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Dear Limited Partner,

The Partnerships posted strong gains for the quarter, a substantial but not quite complete rebound from the first quarter drop. Precise results, including a breakdown of investment returns by category and a summary of investments at June 30, will appear in separate quarterly reports published on our website in early August.

In the first quarter, we were substantial purchasers of securities, especially from late February through the end of March. For the second quarter, we were significant net sellers as prices rallied strongly, though we also initiated a number of new positions. Positive developments in a number of portfolio holdings, together with the broad market recovery, contributed to Q2 performance. Gains were led by eBay, Pacific Gas and Electric (claims and equity), Liberty Global, Viacom CBS, Steinhoff, and Translate Bio. There were no material declines for the quarter in the public portfolio. The private portfolio was quiet, with scattered markdowns exceeding modest gains. Hedges cost us about 1% of NAV in the second quarter, after contributing about 3% in Q1.

<u>Market and Economic Developments</u>

Surreal doesn't even begin to describe this moment. Events that would typically span years have been compressed into a few months this spring. Historically low unemployment in February turned into historically high unemployment by April. A 34% decline in the S&P 500 from late February to mid-March was almost entirely reversed in only 11 weeks of trading, a dizzying degree of volatility that may not be over yet. During this period of recovery, every single stock in the S&P posted a gain, a rally that might best be described as overwhelming but certainly not discriminating. And the Nasdaq did even better; propelled by a handful of tech favorites, Amazon, Microsoft, and Apple in particular, that index continues to hit new all-time highs, and is now up approximately 20% on the year. Those three stocks alone accounted for around 60% of the Nasdaq's year-to-date gain. Meanwhile, devastated by the economic shock, many companies eagerly sought fresh capital, and the credit markets gleefully provided it on favorable terms, resulting in a record-high volume of U.S. investment grade corporate debt issuance over the first half of 2020.

Fed policy has been magnificently successful in achieving its objectives not only of lifting securities prices but also of altering investor behavior. The Fed wanted to influence buyers of securities to be bolder in their pursuit of return. The head of a major pension fund recently authored a piece describing how the fund had responded to lofty markets and low yields on safe debt instruments. Their reaction was not to lower the fund's currently aggressive 7% risk-adjusted return objective to a more realistic threshold, but instead to direct more assets into "lower volatility" private investments while leveraging the portfolio. Private investments, of course, have the same underlying risk and inherent volatility as public investments – though because they are

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not publicly traded, their intermittent and privately determined appraisals may make them appear to be less volatile. And as for the choice to leverage up, we can only note that leverage is a double-edged sword that enhances returns in good times while sinking them in down markets. If markets falter, this fund will have not solved its problems but rather have multiplied them.

Central banks, led by the Fed, continue to be the predominant driver of financial markets. By holding down interest rates, they influence investors to bid up the prices of securities, irrespective of the economic backdrop. By maintaining these seemingly never-ending policies and willfully ignoring developing bubbles, the Fed has engineered a strong market recovery even as the unemployment rate tests Great Depression levels. The Fed balance sheet grows larger and larger, and the annual U.S. budget deficit approaches a level triple its previous ignominious record high. Investors are being infantilized by the relentless Federal Reserve activity. It's as if the Fed considers them foolish children, unable to rationally set the prices of securities so it must intervene. When the market has a tantrum, the benevolent Fed has a soothing yet enabling response. As with the 30-year-olds still living in their parents' basements, we can only wonder whether the markets will ever be expected to make it on their own.

Investing lies at the intersection of economics and psychology. That crossroads is particularly challenging to navigate right now because investor psychology is surprisingly ebullient even though business fundamentals are often dreadful (albeit in some cases improving off of unfathomable lows). Investors are besotted with the idea that the economy is "opening up," as if anyone believed we would never again come out of our homes. As the economy began to rebound off the lows in Q2, investors exuberantly chose to celebrate the beginning of a return to normalcy with buy orders, irrespective of valuation. There is little evidence of thought as to whether the price of a security already reflects current and projected future news flow, or whether the opening up of the economy might be premature, a sign not of strength, but of impatience, lack of resolve, and poor judgment.

Given the exuberance in equity markets, it perhaps isn't surprising that shares of bankrupt companies are lately among the top performers, some doubling and even quadrupling off their lows, as speculators scrape together a few dollars of surplus cash not to buy a handful of magic beans, but worthless shares that might nonetheless produce quick trading gains. The madness has gotten so out of hand that bankrupt car rental giant Hertz was at one point even considering an offering of its shares in lieu of a standard debtor-in-possession loan to facilitate the company's reorganization. These companies are like Schrödinger's cat – both alive and dead at the same time. They are closed for business, the operating model rendered uneconomic, the customers scared away, but their shares tell a story of viability.

