AVENIR CORPORATION
INVESTMENT MANAGERS

August 2020

Dear Friends and Fellow Investors,

Midyear Review

That was fast. In March, according to JP Morgan, "…the U.S. equity market moved from a record peak to a trough over 14 days compared to 14 months during the Global Financial Crisis." The immediate cause, of course, was fear of global economic devastation induced by the COVID-19 pandemic, compounded by the U.S.-China trade war and the Russia-Saudi Arabia oil price war. Over those 14 days ending March 23rd, the S&P declined 29%. But the whiplash had only started. By April 8th, only 12 trading days later, stocks had risen 20%, marking a new bull market, only 20 trading days after the demise of the last one.

The S&P 500 has rallied 47% from its bottom. Considering that second quarter GDP fell a record 32.9% annualized, the June unemployment rate was 11.1% and the headlines carry daily news of a resurgent virus and corporate bankruptcies, it is no surprise that we are often asked by clients if Wall Street has become disconnected from Main Street. The answer is obviously yes, but that doesn't mean that many quality businesses aren't worth their current price and more. By chasing us all indoors, the pandemic has revealed in a unique way the value of a handful of durable franchises that have become the foundation of our economy, whether we fully appreciated that fact or not.

An example familiar to Avenir clients is our investment in the software industry, which for decades has been an enabler of the digital economy. Its products range from the familiar, to its collaboration software and enterprise data center business. These tools worked in concert to facilitate the continued functioning of the economy under shutdown conditions. The great surprise has been the efficiency of the remote work environment. Supported by infrastructure investment in fiber, data centers and the cellular network, remote work is likely to remain a permanent and prominent feature of our economy. Many enterprises were suddenly required to pull forward digital capabilities that were gaining traction; these advances would have occurred anyway, but at a more measured pace over many years, absent a catalyst such as the pandemic. Proof of their value is in the high level of crisis functionality that businesses dependent on their products have experienced, often achieved with reduced expenses per dollar of revenue. The resulting rise in recurring revenues from this pull forward is largely permanent and accrues to its shareholders forever.

Our investment is not the only software-centric enabler of this phenomenon, but it may be the most important and certainly the most visible. Its success reminds us of a simple insight from Robert Smith, founder of Vista Equity Partners: "Software contracts are better than first-lien debt."

Extraordinary Response

Emboldened by the apparent lack of consequences for the novel money-printing experiment deployed for the first time ever during the Global Financial Crisis of 2008-2009, federal policymakers have *tripled* the dollar amount of federal assistance used in the mortgage crisis to fight the economic impact of the pandemic. And they have spent it in less than six months, compared to ten years for the GFC expenditures. Notably, due primarily to debt-funded CARES Act federal transfers, April 2020 disposable personal income *rose* 12.9% over the previous month to a record level. We have mentioned in previous letters Warren Buffett's famous 2008 *New York Times* editorial when he warned of the potentially unknown but dangerous "side effects" of this "new medicine." The thinking must be that if one pill made us feel ok, three will make us feel great, reminding us of the 19th century English poet William Blake who wrote "You never know what is enough unless you know what is more than enough." It appears our politicians will help us find out exactly how much federal debt is "more than enough." We are not economists, but we do know there are no free lunches.

Durable Franchises

We have no predictions about the direction of the economy or markets, and certainly not the virus. The trajectory of the virus and its ultimate duration and impact on the economy are unknowable. What *is* knowable is that on occasion, the unthinkable happens – unforeseen acts of terrorism occur, real estate bubbles burst, or a pandemic emerges. This means we must own businesses with both bulletproof balance sheets and outstanding and durable business models that can withstand unthinkable economic hardship, which are run by ethical managers whom we can trust to act in our best interests.

As always, please call or email us if you have any questions or thoughts. We look forward to hearing from you. Most of all, we hope you and your families are healthy, safe and remain so.

Respectfully,

Peter C. Keefe James H. Rooney