CALIFORNIA STATE UNIVERSITY SAN MARCOS COUGAR FUND

# COUGAR FUND REPORTER

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## A NOTE FROM THE CHIEF INVESTMENT OFFICER: COLIN ANDREWS

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I have had the great pleasure of serving as Chief Investment Officer of the inaugural Cougar Fund here at California State University San Marcos. We have had the unique opportunity, as stalwarts of a new organization, to take the fund's initial positions in public equities. Our dedicated portfolio managers, directors, and analysts met weekly and communicated often to parse the activities of the market and determine viable investments.

We experienced a strong equity market in the last half of 2019. In October 2019, The Cougar Fund made its first purchases. They consisted of exchange traded funds (ETF's) that were highly correlated with the 11 sectors of the S&P 500 index and had low expense ratios. These purchases coincided with the market's subsequent run up from the 2900 levels. Diversification is a large component of our decision to purchase ETF's that match the market. Portfolio alpha over our benchmark index is derived from the additional purchases of single stock securities and active weightings in market sectors. The market extended its rally in the first quarter of 2020 with the S&P 500 reaching highs of 3393 in February. Our portfolio of ETF's, stocks, and cash did well in tracking the benchmark, reaching a return on invested capital of 14% by mid-February.

The novel coronavirus and its associated infectious disease, Covid-19, has become a global pandemic. The initial implications of this disease were difficult to model, and its impact on the global economy and financial markets has been severe. Volatility has increased substantially. CBOE's volatility index, VIX, reached a high of 85 in mid-March. It had been trading in a range not exceeding 23 for all of 2019. Market participants should expect increased volatility for the remainder of 2020 and possibly beyond. Monetary policy has loosened in response to the crisis. The federal reserve lowered the federal funds rate to zero and initiated QE infinity with the purchase of treasury securities and mortgage backed securities. In an unprecedented move, the federal reserve has also initiated the purchase of corporate bond ETF's, both investment grade and high yield, in an effort to calm credit markets. Treasury yields fell substantially from the range of 1.50%-2.00% for the 10-year bond at the initiation of our portfolio to a current 0.62% as of the time of this writing.

Our portfolio was not immune to the market sell-off; however, due to our robust due diligence process, we fortuitously hold a substantial cash position that has partly shielded our losses when compared to the S&P 500. From the end of October, the time in which The Cougar Fund gained exposure to all eleven sectors of the S&P 500, the market has returned -4.93% and The Cougar Fund has returned -2.56% overall at the time of this writing. With a significant cash position, our portfolio managers and analysts are hard at work searching

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for companies that offer significant value given the current environment and have strong balance sheets to weather this storm. We view this as an opportunity to gain long term positions in strong companies that will be staples in our portfolio for the foreseeable future.

The implementation of this fund has been a most rewarding experience. All of our analysts realize the tremendous responsibility that comes with managing a fund of this size. The determination and professionalism displayed by the men and women that constitute this inaugural fund's staff is praiseworthy. The systems we have put into place will hopefully allow future fund leaders to achieve great success.

*"The real-world investment management and security valuation experience garnered from this organization will remain a highlight of my experience at California State University San Marcos. I cannot wait to see what the future has in store for The Cougar Fund and the proud students who will run it."*

