April 2020

Not If, Not When, But How

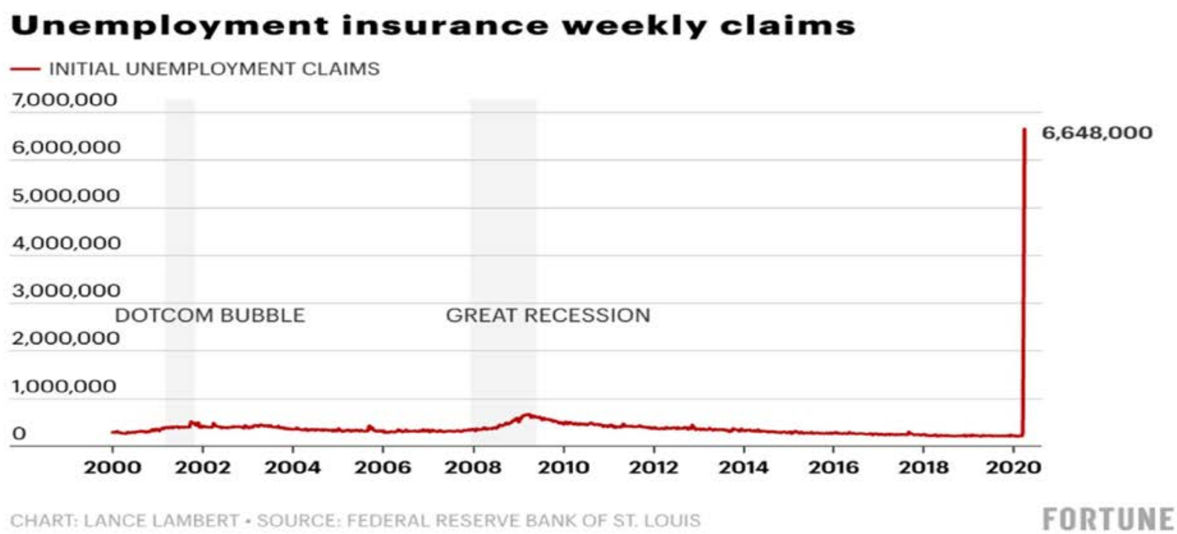
As we continue to work with clients to navigate the impact (shock) of the global pandemic, we are operating within the context of what is currently known, which is rapidly changing on an ongoing basis. At the same time, we are moving through a research process that we believe will result in future opportunities to pursue based on various contingencies that we might face with respect to portfolio decision-making. We recognize, as always, that this will not be a monolithic course of action across our client base. How the new reality of COVID-19 affects us all in a physical, mental, emotional, or spiritual way will differ greatly based upon our perspective and circumstances. The financial impact is naturally no different with respect to its divergent nature. That said, there are certain foundational pillars that should help guide investment decision making in the current environment.

At the back of this letter is a table, which is our attempt to scope out an appropriate roadmap for the portion of an investment plan that would look to be more tactical in nature based upon significant economic and market developments that are unfolding before the world's eyes. While we don't profess to have a reliable crystal ball to tell us what is going to happen in the coming months and years, we are big believers in the notion that we should plan in advance for scenarios that we may be facing. John F. Kennedy once famously said, "The time to repair the roof is when the sun is shining." While life under quarantine doesn't feel particularly sunny, we heed this advice as a call to be proactive in the face of less than ideal conditions.

As it pertains to investment strategy, it is important to attempt to identify conditions that may signal a pivot in the landscape, as well as an action plan once we get there. The table breaks current and future periods out between a starting point and three prospective subsequent phases, with thoughts on applicable steps we will consider at such time. The highlighted investments are not only designed to reflect potential allocations, but also to inform the investigative research process that we will undertake well in advance of the suitable time to invest. In the remainder of this letter we discuss our thoughts and approach at a high level, with detailed layers of each scenario expressed across the table.

In the short-term, where generally speaking sentiment creates risks and opportunities, our focus is on dislocations that have been created by technical factors (primarily the unwinding of leverage in certain markets) that can result in a temporary window to take advantage of distorted risk versus reward prospects. These are listed as 'Phase 1 Opportunities' in the table. Here, we are primarily focused on credit markets with an emphasis on the securitized marketplace where leverage is paramount. We are finalizing a basket of funds that we think will allow us to capitalize on what we believe to be liquidity as opposed to solvency-related issues. We will have specific recommendations and will communicate those to you over the next several days.

