Dear xxxx;

The goal of the Federal Reserve is to promote a strong US economy by maintaining maximum sustainable employment, stable prices, and moderate long-term interest rates. A black swan event is an unpredictable event beyond normal expectations with potential serious consequences. Examples include but are not limited to September 11, 2001; the bankruptcy of Lehman Brothers; COVID-19; negative oil prices; etc. As has been done during past black swan events, this year The Fed has repeatedly stepped in to prevent US economic annihilation. In his 1970 book *Winning on Wall Street*, Dr. Martin Zweig coined the phrase, “Don’t Fight the Fed.” “Don’t Fight the Fed” means investors should never bet against the US especially once the Fed has begun taking preventative action after a black swan event.

During the last three months, fixed income was up (+2.90%) this, US Stocks (+22.13%), International Stocks (+15.38%), and Commodities (+10.47%) saw significant reductions in value. Markets were once again extremely volatile this quarter. Out of 64 trading days, the S&P 500 closed up or down more than 2% seventeen times. This letter will provide an analysis of the major geopolitical, financial, and thematic events that shaped the quarter.

Alphabet Soup, A Nike Swish, & A Square Root Sign

As COVID-19 began spreading throughout the world, economists, pundits, and seemingly everyone else has offered a different letter or sign to try to paint a picture of what the economic fallout and recovery would look like. Even before the stock market rout began, the most regularly touted symbol was the letter V. However, during this quarter, we have heard everything from the letters L, U, V, and W, to a Nike Swoosh, and even a square root sign.

The letters and symbols do not have any meaning in themselves, instead they are used to predict what the future holds. Looking at the US stock market through June 30, 2020, it certainly does look like a Nike Swoosh. US economic data is mixed. After tremendous drawdowns in manufacturing, housing starts, and consumer confidence in April, May and June have revealed dramatic improvements. However, two areas not improving nearly as quickly are the labor market and the surge in COVID-19 cases in the US. Currently, the US is facing an unemployment rate of 13.3% with first-time unemployment claims of 1.48 million last week. To prevent another stock market correction, Congress must either extend the $600 supplemental unemployment insurance that expires July 31st or provide a different benefit to individuals who have lost their jobs due to the pandemic.

FAAMG versus SPY versus World ex US Equities

Facebook (Q: +36%, Y: +11%), Apple (Q: +44%, Y: +25%), Amazon (Q: +42%, Y: +49%), Microsoft (Q: +29%, Y: +30%), Google (Q: +22%, Y: +6%) have performed exceptionally well this year. These are the five largest companies in the US by market cap and they represent 21.63% of the S&P 500 Index. While FAAMG has absolutely crushed it this year, the remaining 495 companies in the S&P 500 have not been so lucky. FAAMG’s 21.5% weight in the S&P 500 is one of the primary reasons the S&P is trading so close to its record highs reached early this year, before COVID-19.

Looking at the equity markets through a broader lens, we can see a truer representation of the world's performance in 2020. The S&P 500 excluding FAAMG has returned -9.87% this year while the MSCI All Country World Index excluding the US returned -12.16% this year. While the markets excluding FAAMG are down, they are not performing nearly as poorly as expected given the extremely high unemployment and the fact that COVID-19 is an active, highly transmittable, deadly virus with no cure nor vaccine.

COVID & Economic Reopening Trade

Based on data disseminated by John's Hopkins Coronavirus Resource Center (https://coronavirus.jhu.edu/map.html), on June 30th, 2020, globally, COVID-19 has infected 10.4 million people, killing more than 500,000. In the US, 2.4 million have been infected and 125,000 killed. At the time of print, there is no vaccine and there is no cure. However, a vaccine is expected in the next few months and there are treatments available that have been shown to be effective at saving the most critically ill patients. While hospitalizations are increasing quite dramatically across the US, the mortality rate is decreasing. https://www.cdc.gov/coronavirus/2019-ncov/covid-data/covidview/index.html

Starting in late April US states began reopening their economies. For the most part, the states with the fewest restrictions have seen the largest increase in new positive cases. The rise in cases has led to a few dramatic market drops; however, the stock market spent most of the quarter on an upward trajectory. Reasons for these gains include optimism, fresh capital printed by the government and dropped into the hands of almost all US citizens, and a lack of anything to do with the money aside from buying stocks. New accounts on Robinhood and discount brokers have skyrocketed, trading is up 2-300% year over year.

The economic reopening trade is defined as companies that will surge back to life once the economic shutdown has been halted. These companies include hotels, restaurants, airlines, mall REITs, retailers, etc. Several of the companies in these sectors have climbed 100% or more from their 52-week lows reached on or near March 23rd. We believe many of the stocks in these sectors have run up too high and too fast and we expect them to pull back in the immediate future.

Federal Reserve Actions Continued

During the second quarter the Fed has continued to assuage the US stock market. Below is a list of the actions that have been taken by the Federal Reserve during the second quarter to shore up the economy:

- Purchases of fixed income exchange traded funds
- Purchases of fallen angel Bonds – this is debt of companies that were investment grade but have recently been downgraded due to COVID-19 related concerns
- Purchases of commercial mortgage backed securities (CMBS)
- Purchases of residential mortgage backed securities (RMBS)
- Expansion of the Main Street Business Lending Program to lend money to small and midsize businesses

- Purchases of investment grade individual company corporate bonds
- Creation of a Municipal Liquidity Facility to lend funds to municipalities to help manage cash flow stresses caused by COVID-19
- Publicly pledging to keep interest rates at or near zero until at least 2022

The actions taken by the Fed and the money shoveled into the market during the second quarter are two more reasons the US stock market has performed so well. If the market remains where it is or moves higher, we do not foresee additional monetary actions by the Fed. If the market should collapse back to or near its March lows, we believe the Fed may begin purchasing US Equities but will not set the Federal Funds Rate below zero.

