

Dear Pershing Square Investor,

A number of press reports have raised questions about my appearance on CNBC last Wednesday, and some have even questioned whether my appearance was intended to drive down the market so that we could profit on hedges we had previously entered into. I thought you would find greater transparency into our investment positioning over the last few weeks helpful in responding to those who have expressed concerns.

As you know, we have been extremely alarmed about both the health risks of the coronavirus and its economic impact since earlier this year. While we are a long-term investor, we view our principal responsibility as preserving capital and protecting our investors from losses. In light of our concerns, we had two choices: we could either sell all of our investments or hedge our portfolio. We chose to hedge coronavirus risk rather than sell because we are long-term investor, and we believe that all of our companies would eventually recover, and create substantial value over the long term.

As a result, in February, the Pershing Square funds purchased credit default swaps (CDS) on various investment grade and high yield credit default swap indices, namely the CDX IG, CDX HY, and ITRX EUR. At the time of purchase, the IG or investment grade indices were trading near all-time tight levels of about 50 basis points per annum. The high yield index, the CDX HY, was also trading near its lowest spread ever. When one adjusts for the fact that a number of companies in the high yield index were on the brink of default (and these near-default companies' spreads were in the thousands of basis points), the spreads on the rest of the companies in the index were actually well below the 2006-2007 all-time lows.ⁱ

Because we believed that the coronavirus could only be stopped in Europe and the U.S. with an unprecedented economic shutdown, based on what we learned from China, we were confident that U.S. and European credit spreads would likely widen substantially from their near-all-time lows. We believed that global shutdowns would also affect all of our portfolio companies negatively to varying degrees, causing their stock prices to decline substantially. We believed, however, that our hedging program would likely be an effective one because as the spreads on the indexes widened, our CDS would become much more valuable.

Based on this analysis and to protect our investors from these potential losses, we purchased a very large notional amount of CDS. We disclosed that we had done so in a press release issued by Pershing Square Holdings, Ltd. on March 3rd, 2020:

"Dear PSH Shareholder,

During the past ten days, we have taken steps to protect the portfolio from downward market volatility. We have done so because we believe that efforts to contain the coronavirus are likely to have a substantial negative impact on the U.S. and global economies, and on equity and credit markets. Our approach to address this concern has been to acquire large notional hedges which have asymmetric payoff characteristics; that is, the risk of loss from these hedges is limited, while their potential upside is many multiples of our capital at risk. These hedges will likely mitigate portfolio losses in severe market declines, while also somewhat reduce the portfolio's upside potential if there is minimal economic or market impact from the virus."

On March 9th, we issued another press release which disclosed the following:

“Dear PSH Shareholder,

We are reporting our NAV today so that shareholders are informed of the materially positive impact on NAV of various hedges that we previously acquired to protect the portfolio from downward market volatility. As we explained in our March 3, 2020 communication, we have acquired large notional hedges with asymmetric payoff characteristics which will help to mitigate portfolio losses in severe market declines, while reducing the portfolio’s upside potential if markets recover. While recent market declines have caused the market values of our portfolio companies to decline substantially, the increased value of our hedges has more than compensated for these losses as you will note from today’s reported results.”

At the time of the March 9th press release, our CDS contracts had increased in market value from zero to approximately \$1.8 billion because of spread widening.

By March 12th, our CDS contracts had increased in value to \$2.75 billion, and we began selling. We sold because the risk-reward ratio of holding the contracts at 140 basis points was not nearly as compelling as when spreads were at 50 basis points. Also, our CDS position had become a very large percentage of our portfolio, approaching 40% of our capital as our companies’ stock prices declined.

Furthermore, the deterioration in markets greatly increased the opportunity cost of our owning CDS. In order to make a meaningfully greater profit on CDS, spreads would have to widen further to approximately the levels they briefly achieved during the financial crisis. Had we had been able to sell our entire CDS position on March 12th, we would likely have done so, but because of the very large size of the position, it would take us more time to exit.