## INDUSTRIALS & MATERIALS SECTOR: ELLIOT ESTRADA

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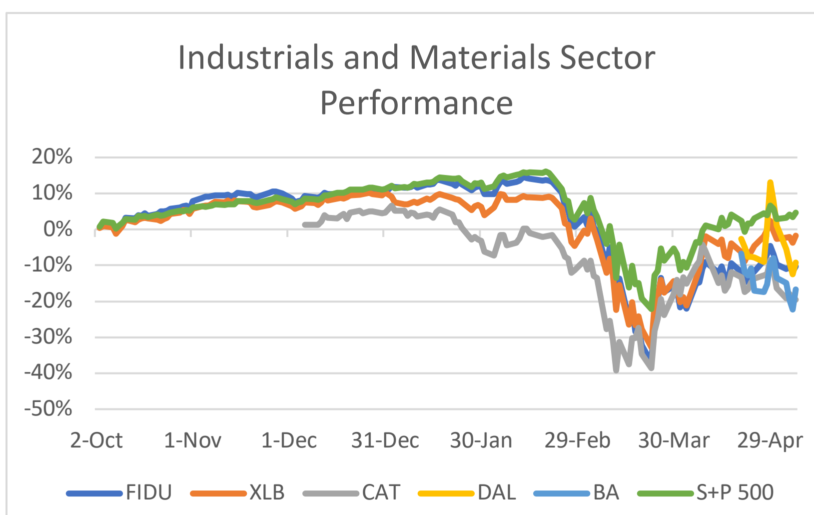
It has been my absolute privilege to serve as the first Industrials and Materials Sector portfolio manager for The Cougar Fund here at CSU San Marcos. It was exciting to build an organization from the ground up. For many of us, myself included, this is our first undertaking of this kind.

Every single component of running the Fund had to be developed: communication mediums, presentation standards, and even equity valuation workshops. We hope that our work will serve as a foundation for future finance students, or any CSUSM student who wants to dive into the world of investing—to build and grow the fund into world class educational experience that yields bright financial professionals.

Over the past year, the financial markets have been on a whirlwind ride. The last quarter of 2019 was marked by volatility caused by the novel Coronavirus. By the first quarter of 2020 the decade long equity bull market ended as the manufacturing center of the world, China, shut down to curb the spread of the virus. These measures were replicated globally as governments attempted to contain the virus and not overburden their healthcare systems. All but essential services were shut down. Industrial production suffered greatly. Overall, industrial production in the U.S. fell 1.9% in the first quarter of 2020 with durable goods hit the hardest at 3.1% decline. Apparel and transportation related subgroups were especially hit at 5.6% and 8.8% declines, respectively.

The Industrials Portfolio as whole tracked the FIDU core ETF holdings, which is an ETF that tracks the S&P 500 industrial sector. It is outperforming by 0.6%. The fund took positions in April 2020 into Delta Airlines (DAL$21.71) and Boeing (BA$121.86). These two investments were made based on significant value plays. Both were down ~40% from the year prior. We expect short-term operations to be poor, but long-term, we expect the companies to outperform



competitors and materialize sizable gains based on our price targets of $47.12 for DAL and $171.24 for BA. Caterpillar (CAT$107.67) has been hammered by delayed building activity but it is strongly corelated to economic activity and should rebound with more favorable economic conditions. We expect strong performance based on investments it is currently making in its supply chains to make them more reactive to sudden shocks or changes in demands for certain types of machinery. Fortunately, many of the contracts held by the company span 5+ years and will contribute to stable earnings. I am confident that the fund will realize upside from our investments in the long term.

