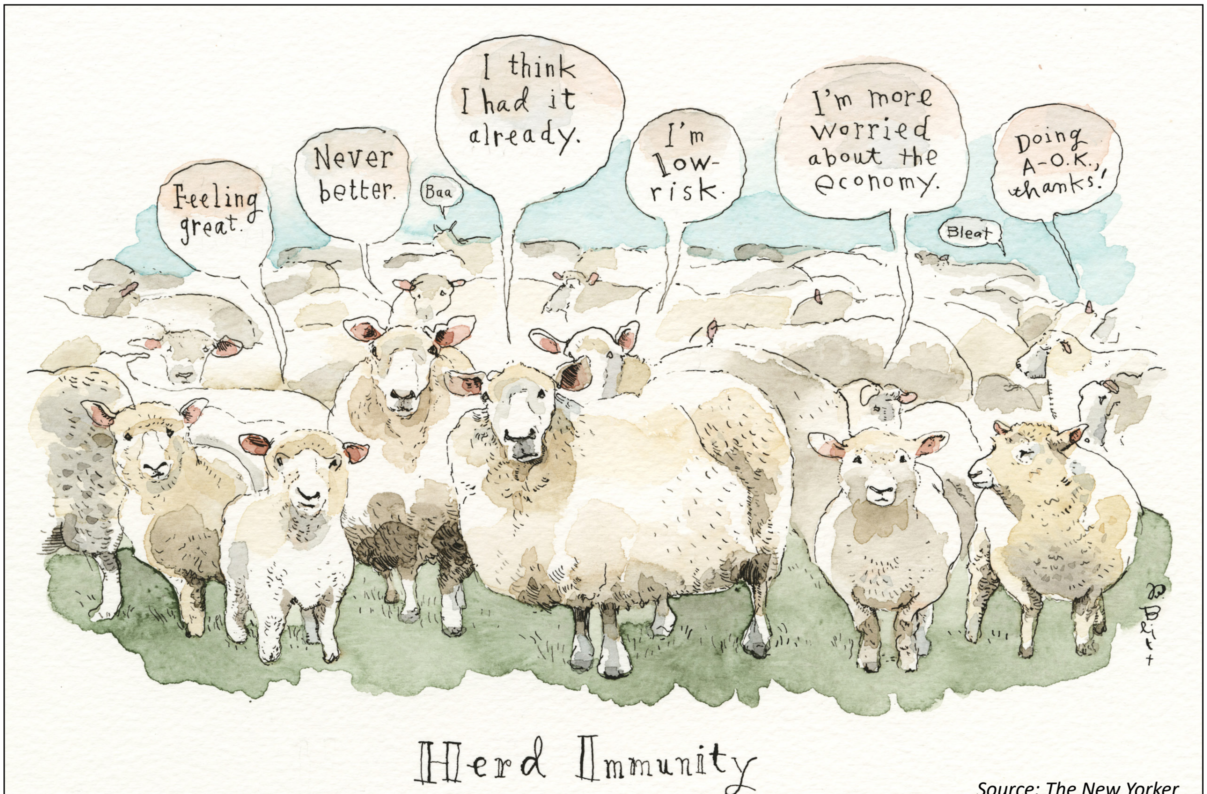
JAG CAPITAL MANAGEMENT LLC

2nd Quarter 2020

Quarterly Comments



Source: The New Yorker

