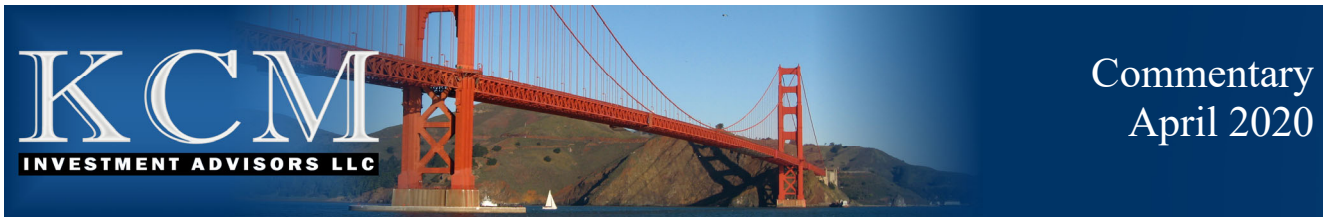


Panic: The Un-Smart Investment Strategy

All of us at KCM are working hard to assess the unprecedented challenges that the Coronavirus (Covid-19) pandemic, as well as the Federal Governments actions being taken to slow the virus's spread, pose for the U.S. and the rest of the world. Please know that during this stressful period, we are committed to your financial well-being. We promise to be available to answer questions thoughtfully and completely, and to help you make the wisest possible investment decisions.

You Can Communicate With Us At Any Time. Our offices are partially closed in order to comply with the Shelter in Place order in Marin County and the other six Bay-area counties. Some KCM employees are working remotely. Even so, we are fully staffed and continue to coordinate activities with our customary dedication and efficiency. We recommend that you communicate with us by Email and promise we will reply as fast as we can.

Let Us Look To History. As you are well aware, the past month has seen the most volatile market environments on record. As investment advisors and asset allocators, we are trained to look to history, especially when trying to put volatility in context. Although this crisis is different (we are facing a health scare-induced "shock"), we are confident in the U.S. financial system and we believe that over the intermediate to longer term the markets will rebound, just as they have during past market shocks.

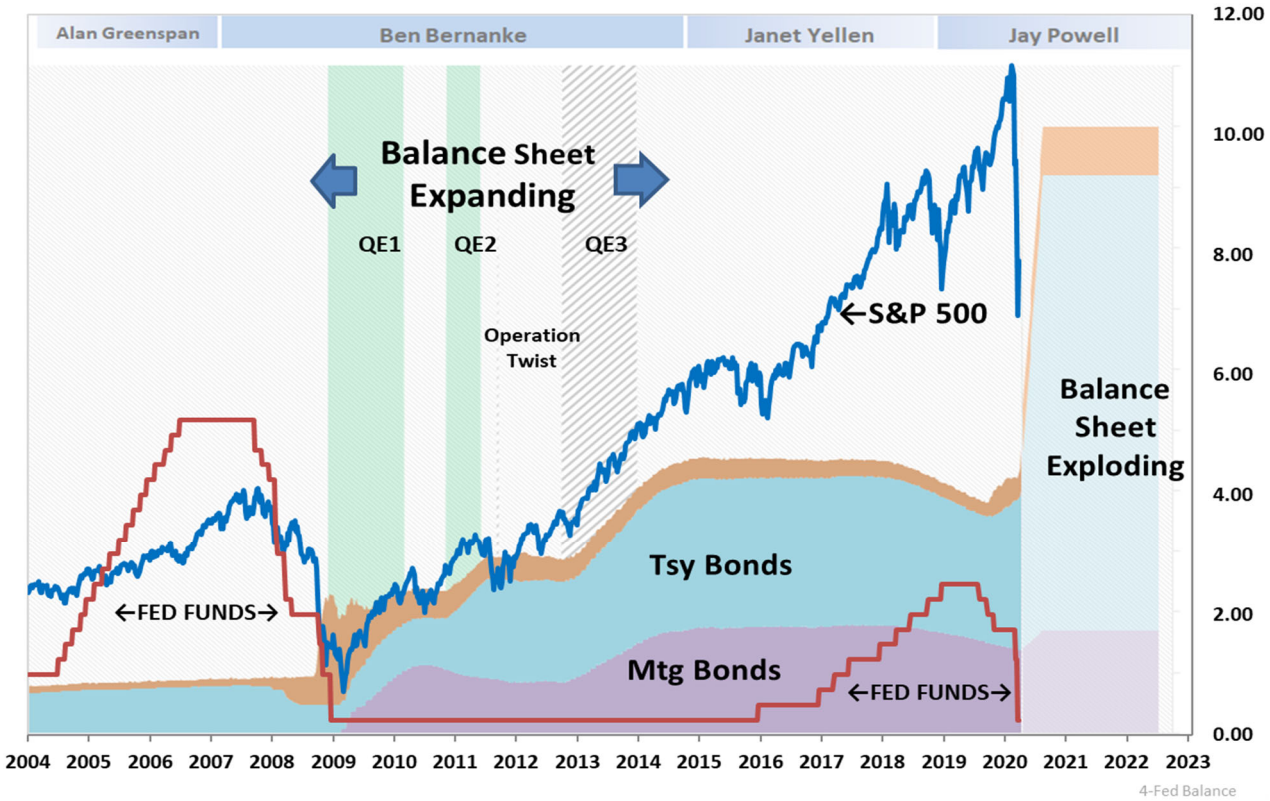
Stay Calm And Patient. It is not easy to make investment decisions in an environment of volatility and uncertainty such as we see now. Our view is that amid the chaos, remaining faithful to your investment policy is the best initial approach. Then, as the dust settles, we anticipate dislocation and other opportunities to reallocate assets worth pursuing.

