Our View

April 2020

Preface

First and foremost, everyone at New Providence hopes you and your family are healthy and safe. If you want or need to speak with any of us, for any reason, we are available at any time.

The coronavirus is not just a human health crisis, it is also an economic one; and while we are all working remotely, we are entirely focused on successfully managing your capital through this crisis.

Health Crisis

Let's start with a very basic question, can this crisis be resolved? Yes, it can. This is a positive and essential conclusion in being able to invest. What is currently uncertain is the exact timing of a solution, either the optimal treatment of disease symptoms, or a vaccine, or whether the virus just runs its course. However, the sophistication and scope of medical research today makes oft quoted comparisons to the 1918 Spanish Flu epidemic ill-suited in our view. A medical remedy is a matter of time, and one must be optimistic about significant progress and global cooperation on this front. The epicenter of the health crisis was China in December, now three months later, the country is re-starting essential manufacturing and services.

Economic Crisis

What will the economic impact be? Truthfully, it is too early to know as this is a function of both the industries that will be considered 'essential' and allowed to remain operational on some basis, and the duration of the economic shutdown. Potential scenarios for these outcomes can range from manageable to draconian. The good news, however, is that governments around the world are committed to putting a floor under this crisis.

Liquidity: First, the response to avert a liquidity crisis is being dealt with swiftly through massive monetary and fiscal policy coordination:

• The Federal Reserve has reduced interest rates to just about zero and said there is essentially no limit to what they will do to prevent a financial or monetary meltdown or freeze, or a significant increase in interest rates. Other central banks are responding with interest rate cuts and monetary stimulus as well.

• The U.S. Congress passed legislation for $2 trillion in fiscal stimulus to benefit individuals and businesses, equivalent to about 10% of national GDP. This impact will be greater though as it will applied very quickly.

• In aggregate, the G20 agreed to $5 trillion in economic stimulus, an enormous sum that will be spent relatively quickly, and should dampen the downturn and allow for a swifter recovery.

• It is likely that further efforts can and will be made if/when the private sector needs it to prevent an economic collapse.

Solvency: It is now clear that a global recession will occur this year. Industries such as energy, mining, airlines, restaurants, travel and hotels, will face the harshest of operating conditions while no business will be wholly spared. The strongest competitors though will survive and emerge with fewer competitors.

Companies with highly levered balance sheets and short-term debt repayments will face an existential crisis. We are focusing, as we have, on investing in the equity of high-quality businesses that should, with their strong balance sheets, be able to weather today's challenges and emerge competitively stronger post-crisis.

We expect that this crisis will generate distressed investment opportunities: from opportunities within the liquid credit markets, to opportunities for rescue financings and distressed-for-control strategies. New Providence is assessing these and other areas for attractive risk-adjusted returns and the potential deployment of capital.

Confidence: One only need to see the recent historically high U.S. claims for unemployment to recognize that consumer and business confidence and spending will be severely impacted. When the health crisis is averted, confidence and spending will return.

Our Focus

Our focus is on managing risk and reward and trying to optimize a balance between the two, and to do so with an intermediate to long-term timeframe. The global challenge at hand is significant; however, the economic damage incurred is not permanent. Investors need to recognize that timing market bottoms is elusive, but what will facilitate our understanding that it is close at hand will be the combination of: slowing spread of the virus; evidence that fiscal and monetary policy stimulus is working; and a capitulation in investor sentiment and positioning.

In March, we prioritized a number of tactics that we believe will have long-term return benefits:

- We modestly added exposure to U.S. equity allocations[1] on price weakness as the U.S. policy response has been the strongest, which ultimately should speed up the economic recovery.

- We are reviewing international equity allocations and assessing the various market dislocations. It seems probable to us that Asia will be the best situated international geography post crisis, although specific countries will vary significantly.

- We are raising additional liquidity in portfolios from our diversifying strategies,[2] which in aggregate, have protected capital relatively well in the downturn.

While equity markets rallied in the last trading days of March, we would not be surprised if markets remained volatile for some time before this crisis is resolved. The enormous daily volatility of security pricing is evidence itself that the markets do not know the value of the underlying equity or credit. One should not assume that near term negative prices equate accurately to the intrinsic value of your investment in the underlying business. Public markets though are re-pricing more quickly, and with better liquidity, than private markets, so while we will continue to look for attractive investments, regardless of structure, we view the immediate opportunity set in public markets to be more attractive.

Finally, in the history of mankind it has been fruitful to be “long” human ingenuity, resourcefulness, compassion, and perseverance. We expect this period in time will serve as another example of that.

[1] Portfolio specifics vary by client portfolio.
[2] Low to no correlation to equities.