Q2 2020

Maclura Investments

Quarterly Report

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In spite of the devastation caused by the world-wide economic shutdown in the first quarter, the stock market roared back strongly in the second quarter with its best return since 1998. The Morningstar U.S. Markets Index, a broad index that captures 97% of the investable market, returned 21.98% for the 2nd quarter, while remaining slightly down (-3.11%) from where it started at the beginning of the year. The recovery in stocks during the quarter was driven by the perception that the economic downturn caused by the self-inflected shutdown of the world economy to flatten the curve of the COVID-19 pandemic will be relatively brief with the help of the world-wide fiscal and monetary stimulus efforts.

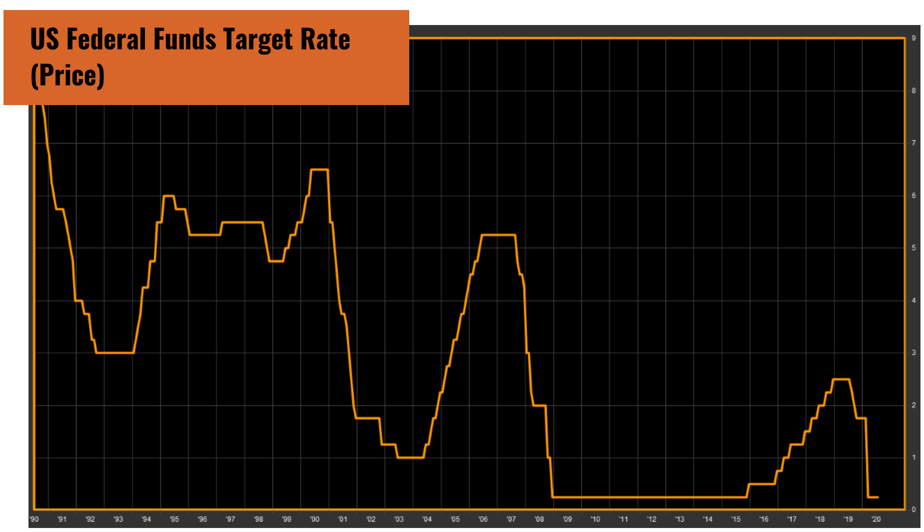
Growth stocks continue to outperform value stocks as illustrated in the table below. There are multiple reasons for this, but primarily, when investors have concerns about the growth prospects for the economy, they gravitate towards companies that have proven the ability to grow over the past several years.

The broadening out of the economy continues to be questioned daily as investors monitor the number of COVID-19 cases and extrapolate the trajectory of the economy. When looking over the past five years, the only significant period that value outperformed growth was after the passage of the tax reform late 2017, which helped give a boost to retailers that were weighted heavier in the value index.

At Maclura Investments, we continue to believe that growth stocks will outperform value stocks but we have been finding selective opportunities within the value universe to gain exposure for clients to diversify once the broadening of the economy takes place. The technology sector, which has a higher weight in growth indexes versus value has been the strongest sector year-to-date, as shown in the table below. The interest rate and economy sensitive sectors of financials and industrials, respectively, have been the weakest sectors year-to-date and are heavier weighted in the value indexes than growth.

Morningstar Index Market Returns	2015	2016	2017	2018	2019	2020 1st Qtr.	2020 2nd Qtr.	2020 YTD
Technology Sector	4.01%	14.06%	37.14%	-1.29%	46.66%	-12.27%	31.71%	15.54%
Healthcare Sector	7.13%	-3.44%	22.71%	5.91%	21.77%	-12.80%	15.86%	1.03%
Industrial Sector	-2.78%	18.71%	22.43%	-11.90%	31.40%	-27.47%	17.87%	-14.50%
Consumer Cyclical Sector	6.29%	5.75%	24.47%	0.09%	27.25%	-22.03%	36.20%	6.20%
Consumer Defensive Sector	5.57%	7.02%	13.27%	-8.40%	27.51%	-14.00%	11.43%	-4.17%
Financial Service Sector	-0.26%	20.63%	22.67%	-9.90%	33.37%	-29.53%	16.09%	-18.19%

With the U.S. declaring a national emergency on March 13th over the COVID-19 pandemic, the Federal Reserve options were limited when compared to past recessions, where historically, the lowering of short-term interest rates (the Fed Funds rate) by 500 basis points was the first course of action. With the Fed Funds target rate at 1.75% in February this year, the Fed had to resort to new options to support the economy.With the Fed Funds target rate at 1.75% in February this year, the Fed had to resort to new options to support the economy. As illustrated in the chart below, the Federal Reserve had been slowly increasing short-term rates in an attempt to reach a "normalized level" after years of near zero rates and multiple quantitative easing programs to reinvigorate the economy after the 2008 great recession.



Now with short term rates back where we started (0.00 – 0.25% range) and Fed Chairman Jerome Powell indicating that these low rates are here to stay at least through 2022, there aren't a lot of options for investors wanting income yield, particularly now that there is a new market participant in the corporate bond market: the Federal Reserve.