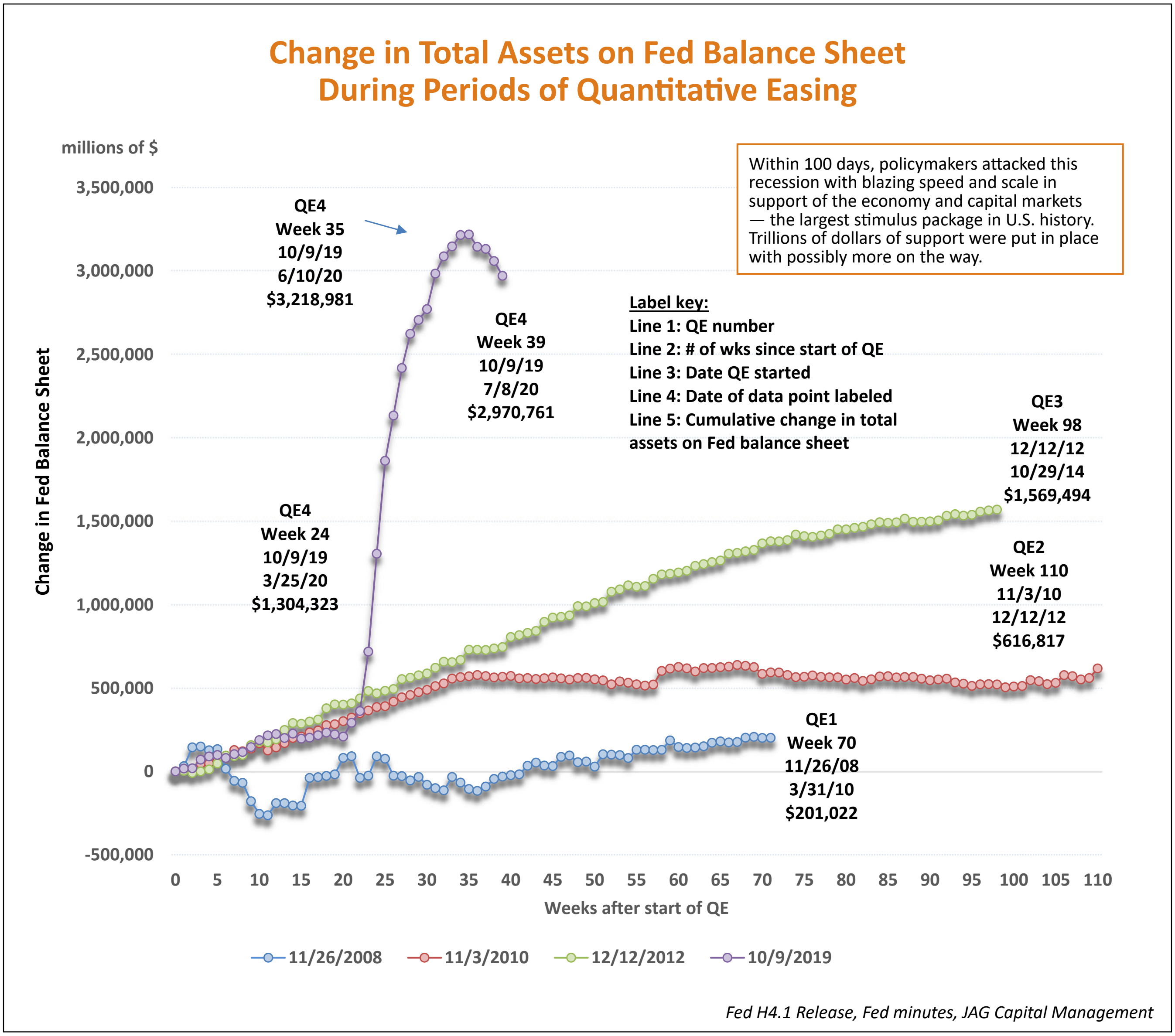
**Now this is not the end. It is not even the beginning of the end.
But it is, perhaps, the end of the beginning.**