Movie theater chain AMC provides a fascinating illustration of the equity market's optimism in the face of extremely adverse business conditions. With all its U.S. theatres closed, the company reported on June 3rd that "substantial doubt exists about our ability to continue as a going concern for a reasonable period of time." Nevertheless, soon after this filing, shares of AMC actually traded above their early-February level. By contrast, over this same time period, AMC's subordinated bonds reflected a much harsher reality, trading down from 90 to 30 cents on the dollar.

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Famed investor Jeremy Grantham has observed the extreme nature of today's stock market valuations, noting "we are in the top 10% of historical price earnings ratio for the S&P on prior earnings, and simultaneously are in the worst 10% of economic situations, arguably even the worst 1%." Economist David Rosenberg notes that "… the stock market (financial assets in general) have become a casino with no more true price discovery or risk assessment, given all this global central bank alchemy and these maneuvers that have created a one-sided, 'heads you win, tails we bail you out' psychology." He continues, "The Fed is distorting risk markets on a scale never before seen. They are making a mockery of capitalism and bailing out bad actors. The system is broken." Rosenberg adds, "… we are witnessing the last hurrah of the equity market wagging the economy's tail instead of the other way around — the way it used to be when it was productivity that was the source of real prosperity instead of the illusion of wealth generated by endless attempts at creative financial engineering."

In a world where 100-year storms seem to occur every few years, the U.S. continues to bumble through what are now cascading crises. COVID-19, the resultant massive economic dislocations, and wide-scale, countrywide protests against systemic racism now dominate national life. The demonstrations appear to be leading to a productive and overdue debate about how to confront racism in police departments as well as a larger conversation about race and the daily indignities and obstacles faced by Black Americans.

By contrast, there has been only halting progress to date in fighting the COVID-19 pandemic, which is still claiming American lives, totaling over 140,000 since March. We have "flattened the curve" in major Northeast cities impacted by the outbreak, but have not yet achieved herd immunity. And many southern states, which appear to have reopened too soon, are experiencing record highs not only in cases but in hospitalizations. Of course, the pandemic and the human response to it will decide when we can return to normal, not governors or presidents. While many people choose to socially distance and wear masks, some, as columnist Paul Krugman pointed out, are failing this real-life version of the Marshmallow Test, the psychological experiment conducted decades ago where most four-year-olds experienced great difficulty deferring gratification. We know how to fight the COVID-19 pandemic; we simply lack the will to engage in the fight. While countries including New Zealand and Taiwan seem to have successfully controlled COVID-19, America's unwillingness to coordinate testing and contact tracing in sufficient numbers, and many people's refusal to socially isolate and wear masks, has allowed the virus to surge out of control at this time.

Perhaps three months of isolating at home approaches a human limit of patience. People generally crave a return to normalcy and are intent on getting back to their lives as before, brazenly ignoring the risks of prematurely doing so. That said, even in the states most aggressively relaxing safeguards, things are far from normal. Of those businesses that have reopened, restaurants, gyms, hair and nail salons, and retail stores are mostly operating at uneconomically low rates, at least for now, due to social distancing protocols.

Portfolio Developments

In the first quarter of 2020, our portfolio experienced material short-term market price

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erosion for many holdings, but we believe quite limited longer-term value destruction. The second quarter gain in many of our positions reflects both the market's strong Q2 recovery as well as positive fundamental developments for a number of our holdings.

Fortunately, our investment in the subrogation claims and equity of Pacific Gas and Electric, the firm's largest position, was not impacted by the COVID-19 fallout. As we expected, PG&E's bankruptcy plan was confirmed by the judge overseeing the case, and the company emerged from bankruptcy on July 1st. Importantly, upon emergence, cash was placed in a trust for the benefit of the subrogation creditors. A substantial initial distribution from this trust, estimated to be roughly 80% of anticipated recoveries, is expected to be paid later this month.

Meanwhile in May, Liberty Global announced the merger of its Virgin Media subsidiary in the U.K. with wireless carrier O2. This transaction is expected to close in 2021, and should result in a cash distribution to Liberty Global along with significant ownership in the combined company. Substantial efficiencies from the merger are expected to greatly benefit the combined company going forward.

EBay's share price has risen as its marketplace business has benefitted greatly from the current environment. Sales volumes on the eBay marketplace are expected to increase from flat in Q1 to 25%+ growth in Q2. We expect revenue to grow well in excess of volume growth going forward as the company begins to replace its PayPal relationship with its own managed payment system. In mid-July, the company announced plans to sell its online classified business to Adevinta at an attractive valuation for cash and equity in the combined company.

McDermott has also consummated its reorganization plan, and the sale of its Lummus subsidiary has closed. Proceeds from that sale will fund the reorganization plan and repay the company's outstanding debtor-in-possession loan. We hold debt and equity instruments in the reorganized company.