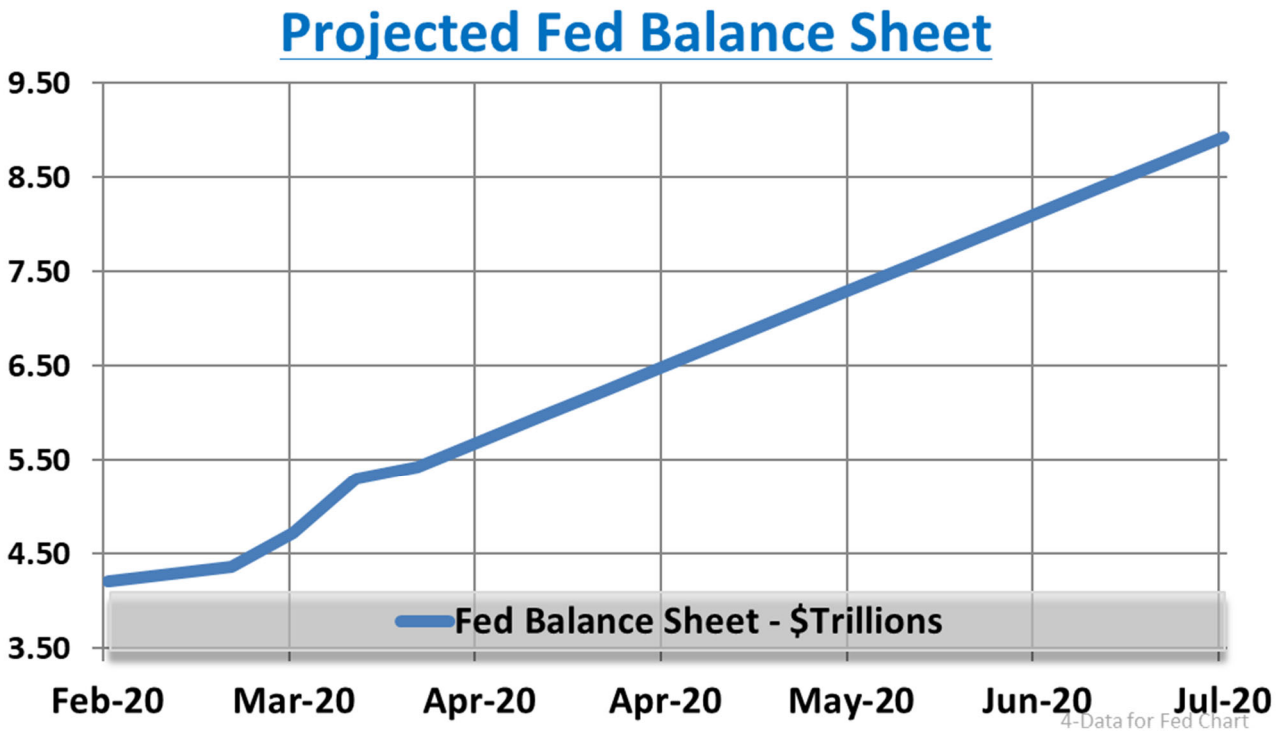
Have Faith In KCM – And *Feel Free To Call Us.* We take our responsibilities *very* seriously and believe our experience and expertise will help us to navigate the troubled waters. We greatly appreciate your steadfastness and loyalty in the interim. We are glad to speak with you about any of your concerns.

It is impossible to pinpoint exactly how and when the current worldwide economic freeze (Recession) will end, but we can look to history as a guide to see how past economic collapses have compared and what it took to recover.