– Winston Churchill, from a speech in 1942

Markets Make an Optimistic Forecast

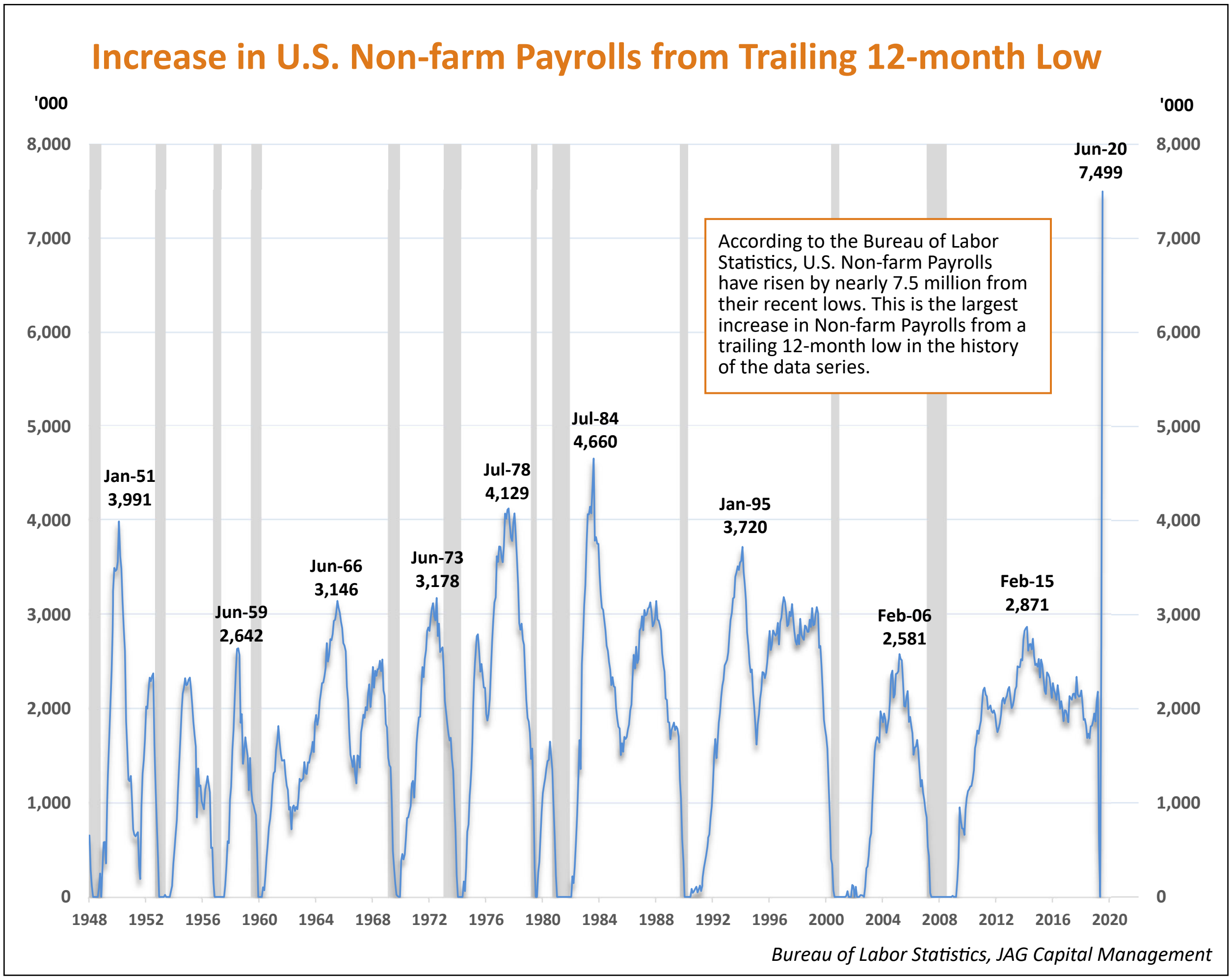
IT is almost impossible to overstate how tumultuous 2020 has been thus far. Indeed, for those of us who study history, the news flow of the first half of 2020 has “rhymed” with historical accounts of 1918 (global coronavirus pandemic), the 1930s (deep contraction in the economy and huge spikes in unemployment), 1968 (societal unrest and distress), 1987 (stock market crash), and 2008 (credit market liquidity crunch). All of this, and more, crammed into just a few months.