Also in June, Translate Bio announced that it was partnering on its vaccine business with Sanofi. Terms of that agreement include a $300 million upfront cash payment, potential milestone payments totaling $1.9 billion, and the purchase of $125 million of TBIO shares. The stock is trading higher in the aftermath of that news.

There have been some adverse developments in our public portfolio driven in part or in whole by COVID-19, but we believe many of these will be temporary. For example, the Steinhoff reorganization plan, including the IPO of its Pepco subsidiary, has been delayed as many of its retail stores in South Africa and Eastern Europe were temporarily closed. Fortunately, most have now reopened, and a number of their peripheral businesses, whose dispositions had fallen through, are once again going under contract. Xerox's offer to take over HP has been shelved, and those shares initially slumped before recovering by quarter-end. HD Supply's plan to split into two companies was delayed, but is now expected to be completed by the end of 2020.

Similarly, our private portfolio has experienced several favorable developments. In June, Albertsons/Safeway completed a financing with Apollo Global that resulted in a significant payout

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to shareholders. Albertsons/Safeway subsequently went public in an IPO in late June. At recent trading levels, shares we indirectly own along with distributions received to date are currently worth over three times our cost basis on the $80 million investment we made roughly five years ago. Our residential developments in Miami, Denver, Lake Tahoe, and southern Delaware are experiencing strong sales traffic and are generally performing ahead of plan. In late April, we closed on the sale of a prime office building in our Barts project in London at a pre-COVID price. After a significant asset sale in Q1 at our On3 New Jersey commercial development, another building recently went under contract at an attractive price, and we are in negotiation with a strong credit tenant for the last remaining building in that project.

However, some of our private holdings have been challenged as a result of the pandemic. For example, a mixed-use property outside of Cleveland is impaired because many of the retail locations have been closed and rent is currently not being paid. Occupancy is falling at a major residential property we own based, we believe, on temporary factors driven by the pandemic. Sales of completed condo units we have developed in Spain were temporarily put on hold, but have now resumed. Construction at several real estate projects has been slowed or halted due to the coronavirus, but is now generally back on track with safeguards in place to protect the workers.

In Q2, rebounds in the mortgage and credit markets provided an opportunity to monetize a recently-purchased portfolio of residential mortgage backed securities as well as one material corporate debt holding at healthy gains. The sale of these positions, as well as reductions in various equity positions into strength, have boosted cash balances to 31% of NAV at June 30.

There is usually a lag between public markets falling and private opportunities beginning to surface. This cycle appears to be no different. While we have recently bid on several large portfolios of distressed assets, the widespread market rebound kindled considerable competition and most of the transactions we underwrote traded well above our targets. As conditions on the ground deteriorate, however, our real estate pipeline is starting to fill with potential opportunity that is reminiscent of prior cycles – e.g., partially-completed development projects that are in need of rescue financing, banks looking to exit troubled loans, and hotel groups seeking liquidity. Similarly, our private equity team is working through an extensive deal pipeline, including tuck-in acquisitions for companies we currently own, growth equity opportunities, and hard-hit companies in need of a cash injection or restructuring. For now, counterparty urgency appears limited, and our underwriting is necessarily conservative so it is hard to know when the pace of capital deployment might pick up.

Peering into the Future: The Possible Longer-Term Ramifications of the COVID-19 Pandemic

For most of the last century, a reasonable approach to assessing a company's future prospects was to expect mean reversion. Fluctuations in business performance were largely cyclical phenomena. The stock market, as always, could be fickle. What was in favor today might well become disfavored in the future, and what was out of favor today might well rebound tomorrow. This quote from Horace's "Ars Poetica" was prominent in the preface to Benjamin Graham's "Security Analysis": "Many shall be restored that now are fallen, and many shall fall that now are in honor." But today, technological disruption has damaged or destroyed many business

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models while elevating others. At this moment, it's hard to imagine Amazon's online business collapsing or J.C. Penney's retail operations being fully restored. Not everything will revert to the mean, and many companies, and especially small businesses, are reverting to not existing anymore.

In this spirit, we ponder the current moment from the "eye of the pandemic storm." It's always tempting at a time of upheaval to imagine that society will be forever changed. After the terrorist attacks of 9/11 that killed 3,000 Americans, it was easy to imagine a bleak future of mayhem and unbridled fear. And today, almost 19 years later, enhanced airport and office building security is still a regular part of our lives. But it took only a few years for air travel to return to pre-9/11 levels, and life to basically get back to normal. In the depths of the 2008-2009 financial crisis, it was easy to imagine investor behavior would change forever, because investors would have been permanently chastened, but Jeremy Grantham at the time predicted that any change would not be long-lived, noting that investors "will learn an enormous amount in a very short time, quite a bit in the medium term and absolutely nothing in the long term." And that's exactly what happened.

