MRP CAPITAL INVESTMENTS, LLC

2nd Quarter 2020 Client Newsletter

Capital Market Update

Inside this report:

As quickly as the market fell late last quarter, it rose almost as rapidly this quarter. We had mentioned in the last Capital Market Update that *"Generally, with little data to work with, the market prices in extreme scenarios. We will see if this is the case this time."*

Indeed, it appears that is exactly what happened. The S&P 500 for the quarter rose over 20% and at the close of the 2nd quarter the price change of the S&P stood at –4.04%.

S&P 500 2020 Chart Supplied by BigCharts.com

As we progress, we have a lot of issues to sort out in the market. When everyone gets this newsletter we will be in the midst of earnings season and it seems to us that in regards to what companies will actually earn moving forward, will be anybody's guess. That is what makes this earnings season so important. It will highlight what company's business models have the wherewithal to function in a rapidly changing economy.

On top of that, the election should come into people's focus near the end of the coming quarter. And, of course, daily news related to the COVID 19 pandemic will move the markets up and down.

Never a dull moment in 2020!!

FEAR!!!

The legendary investor, Warren Buffett, has many quips and sayings relative to the investment world. One of those sayings is, 'The market runs on fear and greed. When the market is fearful lean towards greed and when the market is greedy lean towards fear.'

Here at MRP Capital Investments, we understand and firmly believe in that ideology given that Behavioral Finance has a big role in how we invest. Many people think the market and the world of investments is a strict and rational place where mathematics and elegant formulas rule the day. And, indeed, those things play a big part in understanding fair value for investments, but emotion usually overwhelms that logical and common sense approach to the making investment decisions.

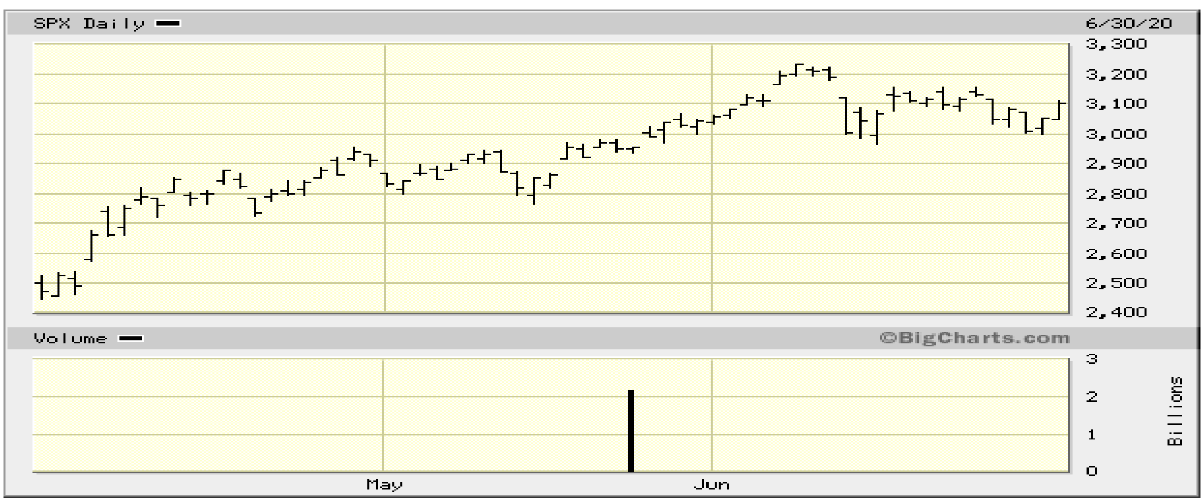
When people see the market rocketing higher, they are compelled to buy because they fear missing out on big returns...especially if their friends are bragging about how much money they are making in the market. Conversely, they tend to sell when the market is falling because they get rattled over the fall in market prices.

We think it is important to do all the math concerning fair value of investment options in regards to earnings, cash flows, balance sheet strength, and the like. That work gives us an understanding of what the "fair value" is for any specific investment. From there we can compare the price the market is giving it versus this fair value analysis. Any over (or under) valuation can, potentially, be an opportunity, but understanding why there is the discrepancy is a key part of the process.