The intermediate-term relies on a combination of fundamental analysis along with a healthy dose of portfolio construction acumen and humility. The latter point is an acknowledgement that in some ways we find ourselves today in truly unchartered waters. We have managed portfolios through recessions created by wars, terrorist attacks, oil shocks, and asset bubbles. What we don't have a playbook for is a recession caused by a global, self-imposed grinding to a halt of a significant proportion of human and economic activity, with a resultant 6.6 million-plus in weekly unemployment insurance claims. Unquestionably, slowing the spread of the virus is a health as well as an economic imperative. That is probably where the use of the word "unquestionably" should cease in this and any related conversation.



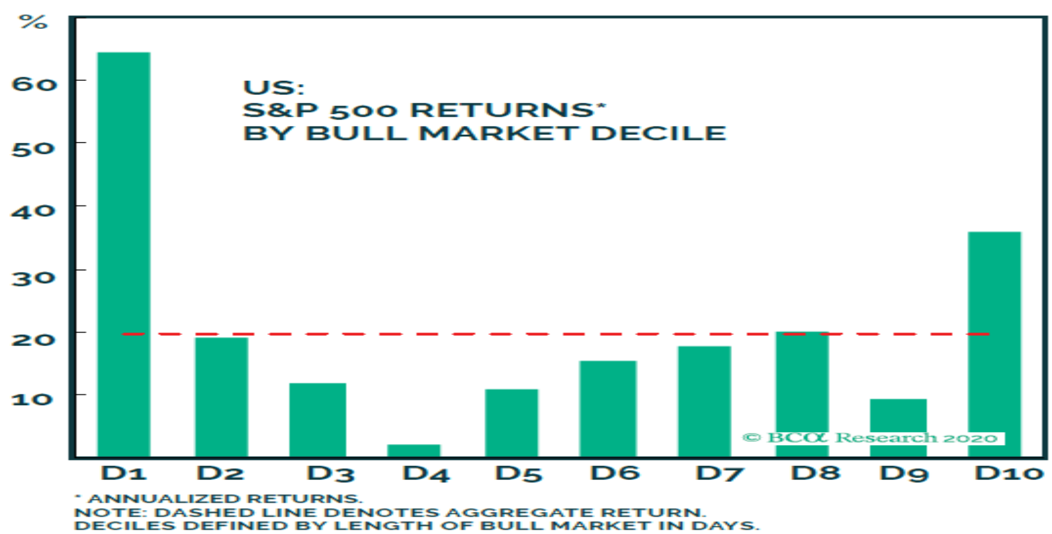
We know that eventually the economy will open up, so it is not a matter of 'If.' Consensus is that it will start to open up sometime in the next four to eight weeks, so it is not critically a matter of 'When.' Where anyone with conviction is fooling themselves is in the question of 'How' the economy will react when the door to our pre-COVID-19 lives is eventually cracked open. This is relevant because, over a reasonable period of time, the fortunes of the economy and the fortunes of financial markets converge, although this is rarely a coincident development.

The 'When' is, of course, a factor in what the 'How' will look like. The longer this self-imposed economic shutdown lasts both the first order and second order damage will be deeper and harder to predict than it might be otherwise. First order impact is largely a result of readily envisioned math and is being seen in current economic data projections. This includes immediate unemployment and wage loss, and ultimately the shutdown of businesses within certain industries. Second order effects might include unemployment resulting later on from supply chain disruptions, as well as diminished economic growth due to lack of consumer confidence, or from changes in the capital allocation decision-making of both consumers and businesses.

From a policy perspective, fiscal and monetary stimulus has been implemented that will hopefully ease financial stress to some degree. These include a range of Federal Reserve tools that have been brought to bear that go back to the Great Depression in their origin. It may, however, be decisions around the quarantine unwind that have the greatest impact on our future. While these decisions are not black and white, they are life and death. In an attempt to quantify the morbidity of the scenario analysis that public officials and their medically-trained resources are performing, Michael Greenstone and Vishan Nigam, both of the University of Chicago, have studied a model of America's COVID-19 response options.