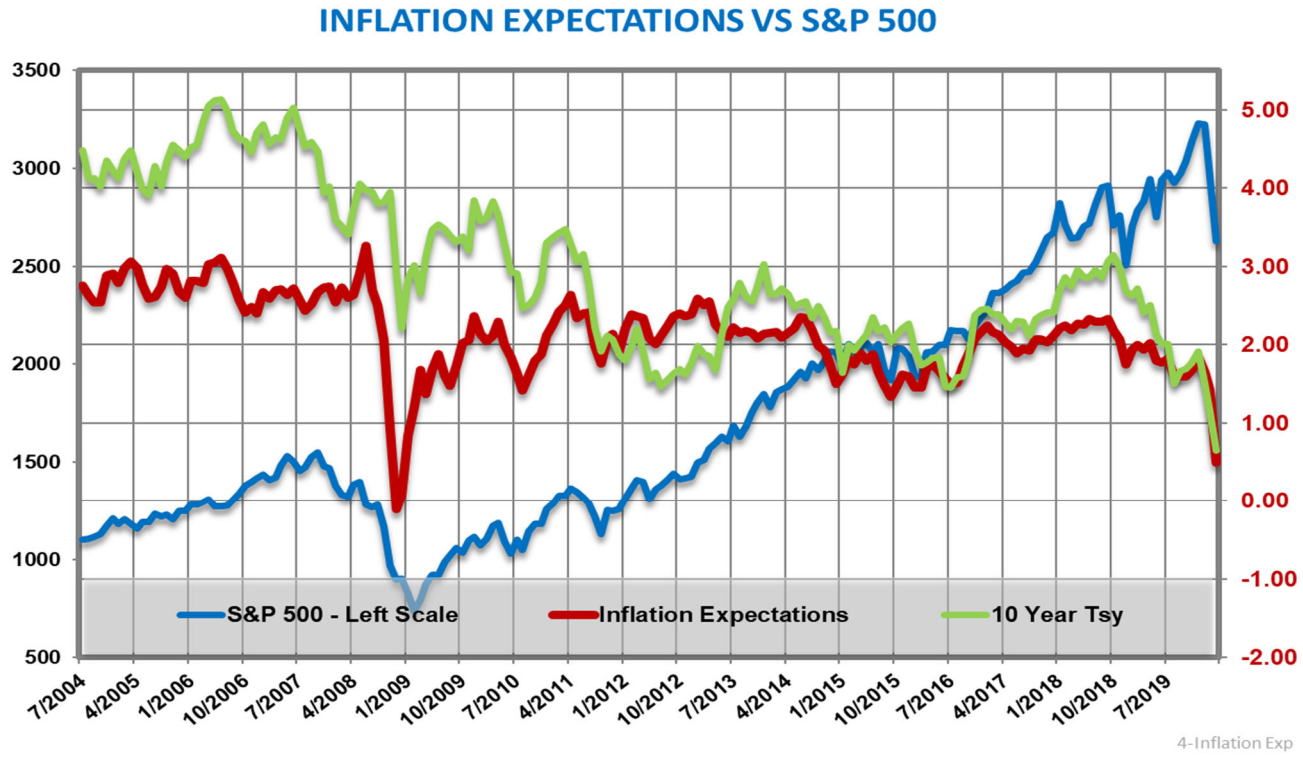
The chart below illustrates the Federal Reserve's reaction to the market decline of the 2008 "Great Recession" and how the market responded. The chart **also shows the Fed's bold and early response to the *current* economic crisis: it cut the Fed Funds rate to 0.25% and is assertively making "limitless" Quantitative Easing purchases that may swiftly expand its balance sheet to $10 trillion. The Fed's quick and forceful action – along with the unprecedented $2-plus trillion, consumer-focused, Coronavirus Economic Recovery Package (about 10% of GDP) – is larger and faster than all the stimulus provided in 2008-2014. KCM believes the Fed's smart forthrightness in dealing with the current crisis will support a fiscal and stock market recovery.**

We understand that the efficacy of economic policy will depend on the virus itself and the vigor of the worldwide fight against it. But remember, we are on a **"wartime footing,"** making it likely that both the Federal Reserve and the Federal government will, as necessary, aggressively expand their responses. **Please note the stock market bottomed in March 2009, while fiscal and monetary stimulus remained necessary and continued for about another 6 years. Are we at a point in the market that is similar to March 2009?**