## ENERGY & UTILITIES SECTOR: JUSTIN SANCHEZ

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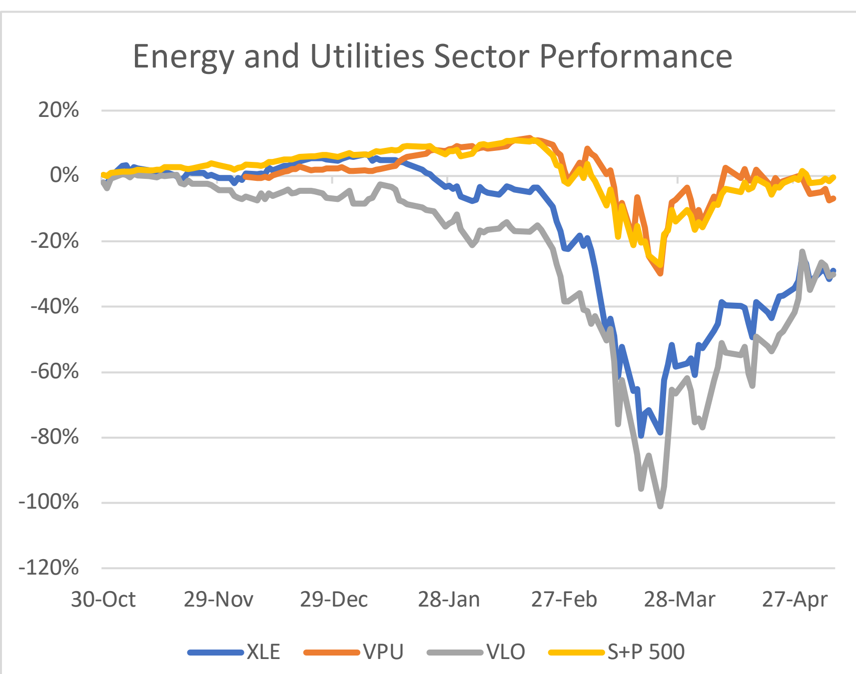
The Cougar Fund's Energy and Utilities sector is ardently identifying potential securities that may be undervalued in the current market. Due to the fundamentals of these sectors, there may be a hidden opportunity where predicted security value converges with price. Finding value in these sectors is critical because of the increased selling pressure the market has endured. Since the outbreak of the coronavirus pandemic, the oil industry (which the fund has a stake in) and the market as whole have taken a hit and dropped in value. The subsequent demand shocks have affected all the security holdings within this sector.

Oil has been on the decline due to the lack of demand, causing oil giants to cut production down 50 to 70 percent. Oil valuation is reaching unprecedented all-time lows driven by lack of demand and a lack of storage capacity. We even witnessed a brief anomaly in the oil futures market as the May contract ended, at one-point trading at $-39. Nonetheless, oil is expected to regain value as the economy recovers, but it is uncertain if it will ever reach all-time highs as before.

The energy sector consists of drilling and exploration of crude oil, services and transportation of oil, and the selling of oil. It would be wise to explore nontraditional options in energy that may replace the oil such as solar and other alternatives. As for the utilities sector, the ETFs have faced some selling pressure, but these are expected to stabilize because utilities are generally more defensive.




The Cougar Fund's energy and utilities securities consist of one stock and two ETFs. There is a position size of 20 for the Valero Corporation stock that has been devalued by 36.87 percent. The two ETF holdings are the positions of 25 shares Vanguard Utilities Sector ETF and 90 shares SPDR Energy Select Sector ETF, both of which have lost value at 38.32 percent and 13.30 percent respectively. Despite diminishing returns, Valero has been higher than the market average. The holding period return for these securities are anticipated to increase as the economy recovers from the effects of the coronavirus.

