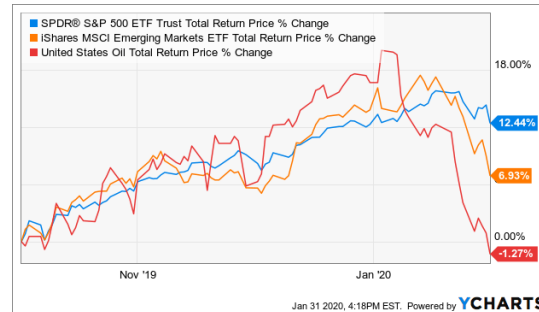
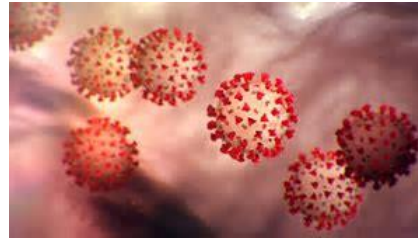


# BROXTON

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## CAPITAL ADVISORS



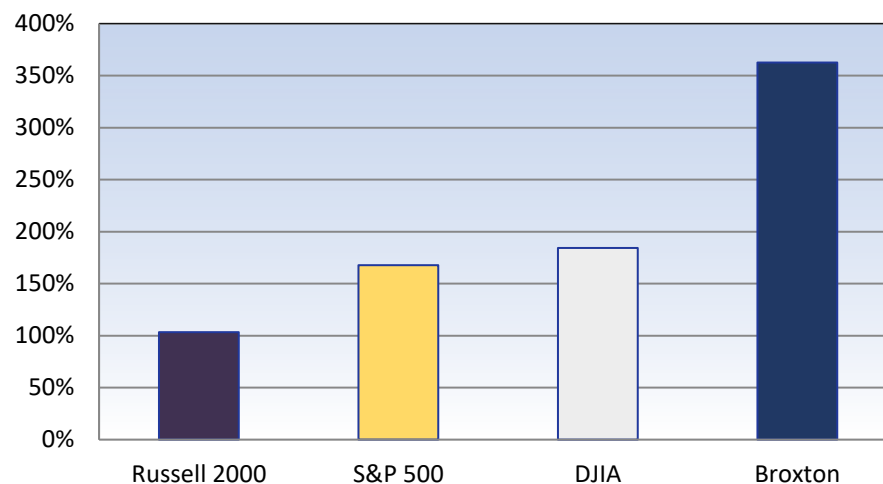
## Investing Outlook March 30, 2020

Broxton Capital Advisors & its predecessors successfully navigated the 2000 and 2008 markets and we share our analysis of the current environment and methods for limiting risk.

**Broxton Capital Advisors and Russell 2000, S&P 500 and Dow Jones indexes returns since January 1, 2006 through March 27, 2020<sup>1</sup>**

## Broxton Recommendations

We have historically avoided a lot of the destruction inherent in down markets. This is mostly due to following basic investment rules that limit risk. When the current downturn began in late February the S&P 500 index was trading at around 25 X trailing GAAP net income, historically this is considered high or overpriced. At this time, we are also concerned that the predicted economic recovery may be overly optimistic and could take longer than expected. Here are our ideas for avoiding losses.



## Be Aware of Higher Risk Areas

In 2007 we warned on the then building sub-prime risk and avoided investments that had exposure to sub-prime mortgages. In 2020 it has become apparent that commercial real estate and oil & gas companies have higher risk. Companies that have higher or extremely high price to earnings ratios are at risk in the current environment (many of these shares are in the indexes).

## Avoid Most Indexes, Mutual Funds and ETFs

Indexes do well in rising markets because most stocks are going higher. In the next five years investors should choose individual stocks or bonds which are analyzed and will perform well in the current and future environment. Stock buybacks may be reduced by over 80% and have been a primary source of index performance. Dividends are being reduced or eliminated. Notable names such as Ford, Signet Jewelers and Boeing have eliminated their dividends this month. So, the indexes will be challenged in 2020 and 2021.