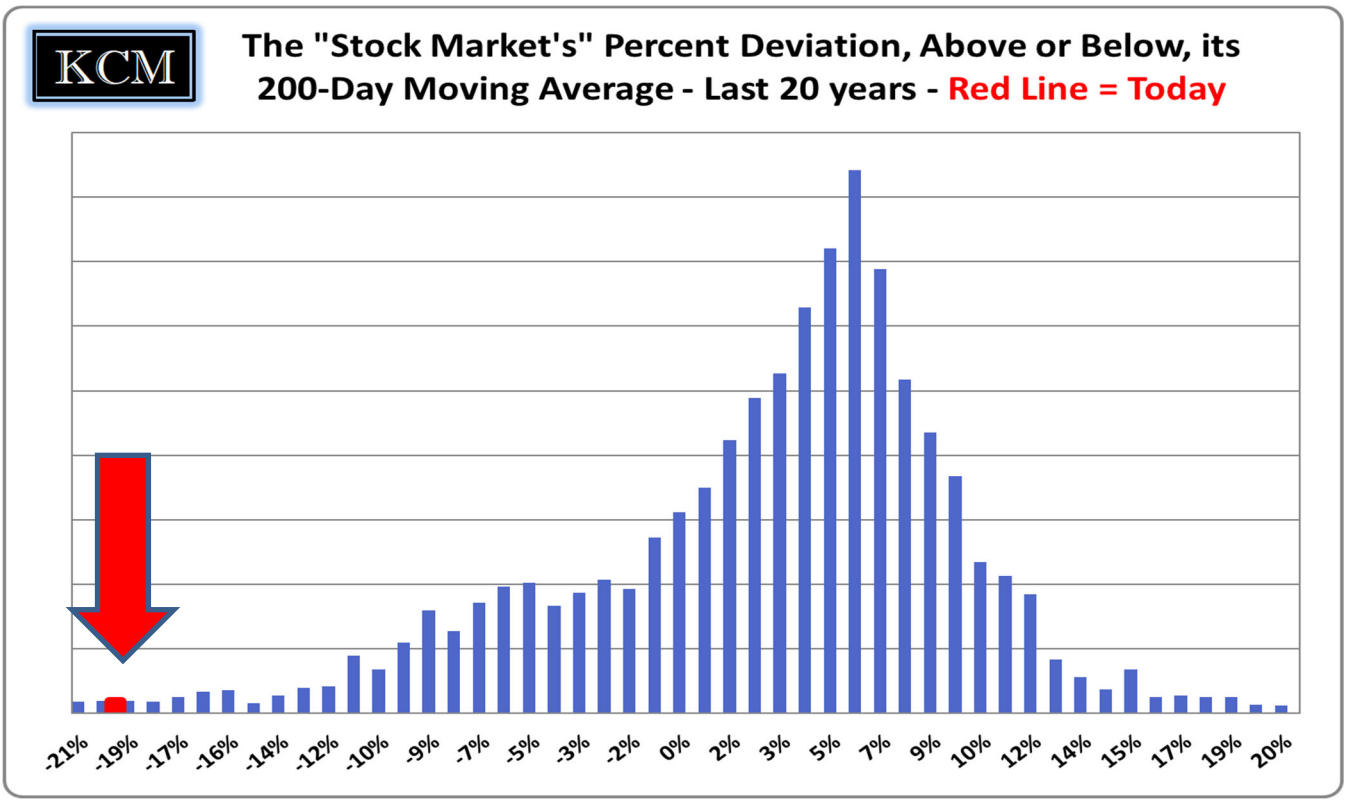




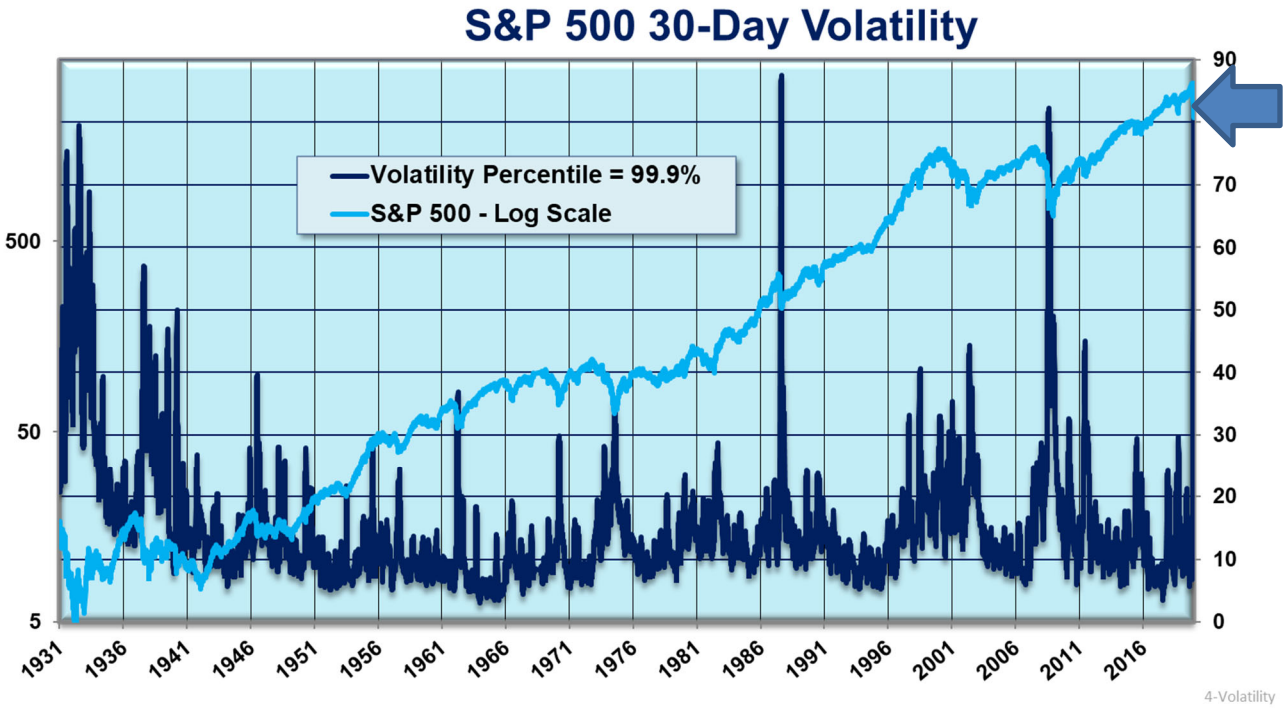
The Fed increased its balance sheet over 7 years, from about $1 trillion in 2007 to about $4.5 trillion in 2014 (see chart on page 2). That balance sheet is **projected to soar from $4.5 trillion to $10 trillion in the next 3-4 months!** Declining inflation expectations and Treasury bond yields should be a positive for the stock market (note today vs. the market bottom in 2009 in the chart below).