So, we wonder, since life has been anything but normal over the last four-and-a-half months, what aspects of our daily experience might undergo lasting change as a result of the COVID-19 pandemic and society's response to it, and what might quickly return to normal. We believe there could be long-lasting implications, and ruminate on some of these in the pages that follow. We view this as an interesting exercise in trying to look ahead, although we harbor no illusions that the future will prove amenable to accurate prediction.

Here is our list, ranked according to our level of conviction that the suggested changes will occur. A few of these ideas are clearly more conjecture than evidence-based at this time:

1. Acceleration of the digitalization of the U.S. and global economies
2. New ways of working, learning, and providing healthcare
3. Partial reversal of globalization and the development of an American industrial policy
4. Reckoning with the life and death implications of inequality
5. Real Estate becomes more challenged as an asset class with deteriorating fundamentals for retail, hotel, and possibly office properties
6. COVID-19 forces humanity to reorganize its priorities and better prepare for risk
7. "The Fauci Effect" – renewed confidence in experts, science, and truth, and a desire to serve society
8. Declining dominance of capital over labor

<u>Acceleration of the Digitalization of the U.S. and Global Economies</u>

Sometimes, right before our eyes, a major sea-change occurs. While socially distancing at home, just about every one of us has increased our purchases on Amazon. eBay and other online retailers have also experienced a boom in business. Amazon was already a commercial hurricane leaving in its wake large swaths of destruction across the retail landscape. The company is expected to generate nearly $1 billion of revenue per day this year, tripling its sales since 2015 (although some of this growth was through acquisitions). Amazon now employs over 840,000

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people, more than the populations of Wyoming, Vermont, Alaska, or North Dakota.

Consumers were already attracted to online shopping for its unbeatable convenience, with items arriving effortlessly at one's doorstep, the ability to easily compare prices across online stores, and ready access to a repository of reviews to inform the buying decision. No trips to the store, no waiting in line, no lugging heavy packages across parking lots. Now, e-commerce provides the added benefit of avoiding the risks of COVID-19 transmission from shopping in-store while also avoiding the highly necessary but undeniably unpleasant navigation of a shop's social distancing measures. These inconveniences may pass, but many who have pivoted to shopping online are likely to become permanently habituated into this mode of purchasing, especially for repeatedly purchased consumables where in-store browsing offers little value to the consumer.

It seems that no part of retail is fully immune to this trend. Physical retail's most ardent defenders offered the same assurance about various classes of goods: "Surely this category cannot go online. Consumers want to try before they buy." This had been said at various points in the past about eyeglasses, mattresses, apparel, home furnishings, televisions, bathroom and kitchen tile, perishable foodstuffs, and automobiles, and yet all of these are now challenged by purely online competitors. While each of these categories is at its own point on the journey to full online acceptance, this trend is both ineluctable and accelerated by COVID-19.

The internet was already wreaking havoc with existing business models. Disruptive change is everywhere. But in many cases, the COVID-19 pandemic has accelerated changes that were already underway. Indeed, it has been observed that the pandemic has managed to achieve, in a period of months, levels of digital transformation that had been expected to occur over a decade.

<u>New Ways of Working, Learning, and Providing Healthcare</u>

Videoconferencing technology is now used ubiquitously as a way for us to connect when we cannot (or choose not to) meet in person. It seems unlikely we will fully revert back. If there ever were a technology ripe to take advantage of a moment, it's the "Hollywood Squares" of a Zoom session, where we convene without any physical presence, conduct business, and even experience a more inclusive, more engaged, and sometimes more effective meeting. What's not to like?

Zoom is not just useful for business meetings, though the idea of a meeting that involves none of the time, expense normally involved in traveling to the meeting, or wear and tear is itself quite alluring. The very definition of a meeting has changed; literally, "meetings" are now taking place with no one actually meeting in person. Technology has expanded the playing field to include other important uses: we can now join teleconferences to provide tele-medicine, a service that had been needed but not embraced largely because of an antiquated medical fee reimbursement system. Necessity being the mother of invention, few have been visiting their physicians in person amidst the pandemic, and doctors certainly are not eager to be exposed to people who may have COVID-19. Many have compensated for that with remote visits that accomplish much of the same result without wasting time or risking contagion in crowded waiting rooms.

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Similarly, colleges and universities, as well as elementary and secondary schools, have physically closed amidst the pandemic. Distance learning has replaced in-person attendance. While the experience of taking college courses online is certainly different (and the social aspects of the remote college experience are definitely inferior), distance learning could still provide a great education, as the world's outstanding faculty become more accessible to larger numbers of students.

