Quarterly Letter December 2020

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THALASSA CAPITAL LLC

"Night never had the last word. The dawn is always invincible."
–Hugh B. Brown

A very interesting year is coming to an end. The world experienced its first pandemic in 100 years and many of our true and tried ways and beliefs were put to the test. Domestically, we also endured a difficult election that had all the marks of becoming a classic tail-risk event; fortunately, our institutions held strong and the process and rule of law seems to have prevailed.

Given such a background, one would have expected a much different picture from financial markets. We did endure massive bouts of volatility, but overall money flows did not abandon most risky assets and some sectors such as technology had (again) a banner year.

In our last quarterly investors' letter, we highlighted a few emerging trends and singled out expectations about market developments. In our last missive of the year, we would like to build on those themes and provide a blueprint of actionable ideas.

One clear trend should be identified in increased fiscal spending. The speed and largess of it still depends on the run-off Senate elections in Georgia. However, regardless of the outcome, it is reasonable to expect more government spending in different critical areas, from broadband to energy transition, from education to a redesigning of supply chain resilience. We would also expect fiscal spending to touch the health care system even though it is unclear how and what areas could be eventually affected. On a related sector, we continue to see opportunities in big pharma and biotech where innovation is exploding, valuations are reasonable, mergers and acquisitions should continue, and people's perception might be more positive after the significant response of the industry to the virus threat.

2021 should also see a rebound in consumer spending, given a probable gradual lifting of restrictions and continued fiscal support. The savings rate remains significantly higher than historical averages and we would expect it to decrease as life return to normal.

While we expect fiscal policy to become the driving force in government directed intervention, we also continue to expect monetary policy to remain benign. Alongside the Fed, it would be reasonable to expect more action by the UK central bank as that nation works out its exit from

the European Union. The ECB should also continue to show a dovish stance as economies like Italy and Spain were severely damaged by the virus.

This last comment leads to an analysis of the relative speed of recoveries in different geographical areas. Europe and the US should see cyclical recoveries in 2021 but Asia might show a faster upswing. A few factors might converge to this effect such as a more coordinated response to the health crisis, the resurging momentum of China and the emergence (as a consumer force) of the Asian millennial population. Henry McVey, Head of Global Macro at KKR states that there are now 822 million Asia millennials or, in relative terms, 12 times more than in the US alone.

This demographic trend has implications not only on the geographic area to bet on but also on what consumer sectors. Millennials are coming of age as a consumer force and that will create winners and losers based on their views. In our opinion, this means that while traditional cyclicals will probably have the upper hand in the first part of the recovery, we should still pay attention to "disruptors" that cater to a view of the world shaped by this rising demographic force.

In essence, all this means that we expect equities to do fine in 2021 albeit in a more discerning fashion where winners will probably be very different that 2020 winners. We continue to like credit because of the Fed's bid but we do like a more diverse exposure to it; we like allocations to credit that include Emerging Markets, mortgages and active management overlays.

The fiscal card also puts on the spot infrastructures; in this case a mix of equity and debt might be optimal. Infrastructure projects with good collateral and predictable and rising cash flows can also provide a hedge against inflation which central banks around the world are so keen to reignite. A mix of inflation hedge and good valuations also supports some sectors of Commercial Real Estate, as we outlined in our last letter.

Rising inflation should also favor a continuation of the weakening trend in the dollar and support gold. In the context of the Millennials shaping new trends, Bitcoin could eventually become the new gold but at these current levels, it is hard to expect any additional appreciation.

In conclusion, we expect another volatile year ripe with opportunities and risks. In this light, tactical hedges or allocations to alternative investments equipped to manage the tails of the expected returns might be a reasonable addition to long term and intermediate term allocations.

As always, we would like to thank you for the renewed confidence in our work,

Youri Bujko

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