## REAL ESTATE & FINANCIALS SECTOR: DANTE RIENZE

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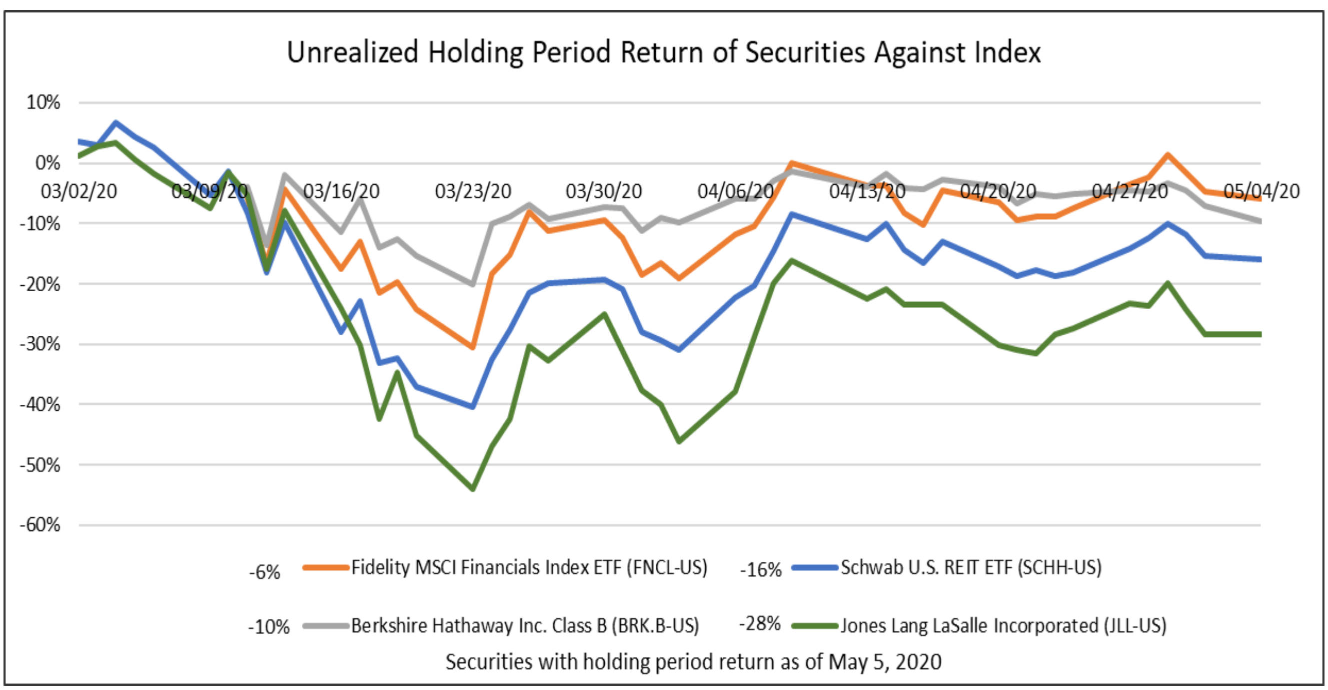
The United States Real Estate sector is under tremendous stress due to the conditions in the overall economy. COVID-19 has caused an unprecedented amount of damage to this sector's returns. During this economic downturn, the demand for housing has declined considerably. Also, commercial real estate performance has a high correlation with the overall economy. If US gross domestic product has a substantial fall for the year 2020, its likely commercial real estate will suffer as well. Fortunately, the finance and real estate sector of the fund believes that there will be a sharp recovery for the domestic real estate sector. As the COVID-19 pandemic subsides, the fund expects to see mortgage applications rise due to the low-interest-rate environment. Unlike the financial crisis, COVID-19 has not affected a broker's ability to write mortgages to trustworthy applicants. This will enable consumers to receive the cheapest financing options in United States history.

*"The environment for bulge bracket banks seems fairly strong as many larger companies will be pursuing mergers and acquisitions, along with issuing new corporate debt."*

Financials have been struggling along with the overall market as lower interest rates have reduced the bottom line for many banks. This would normally be offset with an increase in demand for loans, but COVID-19 has caused delays in this area. We anticipate an increase in demand for loans as the economy begins to reopen. Many investment firms have struggled with the current market conditions as their equity and fixed income investments have declined in value. The environment for bulge bracket banks seems fairly strong as many larger companies will be pursuing mergers and acquisitions, along with issuing new corporate debt. This should enable deal flow for these public investment banks to remain strong during these times.

Our sector strategy for the fund is to maintain an allocation in line with the S&P 500's allocation. This allows our sector to contain 16.5% of fund total capital, though due to the circumstances of the spring 2020 semester, we remain underweight. Currently, our sector portfolio consists of four positions open throughout the fund's first operating year. The core



position of the sector is achieved through low-cost ETF's which provide some degree diversification. This portion totals 8.25% of the fund total capital, with the remaining resources of the sector intended for individual securities. As of May 5, 2020, the fund's two securities within the financial and real estate sector have been underperforming their benchmarks. Jones Land LaSalle Incorporated has had a difficult year as its performance is highly correlated with the overall market, but it's likely the firm will recover rapidly as the real estate sector strengthens. The company is strong and will benefit greatly from the pent-up demand likely to hit the market after the pandemic.

Berkshire Hathaway Inc. Class B has been closing some positions they felt were not in their best interest. BRK is sitting on upwards of $125 billion in cash going into the second quarter of 2020. The firm's large cash reserves indicate BRK believes prices may continue to drop and retest March lows. Lastly, due to BRK's current market conditions, the firm missed earnings substantially with a net loss of 49.8 billion as their equity portfolio took a massive hit. With that in mind, the firm expects BRK to rebound throughout 2020 as they remain a strong defensive firm with a large opportunity fund.