It is critical to note that, while there are undeniable benefits to videoconferencing technology, there are also significant drawbacks. Virtual meetings lack the nuance, the body language, and the fluidity of their in-person counterparts. It seems likely, though, that hybrid solutions will emerge, as well as technological improvements that narrow the gap between the virtual and the real.

Partial Reversal of Globalization and Development of an American Industrial Policy

The pandemic led to instantaneous shortages in protective gear (PPE) at U.S. hospitals, shortages that persist to this day. It also became apparent that through benign neglect, and perhaps a desire to bring down healthcare costs without sufficient regard for healthcare quality or risk, we allowed the production of many pharmaceuticals, and the raw materials that go into manufacturing them, to be moved offshore. We inadvertently created a supply chain that was dependent on sometimes undependable foreign suppliers, who were completely outside national control and who operated under governmental regimes that sometimes had interests other than the health and well-being of Americans. The invisible hand of the market can often lead to economic efficiency, but the invisible hand is apparently driven by an invisible (or non-existent) brain. No one could think, in retrospect, but even in prospect, that it makes sense to outsource American production in ways that made the American people dependent on their greatest geopolitical rival, one that routinely pilfers our intellectual property, and one with which we are in an escalating trade war. Hopefully we never make that mistake again. We have always consciously maintained a few strategic industries. We primarily rely on domestic companies to produce fighter planes and warships, for example. And we will not permit foreign ownership of our most strategic technology companies. We expect future administrations to be far more thoughtful about organizing American supply chains in ways that protect and secure all necessary goods and supplies. For many goods, the certainty of supply must and will take precedence over the cost.

Reckoning with the Life and Death Implications of Inequality

The pandemic and social protests have put into stark relief the life and death implications of economic and racial inequality in our system. Income and wealth inequality have become more apparent in recent years, as a booming economy failed to boost the fortunes of all. Today, with Wall Street largely recovered from its March 2020 selloff while Main Street has barely lifted off bottom, a pernicious and crushing inequality could not be more evident. It's untoward that, once again, Wall Street has been effectively bailed out while programs designed to assist Main Street have been ill-designed, slow to be implemented, and inadequate to address the pandemic's lasting impact.

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Racial inequality is ubiquitous. Black and Hispanic people, on average, earn significantly less than whites. People in these groups have significantly less accumulated wealth in the form of home ownership or savings, the likely result of wage and job discrimination, racial covenants affecting the ownership of property, redlining, discrimination in mortgage availability, educational barriers, and many other factors. Black people face relentless discrimination in their daily lives – in job interviews, while shopping in retail stores, while driving their cars, and in interactions with police. Many are still judged more on the color of their skin than the content of their character. Black life expectancy is considerably below that of other groups.

COVID-19 has highlighted these different societal outcomes, as Black and Hispanic people experience far worse health outcomes from the virus, the apparent result of increased likelihood of pre-existing conditions and more limited access to healthcare. They are also far more likely to have jobs on the frontlines of workplaces deemed essential, such as in food processing plants or as bus drivers, exposing them to the virus at disproportionate rates. And Black and Hispanic people are more likely to take mass transit to their jobs, again multiplying their risk of infection.

Street protests in the wake of the killing of George Floyd by Minneapolis police have launched a mass movement that has made all of the country more aware of the racism that still permeates many aspects of our society. Whether this movement will lead to sustained change is uncertain, but Black Lives Matter has expanded in scope from scattered protests to a nationwide conversation in only a handful of years.

We have long recognized our good fortune to be working at Baupost; this is even more apparent in the current moment. This motivates us to prioritize the philanthropic efforts of the firm, supporting those in greatest need in the Greater Boston area and beyond.

<u>Real Estate Becomes More Challenged as an Asset Class with Deteriorating Fundamentals for Retail, Hotel, and Possibly Office Properties</u>

Before the pandemic struck, retail properties in the U.S. were already under threat. The U.S. had become over-stored – the country had four times more retail real estate per capita than Europe. Online shopping has been growing by double-digit percentages every year since 2009, taking market share from brick and mortar retail.

The ongoing impact of the pandemic – shutting down many retail stores, followed by social distancing requirements as we open up, and enduring concerns by vulnerable citizens about entering crowded places – will offer a protracted challenge to physical stores. As noted, the pandemic has accelerated the switch to online shopping. In the wake of recent street protests, some of which turned into looting, the new look of retail property in major cities – boarded up – is obviously not a value enhancer.

