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THE WORLD IS NOT AVERAGE

We hope this letter finds you and your families safe. The lifestyle changes to which we have all had to adapt – working remotely, speaking with loved ones via Zoom, and waiting for the uncertainty surrounding the virus to clear – have challenged all of us to be evermore resilient.

With global economies slowly emerging from their self-imposed shutdowns and a coordinated effort on behalf of the world's central banks, we witnessed markets rebound in the second quarter of 2020, evidencing similar resilience. The S&P 500 Index delivered one of the strongest quarterly performances on record - rising 20% - erasing much of the year's decline.

To many, this recovery in asset prices seems confusing. One might ask how markets can be priced within striking distance of their February highs when, objectively, the world's economies are meaningfully weaker and businesses are facing unforecastable near-term futures. Not to mention, we face mounting societal challenges: the global pandemic altering life as we knew it; communities across the country coming to grips with historical inequities; and political polarization starkly on display.

The answer to this question may be that the market's performance is obscuring the realities of the current environment. As we all know, the S&P 500 Index is an average. Unfortunately, averages can be highly misleading and should be viewed with caution. The problem often results from an average capturing an extremely wide set of data. For instance, if one were to find their head in the oven and their feet in the freezer, they might have an average temperature of 72 degrees, though that would hardly describe their actual experience.

The S&P 500 Index of June 2020 is very different than the S&P 500 of January 2020. The spread between the cheapest and most expensive stocks in the market has widened to historical proportions. While the averages appear similar, the markets today are much more like the above example: there are some stocks that have soared over the last 3 months while the vast majority more appropriately reflect the present economic uncertainties. For example, the S&P 500 Index was down 4% through the second quarter, while the average stock in the index declined 11.8% through the same period. The difference in these statistics reflects the impact of Facebook, Amazon, Apple, Microsoft and Google representing 25% of the index's return. Said another way, excluding these five companies the S&P 500 Index would

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have declined more than 13% through the second quarter. Investors continue to take shelter in these handful of large-cap growth stocks and remain largely skeptical of everything else.

The challenge for us as investors is to identify the companies that will not only prosper in the short-term, where market participants are rewarding fast-growing companies, but also will reap rewards into the future. The current market presents a unique set of considerations. The three largest stocks in the S&P 500 Index (AAPL, MSFT, AMZN) represent an exceptionally large percentage of the overall market – 16.6% vs. 15.2% for the bottom 300 stocks in the index. This is reminiscent of the dot com bubble 20 years ago. Further consider that Apple and Microsoft are larger percentages of that index than the Utility, Energy, Real Estate or Materials sectors in their entirety.

Building concentrated, yet well diversified, portfolios compels us to look in places beyond where other investors have myopically focused. Using the discipline that has served us well over the longer-term, we not only hold securities in these truly loved sectors, but we have found companies outside of this narrow band. While growth is important, it shouldn't be at any cost. Investing your money should be done with an eye toward securing cash flow, earnings and growth – though at a reasonable price. Including stocks that are outside the limelight helps protect you from the inevitable reversals in fortune that over-loved securities experience at some point.

Of equal importance to stock selection is the ability to stay the course through major market sell-offs. We have often reminded you of how markets recover after precipitous declines. Last quarter we cited three major market meltdowns: 1987, 2000-2, and 2007-9. In those instances, recoveries ranged from 22 to 48 months. The speed of this initial recovery from the most recent sell-off is unprecedented.

This rapid rise has left many investors extremely cautious, so we want to add a little long-term perspective to the market's wild ride over the last six months. There will always be intellectually sound reasons to sell, as is captured in the following detailed graphic.

However, for long-term investors, the reasons are usually transitory. Selling needs to be a disciplined and thoughtful process. It should be driven by your financial needs, not the headline of the moment.

We at Peter B. Cannell & Co. are here to help you be both thoughtful and disciplined. We are your partner in this journey.

We thank you for your trust and wish you continued health and resiliency during these challenging times.

Sincerely,

The Partners of CANNELL & CO.