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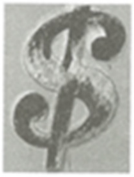

May 26, 2020

Our last intra-quarter communication was written mid-March in what felt to be the jaws of the storm. We hope that the note conveyed confidence in the United States, its economy, and our financial markets. The world seems a bit more settled today although there is no shortage of uncertainty. Now may be an appropriate time to share our thoughts on the longer-term inflections created by the COVID-19 pandemic. First, however, a brief recap of our take on the last two months is useful:

- State mandated lockdowns cause the economy to "hit a wall" with 40 million unemployment claims testifying to the crash's force of impact.
- Trillions of dollars of fiscal stimulus were enacted to bridge the country through the lockdowns.
- The Federal Reserve lowered rates to practically nothing, resumed quantitative easing, and provided targeted liquidity to credit markets.
- Much of the equity market appears to have so far pulled off the rare "V"-shaped recovery (Yes, many believe that "V's" are akin to unicorns but you don't see pandemics very often either.)

We attribute the market's rebound to investors looking over the proverbial valley to recovery on the other side. April's economic data was awful but stocks are focusing more on the forward trajectory than the current level of activity. If one looks carefully, green shoots can be seen and we believe that pent up demand is evident. Of course, investors find it much easier to be optimists when floating on a sea of liquidity provided by the Fed.

The timeline of the virus, more specifically the rate of change in new cases, appears to be a determinant force for the economy and financial markets. We recently entered the reopening stage with all states at least partially relaxing lockdowns. It is difficult to estimate the timing or rate of the national recovery given that states' policies vary widely. Recovery is likely to be uneven and it should be noted that two of the largest economies, California and New York, are in the earlier phases of restarting. That said, we anticipate that investors will remain focused on the broader pattern of an improving economy. The potential of a resurgence in new cases due to reopening is an obvious risk. Investors can probably live with some bumps in new cases as long as there are not major shutdowns again.

Longer-term, the pandemic creates both risks and opportunities (sorry for the cliché but it is true.) An almost universal concern is that there must be some type of eventual payback from the extraordinary monetary and fiscal stimulus undertaken. We find some of these payback fears less alarming:

- Emergency liquidity measures creating higher inflation: Inflation was not built during previous cycles of quantitative easing; we have an extremely long runway from today's depressed levels until capacity utilization commands pricing power.
- Massive supply of Treasury bonds eventually leading to higher interest rates: Eventually is a tough period of time to evaluate but the current liquidity should depress rates for an extended period; U.S. government obligations offer safe haven value in a tumultuous world.

The risks that we are more focused on include:

- Damage to small businesses derailing recovery: Access to capital is imperative in a crisis and this is where small businesses are most vulnerable; it is unclear whether government funding programs are sufficient to preserve small businesses' critical job creating role; data on small business in the aggregate is not readily available.
- Risk of negative U.S. interest rates: Interest rate options recently priced in about a 20% possibility of the Fed Funds rate going below zero; the U.K. government recently issued negative rate bonds for the first time; the Fed has publicly expressed its disdain for this policy option probably because it would hurt the banking system (think of Europe) as much as any benefit; we view this risk as more of a possibility than a probability.
- Slower long-term GDP growth: The pandemic's economic destruction and the indebtedness created theoretically drags on growth as measured over a decade or so; this is analogous to the "new normal" we lived through after the Financial Crisis; yes, GDP growth was slow but financial returns were impressive. Anemic economic growth can create political upsets, however.
- U.S.-China trade relations: The pandemic has already appreciably escalated tensions between the two countries. There is currently a groundswell of negative public opinion in America regarding China related to the origin of the virus. Politicians of both parties will likely vocalize this anger with punitive legislation proposed and, to a lesser degree, enacted. Adding fuel to the fire, China's plan to impose sweeping new security laws in Hong Kong demonstrates a calculated disregard for U.S. reactions. Regardless of whether this only amounts to a geopolitical game of chicken, the rhetoric creates an atmosphere not friendly to financial markets.
- U.S. politics: The November election was always going to create uncertainty, but public reaction to the virus, lockdown/restart policy, and severe economic damage adds even more unpredictability to the equation. For example, recent polls show that a change in control of the U.S. Senate may now be more likely. History demonstrates that there is often a political/legislative reaction to traumatic events. As an example, the Financial Crisis resulted in Dodd-Frank (which contained the Volker Rule and created the Consumer Financial Protections Board) and Basel III. This time around, the tax cuts (corporate and

personal) enacted in 2018 look vulnerable as they are a highly visible way to pay for some of the recent stimulus.

We should be clear that the laundry list of risks above are future possibilities rather than eventualities. Currently, the market is being driven by liquidity and an uptick in economic activity as we restart. Neither of these forces show signs of exhaustion, and we may be restarting the economic cycle just the way we have come out of previous recessions. Further, there are exciting opportunities particularly at the company and industry level near-term.

As described in our previous communications, the pandemic has accelerated the transition to a digital world, and we have added to this thematic. Online retailing comes first to mind, and we would like to share some commentary from a variety of company managements that have helped us gain conviction:

- On the pandemic's impact: "One profound change will be a dramatic acceleration from physical to digital."
- On sustainability of consumer habits in new categories: "I certainly point to grocery."
- On how long the shift online will persist: "It would be hard to say exactly how long any of the changes last, although I believe many of them will be permanent."

Importantly, the theme is far broader than e-tailing. For example, we have added to financial technology positions associated with e-commerce which is illustrated by the following management comment:

- "The pandemic has fundamentally altered consumer behavior and enterprise operations, making digital transformation a necessity."

The portfolio also contains sizable exposure to cloud computing but we would like to drill down a bit deeper into the Artificial Intelligence/Machine Learning sub-segment. We have a significant position in the leading provider of accelerated computer processing which enables the speed, efficiency, and power required by today's data centers, artificial intelligence/machine learning, and graphics rendering. Asked as to what opportunities the pandemic has created, the management responded:

- "The world's enterprise digital transformation and moving to the cloud is going to accelerate. Every single company can't afford to rely on on-prem[ises] IT."
- "A great deal of science being done on COVID-19 uses our technology for acceleration…including sequencing the virus…can accelerate genomics analysis from days to minutes."

The above quote reminds us that a vaccine is critical. We cannot add much to the conversation regarding timing but the progress to date is amazing and we believe that there will be a vaccine.

Life sciences and technology are on our side in combating the virus and those are two powerful allies. Best wishes,

Craig B. Steinberg