Commentary for March 2020

Summary Thoughts on the Current Environment

– The "Virus" defines the concept of a transitory moment.

– We have no doubt that "2020 is canceled" as far as earnings and estimates.

– The depth of the resultant "info-demic" is uncertain, as is the timing of when maximum financial market effect has been reached, but we would suggest the turn will be aggressively V-shaped.

– There is zero liquidity in financial markets generally and US Small Cap specifically. The sell-side has evaporated via closures or consolidation, does not make markets post-2009 and are excessively oriented to indexes instead of security selection. Short-term flows are blindly "risk on/risk off".

– In Small Cap specifically, you have to "be there" in the later innings of inflection points—the only way to put capital to work.

– We are not making the call that "equity valuation at large" is cheap, but 2020 has exacerbated recent spreads between "haves and have-nots."

– There are lean-in opportunities in "the usual virus suspects". We have carefully picked Cinemark (Ticker: CNK) and Six Flags (Ticker: SIX).

Let's be clear. The only people who call bottoms consistently are liars or criminals. But valuations in what we think we understand—and the anxiety we see around us (and occasionally in us)—suggest leaning in.

Our Call for Action

Properly speaking, there are only three reasons why someone should allocate capital to a money manager:

1. New funding or capital inflows.
2. An existing partner whose strategy makes intellectual sense has developed legitimate "people problems"—as in defection, death or dismemberment, merger hiccups, or acts of moral turpitude. You need someone else to fill the roll.
3. The area in which a manager operates has become painfully undervalued and the manager for the first time in as long as you can remember, is asking for money.

We think we have entered Scenario 3. This is one of those briefly awful periods that we secretly hope for when things are good and ideas are scarce, but that cause sleep patterns and cocktail consumption to change when they actually happen.

– The Russell 2000® and Russell 2000® Value indexes are down 21% and 25% YTD, respectively, as of this writing. This is a time to make money.

– Our portfolio trades at its widest discount to fair value since January 2016, which was frankly the last time we penned a letter like this.

– Currently we are fully invested, and we think more capital can be put to work, not only in existing names but new ideas as well.

This is without a doubt the most promotional statement Cove Street Capital has made since 2016 and frankly the second of its kind since our inception. We are a firm that does not use the word "marketing" or "product" in any of its literature. There currently is an enormous opportunity to invest in Small Cap and we enhance that opportunity with thorough research and careful security selection.

> "Be greedy when others are fearful and fearful when others are greedy"
> — Warren Buffett