January 10, 2021

Dear Friend of Valara Capital Management,

For the fourth quarter and twelve months ended December 31, 2020, Valara Partners, LP. produced total returns, net of fees, of 16.39% and 20.41%, versus 12.15% and 18.40% for the S&P 500 index, respectively. While value, as a style, finally outperformed, we beat it too – nominally in the quarter and substantially for the year.

QUARTERLY REVIEW

While the economy continues to recover from the Spring closure, there is still a great deal for markets to fret over making it remarkable that the S&P 500 ended the year at a new all-time high. The good news in the quarter included confirmation of a strong GDP rebound in Q3 (up 33%from Q2, albeit still down 2.8% year over year), news that multiple vaccines had emerged from the approval process and were ready for distribution, acceptable Q3 earnings reports and modest additional Covid-19 relief stimulus. Although Q3 earnings were generally on track, they were greeted as reason to sell technology stocks (with the noteworthy exception of semiconductors) – presumably because they were not strong enough. In what recently has been an unusual outcome, the technology sector did not lead the market in the fourth quarter (more below). The bad news included the continuing ramp of the second wave of Covid-19, the emergence of a more contagious new strain(s), record infection rates and death tolls, a return to selective economic restrictions and the predictable election fallout. While post-election frustrations were expected, the rush to censor, shame and punish those with alternative viewpoints is concerning. How can we "heal" without speaking and listening to each other. The political divide continues to ominously widen. The Federal Reserve (FOMC) held two meetings in the fourth quarter and remains accommodative, with M1 and M2 still rising strongly. The dominant narrative continues to emphasize the need for more help from fiscal policy. The expectation for emerging inflation continues to gain support and was buttressed in the last three months of the year by a new Biden budget plan, a falling US dollar, rebounding interest rates, rising prices across the commodity complex and Bitcoin making a new all-time high (more below).

To repeat a familiar refrain, US equities remained strong in the quarter and, in the final analysis, the year. Globally, while the quarter was generally strong, led by the second-tier stock markets (Korea, Brazil, Argentina…), the year was much more mixed. For the twelve months ended December 31st, Korea was the strongest performer, up 43%, followed by China, up 27%, and the US, up 16%. Smaller capitalization stocks and emerging markets, with a tilt toward value were the themes for the fourth quarter. Leading sectors included Energy, Financials, Industrials and Materials. Laggards included gold miners (they still had a great year), Consumer Staples, Utilities and Health Care. Credit markets in the US sold off as interest rates rose but the spreads between the weakest and strongest credits narrowed. Bitcoin was a standout performer for the quarter and year. Some have asked if this means that BTC is replacing gold. To this I would offer that, while both may be considered apolitical, Bitcoin's strength is more in the direction of payments facilitator while gold's is in the direction of store of value and provider of anonymity. In other words, they compete and/or they don't, depending on your interest.

PERFORMANCE COMMENTARY

It gives me great pleasure to write that value outperformed growth (by 4.9%) and the S&P 500 (by 4.1%) in the quarter. Clearly that helped our results for the last three months. Secondly, smaller cap stocks outperformed larger ones. As we have made new investments in the last few years, the most attractive opportunities have been on the smaller end of the large cap universe. This also helped us in the quarter. Thirdly, our sector overweights in Energy, Financials and Materials were favorable while our overweight in gold stocks was not. On a net basis sector weighting was roughly neutral. Our individual stock selection was where we shined the most. Fluor Corp was up 81%, Baker Hughes, Ralph Lauren and National Oilwell were all up over 50%, Citibank and Mohawk were up over 40% and Discovery, AIG, Quanta, Murphy and Textron were all up over 30%. While I am very pleased with this, we needed it to overwhelm the "normal" correction (after a strong nine months) that we experienced in our gold holdings.

The most noteworthy trade in the quarter was the completion of our sale of the SPY from the portfolio. I also trimmed our position in Quanta Services into strength. Proceeds were invested in a new position in Omnicom (Advertising), and increases in our positions in GAP, Viatris (the old Mylan), Baker Hughes, BorgWarner, ConocoPhillips, Discovery, Fluor, Mohawk, National Oilwell, Ralph Lauren and Textron. While many of these additions were to names that were strong in the quarter most were bought opportunistically in the first six weeks, near their relative lows for the cycle. Baker Hughes and National Oilwell are good examples of this – ending the year up 38% and 58%, respectively, from our purchase prices on November 4th. To put it bluntly, I am very excited about having successfully deployed all of our capital into extremely attractive value opportunities (more below).

OUTLOOK

The economic outlook remains cloudy for many reasons, not the least of which being that the pandemic disrupted many of the trends in place before it started. For the immediate term it would seem likely that the economy continues to recover as the vaccine rollout broadens and begins to reduce the economic impact of the virus. The Federal Reserve and new Administration are both likely to remain supportive. That said, you may recall that as 2019 closed I was concerned that the global economy was slowing and appeared to be late in an extended expansion. I do not think that the pandemic reset the clock even though the response to it certainly boosted asset prices creating new highs everywhere you look. Valuations broadly appear elevated.

Therein lies the challenge. While the economy may have the wind at its back, one might reasonably ask if valuations already reflect a great deal of optimism and confidence. The virus is not yet defeated, debt levels are high, interest rates have risen off their lows with inflation a hot topic, the dollar has been weak and politics are still a mess. I would be wary of overly bullish expectations for the market in the near term.

A noted above, I sold the last of the SPY from our holdings. This puts an exclamation point on the fact that our portfolio of 31 stocks is significantly different than the market as a whole. Most importantly, it trades at a multiple of earnings under 10x which is less than half that of the S&P 500[1]. As a result, my expectations for our portfolio over time bear little resemblance to what I might expect from the index. I have rarely been more optimistic or enthusiastic about our prospects to outperform in the years ahead. As always, by sticking to our disciplined investment process I hope to bring this vision to fruition. Thank you for your continued faith and confidence. Please call or email with any questions you may have.

Sincerely,

Robert W. Simmons, CFA
Principal

[1] All references to P/E are based on normal earnings power rather than trailing earnings or forward estimates.