Fixed Income Quick Update

The US and international fixed income markets traded normally during the second quarter. When yields rose prices dropped and vice versa. The Fed provided liquidity and the market prices of all fixed income ETFs stabilized moving upward to meet their net asset values. The first quarter fixed income dislocation was painful yet short-lived.

Oil Goes Negative

On April 20 at 2:08pm ET, the price of a barrel of oil did the unthinkable and fell below zero for the first time ever. In fact, the price of a barrel of West Texas Intermediate (WTI) fell as low as -40.32. The ability of oil to fall below zero is due to a technicality in the oil market. Oil is traded on its future price and if an investor holds a contract when it expires, they must take physical delivery of the oil. The May futures contract expired on April 21, so traders were liquidating their positions to avoid taking delivery of the oil. This selling was happening amid a global pandemic, an oversupply of oil, and a drop in global oil demand. WTI is landlocked, so even if traders wanted to take delivery, the onshore oil storage was full. This meant traders had to sell for whatever they could get, even if that price were negative.

The largest losers were retail investors who held the United States Oil Fund (USO), retail investors who held the Bank of China’s Crude Oil Treasure, and Interactive Brokers, a high-tech discount brokerage firm. USO is an ETF that many retail investors believe tracks the price of oil. In fact, it tracks the future price of oil. As the oil market seized, the ETF had to liquidate its May contracts to purchase June contracts. The ETF could not take delivery, so it was forced to liquidate billions of dollars of futures. Investors lost about 50% in a couple days. The Bank of China’s Crude Oil Treasure was also forced to liquidate its futures near market lows and retail Chinese investors are estimated to have lost $1b. Finally, Interactive Brokers did not update their systems to allow for negative prices. This bug caused an $88m loss for their clients which was covered in full by the company’s reserves.

This was a black swan, and although it happened, the goal of any market is to be fair and orderly. Most market participants believe that negative oil prices were a once in a lifetime occurrence. There will be protections put in place to make sure negative prices do not happen again.

Conclusion

COVID-19 is a terrible disease wreaking havoc on our country, our world, and our way of life. The stock market has shrugged off the bad news and continues to recover more quickly than would be expected. On June 8th, the S&P turned positive for the year. By June 23rd, the Nasdaq was up 12.91% for the year. While both markets closed out the quarter lower than their recent highs, they are still trading at much higher values than could be expected given the problems our country is facing.

We believe that stock markets in the US and across the globe will remain volatile. There will be huge drawdowns caused by COVID-19 statistics and fears of economic collapse. The biggest fears at GA Pincus Funds are that spiking COVID-19 cases will force states to re-close their businesses creating more unemployment, coupled with the ending of supplemental unemployment benefits on July 31st. We believe it is possible for these outcomes to be prevented through acts of Congress, however, these are the worries that keep us up at night.

That said, there will also be strong multi-day gains brought on by positive economic data and Fed/Congress stimuli. At some point there will be news of a cure or vaccine and stocks across the globe will soar. The order of these events is anyone's guess. At GA Pincus Funds, our goal is to help you profit from these market phenomena by continuing to buy low, sell high, and harvest tax losses where applicable.

Client Referral Network

One of the oldest and most successful methods to grow a business is through word of mouth. GA Pincus Funds has been fortunate and has grown substantially due to referrals made by you and your fellow clients. We would like to use our future quarterly newsletters to return the favor to our clients. We plan to dedicate a section of our newsletters to our client's businesses. Rather than list your name or company name, we will instead indicate the category of business and location where you operate. For example, Real Estate Professional in Chicago, or Employment Lawyer in Georgia, or Public Relations Professional in New York, etc. If you would like to participate in this program, please let us know. This referral program is **free marketing** for your business. **We will not accept payments for these referrals.**

Performance Calculations

The performance of your accounts is calculated daily, taking into consideration daily deposits and withdrawals, and those daily returns are combined to form your quarterly, YTD, and since inception returns. When we round off this enhanced precision it may shift your performance by 0.01-0.02% when compared to the calculation ((end date value – start date value)/start date value). Please note, the performance figures on your statement are accurate and are GIPS (Global Investment Performance Standards) compliant.

It is impossible to predict whether and by how much the market will increase or decrease. Our algorithm rebalances your accounts according to changes in the relative weightings of the securities you hold. As one security becomes too heavily weighted the algorithm sells shares in that security. Conversely, as one security becomes too lightly weighted, the algorithm purchases shares of that security. Instead of rebalancing based on time (as most managers do), this algorithm rebalances based on a securities' relative weighting in the portfolio. This gives GA Pincus Funds a long-term advantage. No matter what the market does in the future or has done in the past, if your time horizon is long enough (>1 year), this algorithm has proven itself to be successful.

Please stay safe and healthy. I am always available to answer any questions you may have.

Best regards,

Gabriel

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