In the near future, we predict that less than 35% of companies will do well. When you buy indexes, ETFs and Mutual Funds you also get the other 65% that you don't want to buy. Since more companies are doing poorly rather than well, the indexes perform poorly. As an example (only): investors may want to buy Colgate Palmolive in this environment but may want to avoid Chevron and Disney which are facing challenges. When you buy the S&P 500 index you get all three shares.

### Use Active Managers

Active Managers can navigate the current landscape.

### Allocation to Cash and Precious metals

As the situation evolves, opportunities will arise. Keep an initial allocation in precious metals of around 5% which can be expanded to react to certain market dynamics. Maintain cash positions in order to take advantage of opportunities that may arise.

### Analyze Fixed Income allocations

Investors or Advisors who blindly allocate fixed income securities may be in for unwelcome surprises. As said above investors should choose individual stocks or bonds which have good balance sheets and will perform well in the current and future environment.

## Current Situation

### Virus

The family Coronaviridae are common viruses that cause a variety of diseases, in mammals and have been described in swine, cattle, horses, camels, etc and various wildlife species, most coronavirus infections are widespread, subclinical and remain unstudied. In humans, coronaviruses are included in the spectrum of viruses that cause the common cold. COVID-19 is from the family Coronaviridae. ***“There are 219 virus species that are known to be able to infect humans. The first of these to be discovered was yellow fever virus in 1901, and three to four new species are still being found every year. Extrapolation of the discovery curve suggests that there is still a substantial pool of undiscovered human virus species”.*** Viruses are parasites that have co-evolved with the animal kingdom, usually are species specific and are not considered “life.” People who are severely medically affected by Covid 19 are being harmed by an elevated auto immune response, referred to as a [“cytokine storm.”](#)

### Economic Situation

Millions of people have lost their jobs and hundreds of thousands of businesses have been shuttered. Consumption of tell-tale goods such as gasoline have dropped over 30% in many areas. The economy is at a depression level and waiting for a restart at this time.

## Response of Media, Federal and Local Governments

In our opinion, there seems to be little insightful analysis in the media regarding the Covid 19 virus crisis or the government response. However, many local and State governments are creating a response which is comprised off “turning off” the economy by ordering most businesses to be shut down with the assumption that the economy can then be “turned on”. The federal government has warned people to stay away from crowded places and keep social distancing. This is causing a massive shift to the left in the demand curve for almost all goods, and in general, is the biggest disruption ever to the economic environment. This is planned to be reduced by a succession of massive stimulus plans that are trying to inject cash into all businesses. However, this could be worrisome due to the fact that there are no econometric models, historical datapoints or schools of thought that support this course of action and outcome. We examined two separate historical events in order to compare with the current Covid crisis:

### Massive Arial attack on London (The Blitz)



- Early in world war 2 it became known that Axis armies would invade Britain, instead this turned into a prolonged bombing campaign which killed over 40,000 Brits
- Businesses interrupted or halted? NO
- Effect on GDP per Capita? GDP per Capita increased through this period.
- After effect? The war ended and everything pretty much returned to normal. Keep calm and carry on ideology pretty much worked.