They found that if the government took no action, over 3 million people in this country would die as a result of the virus. With fairly minimal social distancing measures put in place that total drops by 1.7 million, leaving the death toll at roughly 1.5 million people. Even that course of action, while still insufficient to prevent a tragic result, brings huge economic impact. Age-adjusted estimates of the value of lives saved make those 1.7 million people worth about $8 trillion of economic impact, or 40% of GDP.[i] On the other side of the ledger, just as described above, a decision driven by concerns around health considerations has economic consequences, the reverse is true as well. A decision to quarantine the population for a period of time carries with it the knowledge that a recession will be manufactured, but also the understanding that deep economic pain will take both a physical and mental health toll on a population.

Investment considerations in periods of high volatility often involve cross-currents, reflecting the fact that it is not mutually exclusive to identify an equity market entry point as likely attractive on a long-term basis, while also acknowledging that a better opportunity may lie around the corner if the market continues its downward trend. It is this admittance that we don't have a crystal ball which informs this course of action. It is also a recognition, as per the chart below, which dates back to 1966, that historically if you miss the beginning of a bull market rally then you miss the window for the most significant returns.



For clients who are underweight equities relative to strategic targets, it means that we take an incremental approach to adding equity exposure, with a willingness to add if markets drop from here so that a "dollar cost averaging" benefit is created. Within stocks, we are currently emphasizing U.S. equities, in part based on a belief that the U.S. banking system is stronger than its counterparts around the globe. However, in the long-term, we believe there is a compelling case to be made for non-U.S. equities. Within U.S. equities, at this point of heightened volatility and uncertainty we are focused on large capitalization companies, in particular those with the strongest balance sheets. In what is delineated as 'Phase 2 Opportunities' in the table, we will look to shift a portion of our broader equity focus to parts of the market that have been more significantly punished during the current regime.

As we look for these appropriate windows to deploy equity capital, we are also mindful of the unknowns that we are faced with as they pertain to the likely disjointed nature of a recovery around the world, across the country, and from one sector of the economy to the next. Accordingly, we believe that we might not be heading towards a more traditional "V" shaped recovery that would follow a steep decline, but rather more of a "W", with strong surges taking risk assets meaningfully in both directions while the world attempts to find an equilibrium. What this means in portfolio construction terms is that we will narrow the bands in which we rebalance, being more inclined to take chips off the table when "wins" are recognized, and holding steady with our plan to maintain a disciplined approach to adding equities when fear is palpable and capitulation appears imminent.

Longer-term, much of what we rely upon is baked into the strategic, all-weather nature of our asset allocation framework, but this does not mean that we won't continue to be opportunistic around certain investments as we work through to the other side of this seemingly interminable period (which is stunningly less than two months in duration so far). This will involve allocations that look to take advantage of more private, distressed strategies that will inevitably arise in the shadow of a landscape of such economic destruction. These are listed as 'Phase 3 Opportunities' in the table.

All of this requires vigilance, it requires fortitude, and it requires collaboration. While we can't help but think about the human toll that this crisis is taking on our family, friends, neighbors, and the world around us, we remain more focused than ever on making sure that our clients will weather the financial aspects of this storm in a way that allows you to maintain the goals and ambitions that you had when this year began.

Thank you as always for your confidence, and please feel free to reach out to us with any thoughts or questions.