But, retail is not the only category of real estate under pressure. With travel subdued, hotel demand has recently fallen almost 70%; many hotels are currently closed. In past periods, a short-term decline in hotel demand from virus outbreaks or terrorist attacks has fairly quickly recovered to peak levels. But in this period, technological advances that let us Zoom into meetings at low

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cost and with effective outcomes may have lowered the demand curve for some kinds of business travel for good. Yes, a personal meeting may still be better, but people will now consider whether it's really worth the time and expense to travel long distances for something that is not necessarily all that much better than Zoom. In the short-term, colleges and even homeless shelters may lease hotel rooms to facilitate social distancing for their populations. But, over time, we expect hotel supply to shrink in some markets. The networking benefits of large conferences suggest those are likely to return post-pandemic. But run of the mill business travel – the one-day sales meeting in an airport hotel conference room – is not likely to come roaring back.

Personal leisure travel demand seems more likely to return; there may well be pent up demand to go just about anywhere. But until the pandemic is behind us, the desire to jump on a crowded airplane to vacation at crowded tourist destinations, stay in a hotel room that could have dangerous virus particles on its surfaces, and eat and drink at overflowing restaurants and bars, seems likely to remain meaningfully subdued. Local travel by automobile will clearly be preferable to longer distance trips.

In addition, working from home has become a commonplace occurrence that both employees and companies are finding suits them quite well, so it is unclear what will happen to the office world when the pandemic is over. It seems likely that working from home will become a more viable and favored alternative for many workers – they like avoiding the time and money spent commuting, and they welcome the flexible hours and the casual attire. Employers, meanwhile, will appreciate not having to rent as much office space for their staffs. Short-term, the demand for office space per employee could increase as a result of social distancing requirements (de-densification), but demand seems unlikely to stay elevated over the medium and long-term. The longer both employees and employers get used to new ways of working, the less likely things will simply return to the way they were before.

There are other real estate implications. For example, there are largely anecdotal reports of people deciding to move out of city apartments and head out to the suburbs or the countryside. Of course, working from home makes that increasingly feasible. It is hard to know if this is a temporary development or a genuine trend, but it will bear watching.

The challenges to real estate won't apply to every kind of property. Real estate is a vast asset class, and each property is different from every other. While there may generally be deteriorating fundamentals for some retail, hotel, and even office properties, others may be unaffected or even benefit. The surge in online retailing, for example, is increasing the demand for warehouses and distribution facilities. Valuations could be pulled higher if capitalization rates follow interest rates lower, but cap rates could also move higher if buyers pull back, resulting in lower property valuations. For the most severely impaired properties, we suspect there will be greater transaction volume amidst the heightened uncertainty and economic challenges. As always, we continue to carefully oversee our property portfolio, driving occupancy, controlling costs, and opportunistically exiting fully valued holdings, while conservatively underwriting new opportunities.

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COVID-19 Forces Humanity to Reorganize Its Priorities and Better Prepare for Risk

Amidst the devastating loss of both life and livelihoods resulting from the current pandemic, we do not yet have a full appreciation of how much worse things would have been if the lethality of this particular virus had been materially higher. A case fatality rate of around 0.5% (possibly slightly overstated due to a presently unknown number of asymptomatic manifestations) is a far cry from those of many other zoonotic viruses. MERS, another coronavirus, has a case fatality rate of around 35%, Ebola approximately 50%, Nipah virus 40-75%, and Marburg virus 50%. Of those who contract Japanese encephalitis and present with the encephalitis symptom, about one-third of the victims die and another one-third experience permanent cognitive or psychological impairment. Fortunately, some of these are seldom transmissible among humans. We could have been confronted with a virus that has the malignant trifecta of high lethality, long incubation period, and high transmissibility. It is hard to imagine the consequences if COVID-19 had a lethality rate of 20%, let alone 50%. This would not have been a matter of several quarters of sustained economic damage. Rather, this would have debilitated modern civilization – triggering a race for remaining resources that would have extended far beyond toilet paper and Clorox. Guns and gold would be the prevailing commodities. Supply chains would have ground to a halt. The government can designate whomever it wants as "essential," but who would show up to work if the likelihood of surviving an infection was no better than the flip of a coin?

Some other observations that follow:

1. The evolution of these pathogens is often highly random. The bubonic plague wiped out a third of Europe in the 14th century. While the plague caused by a bacteria, and the pathology is entirely different than the COVID-19 virus, it was merely a single mutation that turned a fairly more benign stomach illness into a relentless killer.
2. Bill Gates and others warned us that a pandemic could be around the corner. Few took them seriously, and we remained unprepared. A great many lives were lost as a result. We lack the contingency plans to deal with outbreaks of infectious disease, especially in a world where pestilence can spread around the globe in weeks.
3. The political and ideological divisions in our society are powerful and deeply rooted, to the extent that even a simple mitigant, such as wearing a facemask, can become politically divisive. In light of the senseless division, it's fair to wonder "How far gone are we as a society?" The difficulty we have been experiencing even mounting a response to a different but formidable, growing, and perhaps ultimately greater threat – climate change – highlights the challenge before us.
4. Electoral politics presents a fundamental tension when dealing with a pandemic: If we react swiftly and aggressively and the policy response actually results in far fewer casualties in the end, it will look like "overreaction" when the final chapter is written. This is the "paradox of prophecy" we mentioned in a letter a number of years ago. "Surely we did not need such a disruptive response," many will say, citing how few lives may be lost in a future pandemic. The painstaking work of teasing out how such a response actually translated into saved lives may never leave the realm of academia. This seemed to be at play among some U.S. governors early in the crisis, as the most extreme scenarios failed to play out, leading to a premature "opening up" in many

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jurisdictions, a choice that wasted earlier and successful efforts at containment while costing tens of thousands of lives.

