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Long Term Returns Require Patience and Endurance

Martin Investment Management, LLC extends our deepest sympathies to all individuals, families, and colleagues that have suffered from the consequences of COVID-19 and other misfortunes this past year.

The third quarter of 2020 has shown a robust economic rebound after the second quarter's historic U.S. economic annualized decline of 31.7%. The U.S. economy is beginning to unlock, and re-openings are being aided by better processes, medical advances, and awareness that the modern economy can be robust in the presence of an infectious disease.[1] The Atlanta Federal Reserve's "GDP Now" model is suggesting that the third quarter of 2020 will see U.S. GDP grow by 25.6% on an annualized basis. U.S. consumer confidence increased in September 2020 with the Confidence Board rising to 101.8. With consumers making up 67% of U.S. GDP, this matters.[2] Retail sales and industrial production have been surprisingly strong. Housing indicators are also strong.[3] New and existing home sales reached their highest levels since 2006, with housing demand fueled by low mortgage rates and an expected long term shift to remote work and increased workplace flexibility.[4] There were gains in the S&P 500 Index of 8.93% for the third quarter of 2020 and 5.57% for the year.

Global economic momentum has continued, with recent data releases showing some improvement with occasional pockets of softness. Major central banks globally will remain accommodative for the foreseeable future, with near-zero prospects for any interest rate increases. The International Monetary Fund announced that Europe's economic outlook is more positive now than it was at the beginning of the summer 2020. Consumers and businesses continue to adapt to the virus threat. Consumer spending and business optimism as reflected in the ifo Business Climate Index in Germany came in better than expected, at a reading close to its pre-virus levels.[5] Japan has broken out and is reasserting itself as a global leader. The broader Nikkei 500 has decisively pushed higher over recent days and pushed through the December 1989 highs.[6] There were gains in the MSCI EAFE (USD) Net Index of 4.80% and in the MSCI World (USD) Net Index of 7.93% for the third quarter of 2020, and returns of -7.09% for the MSCI EAFE (USD) Net and 1.70% for the MSCI World (USD) Net Indices for the first nine months of 2020.

The decline in U.S. corporate profits this year was less severe than what was seen in the international markets, resulting in a lower hurdle for the U.S. economy to return to previous levels of activity, output, and profitability.[7] This year's U.S. equity returns have been heavily influenced by the predominance of large technology stocks as their earnings and margins remain resilient. The rally has not been broad-based and has favored the top

five names of Apple, Microsoft, Amazon, Google, and Facebook, which continue to drive an outsized portion of equity returns. Prior to the pandemic, the digitalization of the U.S. economy was occurring. The arrival of COVID-19 accelerated that trend as more people had to work from home or shop online. The relentless upward trajectory in the U.S. technology sector, which was up 30% since March 23, 2020, has faded in September 2020.[8] While there are many reasons for the sell-off in September 2020 in the U.S. markets, such as excessive option activity, U.S.-China tensions, rising COVID-19 cases, and the U.S. election, it is plausible that the valuations of the technological giants rose to the point where profits were taken.

A number of factors continue to weigh on the world's economies in the third quarter of 2020. The labor market remains weak, especially in certain industries such as art, entertainment, travel and tourism. Both business and consumer travel continue to be stagnant. Aircraft order cancellations continue, and orders are mixed across industries and generally slower. Truck tonnage and railcar loadings have contracted slightly.[9] According to the Bankruptcy Institute, commercial bankruptcy filings are up nearly 30% through the end of July 2020, as compared to the same period in 2019.[10] The damage to small businesses has been extensive, and fewer service-based employment opportunities exist. About 70% of jobs created by the private sector have historically been provided by businesses with fewer than 500 employees. Prior to COVID-19, service-based employment comprised almost 90% of the U.S. economy. The labor market is fundamentally changing due to the pandemic as distance working continues, crowded urban offices remain empty, and headquarters relocate to lower tax jurisdictions. Exodus from urban areas creates enormous revenue loss for cities and for businesses dependent on city dwellers and workers. Retraining workers to gain the needed skills for the new economy is a long term process and creates short term economic disequilibrium. Because the U.S. economy is driven by consumption, job creation is essential to sustainable consumption rates.[11]

