Fortress Global Funds Quarterly Reports

Fixed Income Fund

Global Opportunity Wealth Fund

US Equity Fund

International Equity Fund

Emerging Markets Fund

Income Builder US Fund

Income Builder International Fund

March 31, 2020

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April 2020.

Dear investors,

The first quarter of 2020 saw one of the most violent declines on record for financial assets as the world responded to the COVID-19 threat. Stock markets have experienced 30%+ declines before, of course, especially from points of relatively full valuations, and there have been 10-20% drops in corporate bond prices too. But these have not happened within the space of only a few weeks, and especially not from a starting point of a mostly healthy global economy. The Fortress funds felt the pressure of this selling in both equities and corporate bonds during the quarter. The equity funds all declined more than 25%, and the Fortress Fixed Income Fund, which invests in US government and corporate bonds, was approximately unchanged. Our focus on owning high-quality securities at reasonable prices remains intact, across all markets. With many equity and corporate bond prices relatively depressed the return prospects from here are better than we have seen in years.

Under the surface of the financial market turmoil, the divide in performance between higher priced “growth” shares and more modestly priced “value” shares, where we typically invest, continued to be stark and unfavourable. The performance of our funds reflects this – they all lagged the broad market in the first quarter. As an example of the dynamic under the market’s surface, the US large capitalization growth index declined 14% in the quarter while the corresponding value index dropped 27%, and the mid-cap value index fell 32%. Many stocks and sectors were cut nearly in half. The broad market decline of 20% reflects this, combined with the outsized boost from strength in some of the largest growth stocks in the index. This value vs growth divide was already at a noteworthy extreme late last year, when we shared a version of the long-term chart on the left, now updated to the end of March. It illustrates the relationship between value and growth globally back to 1980. This is now the cheapest value has been. The graph on the right shows a similar value vs growth comparison, within the US equity market. Again, we are now at an extreme that rivals the 1999 technology bubble.

Global Value/Growth

US Value/Growth

Source: Bloomberg

Why does this matter? As the saying goes, trees do not grow to the sky. More and more of the content of the US and therefore the global equity indices is silently being made up of the shares of relatively few highly priced companies at higher and higher valuations. This is a concern for broad based equity investments

going forward. Eventually the earnings and stock market valuations will normalise, and this will almost certainly have an impact on the overall market. For now, though, the fashion of the last 10+ years remains intact and hundreds of well-valued companies with real earnings, healthy dividends and responsible balance sheets remain undervalued as investor attention focuses elsewhere. But this cannot last forever. We believe this theme within the US and, just as importantly, globally will be one of the most important for investors in the coming years. We have seen it before and when the tide shifts it brings many, many years of *substantial* returns to portfolios made up of shares in real, growing businesses that are trading at reasonable valuations. Eventually, price matters and we have been and continue to be positioned accordingly.

On the current topic of COVID-19, we are far from disease experts and cannot predict what will happen next with the virus. But it might be possible to offer a few observations about where things could go from here, based on what is known and what can be reasonably guessed at. These can help us as we look at individual investments and interpret headlines and broad market movements. We think these points might include:

1. **The range of potential outcomes for investors is still wide.** While it seems the global lockdown phase will be ending soon, and with it the intense disruption to so much of everyday life, there is still no indication of how quickly employment levels across all industries can return to normal. We also do not know what the impacts will be of the shutdown that has already occurred, including secondary financial or psychological effects on companies and individuals that may (or may not) play out in the months to come. These may be better or worse than currently feared – we just don't know. From an investment perspective, though, the chances of another panic like what we saw in March is much reduced because it will be hard, if not impossible, to recreate the fear of the unknown that consumed investors at that stage in the crisis.

2. **The global economic "pie" is now smaller.** Even as life returns to what we might call normal, the additional short-term and long-terms costs of dealing with the disease, and preparing for the next one, will almost certainly take resources from other activities and make us all poorer *relative to where we would be otherwise*. This is not an absolute loss – it is a relative one. Collectively we will become more efficient, but part of the benefit of that efficiency will go to paying for this crisis and prevention measures against the next one.

3. **The "sheep" are being separated from the "goats" faster than normal.** Vulnerable businesses have been scaling down or closing altogether as the current situation forces hard decisions quickly. There is no doubt real damage being done but the stronger businesses will get back to normal relatively quickly if they haven't already. This may be good for profits in the long-term, which will help investors in those real, viable businesses. Those that are less than viable will need to have adjusted quickly or will risk restructuring.

4. **The Fed's "tide" to lift all boats might become a tsunami.** We have now had a good look at the Fed's reaction function under extreme duress, with huge easing and asset purchase programmes and a desire to err on the side of too much rather than too little support. They are clearly prepared to make sure a replay of 2008/2009 doesn't happen again, which is partly a psychological effort. The support is meant to lift all (viable) boats, and those that are already relatively strong might just be *lifted even farther*. We should be open to the possibility that many share prices go on to set new highs as the crisis abates and the Fed's easy money remains, even if economic activity overall is still below the previous levels.

5. **The rest of the world is not the Caribbean.** Just as some industries and companies are having a harder time getting through this period, so too are some countries. Those in the Caribbean with reliance on international tourism are among them and are likely to have some of the slowest

recoveries. Investors in the Caribbean should be aware that much of the rest of the world will be back to something approaching normal well before we feel it here on our shores.

As always, day by day we focus our attention on the things we can control. The portfolios are positioned in well-valued securities with resilience and diversification we expect to last for many, many years, through this crisis and whatever comes next. Nobody knows when or how this episode will pass, but we do know that financial markets will almost certainly begin their recovery well before we see clear improvements in our own everyday lives. Investment performance so far in April suggests that some of this recovery may already be underway.

We are here to answer any questions you may have – please let us know if you would like to discuss your investment or conditions generally.

Thank you for investing with us.

Sincerely,

Peter Arender, CFA
Chief Investment Officer