---

[i] The Economist, A grim calculus, April 4th-10th, 2020

	Ground Zero	Phase 1 Opportunities	Phase 2 Opportunities	Phase 3 Opportunities
What is it?	A market dislocation and, potentially, economic recession, is starting	Opportunities in assets that have meaningfully dislocated due to a liquidity crisis, forced redemptions, or a disruption in the way that markets function	Economic recovery begins, and liquid markets respond, offering varied opportunities	Economic recovery is under way, which presents restructuring opportunities
Signs to watch for	• Widespread realization that Covid-19 will be a major disruptor of our daily lives and economic activity • Investor sentiment turns extremely negative and even panicked • Very volatile up and down trading days • Wide bid/ask spreads and sometimes even no bids at all • Rumors of funds deleveraging, unwinding, or collapsing • "Baby being thrown out with the bathwater"/ indiscriminate selling, including meaningful selloffs in investment grade & "money good" investments • Rush to cash and rumors of banks and ATMs running of money	• New virus cases are slowing down in their growth rate • Government has a plan to deal with the pandemic • News that we're officially in a recession (it's a lagging indicator) • Huge fiscal and/or monetary stimuli • Unemployment rate / unemployment claims are up very sharply • General panic amongst investors and unwillingness to take risk • Very volatile up and down trading days	• Pandemic is nearly under control, with viable drugs and/or vaccine either available or soon to be available • More monetary & fiscal stimuli, likely dealing with specific problematic areas and/or reforms • Credit defaults are up meaningfully • Credit rating agencies proceed with meaningful credit downgrades • Markets calm down and begin a relatively steady climb up	• Covid-19 risk is largely resolved via widely available vaccinations • GDP growth is resuming • Unemployment rate is decreasing • Talk of potentially higher interest rates and/or inflation pressures • Policy response and likely more regulation • Credit defaults peak • More and more, investors are willing to take on increasingly risky investments
Are we there yet?	Either happening right now or may be already behind us	If not there already, we may be there very soon	No	No
How long does it last?	Probably <3 months	Likely no more than 1 year	Uncertain, but could be 1-3 years	Uncertain, but could be 3-5 years
Our action plan	• "Battening down the hatches" • Monetizing strategies that have held up, including tail hedges • Cancelling planned investments that may be affected • Keeping a close eye on potential liabilities, including capital calls or margin calls • Figuring out the plan for future action • Incrementally start taking equity risk for clients who are meaningfully underweight equities	• Quickly investigate dislocated opportunities, particularly those in a liquid fund format, that are shorter dated, and/or those in higher quality asset classes • Deploy a basket of such opportunities • Bring up equity risk in clients' portfolios to target and opportunistically add more beyond that point	• Research a wide variety of relatively liquid market opportunities across a multitude of asset classes, sectors, and fund structures • Rotate Phase 1 investments (including broad equity indices) into more targeted segments, including more "punchy" strategies • Consider rotating some indexed strategies into an actively-managed portfolio	• Research a wide variety of drawdown-structured or single deal opportunities across a multitude of asset classes and sectors • Rotate Phase 1 investments (if any are left) and perhaps some Phase 2 investments into these illiquid opportunities
Specific Investments	• S&P 500 or similar large-cap indices • Select blue-chip stocks	• Basket of liquid funds in dislocated areas (such as high yield corporate credit and structured products) • S&P 500 or similar large-cap indices • Select blue-chip stocks • Merger arbitrage	• Opportunities may include concentrated funds (including sector-focused ones), relatively liquid stressed / distressed strategies, structured products, small cap value equities, MLPs, airlines, energy, retail, hospitality, mortgage REITs, BDCs • This is best implemented via a basket of a handful of opportunities	• Opportunities may include illiquid distressed / restructuring strategies, private credit, commercial real estate, and direct deals • This is best implemented via a basket of 2-4 opportunities

Important Disclosures

The views and opinions expressed above should not be construed as recommendations, an offer to sell, or a solicitation of an offer to acquire any security, investment product, or service. There is no guarantee that historical risk, rates of return, or scenarios discussed will persist in the future. All investments are subject to risks. Prior to investing, investors must familiarize themselves with entity offering materials and be prepared to absorb the risks associated with any such investment, including a total loss of all invested capital. The information provided herein is not intended to replace or serve as a substitute for any legal, tax or other professional advice, consultation or service. Prospective investors should consult with a professional in the respective legal, tax or other professional areas before making any decisions regarding investments.

Permit Capital Advisors, LLC has prepared this report utilizing information from third parties, and took reasonable care to ensure the accuracy of the information. Permit Capital Advisors, LLC does not warrant its completeness, accuracy or adequacy, and it should not be relied upon as such. The statements included in this material may constitute "forward-looking statements" and are subject to a number of significant risks and uncertainties, including but not limited to those set forth under "Noted Risks and Concerns" and "Risks and Opportunity Table". Some of these forward-looking statements can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "will", "should", "seeks", "approximately", "intends", "plans", "estimates", or "anticipates", or the negative thereof or other variations thereof or other variations thereon or comparable terminology. Due to these various risks and uncertainties, actual events or results of the actual performance of an investment may differ materially from those reflected or contemplated in such forward-looking statements and no assurances can be given with respect thereto.

This presentation is produced solely for the recipient and may not be transmitted, reproduced or made available to any other person. Permit Capital Advisors, LLC is registered with the United States Securities and Exchange Commission ("SEC") pursuant to Section 203(c)(2)(A) of the Investment Advisors Act of 1940. Past performance is not necessarily a guarantee of future results.