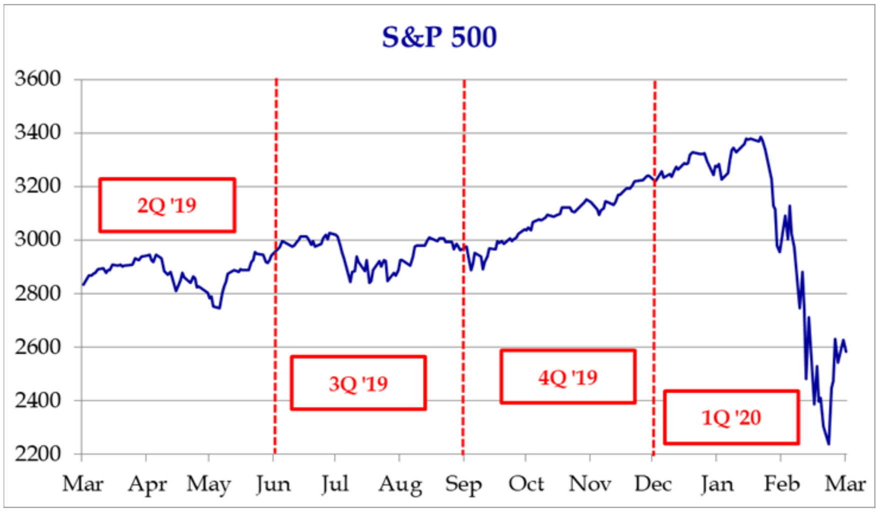
THE BLACK SWAN RETURNS;
THE WHITE SWAN IS COMING

Chart I



Source: Strategas

The end of the first quarter was marked by the fastest bear market in history. The U.S. equity market dropped approximately 34% from peak to trough in about three weeks in March. A pandemic outbreak of a virus called COVID-19 swept throughout the world in a matter of three months. By the time it reached Europe, the U.S. stock market was beginning to freefall. One should expect that the economic data that is likely to be released in the next three months will be equally unprecedented in the speed and degree of decline. This, of course, will reflect the impact of shutting down commerce and consumer spending by employing a stay-at-home containment strategy. Most economic experts are not sure what the total damage to the domestic and global economies will be but, suffice it to say, it will be significant. There is little doubt that the U.S. will fall into a recession due to the negative impact on global growth and the actual closing or partially closing of most businesses.

The result is widespread unemployment compressed into two months or more. In the last three weeks (as of 4/09/20), jobless claims show almost 17 million Americans have filed for unemployment. This surpasses the 15.4 million lost in 2009. A loss of this magnitude is also considerably more than the average of 11.7 million total jobs lost in past recessions. If that happens, we would give up our entire job growth of the last ten years. With this as a backdrop, some economists now are estimating a contraction of 30-35% in GDP in the second quarter of the year. However, the same economists, should COVID-19 be contained next year, suggest GDP growth of 1-2% is possible in 2021.

In the short term, corporate profits will be under considerable pressure. Originally, expectations were for earnings to rise about 5-8% this year from the approximate $158 a share forecast for the S&P 500 in 2019. Now we expect earnings to decline about 15-25% to $120-$125 in 2020. As an early guess on a recovery for earnings in 2021, we expect about $150-$160 a share at this juncture. While this puts the market at nearly 21 times current 2020 projected profits, it also means it is currently about 16-17 times 2021 expectations. Given that interest rates are near zero and are likely to remain very low through 2021 and beyond, current market valuations seem to discount much of the potential earnings declines to come in 2020.

Nevertheless, the debt and equity markets hate uncertainty. Until the country returns to some pattern of growth and unemployment trends begin to decline, the markets are likely to remain volatile. A slow recovery from the economic impact of COVID-19 should be evident by the third or fourth quarter of 2020. Barring a major resurgence of the virus in the winter of 2020-21, the debt and equity markets should show some form of stabilization or growth in the second half of the year. The suddenness of this economic problem gives us hope that the recovery will be reasonably fast. Our current expectations assume 18 months to two years to reach the economic levels achieved in 2019.

<u>THE WHITE SWAN FACTORS</u>

There are many positive factors that have not been fully felt in the economy as of yet. The CARES Act alone is a huge positive (Chart II). We list a few of the many positive trends that are about to emerge.