At the time, the administration and various city and state governments were beginning to take the risk of the virus more seriously. The President began holding daily press conferences with his coronavirus team, various cities were going into lockdown, and a number of state governors, most notably Governors Cuomo and Newsom, were showing strong leadership in addressing the growing crisis. Meanwhile stocks continued to decline, which made the opportunity cost of owning CDS at their then-trading levels of 130 -150 basis points even less attractive. Beginning on March 12th, we began unwinding our hedge, and continued to do so every day thereafter until we completed our exit on the morning of March 23rd.

On the morning of Wednesday, March 18th I sent out four tweets:



Bill Ackman ✓ @BillAckman · Mar 18

Mr. President, the only answer is to shut down the country for the next 30 days and close the borders. Tell all Americans that you are putting us on an extended Spring Break at home with family. Keep only essential services open. The government pays wages until we reopen.

605

2K

7.4K



Bill Ackman ✓ @BillAckman · Mar 18

Replying to @BillAckman

No one defaults, no one forecloses. A 30-day rent, interest and tax holiday for all. The shutdown is inevitable as it is already happening, but not in a controlled fashion which is extending the economic pain and amplifying the spread of the virus.

55

248

1.2K



Bill Ackman ✓ @BillAckman · Mar 18

With exponential compounding, every day we postpone the shutdown costs thousands, and soon hundreds of thousands, and then millions of lives, and destroys the economy.

54

323

1.4K



Bill Ackman ✓ @BillAckman · Mar 18

Please send everyone home now. With your leadership, we can end this now. The rest of the world will follow your lead. A global Spring Break will save us all.

109

299

1.5K



Later that morning Scott Wapner asked me to come on his midday CNBC show, and I agreed. This was my first appearance on television in more than two years.

By Wednesday, March 18th at 12:30pm, when I appeared on CNBC, we had already sold slightly more than half of the notional amount of our CDS, realizing a gain of more than \$1.3 billion, with the unrealized portion of our hedge having a market value at that time of \$1.3 billion for a total of \$2.6 billion. When my interview with Scott Wapner began, the S&P index was already down 6.5%.

I went on CNBC to further explicate my tweets, and to explain why I had gone from being very bearish to bullish, with a caveat. In sum, I explained to Scott that I believed that the best approach to killing off the virus was for the entire country to close the borders and shut down for 30 days, other than for essential businesses, government, and services. Then, carefully, the country could be reopened with testing of all Americans, social distancing, higher mask usage, and other mitigation practices. I also explained that

the alternative of an 18-month period of rolling shutdowns would likely bankrupt almost every business, even dominant, well-capitalized ones. Because the consequences of a rolling shut down of the country that occurred over 18 months were so dire, I explained that I was confident that the administration would choose instead to shut down the entire country at once for 30 days.

I also told Scott Wapner that I was sufficiently bullish that we were buying stocks in the market:

“And I’ve been super bearish, but I got bullish. Okay. And the reason why I got bullish, and I’ve been aggressively buying stocks, including Hilton, today, okay, and I’ve been buying all the way down: Hilton, Restaurant Brands, Starbucks, you know, walk your way through our – the only stocks I’m not buying are companies we’re on the board and are restricted. But the reason why, is the only answer for the world is to shut the world for 30 days.”

Shortly after the show, I heard that some had interpreted my remarks as being very bearish on the market. In fact, later that day, some commentators claimed that I was responsible for the market finishing the day down more than 10%, almost 4% lower from the time I started speaking on CNBC at 12:30pm that day.

At 2:55pm that day, I issued the following tweets clarifying my remarks:



My bullish posture and my statements on CNBC and Twitter were strongly supportive of the markets. I made those statements at the time we were buying stocks and reducing our short in the credit markets. My statements were therefore totally consistent with how we were trading. We had turned bullish and we were in the process of investing about \$2.5 billion in equities. On the show, I made it very clear we were actively buying stocks in the market.

