Animal Spirit

July 2020

In the 2nd quarter of 2020, Lysander-Fulcra Corporate Securities Fund (the "Fund") returned 6.4 percent, pushing performance to -4.9 percent for the first 6 months of the year. However, names that negatively affected Fund performance in March, and performance in the first quarter, are still close to their March / April low prices at the end of June. We added to the following existing positions in the 2nd quarter (portfolio weights as of the end of the 2nd quarter in brackets): Blackberry (2.6 %), Briggs and Stratton (1.8%), Chemtrade (2.0%), Clearwater (2.7%), Millar Western (6.5%), and Tidewater (4.3%).

Specific idiosyncratic situations that are at different stages of their operational and / or balance sheet reorganizing and priced with a high level of margin of safety due to excess working capital valuation support are Sherritt, Briggs and Stratton, and Ferroglobe.

Sherritt recently filed an amended version of the plan of arrangement that was originally issued in late February. The new plan contemplates receiving more of the to be issued 2nd lien bond as well as a pro rata allocation of a new junior bond. While not an optimal outcome for investors who bought bonds at new issue, our timely purchase last spring should start to bear some fruit. Along with a much better covenant package, the new 2nd lien bond comes with a higher coupon and will be a bigger, more liquid bond than any of the three soon-to-be-canceled bonds. Furthermore, and equally as important fundamentally, the company will be reducing debt and interest costs that will remove a financial strain and contribute to improved financial operating performance.

Briggs and Stratton, which is the biggest negative contributor to Fund performance in 2020, has evolved from a short maturity play to one where an asset sale process has been completely upended by the COVID-

19 crisis. This situation is evolving by the day and has entered a phase where a restructuring / asset sale will inevitably take place as the company did not make its June 15th coupon payment. We believe strongly that there is value in our existing bond position but are less clear today how and when it will be realized. Briggs and Stratton is a business that has the ability to thrive during and after these economic environments.

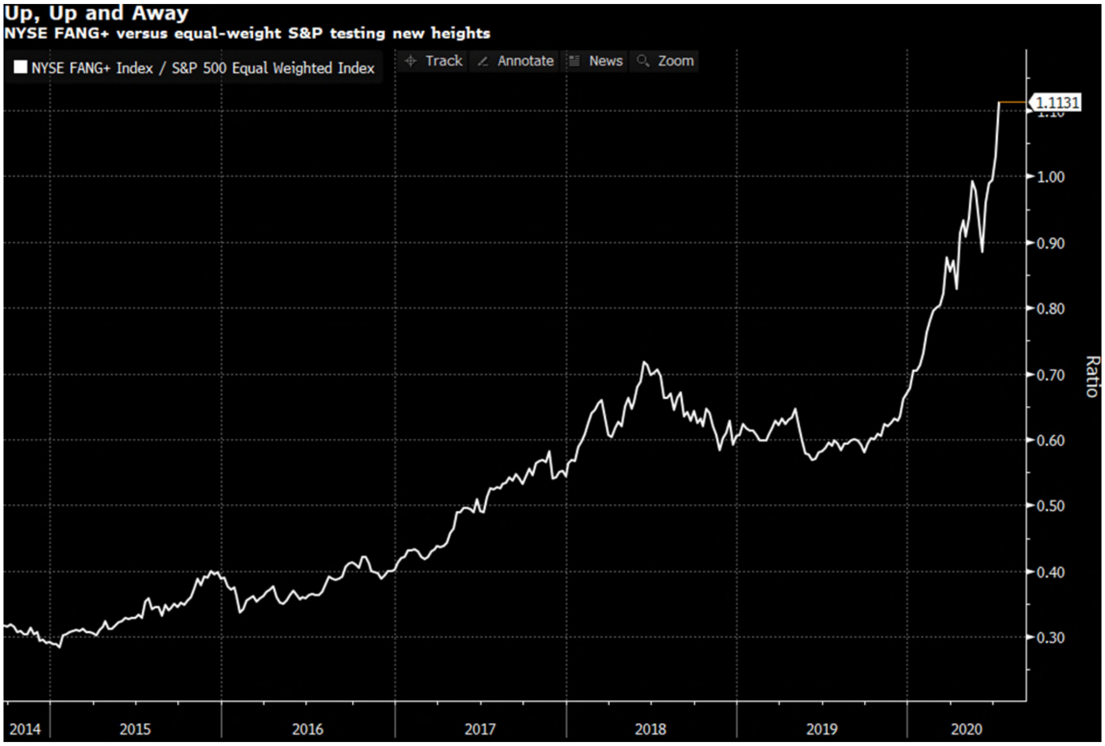
While our initial belief that the senior asset backed creditors of Briggs and Stratton would be unimpaired still holds, the depth of COVID-19's impact on the global economy is affecting the behavior of even the largest financial institutions. Regardless of their position at the top part of the capital structure, 1st lien lenders appear to be aggressively reigning in capital where they see an opportunity. Briggs and Stratton is not an isolated situation and conversations with several management teams recently would suggest banks are having a hard time managing through this recessionary period. This would seem logical given the uniqueness of the risk (COVID-19) and the extensive geographic reach of these financial institutions. Traditional corporate "relationships" are being usurped by a more risk averse mechanical allocation of credit which appears to be particularly acute at the small mid-size enterprise (SME) level. However, if traditional secured capital providers are reducing loan volumes it does create an opportunity for more entrepreneurial capital providers. Briggs and Stratton may provide such an opportunity for Fulcra, although at writing, nothing has been finalized.