This is the first time that the Federal Reserve has implemented a corporate bond buying program to help maintain liquidity in the bond marketplace. The Fed actions magnify the interest in corporate bonds and keep borrowing rates low for quality companies. Additionally, Congress moved quickly and passed the Paycheck Protection Program (PPP) Act of $483 billion and approximately $2.3 trillion Coronavirus Aid, Relief and Economy Security Act package. That makes the $750 billion TARP fiscal stimulus package to address the 2008 financial crisis seem like chump change. Additional stimulus packages are being considered and will likely be coming.

To most people, this may paint a fairly bleak backdrop for the economy and the stock market, but to those that have been students of the market for decades, foreseeing what will likely happen with great probability requires that we face the fact that life always repeats itself if not perfectly, then roughly. As Mark Twain is famously credited for saying, "History does not repeat itself, but it often rhymes."

Similar to 2008, when companies are faced with great uncertainty, there is a rush to lock in their liquidity needs, whether they need it or not. Corporate bond sales exploded to over $1 trillion by the end of May, a figure not reached until November last year. Most companies have eliminated forward financial guidance, halted stock buyback programs, and reduced or suspended dividends to help conserve operating cash. Additionally, companies have been forced to revisit their operating model through the mandated shutdown of the economy and decide how to optimize their expense structure going forward. Certain trends were already in place, but the COVID-19 pandemic is accelerating the transition.

Transitions such as ecommerce are taking a large bite out of the brick and mortar business, and commercial real estate will have a difficult operating environment within retail and office space going forward, as employers are seeing an opportunity to decrease infrastructure overhead and while previously hesitant about the telecommuting business model, now fully embracing it. The most obvious example of benefitting a company from ecommerce is Amazon.com (AMZN), but digital platforms are flourishing in areas that most wouldn't anticipate. For instance, KAR Auction Services (KAR), a leading auctioning platform for car dealers, has transitioned all their transactions to online versus the traditional physical auction of multiple lanes of cars. Last year only 58% of its volume was done online. The COVID pandemic has accelerated their digital transformation of the physical auction industry in which, after weeks of being forced to buy vehicles online, buyers are increasingly more comfortable with the process. Not having the in-person auctions and driving the vehicles through the auction lanes on auction days will save KAR $25 million per year alone.

KAR is only one example of the transformation taking place behind the scenes as a result the pandemic that is positioning companies to expand profitability by lowering their expenses structure. This type of disruption is widespread with companies willing to incorporate new ways of conducting business in the environment forced upon them. Another beneficiary that isn't as obvious as Zoom (ZM) and other technology companies, is Dexcom (DXCM), a leading developer and manufacturer of continuous glucose monitoring systems for diabetes management. They saw an uptick in demand from the hospital setting, as physicians were utilizing the remote monitoring capabilities of Dexcom's system to monitor patients that were being treated for COVID-19. Align Technology, Inc. (ALGN), which has revolutionized the straightening of teeth with its clear aligner Invisalign product, is projected to further gain market share as orthodontists and dentists continue to cede more chair time to the utilization of Invisalign versus using wire and brackets to treat patients. The aligners increase workflow by decreasing the time a patient is in the office.

Additionally, the pandemic has created opportunities by the uncertainty of its impact on the economy, with one of the primary examples being the insurance industry. As a result of the nationwide shutdown, potential liability claims for business interruption has rocked the insurance companies' stock prices, creating an opportunity for investors seeking dividend income to find attractive yields. We would anticipate that courts will hear the challenging of business interruption claims in the coming years but would expect that insurance companies will prevail. In the meantime, high quality insurance companies are trading at attractive dividend yields for income seeking investors.

At Maclura Investments, our opinion is that this rapid adoption of innovation into business models, along with the fiscal and monetary backdrop, positions the stock market favorably to have a multi-year bull run, particularly in companies with characteristics that our discipline gravitates towards: strong secular revenue drivers, formidable competitive positioning, superior capital allocators, scalable business models, and effective commercialization strategies.

We do anticipate a choppy market going forward, as the resurgence of COVID-19 infections will potentially change local, state, and national policies daily. While we view the likelihood of another mandatory nationwide shutdown as unlikely, particularly with the election coming up in November, as of this writing, governors throughout the country are mandating that masks be worn at all times in public places as COVID-19 cases surge, and universities are altering their schedules for the fall semester in an attempt to have on-campus / in-person classes. Based on human nature, there is a high probability that COVID-19 cases will continue to increase. Humans are social animals and tend to resort to the path of least resistance, neither of which are congruent to social distancing. During the nationwide shutdown, most complied with the shelter-in-place guidelines. However, current enthusiasm seems comparable to the longevity of a New Year's resolution in the first week of February, regardless of the original intent.

We advise investors to look beyond the short-sightedness of the news cycle and look forward to find the opportunities in companies seeking to keep innovation moving ahead. During the past quarter, speculators and investors alike benefited from the rapid rise in the stock market. To most industry pundits, this was to be expected after the back stop provided by the central banks throughout the world. Going forward, things will likely be much more difficult, but we believe that our premier list of companies that have screened favorable with the Maclura Foundational Factors are well-positioned to excel.

Maclura Investments, LLC is a registered investment advisor that utilizes direct investing to build customized equity portfolios for individuals with as little as $100,000 to invest. For more information, go to MacluraInvestments.com