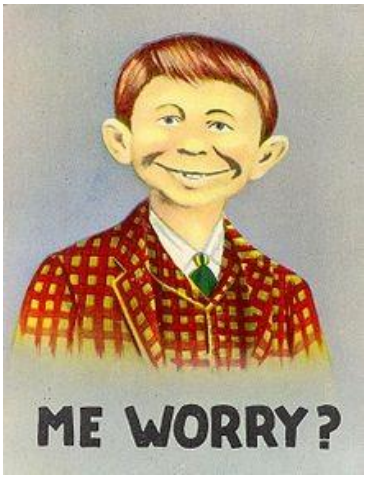
SHINNECOCK PARTNERS

What, Me Worry?
By Alan Snyder



Early postcard said to be original inspiration for character created by Harvey Kurtzman (via Wikimedia Commons)

Alfred E. Neuman is the notorious cover character made famous by *Mad* magazine, although he was first penned way back in the 1930's for a presidential campaign. And, no, I don't remember that! With nary a care in the world and a lopsided grin, all was good. He may be the perfect mascot for current markets, reflecting the disconnect between Wall Street and Main Street.

Many investors have expressed that they are nonplussed, stumped, baffled and even stupefied by this disconnect. Swell, but where does this lead us? Seven scurrilous economic challenges arise for such doubting Thomas Apostles.

1. There is a global recession with the World Bank estimating that 93% of all countries are in recession, many deepening.
2. World trade slumps, losing its traditional salutary benefits.
3. Ginormous government debts abound.
4. U.S. GDP has suffered its largest decline in the last century.

5. 70% of U.S. GDP is consumer driven, but unemployment is at record highs. 14.7 million jobs have been lost through the end of June from pre-Covid times.
6. 50% of U.S. GDP is service related, although service businesses have been generally crushed (doctors, travel, restaurants and your corner dry cleaners).
7. The forward yield curve is effectively flat for 30 years.

Positive thinkers believing in a “V” shaped recovery decry the “left wing” press simply as Chicken Little with a political agenda, ballyhooing only these negatives. Their counterpoints:

1. Ignore earnings in 2020, throw out 2021 and focus on 2022 when all will be well. A vaccine will be available late fall.
2. Never fight the Fed and fiscal policy. Some estimate such ministrations total 46% of GDP, counterbalancing the much lower GDP declines.
3. The U.S. economy bottomed in April 2020.
4. P/E multiples are high but reasonable given near-zero interest rate discounts.

In the face of such uncertain outcomes, our response has been to focus on niche investing. Yes, we hesitate to call such investments a solution, but rather areas of relative merit. Niche investments:

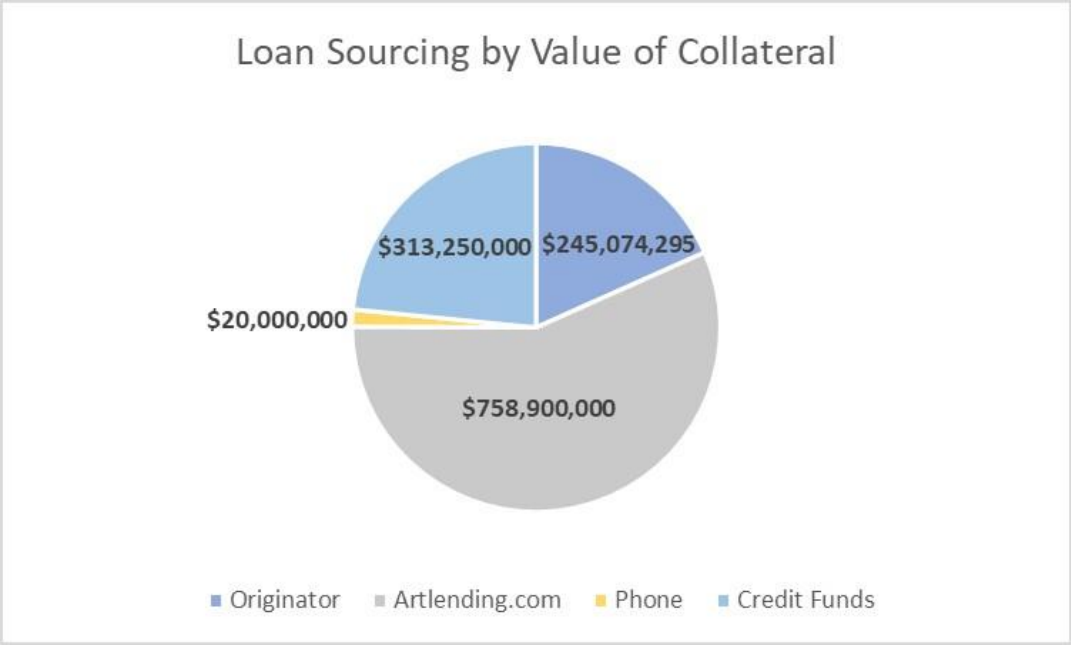
1. Have a defensible position.
2. Enjoy less correlation to macroeconomic events.
3. Are “anti-fragile,” as Nassim Taleb champions.
4. Specialize by product and/or particular markets.
5. Require extra due diligence given typical limited scale and research coverage.

Of course, individual stocks can meet these hurdles. More generally, litigation finance, debt, settlement platforms, bankruptcies, life settlements and specialty finance debt opportunities fit.

Needless to say to the steadfast readers of our scribblings, we are true dogmatists about the benefits of hard asset lending against museum-quality fine art - with short duration, low loan-to-value and collateral under our control. However, two questions have been thrust at us regarding this pursuit:

1. Is there sufficient deal flow to be prudently selective?
2. Given the current economic environment, is the art market still alive?