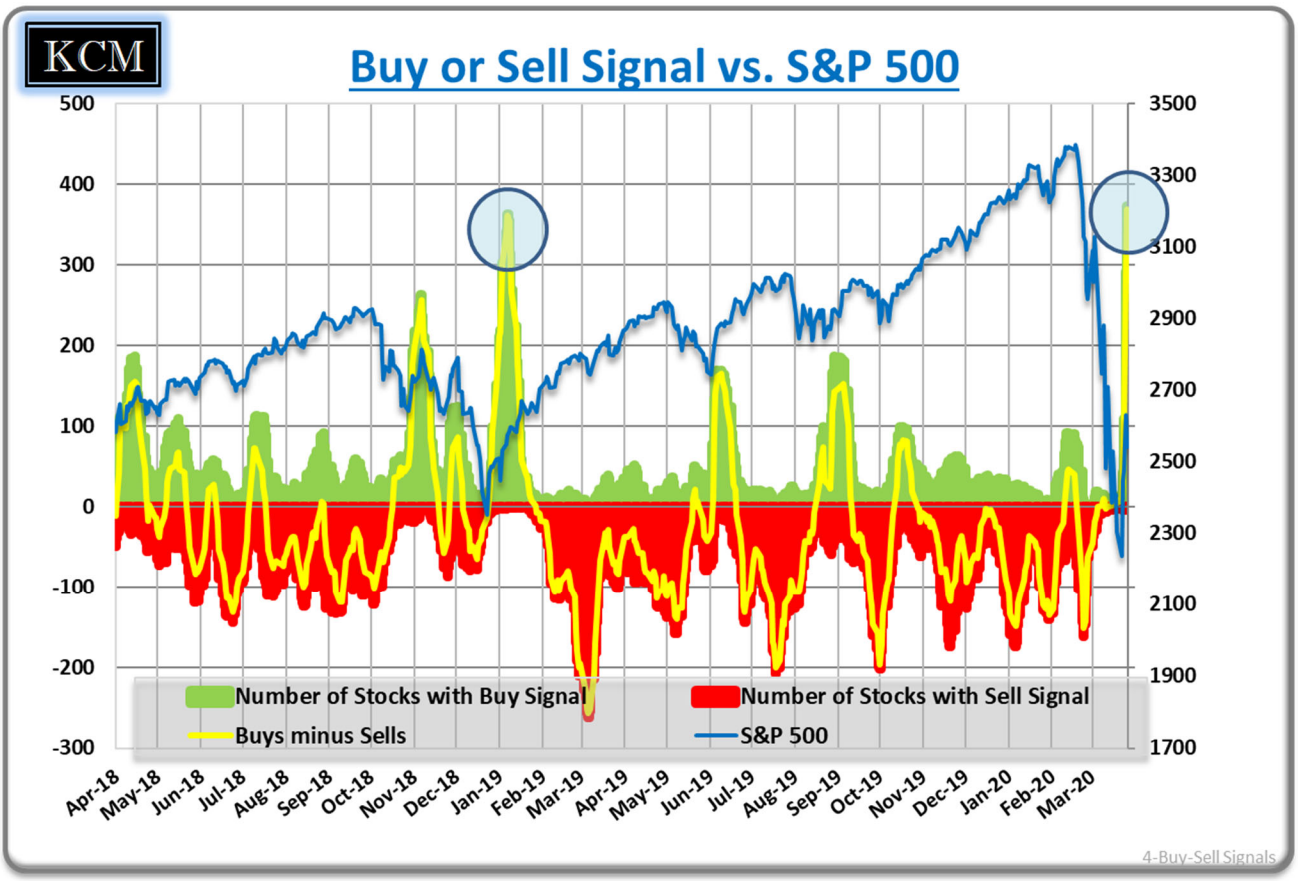


Market bottoms all share certain technical characteristics:

