Alley Company Quarterly Letter
Time Horizon

April 14, 2020

In the throes of the COVID-19 pandemic, fear has gripped Americans as incidences of infection and death have risen sharply during the months of March and April. The coronavirus has overtaken our lives and transformed our world, presenting an unprecedented medical, economic, and human challenge. There is no doubt that the next few weeks and potentially months will be challenging for our healthcare workers, the economy, and all citizens of the United States and the rest of the world.

For investors, the period ahead will be challenging as well, but given the panic-oriented selling that has already taken place, there are also significant opportunities to consider. Our belief is that investors who keep their eyes on the longer term time horizon ahead, and not on the unstable ground at our feet, will experience the best investment outcomes in the future.

The S&P 500 reached an all-time record closing high of 3,386 on February 19 followed by a precipitous decline of 34% to a closing low of 2,239 on March 23. This decline took place in 23 trading days, making it the fastest and deepest developing bear market decline post-1945. Considering the nature of the current healthcare crisis, the likes of which haven't been seen in over 100 years, it's not surprising that the stock market would become untethered from future economic prospects given the high degree of economic uncertainty in the near term. The indiscriminate and in some cases forced selling has created excellent opportunities to reap great rewards for investors who can look to the future with a reasonable time horizon, which for most investors means at least one to three years.

It is our view, and we think most people's view, that at some point in the not-too-distant future the coronavirus will be contained and that we will get to the other side. Although not perfect comparisons, reports that China and South Korea have seemingly contained the virus in a matter of months gives us hope. Never before have we seen the entire global science community bearing down on the singular task of developing antivirals, antibodies, anti-inflammatory drugs, diagnostic tests, and ultimately a vaccine to combat a disease. There are already very encouraging signs on all of these fronts in the early going. And now, the majority of the country is in a shelter-in-place mode that is promoting social distancing behavior and heightened awareness of everyone's responsibility to stay safe.

Further, the Federal Reserve has acted quickly and decisively, essentially going all-in with regard to their effort to provide abundant liquidity to the financial system, having learned valuable lessons from the 2008-09 financial crisis. We believe Fed Chairman Powell has

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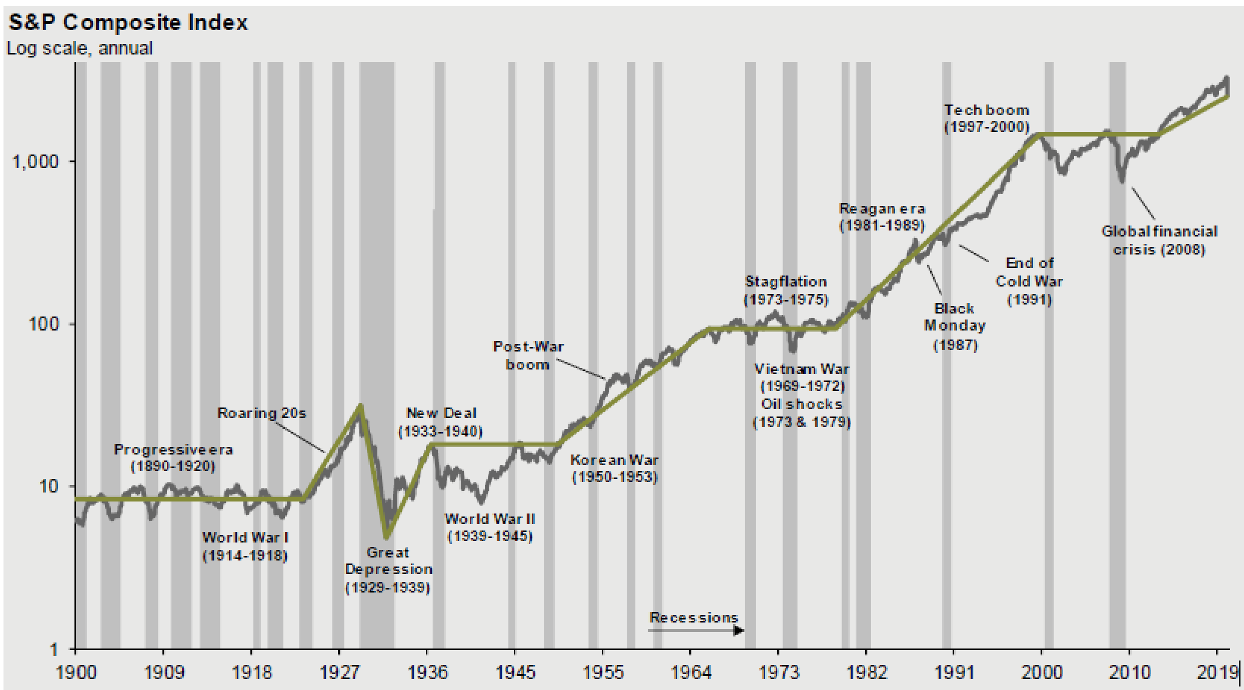
signaled a “whatever it takes” posture. Additionally, Congress and the U.S. Treasury have acted in a big way to support American workers and businesses via the $2.2 trillion CARES Act. It is our belief that more firepower will be enacted if necessary. While this double-barreled support won’t fix the root of the problem – only the medical community and social distancing can – it will help the economy bridge the gap and restart more quickly once the pandemic subsides.

History suggests that bear markets come and go given the inevitability of economic recessions, financial crises, oil shocks, wars, or pandemics. The chart below tracks the S&P 500 price history and records past events that precipitated stock market corrections.

S&P 500 Price History and Past Events



Source: FactSet, NBER, Robert Shiller, J.P. Morgan Asset Management.
Data shown in log scale to best illustrate long-term index patterns. Past performance is not indicative of future returns. Chart is for illustrative purposes only.
Guide to the Markets – U.S. Data are as of March 31, 2020.

While no two bear markets are alike, as they occur for different reasons, bull market recoveries always occur with some happening quicker than others depending on the circumstances of the time. Despite the bear markets that have occurred in the past, the annualized return for the S&P 500 over the past 94 years is 10.2% per year, which in our minds is an astounding statistic and highlights the power of long-term thinking.

Analysis of the recent stock market decline reveals the indiscriminate nature of the selloff where many high quality companies are flashing great buying opportunities. To be clear, not all businesses are on equal footing. Businesses with high levels of leverage, weak business models, and shaky fundamentals will struggle and selling pressure on these companies may well be warranted.

Our philosophy is to own high quality, blue chip in nature companies, that pay stable and growing dividends and have dominant market power in the markets they serve. While a good many of these companies have held up well relative to the overall market, many are still very attractive at current levels given their future prospects.

Making sound investment decisions in the moment requires keeping an eye on the horizon ahead in order to ultimately prosper on the other side of the storm. Our belief is that while the current environment we are living in is to be taken very seriously, and the challenges ahead are formidable, science and the economic tools available to us will prevail and lead us back to more normal times.

As the 19th century novelist Leo Tolstoy wisely noted, “the two most powerful warriors are patience and time.”