BRIDGES TRUST

April 8, 2020

Dear Bridges Trust Client:

We'd like to take a moment to begin on a personal note. We hope you and your loved ones are healthy and safe. One of the most rewarding parts of our business is the chance to build relationships with clients and their families, often over generations. We've always valued these opportunities, but as COVID-19 has disrupted our ability to socialize, share a meal or meet face-to-face, we find ourselves appreciating these relationships more than ever.

We'd also like to thank those among you who are healthcare professionals. Many of you serve on the front lines which often requires you to put your own health at risk. The care you provide can literally mean the difference between life and death. I'm sure we speak for everyone when we say you have our gratitude.

And lastly, we all know people who have been furloughed or are facing significant economic hardship. Through no fault of their own, employers and employees alike are being asked to bear a substantial burden for the greater good. While the direct link between employment and societal health may not be easy to calculate, we firmly believe that these sacrifices will ultimately save lives. Your contributions have not gone unnoticed.

SECOND QUARTER MARKET COMMENTARY

We first wrote about COVID-19 in late February. Like many, we looked to prior epidemics (SARS, MERS, Avian and Swine Flu, Ebola and Zika) to help frame the potential impact. It is now clear that COVID-19 has no precedent. Since our last note, confirmed U.S. cases have grown from 10,000 to over 374,000. The effects of social distancing and efforts to 'flatten the curve' have required a moratorium on economic activity. Few businesses are built to withstand such a shock, which has resulted in more than 10 million jobless claims in just two weeks. To put that into context, total U.S. employment was 152 million and last week's claims were **ten times** the previous record. We've read forecasts that unemployment could reach as high as 15-30%. Again, we turn to context knowing the future may look dramatically different. Unemployment peaked at 10% in the Financial Crisis and 25% during the Great Depression.

The worst quarterly GDP decline in history was -10% in the first quarter of 1958 (only annual GDP was calculated during the Depression). In the throes of the Financial Crisis, GDP's low point was -8% in the fourth quarter of 2008. We wrote in our last note that these records were likely to be eclipsed, now it would seem perhaps dramatically so. Some economic forecasters have predicted a quarterly decline of as much as 30-40%. Like we said, the word 'unprecedented' cannot be overused.

The number of records set in the first quarter is long and not particularly reassuring. The Dow Jones Industrial Average had its worst first quarter in 124 years. The S&P 500 hit an all-time high on February 19th and within 23 trading days dropped 35%, setting off the fastest bear market on record. Stock market volatility (as measured by the CBOE Volatility index) reached 85%, a number only eclipsed during the Financial Crisis, and then just barely. Oil had its worst quarterly performance ever.

Financial news has been almost universally bad and is unlikely to improve in the near term. One positive of the past several weeks was the passage of the CARES Act, the largest fiscal stimulus in history. Calling the bill stimulus somehow seems wrong, as it's not meant to accelerate the economy, but rather mitigate the effects of a pandemic. Like all interventions, it's flawed and its path into the real economy will be disorderly and inefficient, but we suspect it is better than the alternative.

Our *Market Commentary* has normally followed a quarterly cadence, but times of rapid change require more frequent communication. Rather than recite the performance of various asset classes, we thought we'd frame how we're thinking about allocating capital during these times of uncertainty.

We find the most essential question to be the one no one can answer. *How long will this last?* We recently wrote that viral outbreaks are transitory, and while none of us are experts in epidemiology, history may provide context. Countries that were quick to implement social distancing policies have seen a decline in new cases, suggesting drastic measures are worth taking. The Institute for Health Metrics and Evaluation at the University of Washington predicted new cases would peak in most states by mid-April, while a limited few stretch into May. Given the unprecedented nature of this pandemic (there's that word again), and the presence of variables with abnormally wide outcomes, we won't opine. But we do feel comfortable saying we don't believe this will last forever. No pandemic in the modern era has.

If the question 'how long will this last' cannot be answered with more precision than 'not forever,' the next question becomes 'what has permanently changed?' Some have predicted sweeping changes in societal norms. Perhaps handshaking as a custom will wane or that air travel will remain depressed. We are less sure. It's illustrative that post-9/11, global air miles traveled set a new high by 2003. Economies have a way of surprising you both with their fragility and their resilience. If there is a silver lining, it is that America will almost certainly be better prepared for the next pandemic.

What's most important in the near term is stemming the spread. Once that has been accomplished, we as a nation can turn our minds to the task at hand, which is reducing unemployment, shoring up weak balance sheets and returning to economic growth. The same forecasters that are predicting a -38% decline in GDP in the second quarter also forecast a 21% **increase** in the third. While we're not ignorant of the hardship many Americans face in the months ahead, we have seen our country achieve remarkable things when we put our minds to it. Speaking for ourselves, we can't wait to go back to our favorite restaurants, take a vacation and return to using facial tissue for its intended purpose.

In short, this is bad. No one can say exactly when it will start being less bad, but it will and perhaps soon. Pandemics are shocks, not cycles. They can cause a much sharper decline in economic activity than your garden variety recession. But historically, they have always been of limited duration. We find there to be truth in the phrase 'a calm sea never made a strong sailor.' The American system has found a way to navigate every economic hardship of the past 250 years, often much faster than one would have guessed. We strongly suspect that we'll emerge on the other side, a stronger and more resilient nation.

No one can predict how long this process will take. But we have often remarked that as investors, your time horizon is one of your most valuable assets. In the modern era, it's not uncommon for equity markets to drop 30% once or twice a decade, each time triggered by a new and unforeseen culprit. This time, it's a pandemic. Headlines and pundits will try to shorten your time horizon for you. Our advice is don't let them.

Equity prices are ultimately a reflection of a business's future profits and we believe 2020 earnings are all but certain to disappoint. But if this crisis is transitory, as we suspect it is, we have difficulty believing that the earnings power of our portfolio companies in 2025 or 2030 is significantly lower than it was two months ago. As time passes and economic activity normalizes, we believe stock prices will start reflecting future prospects rather than the immediate present. We plan to own equities when they do. We appreciate your confidence and trust in our firm, and as always, if you have any questions, please don't hesitate to reach out to your relationship manager.

Bridges Investment Management Investment Committee

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