

An alternative perspective on the markets

Alpha Leonis Partners AG
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I will give a story that I hope will be an interesting alternative from the deluge of content about interest rates, PE multiples and whether this virus is different or the same as countless others that have been constant companions of humanity since the very beginning.

I have a small statue of Saint George slaying the dragon which I have carried with me since 2005, several years after I first understood the legend of Saint George, the patron Saint of England. The statue sits on my home office desk today in Zurich. As I am now in “home office mode” this icon is viewed often but recently it provoked a lot of memories that are relevant to today’s situation in the markets.

It was September 2001. I was in Zurich for a private equity fund raising campaign that included a road show in Geneva, Zurich and Bern and a series of one-on-one meetings all over Switzerland. Ironically, I was feeling ill, but in typical large company form, I pressed on to meet my obligations to the sales and marketing team that had set up a variety of meetings for me. Then it happened. The planes hit the twin towers and a day later we were in a “global no fly mode”. I was locked down in Zurich. At the time I had two small twins aged 1 ½ years old back in the rural part of New Jersey (yes there is a rural part). I wasn’t suffering as much as many did during this period, but nonetheless it forced me into a period of deeper reflection.

The next morning, I woke up with unusual chest pain; Was I having a heart attack induced by anxiety? I called the concierge at the hotel to order a taxi and I was taken to the hospital and diagnosed with a respiratory infection and given antibiotics and sent back to the hotel for rest. Thankfully no heart attack and over the next days, I recovered and eventually I started to go walk about outdoors. There was no WhatsApp or Instagram and I do not remember calling or texting people often. Quite near the hotel I came upon a small antique store in the old part of Zurich. I was looking for answers, for something to anchor myself in a state of separation and loneliness from my wife and children.

The store was full of old metal Russian icons of various orthodox images of Saints used in the late 1800’s. The old lady who owned the store was like a mystical sage. Dressed in a unique style with a cheerful wise voice, she drew me in with her fascinating ability to tell the stories of these mythological figures; Saint Bernard, Saint George, Perseus et cetera, all stories I had no maturity to absorb when I first learned about them as a teenager in high school, but now I was ready to listen and learn. I was hooked and I ended up buying many small metal antique symbols of these saints that were used as relics to pray by the Russians. One for myself, my two children and my wife and this began my quest for the lessons of these Saints that now what I know to be universal archetypes deeply rooted in our psychology across cultures.

The legend of Saint George has been traced back to a legend in Silene, Libya around 1260. This legend is called the Golden Legend. As the story goes, Silene was plagued by a venomous spewing dragon dwelling in a nearby pond poisoning the countryside. To prevent it from coming into the city affecting the city itself the people offered it two sheep daily then a man and a sheep and finally their children and youth chosen by lottery. One time the lot fell on the King's daughter. The King offered all his gold and silver to have his daughter spared; the people refused. The daughter was taken out to the lake dressed as a bride to be fed to the dragon. Saint George, by chance, arrived at the spot and the princess tried to send him away but he vowed to remain. The dragon emerged from the pond while they were conversing and started to approach them. Eventually with a fight on horseback, Saint George then charged the dragon with his lance wounded it and after a struggle, they gained control of it and together they lead the dragon back to the village where it terrified the populace. Eventually Saint George killed the dragon and cut it to pieces and where the dragon died, a fresh-water spring emerged that flowed magical water that cured all disease. The people later built a church upon this site believing that it now possessed divine powers.

Whether it is this legend of Saint George or a similar one about Perseus slaying Medusa in ancient Greece, there are many stories in virtually every culture of a hero that slays a monster. They all are instructive about human psychology and the persistent battle to overcome our fears. They all teach us of a hero where we can see that on the other side of fear, is hope; where there is an eternal source of magical water. What is not obvious in these teachings is that the hero is basically always within ourselves; it is our choice of whether we allow fear or hope to dominant our thinking. With the risk of being cliché, I woke up recently and found myself thinking, "you can make excuses, or you can make a difference; it is your choice". I made this an internal mantra and now as one of the leaders of our firm, I am making it a principal that drives our company's ethos.