Ferroglobe (1.7% portfolio weight in the Fund as of the end of the 2nd quarter), is one of the largest manufacturers of silicon metal in the world. There is currently a global supply glut of silicon metal that has been exasperated by the COVID-19 crisis as the demand industries of steel, aluminum and photovoltaic cells has been upended. What attracted us to Ferroglobe's bonds is the company's competitive positioning, excess working capital, and price we were able to buy bonds (sub $50) with an implied low multiple to average business cycle cash flow. The capital structure is also straight forward with a senior credit facility, bond issue, and public equity. While the bonds aren't due until early 2022, it is our belief that if market / economic conditions do not improve, there could be an opportunity for existing bond holders, as the fulcrum security, to potentially benefit from a de-levering or bond extension transaction.

Warning: Sports betting can lead to other addiction problems

A recent quote from Dave Portnoy, founder of the popular website Barstool Sports, illuminates the risks in markets today: "It took me a while to figure out that the stock market isn't connected to the economy," he said. "I tell people there are two rules to investing: Stocks only go up, and if you have any problems, see rule No. 1." … reminiscing of statements made prior to the dot com bubble burst.

Retail investors contribution to the rally is plausible, even if difficult to quantify, given the timing/coincidence and strength of government fiscal support and lack of open gambling establishments (closed casinos and no sports to bet on). It could also be pinned to institutional investors' belief that the government/central bank has the economy's back. However, equity valuations as high as they've been since the dot com bubble would suggest otherwise. With 400 of the 500 companies in the S&P500 suspending 2020 guidance in the 2nd quarter, it would seem that not just rational actors have driven the market back close to the all time high reached at the end of February. That being said, one thing is clear, the 10 companies in the FANG Index (Facebook, Apple, Amazon, Netflix, Google, Alibaba, Baidu, Nvidia, Tesla and Twitter) are the reason the S&P 500 is close to an all time high even though the stock prices of over 350 companies in the S&P500 are still below their level from the middle of February.

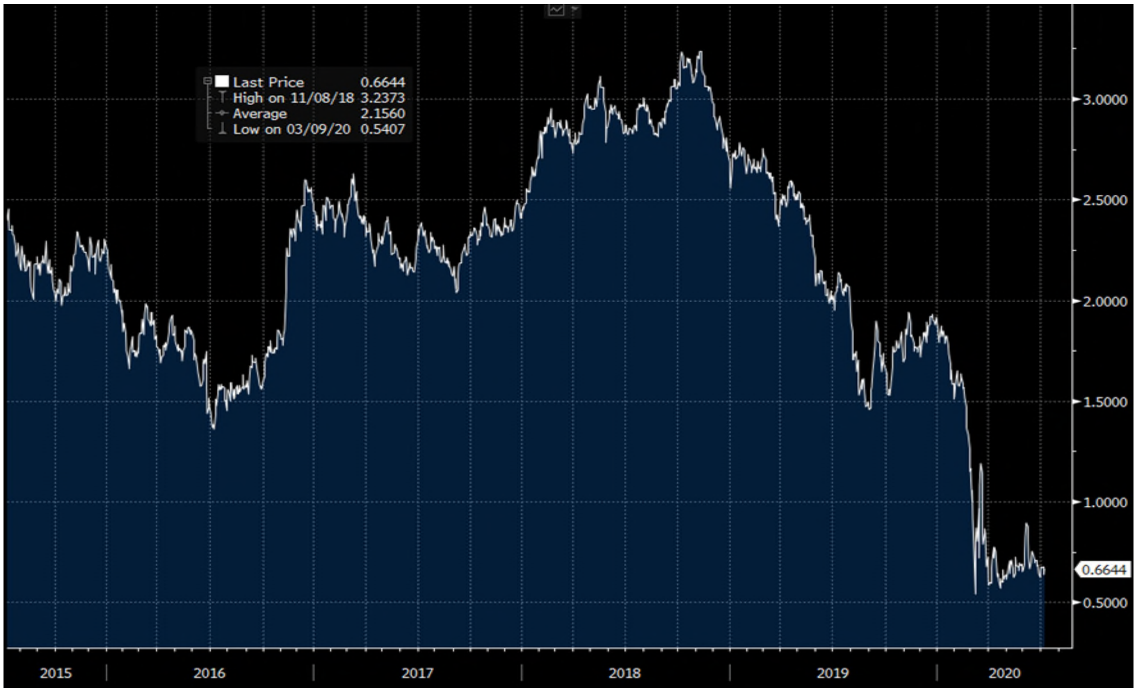


Source: Bloomberg Financial L.P.

Some believe that a permanent shift to an at home work/play world will drive the earnings growth of these FANG's and that their combined 43 times forward P/E is justified. Putting aside the valuation debate, an important factor is likely the perceived scarcity value of attractive stock investments given the lack of forward guidance from more traditional public companies and the complete gutting of the bricks and mortar retail sector.

However, the now more recent new all-time low government bond yield of 60-70 basis points per year for the next ten could be driving an "animal spirit" for something better. Can you blame them?

US 10-year Treasury Yield



Source: Bloomberg Financial L.P.

No, but be careful. The 2nd quarter, which was one of the largest on record for new issues of both High Yield and Investment Grade corporate bonds, sends a strong signal that there is demand for credit. However, 2nd quarter results, which begin later this month, will likely start a trend of sobering earnings and management commentary. A very large margin of safety is required currently as visibility is weak at best. You may not choose to fight the Fed but be prepared to shift alliances quickly. A strong focus on fundamental analysis and patience will always put you in good stead.

Sincerely,

Matt Shandro

Fulcra Asset Management

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