Many times undervaluation of investments, especially if the undervaluation is widespread across many investment options, can be a result of fear in the minds of investors. Frankly, we think we saw this develop last quarter. And in our 1st quarter Newsletter, we tried our best to explain what we were seeing in the market relative to the panic caused by the coronavirus. What we discussed was the virus itself and its mortality rate versus the response by the world's governments to the virus. What we saw was something akin to a giant disconnect.

We saw the global economy being shut down because of a virus that had a 2% (ish) mortality rate. According to the Centers for Disease Control, the death rate of COVID-19 is almost identical to that of the Flu (Influenza). And, of course, the world's economy is not shut down every flu season.

And, it appears, we aren't the only ones who noticed that fact, as the market rallied about 24% in the 2nd quarter.



Nevertheless, there is a tremendous amount of fear related to this virus. However studying the numbers and data related to the virus, it doesn't appear the market's fear is related to the virus itself. It is the fear that the government will shut the economy down because of the virus spreading and, of course, this would have a devasting economical impact and, therefore, most likely, pull down asset prices.

However reconciling these two points makes us believe that any sell off would create great investment opportunities because if the virus isn't that deadly, when the economy opens back up (assuming it gets shut down again) asset prices should rise again...just like they did this quarter.

Of course, we will be monitoring that situation very closely. On another note, we do think the election is the most important thing to be paying attention to. As I type this, Biden has picked up a huge lead in the polls and the market has fallen about 6% from its July 8th high.

We do think who wins the Presidential election is important, as are the Congressional elections. However we have a controversial opinion that the markets are set up for a major Bull Market run at the end of this year and well into 2021, regardless of whether Biden or Trump win the election.

Why? Certainty and Stimulus!!

After the election, the markets will no longer be in the dark about what Congress will look like and/or who the President will be. Therefore, the market will know what the policies will be, what tax rates will do, and what regulations will look like. Obviously, there will be bad things for certain industries, sectors, and countries. But, the inverse is true as well. For instance if Trump wins again, we expect corporate taxes to remain low and this bodes will for U.S. company earnings. If Biden were to win, we expect international investments to outperform U.S. investments, as U.S. tax rates should rise and Trump's "America First" mantra and policies will be reversed and globalism will take center stage again.

Nevertheless, our eyes will be wide open and we will be tracking all the moving parts to the very best of our abilities. As we mentioned in our last newsletter, 2020 is certainly not a boring year.

Discipline

This year has been an incredibly wild one. As we discussed in the last article, we've seen 20% moves in each of the two quarters of this year. Fear and greed have overwhelmed the markets on a seemingly unrelenting basis. This can lead to an incredible amount of anxiety among investors. This anxiety can drive people to make knee jerk emotional decisions. And, most of the time, decisions like that are usually not the most appropriate. Instead of an emotionally driven decision process, we firmly believe that a disciplined investment process always makes sense.

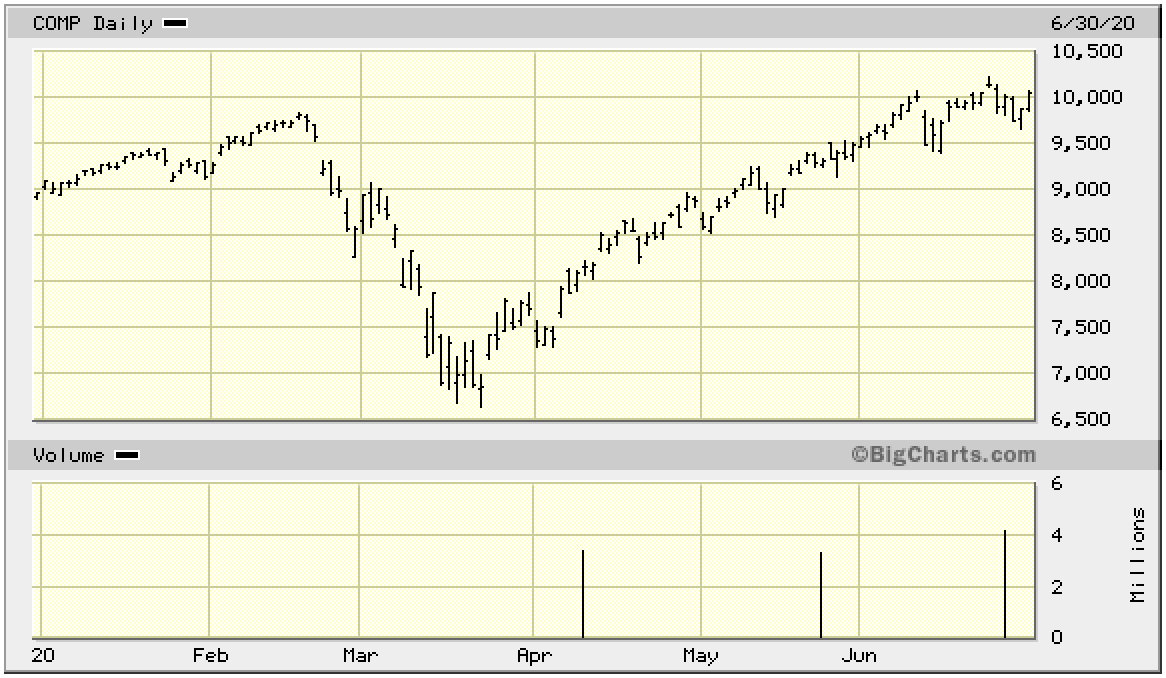
One phenomena contributing to this anxiety is the level of disparity in returns of commonly referenced indices. At the end of the quarter, the year-to-date price change of the Dow Jones Industrial Average was approximately –7.14%.