The current mass psychology around the COVID-19 is at the stage where the dragon is in the pond nearby the village. Global lockdowns are real and the drawbridges to the village moats are being drawn closed; and I am not saying that the current challenges are just mythical dragons, I am saying these issues have persisted throughout human history and our collective responses are following typical patterns. The present circumstances present significant real risks to our aged populations and we should not offer them by lottery or in any other process to the dragon; but I believe we are gaining control over this dragon. The statistics are vastly unreliable and being used to politicians and the media (not consciously) to strengthen their mandates.

As you may be tempted to ask: OK Pinkerton what does this have to do with the markets and how can I prevent this dragon from eating our capital and preventing us from achieving our goals?

All markets are driven by confidence or the lack thereof. Especially when the price of an exchange of a promise or a contract that embodies some assessment of the future variable earnings for stocks or the fixed payments or creditworthiness to pay back an obligation (bonds). Whether it was the tech bubble meltdown in 1999/2000, the World Trade attacks and the equity market rout of 2001-2002, the GFC in 2008 or the current COVID-19 meltdown, market extremes are

driven by an excess of fear or confidence. Currently fear is dominant. We eventually come to see that the worst dragons we ever face are those that are within us and we overcome them. Fear is easy to succumb to, it is natural, it is real, and it is in our DNA and in our biochemistry; the fight or flight mode stimulates brain chemistry and adrenaline. People can be stimulated by fear responses (those who like horror movies) or by other stimulants. They all act the same way to activate our brain receptors. But either way it also can be a choice. It takes a hero and leadership to show us the path to hope. We can choose to look at the current environment as a gift that shows us the way back to core non-material-based virtues; health of oneself of family of community and a return to recognize the excess of unnecessary consumption.

I believe that mass psychology (and its effect on confidence and pricing) will follow the typical pathway, starting with denial then leading to acknowledgement then to fear magnification or spreading (like a virus) and then towards fact-based thinking and rational assessment of the risk. Furthermore I think that equity prices will soon bottom and will begin to start reflecting reality of the statistics. Currently the statistics about COVID-19 are opaque and materially biased. Morbidity is overstated, because of sampling bias (only testing the significantly ill). I am not saying that the 'lockdowns' are an over-reaction; it is the right move to *break the chain* to protect the elderly everywhere. I am saying that once we have more reliable data, the markets will begin to function properly and that is to discount in the right way the price of the future earnings or creditworthiness of instruments. I further will go out on a 'branch' (not a limb) that the current pricing of the future is reaching extreme pessimism because of the opacity of statistics and because of excess anxiety provoked by magnified perceptions to threats to human life. Equity markets have been through real wars, trade wars, currency wars and we will get through the current COVID-19 virus war. Eventually reason and rationality will return because heightened states of anxiety are temporal.

China today is releasing good news on their war against the COVID-19 virus. By the time you read this I hope this good news will be spreading against the tide of negative sentiment.

Equity investing takes patience. Private equity investing takes even more. Private equity strategies are built upon having access to better data that is put in the hands of and viewed through the lens of qualified dragon slayers. Not every dragon slayer is however immune from human bias in judgment and we take it upon ourselves to assess each of our specialized investment strategies on fact-based analysis; the efficacy of the strategy, the demonstration of competency, the alignment of interests, the quality of the company's business model, its teams ability to execute and in effect the total risk reward calculation. Of course, this will always be subjective in the relative weighting of risk and return but this is where experience and access to superior information is critical. Our structure and strategy is built on openness, alignment of interest, individual empowerment and freedom of choice. It is designed to give us access to superior information and to improve the robustness of our decision quality. It is built so that we are able to recognize human based biases of fear and greed, so that we can endure the downside volatility and not be deterred or frightened into paralysis or intellectual lock down.

We will continue to execute our knowledge-based industry focused investment strategy including digitalization, software focused solutions and business models built on a foundation of intellectual capital applied across a wide range of industries and stages.

We would like to remind ourselves and our clients that the period following the World Trade Center attack (2002) or the GFC recovery (2009) all proved to be some of the best vintage years for private equity. Knowing this enables one to avoid the abandonment of strategy at critical times.

Saint George's Day or England's National day is celebrated on April 23 each year. Let's hope that he visits humanity with his lance and kills the dragon of fear that seems to be gripping all dimensions of society in an indiscriminate manner. Afterwards, we will see the the wellspring of human ingenuity make needed and positive changes to our systems and economies that have been the basis of advancements in our societies for centuries.

Wishing you all health and safety and the capacity to never lose hope during these stimulating times.

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Zurich, Switzerland
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