Chart II

CARES Act Provisions		FY20 ($Bn)
Households	Tax Rebates	$269
	Unemployment Insurance	$260
	Other Provisions	$12
Business Tax Changes	Employee Retention Credit	$49
	Payroll Tax Delay	$211
	Net Operating Loss Changes	$80
	AMT Credit Change	$3
	Modification of Limitation on Losses for Taxpayers Other Than Corporations	$74
	Interest Deduction Modification	$7
	Pension Plan Relief	$3
Small Business Loan Facility	Paycheck Protection Program	$349
Fed Business Loan Facility		$454
Loans to Passenger Air Carriers, Cargo Air Carriers & Businesses of National Security		$46

CARES Act Provisions		FY20 ($Bn)
Additional Air Carrier Assistance	Payroll Support for Air Carriers and Contractors	$32
	Suspension of Aviation Excise Taxes	$3
Health Care Response	Funding for Hospitals & Providers to Address COVID-19	$100
	For Medical Supplies in Strategic National Stockpile	$16
	R&D for Coronavirus Diagnostics, Vaccines, Therapeutics	$11
	For CDC	$4
	Aid to State/Local Governments	$150
	For FEMA Disaster Relief Fund	$45
	For Food Assistance (incl. SNAP)	$25
	For Transit Systems	$25
	For Airports (Grants)	$10

Source: Strategas

1. The Federal Reserve has dramatically increased liquidity in the fixed income market. It has moved even more forcefully and quickly than in the financial crisis of 2008-09. Additional support of $2.3 trillion has just been announced (4/9/20) to make credit

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available for small business and municipalities. The Federal Reserve support is unprecedented.

2. The U.S. government has passed a $2.3 trillion fiscal stimulus package (CARES Act). This is aimed directly at supporting all wage earners making $75,000 or less. This bill has also generously expanded unemployment benefits as well. Additionally, spending is also aimed at paying for healthcare costs directly due to the COVID-19 virus. Substantial money is also being set aside for hard hit industries; aid to state and local governments is also significant.

3. More stimulus programs are planned by the government including a long-sought infrastructure spending bill. If it takes on the form of the old CCC programs developed in the 1930s, it could create long-term benefits for the country and put many unemployed back to work.

4. There is a coordinated effort by the global healthcare community to develop a vaccine as fast as possible. Once a vaccine is developed, the global economic engine should again move to accelerate productivity within a matter of months.

5. European and Asian countries are also creating liquidity for various debt markets. Many governments are passing or have passed fiscal stimulus programs similar to the U.S.

While we hope for a V-shaped economic recovery, we expect more of a U-shape. Major metro population centers should see workers begin to return to their jobs by the summer. Even if a vaccine is not developed by this coming winter, the healthcare community will be far more prepared to react to any infection flare-ups. Testing and treatment procedures should be far more effective in the next few months. Their preparations and best practices learned from the last few months should allow for a return to a more normal economic recovery. If the healthcare industry can avoid being overwhelmed again, few, if any, personal containment programs will be needed in the future.

PORTFOLIO OVERVIEW AND STRATEGY

Due to the rapid economic downturn, corporations and municipalities have responded by aggressively tapping outstanding unused credit lines or issuing more debt. In addition, the FOMC has stepped in to provide further liquidity, and is backstopping businesses and now states that are suffering from severe revenue declines. However, regardless of the support, market reactions to this type of activity are generally negative and pricing dislocations occur. In both the corporate and municipal markets, spreads have widened dramatically, and bonds are trading at depressed prices (especially in the high yield markets). While concerning, this is a normal reaction during times of unprecedented economic stress. Our portfolios of individual debt instruments are designed to generally withstand these unprecedented downturns. At this juncture, we assume that should the