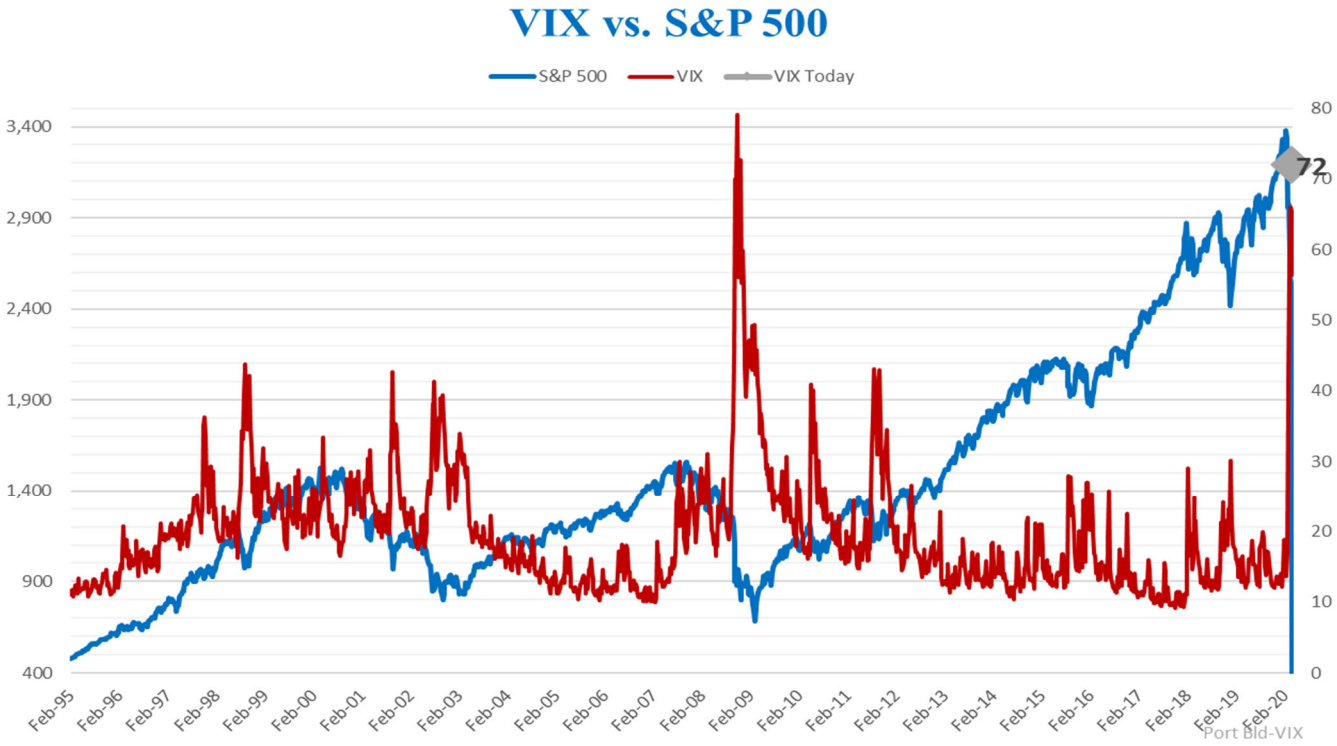


The "Red Line," -19%, indicates the market is about as **oversold as it has been in the last 20 years.** S&P's 30-Day Volatility (below-far right) is at the **99.8 percentile**, comparable to market bottoms in 1987 and 2009.





The "Buys minus Sells" signal is comparable to or greater than recent market bottoms. The VIX (below) is comparable to the major market bottom in March 2009.