## INFORMATION TECHNOLOGY & COMMUNICATIONS SECTOR: SERGIO WORSHAM

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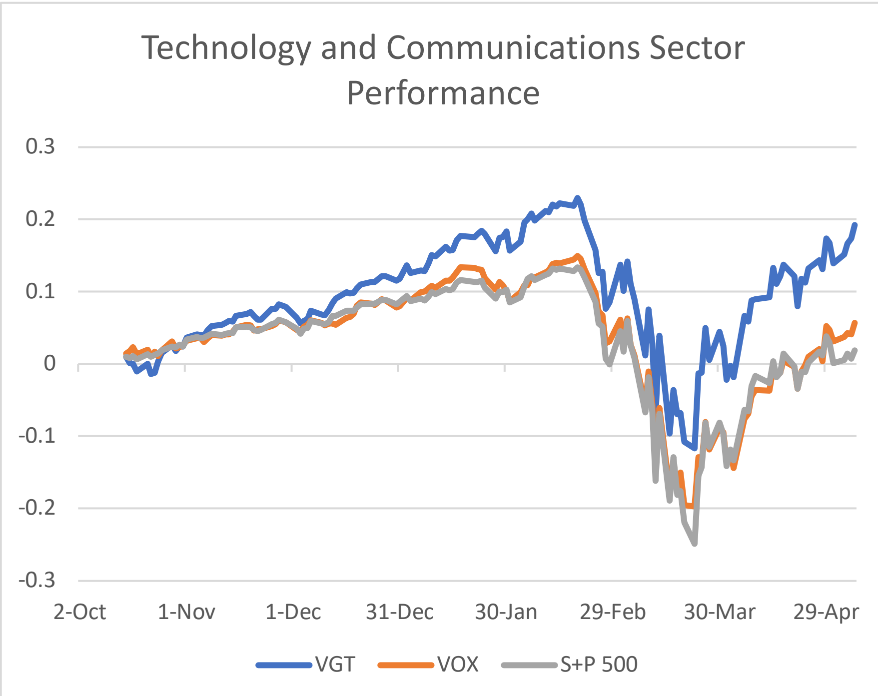
The technology sector is constantly evolving due to new trends and advancements. Some notable trends for 2020 include the future of AI, Data protection, election interface, and the collection of information using 5G. The top emerging markets are artificial intelligence, the internet of things, 5G and cybersecurity. The United States information technology sector is the largest, representing 32% of the globe. Most technology spending comes from corporate and government institutions with household spending coming in second. The growth rate for the information technology industry is about 3.7%. The top categories in the information technology sector are software, making up 12% of the industry, devices and infrastructure, making up 23%, IT and business services making up 21%, emerging tech, making up 17%, and telecom services at 26%.

5G has just come out early 2020 and will impact almost every industry, especially technology. Industries can take advantage of cellular connection in a way they couldn't access before. It will take years for the research and development to happen, but 5G makes it possible. Three of the main differences on why 5G is superior to 4G is its speed, reportedly 100 times faster, low latency that allows quicker, real time data, and the number of connected devices to one sensor which decreases cost due to lower traffic. Some technology companies are reaching out to rural areas to offer internet connection via satellite in 2020, such as ViaSat and others.

The cybersecurity market is predicted to reach over $269 billion by 2026. Lately, there has been an increased need for protecting sensitive data with the threat of increased cyber terrorism. This has boosted the market of cybersecurity. Revenue in the cyber security industry has increased 3% in the first quarter of 2020 when compared to the first quarter revenue of 2019. In the first quarter of 2020, the computer hardware industry has shot down 8% because of the decrease in demand from consumers.