The "Fauci Effect" – Renewed Confidence in Experts, Science, and Truth, and a Desire to Serve Society

This point is perhaps more aspirational than real at this time, but few Americans could have missed the White House briefings on the pandemic by the Coronavirus Task Force. Americans saw expert Dr. Anthony Fauci at the podium as he explained the facts and science of the pandemic and the best path through it. By contrast, Americans also saw a cheerleading but often fact-free president extolling the virtues of remedies he had heard might work and making claims that the virus would just go away.

The country could see who was in command of facts and had a plan, and who was over their heads and grasping at straws, who was fawning, and who was doing their utmost to remain independent and speak truth to power. Now, we can see which governors relied on facts and data and which succumbed to pressure, whim, or denial when the lives of citizens were on the line.

Americans have for some time been drifting away from a belief in science and confidence in experts, partly as a result of the deep political divide in this country, and partly from the disdain in some quarters for the "elites" in society. You see this derision of science and scientific principles in the anti-vaccine movement. Physician and medical writer, Atul Gawande, spoke of this trend and its alarming implications in his commencement address at California Institute of Technology in 2016 when he observed that a belief in science, "has allowed us to nearly double our lifespan during the past century, to increase our global abundance, and to deepen our understanding of the nature of the universe. Yet scientific knowledge is not necessarily trusted. Partly, that's because it is incomplete. But even where the knowledge provided by science is overwhelming, people often resist it – sometimes outright deny it."

Tragically, we are seeing our nation's increasingly reflexive political polarization infect what should be an open- and sober-minded scientific debate about the pandemic. Ideological partisanship is threatening to become intellectual partisanship, contaminating what should be the healthy dialectic of scientific debate. The truth is that our understanding of science, while growing, is inevitably incomplete. We don't know what levels of immunity in society will protect us adequately, what prophylactic measures provide the optimal balance of epidemiological benefit and social cost, where we must increase our vigilance and where we can relax it. For example, we are learning how relatively rare transmission of COVID-19 is from children to adults. Experience in a number of European countries now suggests that it may be possible to open up schools safely, and the benefits to our children and society of doing so cannot be overestimated. But only cool heads and clear thinking will provide these answers, which is where our best scientists and public policy experts must thrive, free of both political pressure and popular panic. As the late physicist Richard Feynman observed, "I would rather have questions that can't be answered than answers that can't be questioned."

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One can only hope that the experience of watching selfless and public service-minded leaders like Dr. Fauci and others calmly and dispassionately provide information to the American people might play a role in restoring science to its rightful place in our psychological terra firma. We can equally hope that the inspirational example of Fauci might motivate more young people to consider a career in public health as a way to give meaning to their lives, that they couldn't imagine a higher calling than to be the next Fauci.

Declining Dominance of Capital over Labor

The returns to capital have surged in recent decades, even as wages, on average, have stagnated. Those with wealth have become richer, while technological disruption continues to rapidly destroy jobs (even as it creates some new ones) contributing to growing inequality. If, as we expect, labor is increasingly successful at organizing itself in the future, there will be considerable pressure for broadening social programs and institutions. It is untenable that the capital-owning class, or at least those owning publicly-traded investments (certain small-business private markets being very different), has been minimally harmed in aggregate, even as unemployment rises to Great Depression levels and much of America burns through their minimal savings. Class relations were uneasy before the current crisis, strained by four decades of widening inequality. It's not hard to imagine that there could be a movement encouraging impacted people not to pay their mortgages, auto loans, and credit card bills, and it would not be shocking if labor and political leaders emerge who begin to advocate this as an appropriate course of action.

The repercussions of our elevation of rugged individualism as a societal value has meant that a layoff, furlough, delinquency, or bankruptcy is seen as a personal (and not a shared) failure, and, thus, collective action is rarely even contemplated as a cure. Unlike the slow hollowing out of the American manufacturing sector or even the Global Financial Crisis experience, however, this pandemic was an exogenous shock felt all at once by almost everyone. It may have the effect of bringing together a large constituency of the disaffected and dispossessed in short order. Labor may start to demand more of the fruits of production, especially now that it is clear that front-line labor is at personal risk to a disproportionate degree not previously understood in keeping supply-chains running and keeping America well stocked and well fed. They may also have growing political support for their demands.