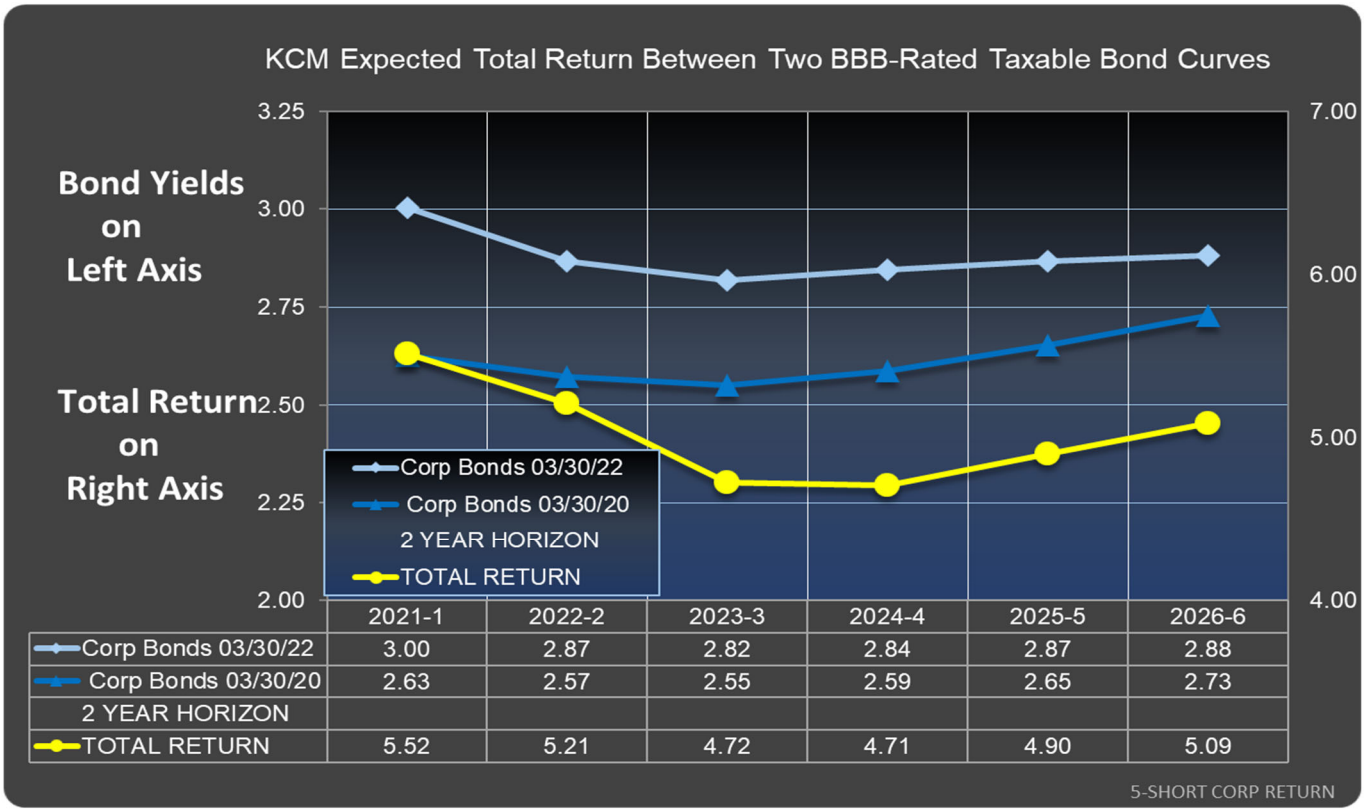


FIXED INCOME

KCM	Before & After-Tax Yields					
Call or Maturity	Calif. + Fed. Tax Brackets	50.3%	47.3%	43.3%	34.3%	31.3%
	Federal Tax Brackets	37%	35%	32%	24%	22%
8-10 Years to Call	CA Muni - Tax Free	1.85	1.85	1.85	1.85	1.85
	CA Muni Taxable Equiv.	3.72	3.51	3.26	2.82	2.69
	Natl Muni Before-Tax	1.87	1.87	1.87	1.87	1.87
	Natl Muni After Calif Tax	1.62	1.64	1.66	1.68	1.70
1-3 years	CA Muni - Tax Free	1.20	1.20	1.20	1.20	1.20
3-5 Years to Maturity	Corp Bond Before-Tax	3.06	3.06	3.06	3.06	3.06
	Corp Bond After-Tax	1.52	1.61	1.74	2.01	2.10
5 Years to Call	Preferreds Before Tax	6.50	6.50	6.50	6.50	6.50
	Preferreds After-Tax	3.23	3.43	3.69	4.27	4.47
10 Year Maturity	Treasuries Before-Tax	0.65	0.65	0.65	0.65	0.65
	Treasuries After-Tax	0.41	0.42	0.44	0.49	0.51

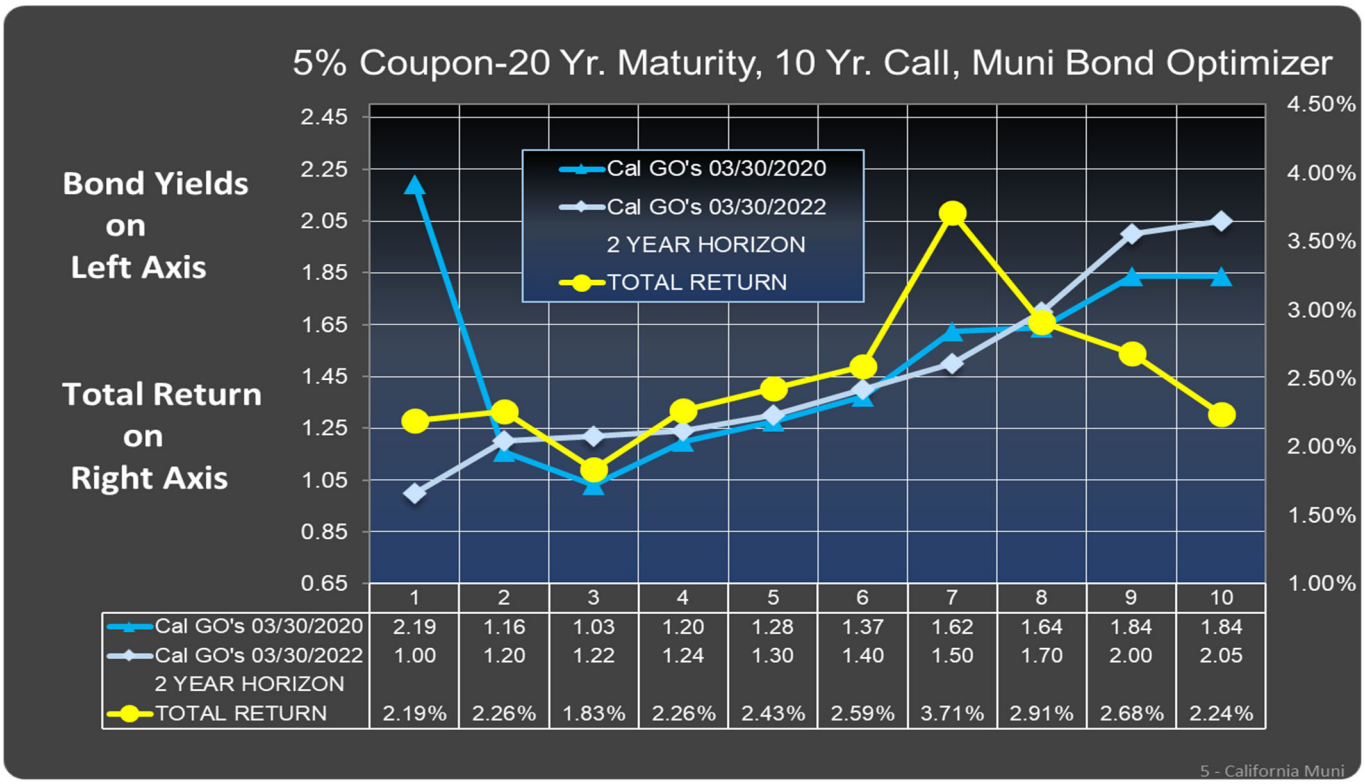
KCM	Living in Federal Tax Only State					
Call or Maturity	Federal Tax Brackets	37%	35%	32%	24%	22%
8-10 Years to Call	CA Muni - Tax Free	1.85	1.85	1.85	1.85	1.85
	CA Muni Taxable Equiv.	2.94	2.85	2.72	2.43	2.37
	Natl Muni Before-Tax	1.87	1.87	1.87	1.87	1.87
	Natl Muni Taxable Equiv.	2.97	2.88	2.75	2.46	2.40
3-5 Years to Maturity	Corp Bond Before-Tax	3.06	3.06	3.06	3.06	3.06
	Corp Bond After-Tax	1.93	1.99	2.08	2.33	2.39
5 Years to Call	Preferreds Before Tax	6.50	6.50	6.50	6.50	6.50
	Preferreds After-Tax	4.10	4.23	4.42	4.94	5.07
10 Year Maturity	Treasuries Before-Tax	0.65	0.65	0.65	0.65	0.65
	Treasuries After-Tax	0.41	0.42	0.44	0.49	0.51

