

Hi-Line Capital Management

Equity Market Update

March 9, 2020

The following is an update summarizing current equity markets and volatility.

The real world generally fluctuates between “pretty good” and “not too bad.” But, equity markets fluctuate more, between “overly optimistic” to “overly pessimistic” due primarily to human emotions. Current fears and concerns have resulted in equity market declines nearing 20% year-to-date.

Over the last two weeks, equity markets have become emotionally hijacked due primarily to:

- Coronavirus – Nobody presently knows the end result, but evidence suggests containment may be achieved with government intervention. This is based on recent results in China.
- Fear of recession – A prolonged pandemic, among other factors, may soon cause global economies to enter a recession.
- Reaction to lowered interest rates – The Federal Reserve unexpectedly lowered interest rates and the reaction has been largely negative.

As it relates to the equity portfolio managed by Hi-Line Capital Management, the year to date results have also experienced a decline similar to equity indexes. But, lower prices bring opportunity. The portfolio recently had 10% cash waiting for buying opportunities which is increasingly available and acted upon.

The following three industries have been most impacted by fear of coronavirus, recession, and lowered interest rates. Below are examples of potential investment opportunities.

- S&P Energy Index – down 44% year-to-date. The decline is generally caused by recession fears and the price war threat between OPEC & Russia occurring today. The portfolio had no energy exposure entering 2020, but recently acquired one new holding in the refinery industry with the prospect of adding more. The type of energy business most favored is not economically tied to the price of oil.
- S&P Airlines Index – down 32% year-to-date. The decline is generally caused by fear of disruption in travel volume due to coronavirus. The portfolio currently holds a 4% allocation and may increase its allocation as the long-term economics of the airline industry remain favorable while the prices have become substantially cheaper.
- S&P Banks Index – down 36% year-to-date. The decline is generally due to recession and low interest rate fears. It is somewhat surprising that banks are down more than airlines, but further proof anything can happen in the short run. Big banks, which represent 12% of the portfolio are less sensitive to the level of interest rates than smaller banks. Big banks derive approximately 50% of their income from non-interest income sources, which mitigates the economic impact of low interest rates.

The equity markets have substantially penalized the above three industries with declining stock prices, but several examples of long-term favorable opportunities now exist at better prices.

As discussed in the past, market volatility is a natural element of investing. The ability to experience and persist through periods of increased volatility is the psychological price paid to achieve favorable long-term returns. Hopefully this memo helps you in remaining patient, disciplined, and long-term oriented.

Thank you for your continued trust and confidence.