We plan to keep stocks in our portfolio that have a strong hold in the marketplace and will be owned for a long period of time. We are currently invested solely in ETF's as coronavirus uncertainty has paused our investment decisions for individual




securities. The securities that are being analyzed currently include CrowdStrike Holdings Inc. (CRWD), VMware Inc. (VMW), Advanced Micro Devices Inc. (AMD), Applied Materials Inc. (AMAT), Akamai Technologies (AKAM), and Qualcomm (QCOM).

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## CONSUMER DISCRETIONARY & STAPLES SECTOR: JACK JOHNSON

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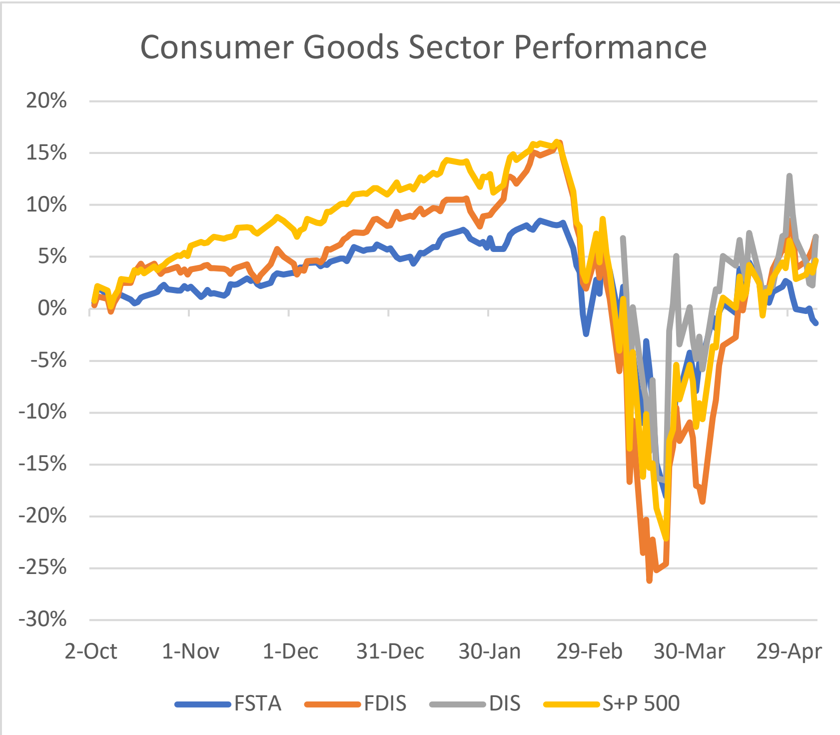
Prior to the effects of COVID-19, the consumer discretionary and staples sectors were generally stable with respect to the S&P 500 index. Companies within the discretionary sector tend to have a greater potential for gains and losses as opposed to the relatively defensive consumer staples sector. Many industries in the discretionary sector were susceptible to seasonality effects which had to be accounted for when analyzing the sector's companies. For example, during the fall, many apparel companies such as Lululemon Athletica, Francesca's Holding Corporation, and TJ Maxx underwent periods of significant increase during the back-to-school shopping season. After back-to-school season was complete, those companies would experience significant decline in stock price. The sector would then experience effects from holiday shopping season. During this season, many companies in the retail industry tend to experience seasonality-related gains, especially toy companies. However, the trade war tariffs with China served as a major deterrent for many of these companies this past fall. For example, Hasbro Inc. lost up to 21.28% in late October because retailers were canceling their orders for many tariff-impacted products. As a result, the wholesalers had no demand and a surplus of inventory that they were trying to rid themselves of. During the early stages of the process, we determined that the best way to attain equity exposure to the sector was through index funds. We decided to invest in Fidelity ETFs for both the staples and discretionary sectors because the correlation to the S&P 500 in each of these securities was very high. Furthermore, compared to their Vanguard and SPDR counterparts, the Fidelity ETFs had low expense ratios, making them rather desirable.