### Chairman Mao's Great Leap Forward

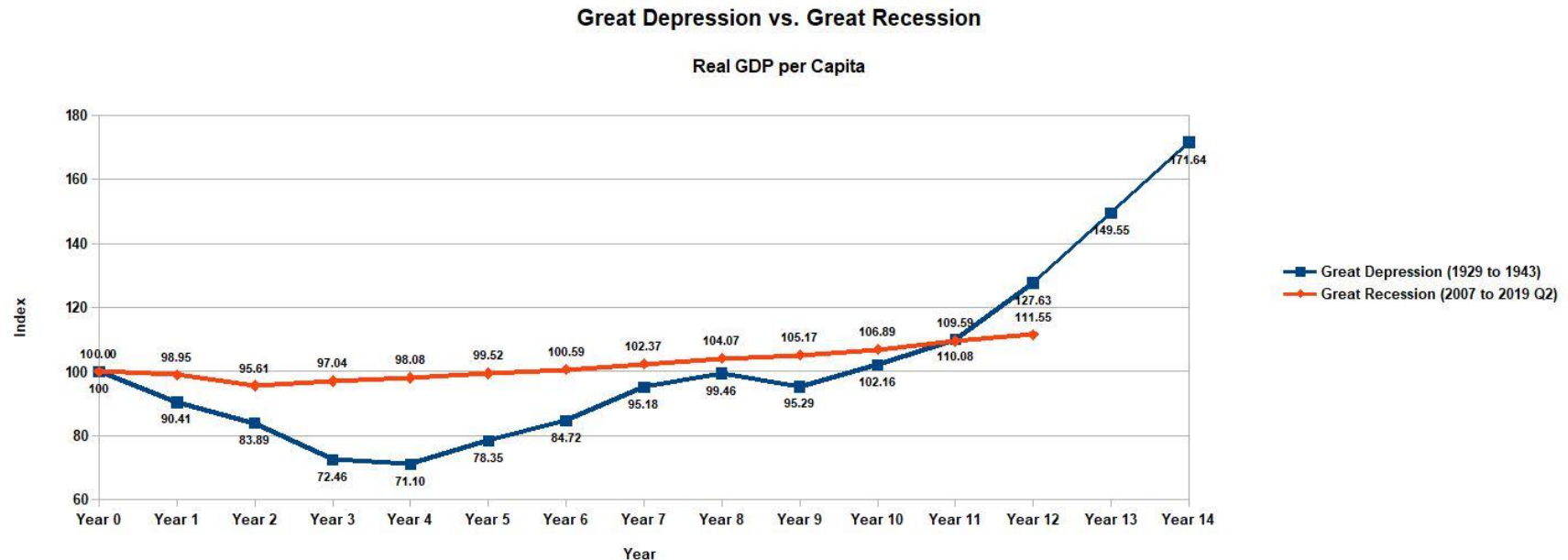
- In 1958 Chinese leaders launched an economic stimulus program intended to strengthen the economy by halting the existing economic environment and restarting a new group-based economy focused on industrial advancements and agricultural improvements.
- Businesses interrupted or halted? YES
- Effect on GDP per Capita? GDP per Capita dropped by 30% +
- After effect? The transition was not immediately successful, caused famines and other types of economic devastation. Over 10 million people died. Stopping the economy and restarting a better idea economy was not well planned and was conducted on a system wide basis simultaneously.

## Conclusion:

There could be unexpected risk in turning off and on parts the economy.

## Recovery Projection

Below are the comparisons between the Depression and the great recession as far as recoveries in GDP per Capita.



2020 recoveries are expected to be faster than these two comparisons but may be aided or complicated by additional factors which could lead to worse and longer than expected recovery time frames. This recovery should also be aided by the massive cash injection that was approved by congress.

## Additional Factors

- Consumer confidence may be slow to recover and take years
- Corporations, governments and small business are undercapitalized but are getting cash injections

- Credit expansion will most likely turn into credit contraction, causing businesses and governments to have less funds
- Economic stimulus through cash injections in the system may have undesirable side effects
- The Federal Reserve will lend its balance sheet to economic participants

#### Example Cheesecake Factory (.0125% of U.S. GDP estimated)

- \$ 2.5 billion in revenue annually
- \$ 900 million paid to employees
- \$ 630 million paid to landlords and utilities
- \$ 560 million in food costs
- After other costs and reinvestments keeps around \$125 million
- **Most locations currently shuttered or operating at a reduced level**
- Restart costs estimated at \$150-450 million
- Restart time frame until cash flow break even 6-18 months



<sup>i</sup> Returns on Graph on Pg. 2 are estimated as of March 27, 2020

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