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A surging stock market in the face of the COVID-19 pandemic

Investment opportunities during the economic recovery

Q. The stock market has had a massive rally since the lows in March despite the COVID-19 pandemic, the sharpest economic contraction in history, high unemployment, and social unrest. Can you explain what drove the stock market rally and how it was possible?

Obviously, the pandemic and the shutdown of the overall economy was a complete shock to the system. The real surprise was how quickly the market seemed to shrug off the unprecedented social and economic paralysis. Governments worldwide were incredibly aggressive in their responses to the pandemic. Fiscal stimuli, such as PPP loans and unemployment payouts were put in place quickly to ease the strain on individuals impacted by the crisis. Central banks followed suit, lowering interest rates and softening the economic blow by buying bonds and even stocks. Finally, as the stock market seemed to stabilize (even as the shutdown continued), investors, having been repeatedly trained to "buy the dip" over recent years, began to pile back into stocks.

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Q. As a part of its asset purchase program, the Fed stepped in and started buying corporate bonds, including junk bonds. Why was this an unprecedented move by the Fed and how did it impact the financial markets?

Fed Chairman Jerome Powell essentially pledged to do whatever it took to keep the economy on its feet, including injecting trillions of dollars into the market for various assets. The actual purchases made by the Fed combined with investors' confidence that the Fed wouldn't stop its buying program gave investors the confidence they needed to re-enter the stock market. While the long-term impact of the Fed's actions will not be known for years, the short-term impact was clearly a positive for investors.

Q. There is a lot of talk about "Don't fight the Fed" and the "Trend is your friend". Can you elaborate on this?

As long as investors believe that the Fed will continue to step in to make massive asset purchases when prices fall, those investors will continue to be emboldened to remain invested and to make purchases. It's somewhat akin to the child who acts tough with the knowledge that his big brother is standing behind him - with the risk of disaster seemingly off the table, investors can largely ignore the prospect of a market collapse.

Q. With interest rates at 0% and the 10-year U.S. Treasury bond yield close to 0.5%, cash and bonds don't look very attractive. What are your thoughts on the fixed income market?

We're generally less inclined to hold bonds at these rates. With that said, fixed income is always an important part of the asset allocation for those with aversion to risk. We remain close to the low end of our bond allocation in our Balanced Fund. Still, we maintain some cash in both funds as we patiently await opportunities to take advantage of volatility.

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Q. It seems like stocks have become the only alternative for investors. However, stock valuations, based on the S&P 500 Index, are now at the highest level in almost 20 years. Should investors look at valuations differently in this environment?

Given what happened during the shutdown, typical valuation metrics (price/earnings, etc.) can be hugely misleading. Can you really judge the long-term earnings of, say, a casino business by looking at their earnings over the last twelve months? We think not. Times like these require added scrutiny, as investors have to decide how much of the "damage" is permanent, and how much is a temporary blip on a company with otherwise stellar prospects. Beyond analyzing management teams and overall prospects, a big part of this analysis involves the quality of a company's balance sheet. Companies with heavy debt burdens will have a much more difficult time surviving the current environment.

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

One of our long-term holdings is **Pool Corp.** Pool is the dominant distributor of products for swimming pools. During this period of social distancing, we've seen consumers spend heavily on their homes and other forms of recreation that do not necessarily involve significant social contact. We've anecdotally heard of pool builders who literally aren't returning phone calls to hopeful homeowners. We believe Pool will continue to enjoy not only this spike in swimming pool installations, but also the long-term maintenance spend (chemicals, replacement parts) for these new pools for years to come. We continue to like the growth profile and the competitive position that Pool enjoys.

> "While we're hesitant to call this a bubble, we are always highly skeptical of exceedingly popular investment trends."

Another company that we owned but kept buying during the shutdown is **Steris**. Steris is focused on infection prevention for healthcare settings. We were mystified when shares of Steris plummeted during the economic shutdown, and we added to our position at what we thought were fire-sale prices. In our estimation, COVID-19 and the specter of future pandemics seems to play to Steris's strengths.

Q. What role does active management play when investing in small- and mid-cap stocks?

Investing in smaller companies can have greater risks as well as greater rewards than investing in large-cap stocks. Smaller companies are less known, tend to be more specific in their business (like a small regional lender whose fate rises and falls based on highly specific trends, compared to a global financial powerhouse). In our experience, there are significantly more opportunities to find attractive investments in the small- and mid-cap world.

Q. As the Fed and the government have flooded the market with liquidity and "free" money, coupled with the sharp outperformance by technology stocks, some investors are concerned that we are approaching a stock market bubble that may burst. What are your thoughts?

"Big tech" has been incredibly strong in terms of stock market performance, which has in turn boosted large-cap indices, which has led to more investor money flowing into those passive indices. While we're hesitant to call this a bubble, we are always highly skeptical of exceedingly popular investment trends.

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Q. What is your outlook and what may drive the performance of small- and mid-cap stocks?
We feel that the market has risen very quickly and we fear that political and pandemic risks are being largely ignored. With that said, we are still able to find some attractive opportunities, and hold cash to be able to take advantage of pullbacks or other market shifts.

Q. What do you believe are the biggest risks to the markets for the remainder of 2020 and into 2021?
We believe that investors today are assuming that the Fed will remain active, that this (or another) pandemic will not lead to further shutdowns, and that the upcoming election will not result in market-unfriendly changes. It is our belief that at least one of these will likely be proven incorrect (or, at a minimum, will come into question in the coming months). As such, we have positioned our portfolio to benefit from durable trends, and are sitting on some cash that can be used to further boost our holdings in attractive businesses.

Opinions expressed are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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.

Price-to-Earnings (P/E) Ratio measures share price compared to earnings per share for a stock or stocks in a portfolio. **Earnings growth** is a key indicator for measuring a company's success and a driving force behind stock price appreciation. Earnings growth is the percentage gain in net income over time.

Paycheck Protection Program (PPP) is a business loan program established by the 2020 U.S. Federal government Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to help certain businesses, self-employed workers, sole proprietors, certain nonprofit organizations, and tribal businesses continue paying their workers.

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 August 5, 2020, the Villere Balanced Fund held 28,227 shares of Pool Corp, Inc. and 66,970 shares of Steris PLC. The Villere Equity Fund held 7,270 shares of Pool Corp, Inc. and 13,460 shares of Steris PLC.

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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