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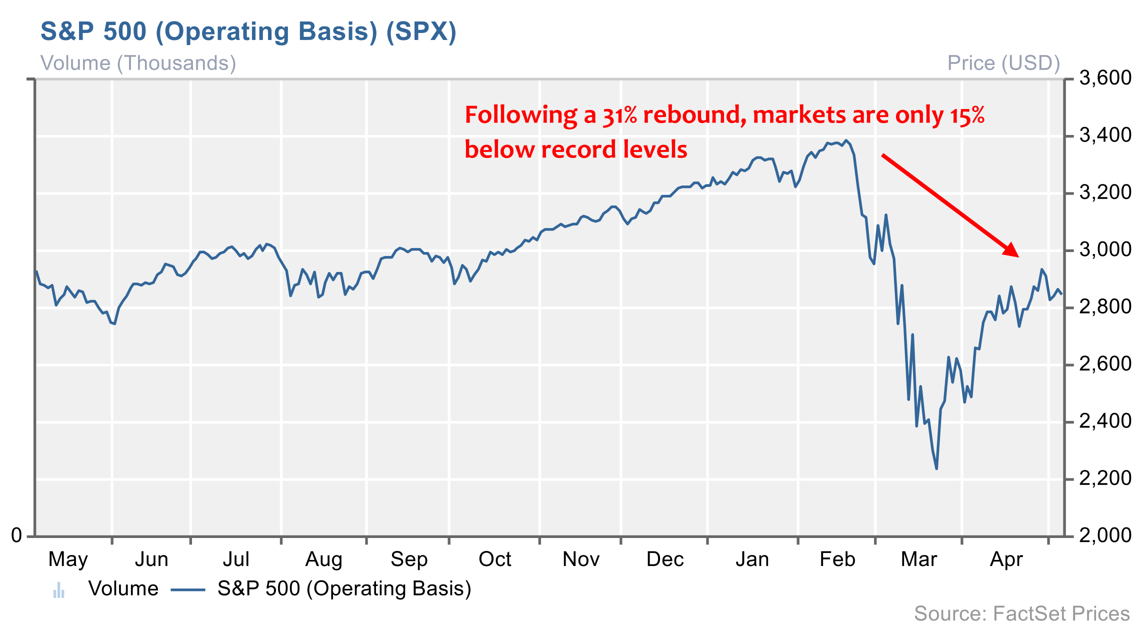
Isolated from Bad News

Summary: Despite the biggest disruption to life in a generation, it makes sense that stocks have barely declined. It's always difficult to obtain a perspective on something still in the process of happening, but we don't believe it is hyperbole to characterize Covid19 as the most disruptive global event since WWII. How then are stocks so little impacted? First, as we discussed last month, the market looks forward, and economies are already in the process of reopening. Second, the Federal Reserve is again backstopping the economy and flooding the market with liquidity. Similar efforts successfully saved the U.S. and global economy during the 2008-2009 housing and financial crisis. Most investors remember this. Third, investors are anticipating ***accelerated secular change***, and bidding up the shares of large technology and other companies, which are perceived to benefit.

Separate Fear from Fundamentals

Long-term approach helps to avoid getting triggered. Firstly, our sympathies if you or your family has been touched by the current crisis. Although this discussion focuses on investments, we do not want to appear cavalier regarding the real impact this situation is having whether from a health, economic or social perspective. With that acknowledgement, we also express our surprise and disappointment that media headlines continue to be totally dominated by stories driven by the Corona-Crisis. We believe this pernicious,

Figure 1. The market (as measured by the S&P500) dropped 35% over a month before rebounding 31%.

