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Dear Clients of MacDougall Financial, July 24, 2020

Don't do anything, just stand there.

It has been a half year of uncertainty, conflicting data, and "unprecedented" aptly describes our present global situation. In the span of a few months we have witnessed the destruction of 7 years of labor gains and have experienced back to back record quarters. The first Q witnessed record lows in the Russell 2000, followed in the second by a record advance in the S&P 500. Meltdown morphed to melt-up! The medical developments and federal stimulus are driving the market and we are living in a 'Stockdale paradox'. Admiral Stockdale, the longest POW in Vietnam (8 years) attributed his survival to his mental ability to hold two conflicting thoughts in his mind guiding his actions. In these Covidian times, it means we have to firmly believe we will successfully adapt and defeat the virus but be very realistic and fact-driven in analyzing and preparing for the long recovery road ahead.

The pandemic has triggered a concatenation of crises. What began as a health crisis, transitioned to an economic crisis, then a political crisis and risks becoming a constitutional crisis in Europe, Hong Kong, and even the USA. The monetary and fiscal authorities are 'helicoptering' money to every market segment and to place this in historical context, the response so far is 20X the Marshall Plan, 5X the New Deal, and 4X the cost of the Vietnam war. The Fed backstops the entire market via its policy of yield curve control (YCC) across the duration spectrum. It is financing the fiscal policies of the Treasury and the adage of "don't fight the Fed" is truer than ever given the unity between the Fed and Treasury. This blunder-buss of money is responsible for the perceived divide between the market performance and the economic data. Despite enormous economic dislocation, the NASDAQ is at new highs up circa 14% YTD and the declines in the S&P 500, the Dow, Russell, and other major indices are mostly single digits. Squaring this with 22-24 million unemployed, massive revenue declines for most private and public entities, the collapse of key labor-intensive sectors like restaurants, lodging, entertainment, travel, education, and retail requires great mental dexterity….aka living a paradox! Deflation remains a greater threat than inflation hence the wide-open money spigots. Thanks to the fat thumb of the Fed, interest rates are anchored near the zero bound. It is a struggle to comprehend a world in which Italy borrows 10-year money at rates below the US Treasury. Unfortunately, this means you are not being paid in the bond markets for the risks you are taking, hence the tailwind to equity investments. To be clear, we at MFC remain cautious about deploying new money into the equity markets. While a depression remains highly unlikely given the actions of fiscal and monetary authorities, we believe the full dislocation of private and public finances has not been priced into the market. This is especially true if the recent uptrend in infections and death rates continue. Hopefully, the negative medical trends subside and forward economic clarity improves. Caution is prudent since the present downside risks exceed the upside potential. The future has never been more opaque, buckle your seat belts!

The stock market is a forward cash flow discounting mechanism and essentially it has forecast a recovery before the economic data corroborates. The jobs data shows this clearly for while we have added 7.5 million jobs in May and June, this is barely 1/3rd of the 22 million or so lost jobs indicating there is a long way to go. Daily we are seeing new bankruptcies and layoffs from both private and public sectors so a full return to normalcy in economic and labor market terms is a distant prospect. We experienced the fastest bear market ever in March (down 34% in 3 weeks!) and followed this in April/May with the fastest bull market ever (up 44% in a few weeks!). Along the way, there have been significant dislocations in both the credit and equity markets and these

contortions have reduced accurate price discovery. This is the time to sit on the sidelines and let the market reestablish a pricing discipline. You have the luxury of "doing nothing" because your safe low volatility assets cover months to years of expenses. Over the next few months, either the equity prices will have to align with the fundamentals, or the fundamentals will have to catch up with the equity prices. In all likelihood, a bit of both will occur.

The pandemic has certainly accelerated many of the pre-existing disruptive forces. Retail is declining more rapidly and fully 25% of total retail establishments might close. The dominant tech platforms have become more ubiquitous, powerful and their large cash positions will enable them to gobble up competitors. These FAANG++ growth companies continue to outperform value stocks making this one of the longest growth cycles ever. Governments are expanding, becoming more interventionist and surveillance is no longer a dirty word! The deglobalization of supply chains has been given a major boost. The geostrategic (aka gastrostrategic) cleavage between China and Developed Countries will proceed apace. Going into the year, China produced 97% of the world's antibiotics and was the dominant supplier of active pharmaceutical ingredients. This will change regardless of who wins in November. Lastly, the protests across the US are being partially driven by the uneven impact of the shutdowns adding to income inequality.

Looking ahead, the second half of 2020 will not lack for excitement. While we can hope for a gradual recovery, volatility is likely to be high and the markets choppy. This is the time to make sure your liquidity is sufficient for remember that "the market can be irrational longer than one can be solvent". Further market advances are very possible as the opening proceeds and our medical arsenal advances provided the virus is 'tamed'. Another stimulus package north of $1 trillion is highly likely as both political parties are in campaign mode. Tax increases will be off the table (until post elections) due to their deflationary & voting impact, modest expenditure cuts might occur, but more debt will be the primary funding source, most of it bought by the Federal Reserve. Given this backing, it is wise to maintain a reasonable exposure to equities (>33% for the elderly, >50% for the young) in line with your age, financial situation, and risk tolerance. For fixed-income investments, the lack of income from government bonds pushes one up the risk curve and the net income gains are often minor. Thus, cash and even gold are becoming attractive investments once again.

In conclusion, we are on a rollercoaster with no end in sight. Success is guaranteed but returning to "normal" is a challenging goal with no definitive time horizon. Some adaptations will be permanent and many sectors will not return to their 2019 operational levels for 3 or more years. Many of the labor and economic dislocations are not fully priced in due to the massive subsidies by the Treasury and Federal Reserve. No one can predict the future, now more so than ever, but rest assured we are in full capital protection mode and are closely monitoring risk in all portfolios. In the spirit of "laughter is the best medicine", I will paraphrase and close with the following: We are at a fork in the road, one path leads to desolation, the other to extinction, pray we have the wisdom to choose correctly.

Please contact us with any queries and stay healthy!

Best, Lanny