VILLERE & Co.
SELECTIVE INVESTING SINCE 1911

Sandy Villere III, Partner & Portfolio Manager

COVID-19, economic headwinds, and a volatile stock market

Opportunities for active managers and selective stock picking

Q. The financial markets have had a strong run since the lows in March, thanks in part to the Federal Reserve's efforts to stabilize the markets and the $2 trillion CARES Act passed by Congress to help offset surging unemployment. Can you elaborate on how the monetary and fiscal stimulus have boosted the markets?

The old saying, "don't fight the Fed," is really relevant here. If we look back at the difficult end of 2018 where the market fell about 15% in November and December, it was because the Federal Reserve ("Fed") was tightening and increasing interest rates. In December 2018, the Fed increased interest rates for the fourth time that year, and were looking at three additional interest rate hikes in 2019. In other words, investors would be "fighting" the Fed. However, by January 2019, the Fed did a total 180 and said they would actually keep rates lower and likely cut rates (which they did) and the market had impressive gains in 2019.

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In response to the COVID-19 crisis, the Fed cut its interest rate target to zero. The Fed has now said they will not only keep rates lower, but they will add significant liquidity (cash) into the economy and even do asset purchases to keep credit markets stable. This has had the impact of really buoying markets. Lower rates will also help consumers keep more of their money as they can get lower mortgages and other borrowing costs, and are able to spend more money, keeping the economy on firmer ground.

The government's stimulus program has also helped stabilize the market. One-time payments to individuals, strengthening unemployment insurance, additional healthcare funding, and loans and grants to businesses are all supporting the economic recovery.

Q. U.S. consumer confidence plunged in April as COVID-19 has sharply disrupted economic activity and left millions of Americans out of work. There seems to be a disconnect between the stock market and the economic challenges facing many companies and people. Why is this?

Yes, given the economic shock and the turmoil all around us, it may seem baffling that the stock market has rallied so much from its low on March 23rd. But it is important to keep in mind that the stock market is forward-looking. This means that while consumers are staying at home and not spending money, the market is already discounting a recession and other bad news from companies, which led to the sharp decline in the market in March. The recession is coming in real time, but the market is already looking forward to a rubber band effect of the potential pent-up demand in spending, to the end of 2020, and what the world will look like in 2021. The unprecedented support from the Fed and the government is also providing what many investors believe is a backstop for the markets.

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Q. We have seen a "flight to quality" and money has recently flown into fixed income, with bond yields at around record lows. What is your view on the bond market?

We don't believe the bond market is attractive with yields as low as they are now. We believe that rather than getting risk-free return at these prices, investors will be getting return-free risk. We have an old adage at our firm that is quite simple: "Buy what yields more." The current yield on the S&P 500 is close to 1.9% and the 10-year Treasury Note yield is only 0.7%. We do believe many companies that are not on sound footing will cut their dividends to shore up their balance sheets and maintain cash, so we are estimating that the forward yield for the S&P 500 will be slightly less than it is now. This is still more than you would get by holding the 10-year Treasury and therefore we find holding stocks much more attractive over a full market cycle.

Q. Why does active management matter during this crisis and when investing in small- and mid-cap stocks?

We believe that not all stocks are created equal. Investors who simply index into the S&P 500 are investing in areas of the market we do not find attractive, such as airlines, energy, and many retailers that are weak and getting weaker. We would rather take a rifle approach and focus on companies that have great businesses in this environment, but also have pent-up demand for their products as we come out of this pandemic and can offer wide appreciation potential as things normalize. Small and mid-cap stocks certainly underperform going into a recession and we have seen that underperformance already occur. We truly believe in looking through the windshield rather than the rear-view mirror, and believe coming out of the recession small and mid-cap stocks will lead the market higher. We also know we are in a trade war with China that may get worse before it gets better. The preponderance of small caps is focused on the domestic economy and that will be the sweet spot in our opinion, looking out several years.

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Q. What are a couple of examples of stocks you hold in the portfolio that represent your investment approach? Why do you like them?

We like **eHealth** (EHTH). The company is growing rapidly and each quarter it has posted numbers that are better than expected and raised earnings guidance. Their business model is similar to an Expedia that has made it very simple for people to buy travel online; eHealth makes it simple for seniors to buy Medicare coverage online. eHealth competes with government-run healthcare.gov and medicare.gov that are very cumbersome to navigate. The demographics are extremely encouraging as 10,500 people turn 65 each day in the U.S. and medical coverage is something they are all searching for. We like eHealth now as people are at home and using the internet more than ever, and we will like it when things get back to a more normal environment as each year people are getting more comfortable using technology to make their lives more efficient. The company also has a strong balance sheet with no debt and $7/share in cash, so it is in a very enviable financial position.