Other Possible Changes Resulting from the Current Pandemic:

1. Do we start questioning certain traditions (e.g., dressing up for work, conspicuous consumption, shaking hands, blowing out birthday candles, etc.)? We've all been jolted into a life of simplicity in the last few months, and having broken with some of these cultural vestiges, might we move past some of them?
2. Family circumstances seem to be changing. With so much time together at home, will there be a baby boom? We have already experienced a pet boom; many animal shelters having enormous inventories pre-COVID are now empty. Will the decision to move aging parents into a nursing home become more difficult? There are surely other changes to come. This much time together could well strengthen happy families and fracture unhappy ones.

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3. If we move to a more digitalized work environment, does that free up time for other activities that were previously spent on commuting, traveling, and unnecessary meetings? (For example, civic engagement, signing up to coach a child's team, etc. in a manner that was far more common generations ago.) We suspect this trend is real, and that will be a good thing.
4. Will we continue to build a "sharing economy" when we move past the fear of sharing contagion? We have all grown increasingly comfortable with the idea of sharing a ride, a condo, a workspace, or even a wardrobe. Perhaps this trend will prove inexorable, driven as it is by sub-optimal occupancy or utilization rates. Or will our apprehension of getting too close to one another stall or delay the continued rollout of the sharing economy?
5. Does COVID-19, in the final analysis, tie us together, in the same way that happens to a sports team after a long season or soldiers who have been through war together, facing a common enemy? We can now declare definitively that *your* health is integrally important to *my* health and vice versa. We are assuredly in it together. Or does the virus divide us socially as we've come to see each other as threats to the health of ourselves and our families, and we've moderated our physical contact (the handshake, the embrace, the high-five, etc.)? We are optimistic that it's the former but only time will tell. If fear of disease becomes a fear of people, we will have lost something of profound importance, and we will be forever changed for the worse.
6. How does COVID-19 change electoral politics? Will the electorate desire more technocratic leadership and demand that those who aspire to office offer both knowledge and experience in maintaining a formalized decision making process? Will grassroots doorbell ringing, BBQ attending, and baby kissing become less frequent? Will mass media become even more important? Will candidates find other ways to reach voters virtually? Will we make it easier to vote from home?
7. There have been interesting legal and even constitutional questions raised by this pandemic. What are the limits of a government's authority to restrict individual freedoms by closing businesses? By requiring face masks? By compelling individuals to remain in their residences or only visit essential retailers, such as pharmacies and grocery stores? And who should be making these decisions – the federal, state, or local governments? It is abundantly clear that for some issues, we need stronger federal direction and guidance because viruses are blind to state lines, and it makes little sense to have one state implementing a much more aggressive set of protocols while a neighboring state takes an entirely different approach. But at the same time, the handling of this pandemic by the federal government has been so poor that it seems questionable to endow it with even more authority.
8. Might we have, without realizing it, developed a "pandemic mentality," just as our grandparents' generation, growing up amidst the economic hardship of the 1930s, developed a "depression mentality"? In what ways have we been subtly altered by so much time isolated from others? Might we have become more self-reliant? Will we continue to perform our new chores and stick to our new routines? Could this even be an opportunity for some to imagine and remake crucial aspects of their lives? People may have had lifelong goals and dreams that, pre-COVID, were regularly kicked down the road ("maybe next year") amidst the constant demands of everyday life. Now, these may come into sharper focus, and motivate people to take the online course, learn the foreign language,

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> plan for the next degree, or make the career transition that they have long been contemplating. At a minimum, will the introverts among us feel validated by the widespread social distancing that they may have consistently craved? It's easy to imagine that we won't fully return to our past behaviors.

As our firm, and indeed our nation, confront this unique crisis in public health and the deep economic damage it has engendered, we welcome this opportunity to share our thoughts with our investors. At Baupost, client communication is generally a team effort and this letter is no exception. In particular, I want to acknowledge the important role of Jesse Downing, a principal in our Public Group, for his many contributions to the second half of this letter.

As always, Baupost continues to pursue investment opportunities on a bottom-up basis, identifying and analyzing one attractive investment at a time. As part of our assessment, we attempt to employ the best possible judgments to inform our projections and probability estimates. At a time when uncertainty is higher than usual and the rate of change is accelerating, we hope that reflecting deeply about how the future could differ from the past may provide useful insights.

We are grateful, as always, for your confidence and support, and hope you have a healthy and enjoyable summer. Please don't hesitate to reach out to us with any questions or comments you may have.

Very truly yours,

Seth A. Klarman
CEO and Portfolio Manager

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