Valara Capital Management, LLC

January 10, 2022

Dear Friend of Valara Capital Management,

For the fourth quarter and twelve months ended December 31, 2021, Valara Partners, LP. produced total returns, net of fees, of 7.74% and 21.05%, versus 11.03% and 28.71% for the S&P 500 index, respectively.

QUARTERLY REVIEW

Although the S&P 500 ended the year at an all-time high, market volatility (disunity of opinion) picked up noticeably in the fourth quarter. The factors that influenced this were the resurgence of Covid 19 in general (and the Omicron variant, specifically) as the weather cooled, good third quarter earnings results, Federal Reserve posturing around the tapering of their asset purchase programs, a generally slowing global growth outlook and persistent inflation. In December bullishness won out largely on optimism regarding corporate fundamentals and a view that the Federal Reserve will remain accommodative. In my opinion the biggest story of the quarter was the Fed. While the media was full of reports about the central bank talking tough, accelerating their tapering plans and moving forward the date of their first rate hike, the fact is that they are still buying Treasuries and MBS and will be doing so for several more months. Even if they begin raising interest rates in March the real rate of interest is massively negative and hence extremely stimulative. With the consumer price index at 6.8% it would be hard to make the argument that the Fed is restraining anything until interest rates move into the mid single-digits. I don't know anyone that expects that to happen. This means that, at least so far, the Federal Reserve posturing is purely political and not truly "inflation fighting". By taking this step, the Fed has secured the bare minimum cover it needs to reverse itself should the economy or markets weaken.

Corporate earnings have been a clear positive and they are expected to remain so as 2022 gets underway. Inflation is still an active debate centered around the continuing issues with global supply chains. It has certainly been the case that Covid continues to hamper production as it flares around the world and to cause general havoc with shipping and transportation. The emerging consensus around the Omicron strain is that the severity of symptoms is greatly reduced – to the level of the seasonal flu or lower (University of Washington study). If that proves to be the case, and Covid lockdowns and restrictions start to fade, the supply chain issues could ease, taking some pressure off inflation.

Meanwhile the bond market remains concerned. While the ten-year Treasury yield hovered around the 1.5% level for most of fourth quarter, it began to lift the last few days of December and, as I write this, has reached a two year high of 1.76% (which was pre-Covid). Corporate bond spreads surged in the fourth quarter, with the rise in market volatility and the spike in Covid infections but eased somewhat as the quarter ended.

PERFORMANCE COMMENTARY

Despite generally rising pressure on "big tech" for abuse of power, growth stocks, once again, led the US markets which, in turn, led those of the developed world. Canada, the UK and Mexico followed the US at a distance and Russia, Brazil, Argentina and China brought up the rear. The leading market sectors were Technology, Materials, REITS and Consumer Discretionary. The laggards were Communication Services, Financials, and Energy. I would note that its unusual to see Tech and Materials sharing top honors and for Energy and Materials to be at opposite ends of the spectrum but it was an odd quarter. While we have a very large Materials exposure, the lion's share is in precious metals which slightly lagged the S&P 500 and diluted the impact on our results. Our significant underweight in Tech was a material headwind.

While we had three big winners in the quarter: Fluor +55%, Pfizer +37% and Quest Diagnostics +19% stock selection on balance was negative. Its not that we had a lot of big losers; we just had too many modest laggards (up, but less than the market). Our two notable losers were Gap, -22% and Citigroup, -14%. Gap reported disappointing earnings and disclosed a supply chain issue that will affect the next several quarters. The announcement did not change our long-term view of the stock.

In terms of trading, it was another fairly normal quarter. I substantially reduced our exposure to Pfizer into its significant Q4 rally and trimmed ConocoPhillips and Mosaic, deploying the proceeds into Discovery, Baker Hughes, Gilead Sciences, NOV, Viatris, Pan American Silver and Barrick Gold. Through this process we increased our level of concentration in our best ideas, adding alpha potential to the portfolio.

OUTLOOK

The outlook has become more nuanced as we begin 2022 – with reasons for both optimism and caution. Each successive Covid variant has been more infectious but less virulent than its predecessor. This trend appears to have taken another major step with Omicron. If this proves to be the case, we could be nearer than recently thought to a more significant normalization of our lives and the pandemic economic impacts. That would be very good news. The present expectations are for 4% GDP and 4-6% corporate earnings growth for the year. On the other hand, the Fed has started to take away the punch bowl, much of the fiscal tailwind is gone and the economy is "laboring" with shortages and high costs for workers, goods and services. Being a traditionalist with respect to economic cycles (philosophically they are needed to clear away the mistakes of boom times and set the stage for another cycle of growth), I intuitively feel that a long-delayed recession is still waiting to be heard from. While the downturn in 2020 was indeed severe it was met with unimaginably large fiscal and monetary bailouts that deferred the recessional cleansing that I suspect we need.

The long-term issue remains high debt burdens – private and public. While the current bout of inflation may ease, with or without a recession, it also may not. I remain of the belief that elevated inflation and negative real interest rates will be the chosen strategy to address our debt issue. While politicians tend to think of this as the easy path (for themselves) it is not easy for the general public and tends to generate political fallout just the same.

Finally, I continue to be very excited about our portfolio. There are two distinct classes of stocks within the S&P 500 (at least) – one idolized and speculative (valuation) and the other overlooked and inexpensive. We are fully invested in the latter. That is not a prediction of great riches tomorrow but it is the basis for my optimism about our long term returns. As always, our path will be guided by our disciplined investment process. I appreciate your confidence and support and welcome any questions you may have.

Sincerely,

Robert W. Simmons, CFA
Principal