual. Stocks generally trade on differing opinions concerning long-term outlooks, resulting in usually measured changes in stock prices. With a dearth of actual information, lack of visibility, and the mysteries surrounding the virus itself, market prices demonstrated high levels of volatility during the quarter, compounded by the desperate need by some market participants to raise cash by any means possible. As the economy closed, in order to "flatten the Covid curve", our immediate course of action was to review the financial health of all of our companies. In this crisis, more than in normal times, our first task was to ensure that our companies had the resources and access to capital to withstand close to zero revenues for an indeterminate amount of time. We know our holdings to be financially healthy, significantly more so than most, with, in aggregate, half the debt level and twice the interest coverage of the market. We were heartened to learn the results of these impromptu stress tests, which gave us the assurance that our companies would be able to bridge the gap, as well as emerge stronger on the other side.

During this dislocation, we were active in trading the portfolios. We trimmed or sold companies that had enjoyed relative outperformance and bought or added to companies of greater quality with better growth prospects trading at a rare discount. Companies comprising our portfolios are leaders within their respective industries and offer enviable growth and defensive characteristics. They are all well-positioned to withstand a long economic slow-down and are also likely to emerge with a stronger market position, a still healthy balance sheet, and durable growth prospects for years to come. Also importantly, none has a large index weight. Therefore, any of these could contribute meaningfully to outperformance at a time when the main benchmarks are more dominated than ever by a handful of companies. We continue to keep our focus on the long-term and believe our portfolios are well positioned to outperform during the recovery and beyond.

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