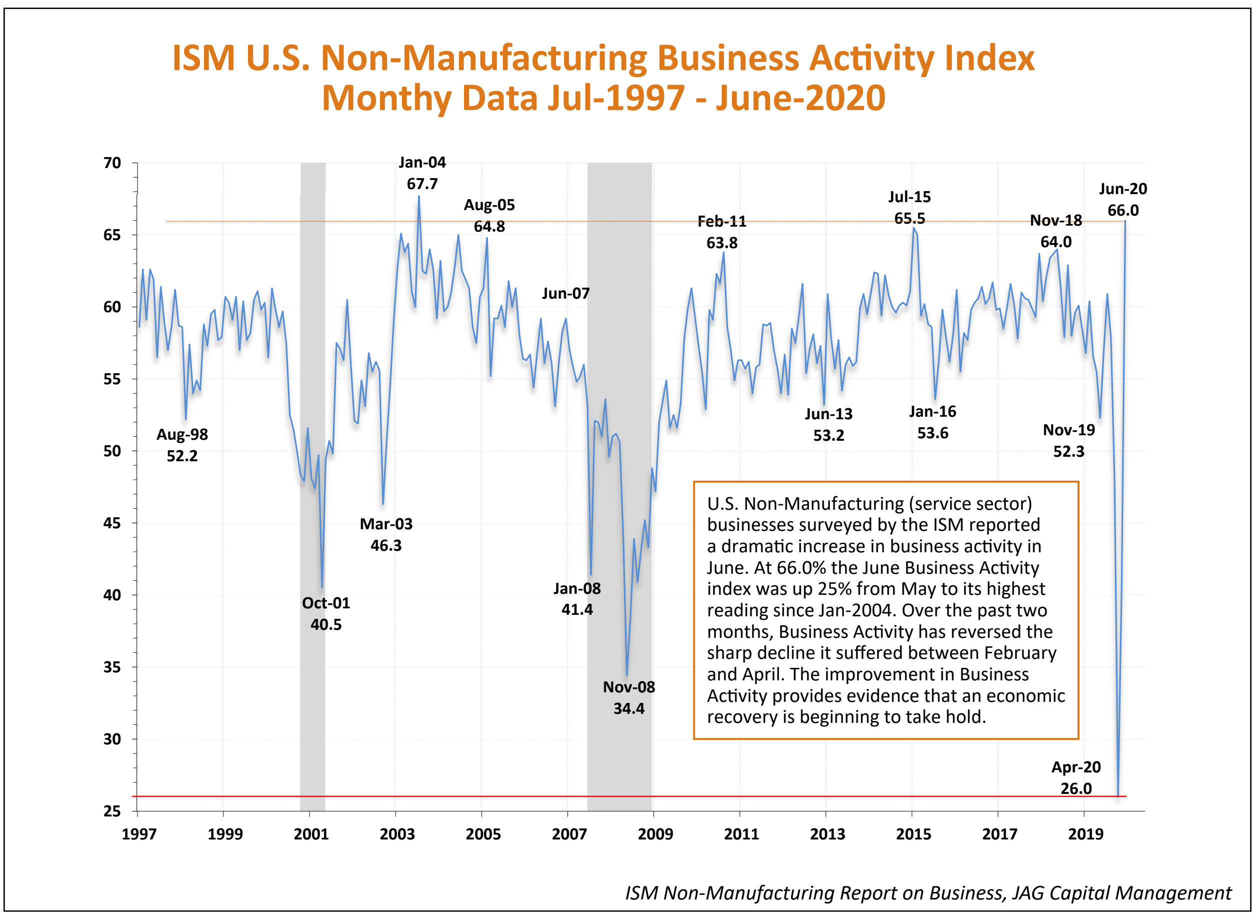
The fact that the capital markets staged such a remarkable recovery in the second quarter largely reflects the awe-inspiring and unprecedented actions by policymakers to mitigate the effects of the intentional shutdown of the economy. In contrast to their relatively slow response to the 2008-2009 Great Financial Crisis, this time we have seen lawmakers, the Fed, and Treasury intervene in the economy and markets with lightning speed and on a gargantuan scale. Remember that the $700 billion Troubled Asset Relief Program (TARP) was originally conceived by Treasury Secretary Hank Paulson’s staff in early 2008 to calm the credit markets. But, it took more than six months — and the sudden failure of Lehman Brothers in September 2008 — for TARP (Troubled Asset Relief Program) to be signed into law in early October 2008.



Far from the months of dithering and debate that characterized the dark days of 2008, this time policymakers have attacked the current self-imposed recession with blazing speed and scale in support of the economy and capital markets. The Fed announced a return to Quantitative Easing (QE) and Zero Interest Rate Policy (ZIRP) on March 15, coincident with the beginning of the economic lockdown. Since then, the Fed has worked with the Treasury Department to effect purchases of a variety of securities, including both investment-grade and junk-rated bonds. Less than two weeks later, on March 27, Congress passed the CARES Act to provide almost $2 trillion in direct aid to individuals and businesses. This represents the largest stimulus package in U.S. history. These trillions of dollars of support were put in place within just the past 100 days, and it appears that much more is on the way.

The fact that COVID-19 appears to be less lethal than projected by many early epidemiological models is probably also contributing to the recovery in the markets. Lower than worst-case fatality and hospitalization rates, combined with the rising probability that a vaccine may be available by the end of 2020, are allowing the capital markets to begin to discount an economic recovery over the next six to 12 months. Indeed, the global economy is already showing signs of recovery as businesses begin to re-open in both the U.S. and the developed world.


Increase in U.S. Non-farm Payrolls from Trailing 12-month Low
'000
'000
Jan-51
3,991
Jun-59
2,642
Jun-66
3,146
Jun-73
3,178
Jul-78
4,129
Jul-84
4,660
Jan-95
3,720
Feb-06
2,581
Feb-15
2,871
Jun-20
7,499
According to the Bureau of Labor Statistics, U.S. Non-farm Payrolls have risen by nearly 7.5 million from their recent lows. This is the largest increase in Non-farm Payrolls from a trailing 12-month low in the history of the data series.
Bureau of Labor Statistics, JAG Capital Management


ISM U.S. Non-Manufacturing Business Activity Index
Monthy Data Jul-1997 - June-2020
Aug-98
52.2
Oct-01
40.5
Mar-03
46.3
Jan-04
67.7
Aug-05
64.8
Jun-07
Jan-08
41.4
Nov-08
34.4
Feb-11
63.8
Jun-13
53.2
Jul-15
65.5
Jan-16
53.6
Nov-18
64.0
Nov-19
52.3
Apr-20
26.0
Jun-20
66.0
U.S. Non-Manufacturing (service sector) businesses surveyed by the ISM reported a dramatic increase in business activity in June. At 66.0% the June Business Activity index was up 25% from May to its highest reading since Jan-2004. Over the past two months, Business Activity has reversed the sharp decline it suffered between February and April. The improvement in Business Activity provides evidence that an economic recovery is beginning to take hold.
ISM Non-Manufacturing Report on Business, JAG Capital Management

"I can't remember—do I work at home or do I live at work?"