The Russell 2000 (a small cap index) was down about 12.5%.

The MSCI EAFE Index (an international index) price return through the end of the 2nd quarter was -12.3%.

The S&P 500 was down approximately 3.14%

And the NASDAQ was UP about 11.11%!



With the numbers presented, we see that the spread between the best performing index and the worst performing index was 23.61%. Historically, that is a massive spread between the best index and the worst. And if you exclude the NASDAQ, the average return of those indices was –8.77%.

Frankly, the answer to "Why?" that happened is simple. A handful of technology stocks drove the NASDAQ higher, while most of the other stocks in the world struggled in the face of coronavirus and a recession led by an economic shut down.

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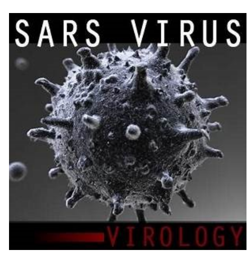
Digging deeper into the performance of the NASDAQ, the top ten stocks in that index make up 55.31% of that index. The other 90 make up 44.69% of it. That is an incredible amount of concentration in just a few stocks for an index. In fact, that is more akin to how an extremely aggressive hedge fund would invest. And understanding that the S&P 500 is a market cap weighted index with over 20% of its assets in tech stocks helps explain why it performed better than the other indices which are more diversified.

Historically this type of narrowing and concentration of the market happens soon before the market begins to rotate assets into other investments. Given the apparent cheap valuations of the other stocks in the world, we believe we could be getting very close to this time. With the earnings that come out this quarter, we should see exactly what companies can earn in this new era of COVID 19 lifestyle and that could be the catalyst for this rotation.

Frankly, it makes sense that this type of return disparity and narrowing of market leadership would cause investor's anxiety to rise. In our over two decades of professional investment management experience, we have seen these kind of events take place time and time again. One thing we've noticed during times like this is that investors frequently attempt to switch investment styles when they see another style posting short term returns that appear to be fantastic. However, they usually make that change at just about the time the market rotates to another style. And this is why we believe sticking to proven long term investment strategies and a disciplined investment process is so important.

One final thing to consider when thinking about this market is that many people are beating the drum that this time "its different." And that is true, we've never had COVID 19 before, but we've dealt with SARS, MERS, World Wars, The Great Depression, Civil Rights protests and riots, Terrorist attacks, oil embargos, and many more crisis' that made people exclaim "its different this time."





Despite those events the market continued to perform just like it historically had, which shows up mathematically as 10% average return with a 16% standard deviation. We believe this is because the market is made up of human beings making decisions about how to invest and human beings, historically, have behaved similarly crisis after crisis. You could say that history may not repeat itself, but it rhymes. Given this, we will continue to monitor developments and invest our client's assets in a manner that is appropriate for them given their goals, objectives, financial position, and risk tolerance while using a disciplined investment process.

<u>Non-Financial Events occurring this quarter</u>

April 27th, Pentagon releases videos of “unidentified aerial phenomena”

May 26th, protests and riots breakout across the USA after the death of George Floyd.

June 1st, ANTIFA designated a Terrorist Organization

May 27th, USA recognizes Hong Kong no longer autonomous.

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