After COVID-19 started to significantly impact the market, our sector began to screen for undervalued companies to potentially buy low. After thorough analysis, we determined that Disney was a company




that we wanted to invest in. During the early stages of COVID-19, Disney had to shut down all its theme parks in Asia. Once COVID-19 was declared a worldwide pandemic, Disney had to shut them down completely, temporarily losing their second largest source of revenue. This put the company at a low point in stock price with potential for a significant rebound once the parks reopen. Additionally, Disney's streaming service has made significant strides in acquiring market share with its penetration pricing strategy. We believe that there is potential for the streaming service to expand and viably compete with Netflix in the streaming industry. The combination of a buy low opportunity with potential for expansion in revenue is ultimately why we invested in Disney. With a long-term investment horizon, we are confident in eventually profiting.

## HEALTHCARE SECTOR: ANDRES CHAVEZ

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To date, the Healthcare Sector of the Cougar Fund has an unrealized holding period return of 17.31%. Holdings include a sole investment in Vanguard's Healthcare ETF (NYSE: VHT). 85 shares were purchased at a price of $163.72 for a total cost of $13,921.15, including transaction costs. This represents 14.51% of current equity holdings for the fund. Strategy for stock screening and acquisition includes a qualitative and quantitative approach. Using a combination of comparable and ratio analysis, the fund can identify undervalued securities. The fund has collaborated and built financial models that compare fundamentals and discount future cash flows to the present with the aim of finding value. In addition to quantitative projections, an analysis of product and management is done to ensure long term value.

Early in 2020, equity markets had their worst week since the financial crisis of 2008, and the 10-Year Treasury Note hit historic lows, as the coronavirus continues to spread across the globe. By now it is clear the virus will have at least a short-term impact on the global economy. In the short term, the market has reacted in a very volatile manner. Healthcare is a defensive sector that has remained resilient in the markets. For the year 2020, the healthcare sector equity benchmark has so far posted a loss of -1.61% compared to the overall market benchmark S&P 500's loss of -10.56% as of the end of April 2020.

Deloitte Insights projected global healthcare spending expected to rise at a CAGR of 5 percent in

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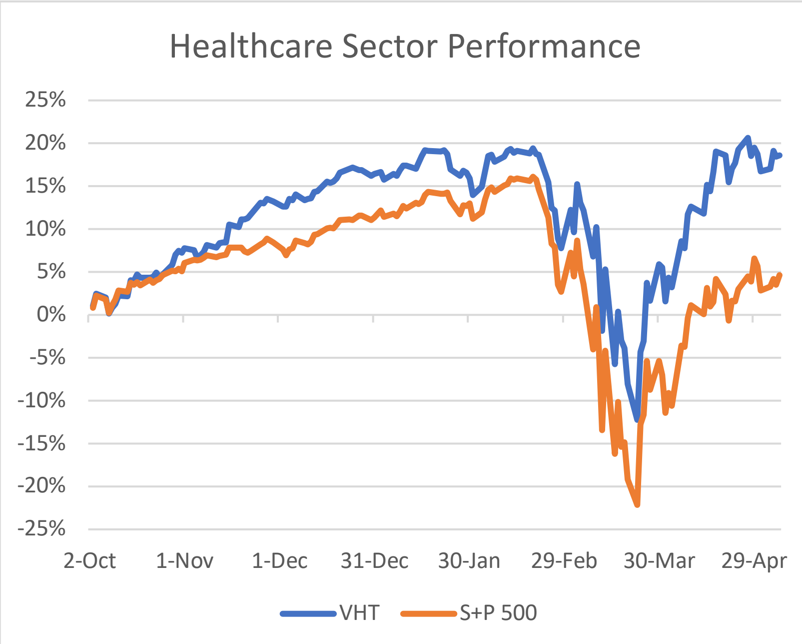
HEALTHCARE SECTOR (CONT. FROM PAGE 7)






2019-23, it will likely present many opportunities for the sector. Unprecedented increase in demand for firms within the healthcare sector will add to growth and relieve any potential losses in cash flows due to systematic economic shortcomings. While the foreseeable future of our economy is uncertain, the fund remains positive. Furthermore, government subsidies including the $2.1 trillion Coronavirus Aid, Relief and Economic Security (CARES) Act have eased investor confidence on the survivability of firms within the industry. The recent correction seen in equity markets presents opportunities to secure long term value.