Source: The New Yorker

Market Outlook

TO paraphrase a famous quote from Winston Churchill, we may not be at the beginning of the end of the COVID-19 crisis, but we appear to be at "the end of the beginning." This implies investors should be looking ahead to the post-crisis and post-recession opportunities and risks. We see several broad themes that are likely to influence capital markets over the next several years.

We think COVID-19 has dialed up the speed of technological disruption. Pre-existing trends, such as the rise of e-commerce at the expense of physical retailers, have picked up additional momentum over the past several months. Mall-based retailers have been losing share to online sellers for years, but the spring 2020 closure of hundreds of shopping malls rushed JC Penney (JCP) and Neiman Marcus to the corporate graveyard earlier than would otherwise have been the case. On the other hand, Amazon (AMZN) has been one of several clear beneficiaries from the struggles of traditional retailers, and it has almost surely added to its dominant competitive position over the past four months. Similarly, rental car giants Hertz (HTZ) and Avis Budget (CAR) have been fighting a losing battle against ride-sharing services since the mid-2010s. The near-total suspension of business and vacation travel threw Hertz into bankruptcy within less than 60 days, leaving Uber (UBER) and Lyft (LYFT) as presumptive winners in the competition for traveler wallet share in the post-COVID-19 environment. The bottom line? Crises have a way of turbocharging the forces of change. We think the current environment is no exception, which means that investors are faced with both great opportunities and significant threats.

In terms of threats, lower rates, and a relatively flat yield curve could pose a stiff headwind for pockets of the market — especially banks. Traditional banking business models rely on borrowing short-term capital (in the form of deposits) and lending this capital out on a longer-term basis to borrowers. Banks then capture the spread between their cost of capital and the yields they earn on the loans they provide. This typically generates a relatively reliable profit. For most of modern history, this "borrow short and lend long" construct has produced steady (if unexciting) earnings growth for the banking industry. But the lower rates go, and the flatter the yield curve becomes, the profit engine for banks will be starved of fuel. We think this is a big reason the Financials sector remains mired in a bear market, with losses of more than 20% year-to-date.

While the outlook for legacy financial companies may be a bit cloudy, the COVID-19 crisis has accelerated the growth opportunities for selected financial technology companies ("FinTech"). We have long believed that the growth of cashless payment services is a secular trend. For a myriad of reasons, the use of physical cash has been declining for many years, in favor of debit/credit cards and digital payment options. The current environment is acting as an accelerant to this longstanding trend. Consumers have been forced to shift their consumption online, where cash payments are not an option. Shopping online allows consumers to avoid making physical contact in stores with transaction terminals. Also, even as consumers venture back into re-opened physical stores over the next several months, it is difficult to see a near-term future in which germ-conscious consumers will not recoil from manually entering their PINs into point-of-sales terminals or even ATM machines. Accordingly, we see opportunities for credit-card processing companies and digital payment solution providers to expand their businesses.

For better or worse, we expect higher-than-normal capital market volatility to persist into 2020s second half. In the coming months, investors will be closely following developments on the pandemic, the Presidential election, corporate earnings, the job market, and the economy. To put it mildly, this tangled thicket of potentially significant market-moving catalysts is unlikely to result in a smooth ride for asset prices. There is an old market saying that notes that investors can tolerate unlimited upside volatility. As we already have seen at various points earlier this year, the same cannot be said of how investors react to downside volatility.

Although we see plenty of intriguing opportunities to earn attractive returns in individual equities, we would not be surprised to see violent short-term moves in the markets over the next several months. Investors should manage their expectations and their risk exposures accordingly.

Longer-term, we remain optimistic that the global effort to defeat COVID-19 will succeed and that economic activity and the job market will continue to improve in coming months. Our team at JAG will continue to do our best to help our valued clients invest to achieve their goals.

We wish you good health and good fortune this summer. As always, please call or email us with questions or comments.

Norm Conley
CEO & CIO

Disclosures

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