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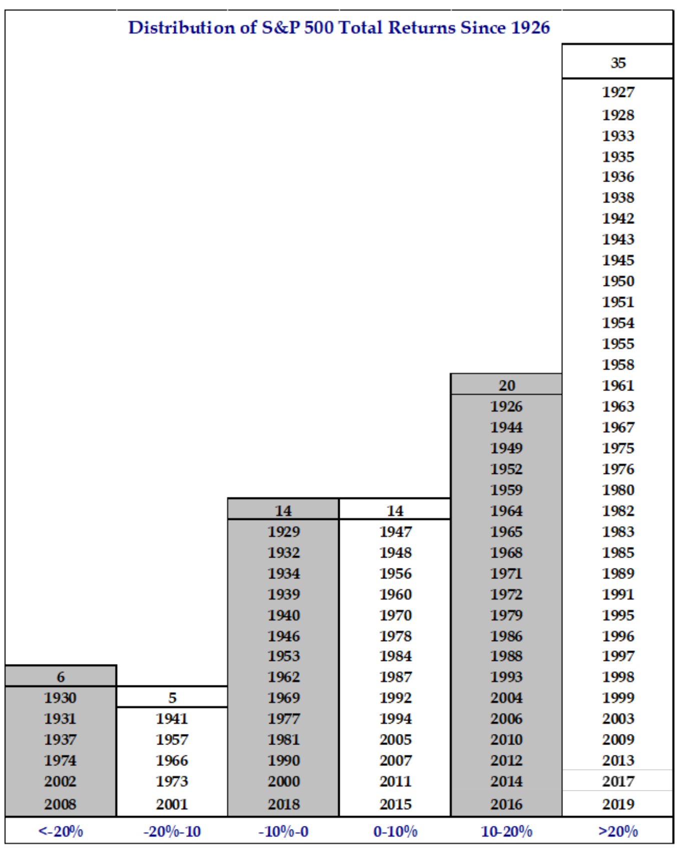
U.S. return to a slow but steady reopening of the economy shortly, the debt markets are likely to return to more normal levels

The equity markets are a different set of parameters. We believe that earnings risk is so unusual for 2020 that it may be largely discounted at this point. Stocks tends to anticipate six months or more into the future. The market is likely to shift its focus to 2021 shortly. Regardless, we believe it is fair to assume that the market is anticipating a return to a recovery in the economy by year end. As mentioned earlier, we believe that corporate profits for 2021 are likely to be flat to down about 5% from the levels achieved in 2019. With a moderate recovery in 2021, S&P 500 corporate profits should rebound to about $150-$160 a share. On a valuation basis, the market is selling at around 16-17 times 2021 earnings estimates. Given the expectation of interest rates remaining very low, market valuations appear reasonable at current levels.

We also point out that the market always recovers from unique economic stress. As Chart III demonstrates, long term, the equity market continues to grow. We believe that once a vaccine for COVID-19 is developed, the stock market is likely to return to its long-term growth profile.

Chart III



Source: Strategas

RECOVERY IS A WHEN, NOT AN IF

Over a 94-year period, the S&P 500 rose 10% or more annually 59% of the time. Long term, the U.S. equity market compounds at 7% plus. The COVID-19 virus is a problem that will likely be successfully controlled in the near future. As the U.S. and global economies recover, we expect equity returns to reestablish their upward pace of expansion.

The KPCM stock selections are based on core fundamental principles, which should give our investor base confidence that our selected companies should not only weather the current storm but emerge stronger. Many should gain market share in the coming months and years.

Our overall focus has been on strong management, strong free cash flow, returns of capital in excess of cost of capital and rising productivity over a cycle. In addition, a substantial part of our equity investments is in the digital economy. This has helped our portfolio withstand much of the cyclical nature of many mature markets.

A black swan event is rarely anticipated. The virus may be more stubborn than we currently understand. Virus infections are likely to reoccur. Keeping lockdowns in place may continue longer than we currently anticipate. Thus, the equity market could retest the March lows or pull back materially from current levels until the recovery potential is more fully understood. Nevertheless, the COVID-19 impact of the past two months will recede. When that happens, we believe our asset allocation, including debt and equity selections, should yield a strong pattern of recovery. Fiscal and monetary policy is very supportive of returning the U.S. economy to a strong foundation of growth.

We have enclosed a copy of our annual ADV Brochure and Privacy Statement for your review. As always, we request that each client provide us with written notice about any changes to their investment needs, goals, objectives, risk tolerances or investment restrictions to our advisory team. Should you have any questions, please contact us at your earliest convenience.

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