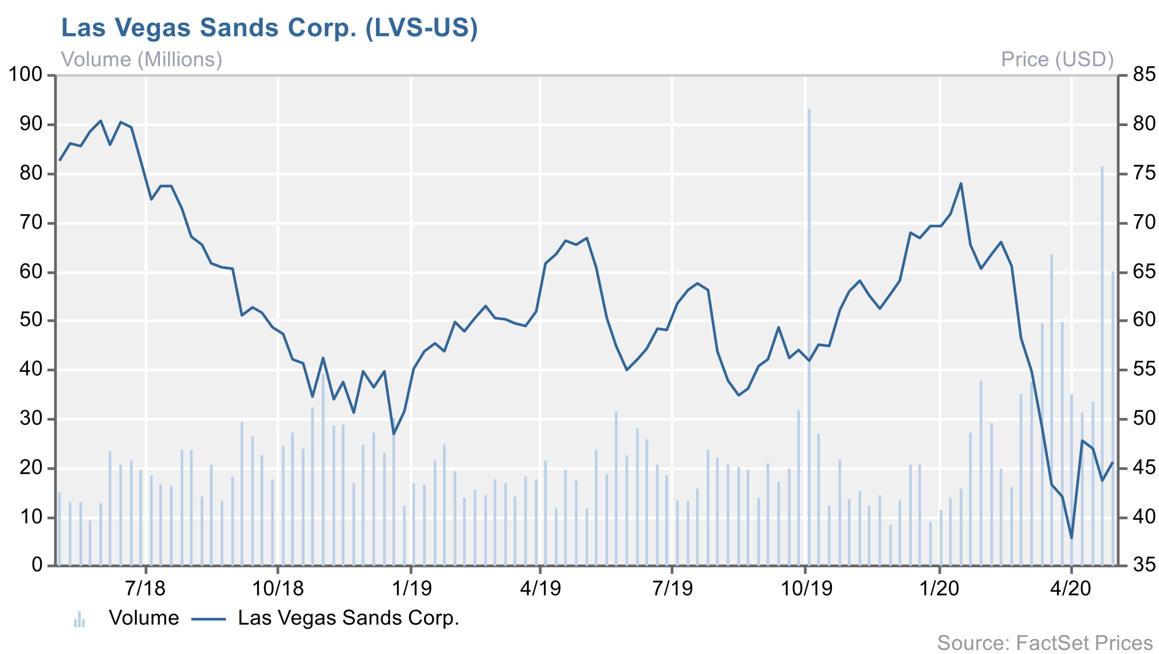


pervasive media noise has amplified social and economic distress related to the crisis. It is also serving to prolong the damage and delay the recovery, in our opinion. People are understandably scared after months inside a media echo chamber reverberating a drumbeat of death and destruction. For our part, we have tried to channel the stoic philosophers and resist all this outside influence. The reality is that, of course, we also felt anxiety and stress during the market's drive in February and March. The 35% rout from top to bottom (figure 1) was among the swiftest destructions of wealth on record. One of our largest personal investments was reduced by more than 60% during less than a month. How to approach this situation? First, know what you own. Second, *have an investment discipline* that includes a long-term outlook. If you're invested in the stocks of high-quality companies, with solid financial positions, competitive advantages, and the ability to grow, then you can look past short-term changes in the prices for these stocks, because they are not relevant to your investment outcome. Tune out the headlines trumpeting what's happening now.

Selection from our Client Portfolio: Las Vegas Sands (LVS)

The Casino operator is an attractive recovery play and long-term holding, in our opinion. In our discussions with professional investor clients, we have been breaking down our investment recommendations into three buckets. The first bucket includes ***defensive names***. These are companies where businesses are still operating during the coronavirus lockdown and may even be seeing increased demand. This bucket includes grocery and drugstore retailers, among other types of companies. In our portfolio, Costco Corp. (COST) is in this category. The second bucket are ***share consolidation*** stories. These companies may have current revenue trends impacted by the crisis, but they are in a stronger position than many of their competitors from a financial standpoint. We expect these companies to scoop up share as their weaker competitors fail. Home Depot (HD) was in this category coming out of the 2008-2009 housing crisis. Today, we see CarMax (KMX) as positioned to take share in the used car market, which remains very fragmented. We own both names. The last bucket are ***recovery plays***. These are companies where current business trends are severely impacted by the Corona-Crisis. They may not be operating at all. This is the bucket in which we want to be fishing right now. Our criteria includes solid balance sheets, good business models with fundamentals that were strong *prior* to the crisis, and where the stock price does not already reflect expectations for recovery. A name meeting these characteristics that we have bought recently is Las Vegas Sands (LVS).

Figure 2. Box Cars to Snake Eyes: Two-year chart for LVS. Shares are at the lowest levels in four years.



Las Vegas Sands (LVS) is among the premier hotel-casino (or "gaming") companies in the world. However, *malgré le nom*, it's really an Asian company. Only 10% of profits (EBITDA) come from Las Vegas. Instead, the company derives nearly two thirds of its profit from Macau (the former Portuguese island territory off Hong Kong) which is the only legal place for casinos in greater China. The balance of profits comes from Singapore where LVS operates a property that looks like a submarine was welded to the roof of a housing development. Crazy architecture is not the reason we like LVS. The first thing that we find attractive is that LVS is a very profitable company. Las Vegas Sands' profit margin (EBITDA) averaged 35% over the past five years. The house always wins, indeed. Besides very high margins, LVS fits into our several of our favorite fundamental themes including exposure to the growth of the Chinese consumer market, and ability to reinvest excess capital at very high rates of return. Essentially, if you could own this as a private company, you'd be psyched. Of course, the casino business is also very cyclical. It's not exactly an essential business. So, when China started to restrict travel at the beginning of the Corona-Crisis, LVS shares took a hit. That's when we started buying it. Business for LVS remains very much hurt. The stock is at its lowest level in four years. (figure 2). Simplistically, we believe the casinos will reopen, profits will rebound, and the stock will recover.

Back in Paris after seven weeks of isolating in the French countryside. I was really enjoying myself in the French farm village. When not working, I was able to spend my time mountain biking, going on trail runs, or attempting furtive fly-fishing excursions (fishing is currently *verboten* in France). I also wasn't really worried about catching coronavirus from my few neighbors or the chickens in their front yard. Unfortunately, teenage daughters launched a successful campaign to return to Paris to be closer to their wardrobes and allegedly better Wi-Fi. So here I am, downloading permission slips for the French nanny-state to justify every time I want to leave the apartment. It's not all bad. We are scheduled to start the *deconfinement* on May 11 and that's not too far away.

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Yours,

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Mr. Zolidis started his career in finance in 1996 following degree studies in Philosophy at Kenyon College and the University of Oxford. He has followed U.S. consumer companies as a senior analyst since 1999, mostly on the sell-side, writing research for institutional investor clients. He also managed money in a buy-side role at a long-short equity fund over 2013-2014. He was named in the Wall Street Journal's Best on the Street list in 2005. Mr. Zolidis founded Quo Vadis Capital, Inc., a Registered Investment Advisor (RIA) and research consultancy, in 2017 and works from New York and Paris, France.

Undesirables. The French countryside probably sounds like a pretty glamorous place to isolate. I can imagine worse places. However, we weren't in the villas and Maserati-driving Russian Oligarch part of the French countryside. We were a lot more likely to see a *troupeau* of sheep or drive past farmsteads with horses in the front yard. These guys lived across the little road from my place.

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The analyst who is the author of this report has a long position in shares of Costco (COST), Home Depot (HD), CarMax (KMX), and Las Vegas Sands (LVS). Quo Vadis prohibits analysts from trading in a way that is inconsistent with opinions expressed in reports [subject to exceptions for unanticipated significant changes in the personal financial circumstances of the analyst].

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