Importantly, our hedge had already paid off prior to my going on CNBC. In fact, we had sold more than half the hedge prior to the show, and the balance over the next three trading days. Our actual realized proceeds of \$2.6 billion was equal to the total realized and unrealized profit we had already achieved prior to my going on CNBC. The hedge did not increase in value during or after I went on CNBC. It stayed at approximately the same value until we exited.

In fact, if you believe we move markets – a highly dubious assertion – one could argue that had I not told the world that we were bullish and were buying stocks, both equity and credit markets would have declined even more than they did, and we would have made more money on the hedges.

The idea that my appearance pushed the market down an additional 4% that day is absurd. This is particularly so in light of my disclosure on the show that we were actively buying hotel and restaurant stocks – companies that have been most impacted by the virus – in addition to other companies in our portfolio.

On CNBC, I disclosed my beliefs to the best of my ability. Yes, I got somewhat emotional as I talked about protecting my immune-compromised father from the ravages of the virus. But, I had become bullish because of my belief that the entire country would soon go into lockdown, and that would be the fastest and best way to minimize the impact of the virus. And that was why I explained that we were buying stocks. I also wanted to shout from the rooftops about the importance of taking the virus seriously so that we would build a consensus to lockdown the country as soon as possible.

The day after, Thursday, Governor Newsom announced that California was going into lockdown. On Friday morning, two days after my appearance on CNBC, Governor Cuomo announced that New York State was going into lockdown. Over the past week, another 19 states have followed California and New York's lead and initiated lockdowns. Another 14 states have also begun lockdown orders in parts of their states. Markets have soared in response to this news as there is now much greater visibility on an end date for the virus' impact on the economy.

The bottom line is that our hedging strategy worked. While we incurred mark-to-market losses on our portfolio equal to \$2.6 billion, we made the same amount on the hedges. Notably, as of our last public report released yesterday, we were flat for the year.

By selling the hedge, we generated \$2.6 billion of proceeds, the substantial majority of which we invested in both new and existing investments, which we believe will payoff as markets recover.

Sincerely,

William A. Ackman

ⁱ A brief primer on CDS: in simplified form, when you purchase CDS, you are committing to pay a fixed spread on a quarterly basis for a fixed period of time (for the most liquid, on-the-run contracts, the term is five years) times the notional amount of the contract. If spreads widen, the CDS you purchased becomes more valuable as you can sell it and receive the difference between the wider spread – let say 150 basis points per annum for five years – and the spread you committed to pay – let's say 50 basis points, for the remaining life of the contract. On the other hand, if spreads narrow to 25 basis points, you will lose money because you will be required to pay the difference: $50 - 25 = 25$ basis points, times the notional amount of the contract for the remaining life of the contract – to your counterparty when unwind the contract.

This is best understood by a somewhat simplified example: assume you purchase \$1 billion notional of CDS on the IG index for 50 basis points. In summary terms, you are committing to pay 50 bps times \$1 billion, or \$5 million of premium per annum for five years. Assuming you sell the CDS a month after purchase at a spread of 150 basis points, you would receive approximately the present value of the spread, in this case 100 basis points per annum, times the \$1 billion notional amount of the contract for the remaining 4 years and 11 months of the contract's life.

The present value of 100 bps for 4 years and 11 months is a number which is slightly less than the present value factor times 4.92 years times 100 basis points times \$1 billion, or approximately \$45 million. Since the contract in this example was only outstanding for one month, the total premium paid would be $1/12^{\text{th}}$ of the annual payment of \$5 million or approximately \$417,000. Therefore, for a total outlay of \$417,000, you would make \$45 million. This understates your actual risk, however, because if spreads were to narrow during that month, you would lose substantially more than the premium. That said, if you were confident that spreads would either stay the same over the next month or widen, you would only be risking the premium of \$417,000.