After more than three years in pursuit of compelling art loans, we have found that with plenty of perspiration, turning over many rocks, a modicum of press recognition, selection of capable third-party art originators, and the opportunistic purchase of the URL artlending.com, winnowing especially attractive opportunities from the proverbial haystack is real. We hope and expect that this will continue:

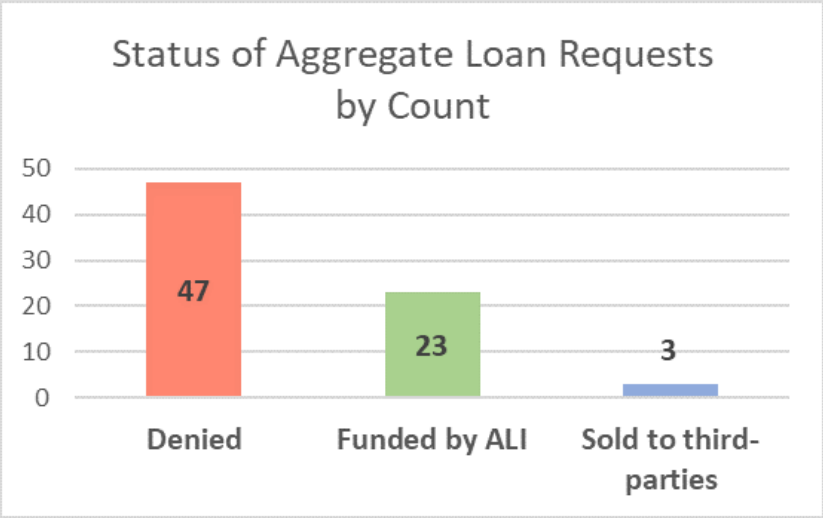


The majority of art loan requests (by collateral value) are via website leads. These leads come from clients who are actively seeking a loan against artwork, generally using art as collateral for the first time. Because of this, these leads often involve low-quality or hard-to-value artwork. Nevertheless, there are several possibilities in our pipeline from this source.

Several compelling opportunities have been directed to us from other credit funds. Unfortunately the large deal sizes have forced us to pass for now. As we grow, we anticipate that this source will be more productive.

Typically, our clients are gallery owners and art collectors. Gallerists routinely work with loan brokers or originators to find additional sources of capital to finance their inventory. This has led to a bias towards loans sourced by experienced originators. Their clients are difficult to find independently because they generally rely on the originator as their

fundraising agent; however, once introduced there is a far better chance of artwork from these high-quality clients being acceptable collateral. In addition, these clients are storied businesses with good reputations and a proven ability to sell collateral when needed.



We have declined to fund approximately two-thirds of all requests we have received. These declinations were caused by one or more of the following;

1. Lack of acceptable valuation metrics.
2. Unacceptable storage demands by client (e.g., client wants the artwork stored in a foreign country other than the U.S. or United Kingdom).
3. Borrower issues. a) We are unable to agree on terms with borrower, e.g., rate, loan term, recourse requirements; b) Borrower may not pass our background check standards, e.g., may be overly litigious.
4. Lack of acceptable provenance/chain of title.
5. Other collateral issues, e.g., insurance, customs, transportation, etc.

Deal flow only matters in the context of an active art market to facilitate price discovery and any necessary collateral liquidations (although we have yet to have our first default). Some assert that the art market is dead. However, heralding the art market's demise is reminiscent of Tom Sawyer attending his own funeral. Yes, the art market swooned with the onset of COVID, but its resilience astonishes. Galleries, art fairs and live auctions paused for several months, yet private sales continued, albeit with less visibility. As the world has slowly reopened, so have galleries with art fairs to come. In the meanwhile, auction houses quickly adapted.

Christie's innovative live-streamed auction titled "ONE: A Global Sale of the 20th Century" wrapped up much later than expected on July 10, but the sale was ultimately a success and the results illustrate the strength of the high-end art market. The first leg of the sale, which took place in Hong Kong, was delayed by "unprecedented bidding" at the modern and contemporary auction that took place there just before the start of "ONE." The sale then ran four hours straight, with intense bidding on many lots and 74 of 79 works finding buyers. In total, the auction brought in $421 million, near the high end of the presale estimate range of $332.4 to $444 million. The pool of buyers was diverse: 37% were from the Americas, 38% from Europe and 26% from the Asia-Pacific region. 38 of the artworks were guaranteed, suggesting many were confident in the strength of the market heading into the sale as well. New auction records were set for Brice Marden (triple the previous record for the artist), Wayne Thiebaud (double), Ruth Asawa, Richard Avedon, Takeo Yamaguchi and George Condo.

Sotheby's June 29 postwar and contemporary evening sale was similarly successful. This auction brought in $300.4 million total: $65.5 for the Ginny Williams collection against a presale estimate of $35.9 - $51.7 million and $234.9 for the main sale against a presale estimate range of $171.4 to $239.1 million. Only one piece offered failed to find a buyer. Phillips' July 2 version of the live online auction format sold all 25 works offered, which is known as a "white glove" sale.

We have seen this resurgence in our own skirmishing as existing portfolio collateral has been sold at prices confirming our valuations and in loan opportunities being pulled before funding as artworks have been sold.

In sum, the art world niche is alive and kickin' with deal selection choices and sales activity. Yay for us and our investors. Now, if only COVID infections would decline from each of us wearing a mask until a vaccine is available and other therapeutics lower the risk from it.

Please stay safe.