The rapid and sharp recovery in 2019 as the S&P 500 Index advanced over 31% from the worst December 2018 sell-off since the Great Depression, due to U.S.-China trade tensions and fears of an economic slowdown, serves as an example of market reaction that proved temporary. The fundamental backdrop of the U.S. economy before the pandemic was positive, but the pandemic has caused great uncertainty and downside risks. COVID-19's rapacious infection and death rates panicked markets forced solid economies to shut down quickly. The markets have quickly come a long way from when the S&P 500 Index fell over 30% in a matter of just 33 days this past February and March. Starting in April 2020, European countries began easing their lockdown restrictions and slowly reopening in a piecemeal fashion. The partial opening spread to the U.S. in May 2020 with all 50 U.S. states now in the process of partially reopening. As more businesses reopen, the pace of job losses will tend to slow. The more an economy reopens, the more the overall data will improve. We believe that pent up demand can result in a strong recovery via the desire to reopen and rebuild the economy.

The markets' upward climb since March 2020 can be attributed to the speed and vast amounts of monetary and fiscal stimulus injected into the global economies. The

central banks around the world have significantly expanded their lending efforts and lowered interest rates. A lower discount rate compensates companies for any disruption in their short term earnings. A dollar of earnings for a company five years from now is worth more in today's dollar. Low discount rates assure businesses that a recovery is occurring and gives them time to recover. The fiscal stimulus programs have been sizable. The U.S. CARES Act enacted in March 2020 approximated 13% of annual GDP, the same amount for other programs: 13% of annual GDP in Canada and Australia, 40% of annual GDP in Japan, 6% of annual GDP in the U.K., and the European Union is currently responding with $2.1 trillion for its 27-member bloc.[12] There is still a tremendous amount of stimulus that has yet to work its way through the world economies. Ultimately we expect that markets will be positively impacted by the definitive news of a proven vaccine.

Martin Investment Management, LLC believes innovation drives long term wealth creation, and the pace of innovation is accelerating. The recent response to COVID-19 exemplifies the speed of innovation. Medical response to testing and treatment of the virus has been as notable as the software developed to address remote work and school. U.S. credit data continues to demonstrate the power of innovation, as internet online retail sales are up 50% year over year.[13] We believe that innovation can be found in many parts of the economy regardless of sector classification, market capitalization, or geographic locations. There have been significant breakthroughs in many industries by new developments in biotechnology, robotics, artificial intelligence, genomics, wireless data speeds, 3D printing, autonomous vehicles, cloud computing, and e-commerce. Martin Investment Management, LLC believes that technology will continue to evolve, creating an exciting backdrop for investors.[14]

Often the early adopters of a new technology can profit more than the innovator. Just less than fifteen years ago, smartphones were a new innovation, which quickly expanded into the main economy. When Steve Jobs introduced the iPhone in September 2007 as "the best iPod we've ever made...it has a phone," he did not discuss the device's internet capabilities or potential for third-party application development until 30 minutes into his speech. When the App Store was introduced with his famous "just one more thing" maxim, it was not on what reviewers focused. They were more interested in the iPod and iPhone integration and the phone's touchscreen keyboard. The App Store went on to create over a trillion dollars in wealth including over $519 billion in 2019 alone. New businesses, business models, and entire industries were built using the platform.[15]

The present uncertainty is focusing our attention more sharply on the resilience of the companies in which we invest during this time of duress. Martin Investment Management, LLC believes that transparency of data, high liquidity, and low leverage contribute to the long term sustainability of an investment. Stocks that can promise earnings growth regardless of what the economy does and/or those that benefit from the lockdown, such as providers of food, social media, and online deliveries receive the benefit of the discount rate without any offset. We avoid complicated investments, which may prove especially challenging in these opaque times. When corporate governance and accounting standards are lax, information is distributed more unevenly to investors.

Typically, illiquidity rises in a crisis and remains elevated after the crisis has abated. Our focus is on security specific investment decisions in understandable businesses with high liquidity and strong return on capital.

Martin Investment Management, LLC continues to be a bottom-up fundamental manager. We seek to research companies that are most sustainably investing in innovative capital expenditure, research and development. Since 2016, Martin Investment Management, LLC uses its proprietary database, Censible.co, to assess and incorporate non-traditional ESG risk factors into its investment process. By identifying companies that are able to generate attractive returns on invested capital at reasonable costs, Martin Investment Management, LLC believes that its portfolios have the opportunity to outperform the broader market over time.

Warm wishes for a colorful and healthy fall season!

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Note:

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