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Another stock is **Ligand Pharmaceuticals** (LGND). The company is focused on developing and acquiring technologies to help pharmaceutical companies discover new medicines. We do not consider it a COVID-19 investment, although I'd say it is getting a nice lift as one of the 300 companies they help is Gilead Sciences that has Remdesivir, a possible treatment for this virus. Gilead has said they want to have 1 million treatment courses of Remdesivir by the end of 2020. Ligand's Captisol technology that Gilead is using should see a very nice uptick. In fact, Ligand raised guidance by $5 million based on their last orders from Gilead. We believe Ligand is in the "sweet spot" going forward given their position in this whole marketplace even if Gilead is unsuccessful in finding a vaccine for COVID-19.

Q. What is your outlook and what do you believe are the biggest challenges to the market in 2020?

I believe the market, as measured by the S&P 500 Index, has already achieved much of its gains for 2020. However, the bias is to the upside potential and many of our small-cap companies have not made the move that the S&P 500 has made. We don't own the large-cap technology stocks in the S&P 500, such as the FAANGM (Facebook, Apple, Amazon, Netflix, Google, and Microsoft), which have risen sharply from their March lows. Therefore, while I believe those companies have little upside potential given the appreciation they have experienced, I'm very excited about many of the stocks we own that have not made those moves yet.

Q. Many investors likely find it difficult to stay the course and remain calm during these volatile and uncertain times. What do you say to your clients?

This is totally natural. It is normal for anyone to look at the current environment and be nervous. If we look back at other periods of sharp market declines, such as the internet boom and bust in March 2000 when the NASDAQ fell more than 70% from peak to trough, and the financial crisis in 2008-09 when then S&P 500 fell 57%, we see that the market is usually resilient. It is typically in periods when uncertainty is at the highest where valuations and investment opportunities are most attractive. When things are perfectly fine, stock valuations tend to be stretched and it is more difficult to get appreciation compared to times like now where stocks are trading at discounted prices.

Q. Villere & Co. is based in New Orleans. How has the COVID-19 lockdown affected the operation of the firm?

We don't consider this lucky by any means, but having lived through Hurricane Katrina back in 2005, we already had a paperless office and all information "on the cloud." We were prepared for the next hurricane where we may have to evacuate. Therefore, we have several days per year when we all work remotely to make sure our systems and trading work as normal. We didn't anticipate working remotely because of a pandemic, but our systems are all working great. From an operational point, we were business as usual from day 1, which was encouraging. We are able to have conference calls each morning before the market opens to discuss strategy, and easily implement our ideas as if we were still working in the office.

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RISK CONSIDERATIONS

A mutual fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contain this and other important information about the investment company and may be obtained by calling 866.209.1129 or visiting villere.com. Read carefully before investing.

Mutual fund investing involves risk; loss of principal is possible. Investments in smaller and medium sized companies involve additional risks such as limited liquidity and greater volatility than large-cap companies. The Villere Balanced Fund will invest in debt securities. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower rated and nonrated securities present a great risk of loss to principal and interest than higher rated securities. The Villere Equity Fund may invest in foreign securities. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks are magnified in emerging markets. The Equity Fund's ability to invest in initial public offerings (IPOs) involves a higher degree of risk than more seasoned companies. Past performance does not guarantee future results.

Yield is the income return on an investment and refers to the interest or dividends received from a security; is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

NASDAQ Composite Index, a market value-weighted index of all domestic and international common stocks listed on the NASDAQ stock market.

S&P 500 is an unmanaged index which is widely regarded as the standard for measuring large-cap U.S. stock market performance. The stock index does not incur expenses and is not available for investment.

It is not possible to invest directly in an index.

As of May 6, 2020, the Villere Balanced Fund held 120,290 shares of eHealth, Inc. and 65,180 shares of Ligand Pharmaceuticals, Inc. The Villere Equity Fund held 28,930 shares of eHealth, Inc. and 20,320 shares of Ligand Pharmaceuticals, Inc. Neither fund held any shares of Expedia Group, Gilead Sciences, Facebook, Apple, Amazon, Netflix, Google, or Microsoft.

Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

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