The tables above compare the current investment alternatives, before and after tax, in fixed income securities. Over the last two weeks, the price and yield on Municipal Bonds, Corporate Bonds, and Preferred Stocks have been highly volatile, mostly for technical reasons. Fixed income mutual funds and ETFs are very liquid, but the securities they own are less so, especially when Wall Street traders are working from home with reduced lines of credit to position trades. Currently Municipals and investment grade Corporate Bonds have fully recovered, and Treasury Bonds are at new lows. Preferred Stocks still have a way to go and, selectively, may provide the best value.



	2021-1	2022-2	2023-3	2024-4	2025-5	2026-6
Corp Bonds 03/30/22	3.00	2.87	2.82	2.84	2.87	2.88
Corp Bonds 03/30/20	2.63	2.57	2.55	2.59	2.65	2.73
2 YEAR HORIZON						
TOTAL RETURN	5.52	5.21	4.72	4.71	4.90	5.09

The aggressive rate cutting by the Federal Reserve Bank and massive worldwide fiscal stimulus are likely to keep Municipal and Corporate Bond yields near recent lows, or push them even lower.



	1	2	3	4	5	6	7	8	9	10
Cal GO's 03/30/2020	2.19	1.16	1.03	1.20	1.28	1.37	1.62	1.64	1.84	1.84
Cal GO's 03/30/2022	1.00	1.20	1.22	1.24	1.30	1.40	1.50	1.70	2.00	2.05
2 YEAR HORIZON										
TOTAL RETURN	2.19%	2.26%	1.83%	2.26%	2.43%	2.59%	3.71%	2.91%	2.68%	2.24%

Stock & Bond Market Valuations

12 Months Ending	Peak 2000 3/31/2000	Peak 2007 9/28/2007	Bottom 2009 3/31/2009	CY 2015 12/31/2015	CY 2016 12/31/2016	CY 2017 12/31/2017	CY 2018 12/31/2018	Current 3/30/2020
Price/Earnings	28.89	17.10	14.38	18.78	20.54	21.82	16.62	16.91
Price/Cash Flow	16.74	20.06	5.18	10.67	12.31	14.10	10.79	11.02
Price/Sales	2.25	1.64	0.82	1.85	1.98	2.21	1.91	1.84
Price/EBITDA	10.69	6.92	5.15	10.47	10.58	11.32	10.01	9.23
Dividend Yield	1.10	1.82	3.59	2.15	2.09	1.89	2.15	2.42
Fed Funds	6.00	5.25	0.25	0.50	0.75	1.50	2.50	0.25
3 Month T-Bill Yield	5.87	3.80	0.20	0.16	0.50	1.38	2.35	-0.01
Ten Year Treasury Bond Yield	6.00	4.59	2.66	2.27	2.44	2.41	2.68	0.65
Leverage Ratio-Lehman	35.50	32.00						
Leverage Ratio-Goldman	24.80	28.40	19.00	11.46	11.47	12.69	12.53	12.18

Given the unprecedented, rapid and unique Coronavirus-induced recession, **stock market valuations appear to be as attractive as at any time since 2009.** Historically low yields and low inflation expectations make stocks even more compelling.

We Are Optimistic

1. Central bankers and governments worldwide are injecting historical amounts of stimulus.
2. Technical market indicators tell us we may be near the stock market low.
3. Low yields (borrowing costs) decrease the cost of doing business, which stimulates the economy, enhancing the attractiveness of stocks.
4. One of our best ideas remains beat-up Preferred Stocks for a portion of investors' fixed income portfolios.
5. Review your Required Minimum Distribution for 2020. If it seems to be delayable, we suggest doing that.
6. Panic: The Un-Smart Investment Strategy.

Jay Kellett, Founder and CEO, and your KCM Team

***All the graphs produced by KCM, data from Bloomberg.**