

April 12, 2024

Dear Friend of Valara Capital Management,

For the first quarter and three months ended March 31, 2024, Valara Partners, LP. produced returns, net of fees, of 1.76%, versus 10.56% for the S&P 500.

## **QUARTERLY REVIEW**

A review of first quarter headlines suggests that a great deal is going on, but not much is new. Sadly, our global conflicts are not improving, and we remain in the same, seemingly tenuous, holding pattern - with no perceptible progress on any of the important issues. January started off with concerns about a soft economy but enthusiasm for ebbing inflationary pressure. The Federal Reserve was expected to start cutting interest rates in March. Asset prices loved it, ignoring escalating geopolitical risk, a runaway fiscal deficit and chaotic domestic politics – the southern border and another possible government shutdown topping the list. Both the S&P 500 and the Nasdaq rallied to all-time highs. As mid-February rolled around, the economy was looking stronger and inflation statistics were ticking up; but, “a few data points are not a trend,” reassurance from the Fed kept markets ebullient. Beneath the surface, growth outperformed value through February, with the artificial intelligence trade being the primary driver. In March, inflation resurgence worries shifted performance back to value’s favor. The above noted “important issues” are all part of a bigger question – is the US losing the confidence of the rest of the world? Outside of the West’s echo chamber, the answer appears to be yes – but it is a process not an event. One suggestion that this may be so, was the dramatic rise in Bitcoin, gold and key strategic commodities – copper and oil most prominently. Of course, there are other possible explanations for this price action; but with gold, it is known that the demand has been largely driven by foreign central banks, in essence, as a dollar reserve substitute.

As the economic data strengthened in the quarter, the Federal Reserve grudgingly pushed back its anticipated initiation of interest rate cuts. By the time the quarter ended it had become a second half event, possibly even 2025. Naturally, interest rates rose steadily as this played out, with the ten-year treasury yield above 4.2% at the end of March. Rising interest rates are not good news for most asset markets, but especially not for commercial real estate, which continues to struggle with occupancy and default. They also keep pressure on the banks’ security portfolios and deposit funding. New York Community Bank was downgraded by Moody’s and narrowly avoided failure by successfully raising capital in March. The Fed understandably wishes to be able to declare victory over inflation because it has other issues to address, including how to manage its balance sheet as the Treasury floods the market with new debt. They need a soft landing. Anything worse would see deficits expand rapidly as tax revenues fade.

Fourth quarter corporate earnings were well ahead of estimates, largely because of better-than-expected profit margins. Revenue growth was uninspiring. The magnificent seven performers of 2023 began to break up in Q1, with Apple and Tesla dropping out of the pack.

## **PERFORMANCE COMMENTARY**

Russell 1000 Growth (+11.41%) and the S&P 500 (+10.56%) outperformed the Russell 1000 Value (+8.99%) in the quarter, but not by much. The month of March saw value regain some ground, otherwise it would have been worse. For once in a long while, Technology was not the leading sector. The top three sectors were Energy, Communication Services and Financials. The laggards were Real Estate, Gold Mining (not really a sector but important to Valara) and Consumer Discretionary. Our sector weighting was a modest negative, with our overweight in Energy partially offsetting our overweight in Mining. Mega-cap stocks outperformed merely large-cap ones, which was an additional contributor to our lagging result. The bulk of our underperformance was attributed to stock selection. As happens from time to time, we had a handful of companies that were decidedly unpopular. These included Warner Brothers Discovery, Pan American Silver and Gilead, amongst others. They all suffered lackluster, but not thesis changing, quarters, and were shunned in a heavily momentum driven market.

Our trading activity picked up modestly but remained below normal, as I have found it challenging to improve on our existing portfolio. We sold our remaining position in Ralph Lauren above \$180 per share (an unpretentious home run for us) for a 127% gain. In addition, we trimmed our positions in Pan American Silver, TechnipFMC, Fidelity National Information Services and Fluor. The proceeds from these sales were redeployed into Mosaic, Warner Brothers Discovery, Newmont and Barrick Gold. All of these trades were done to enhance future return potential and/or manage perceived risk – basic blocking and tackling.

## OUTLOOK

As I write this, the outlook for economic and earnings growth are modest (GDP, 2.5%) and strong (EPS, high single digits), respectively. While I have no immediate argument with the consensus, I believe that the backdrop remains tilted toward an eventual recession. To defeat inflation the Fed needs to slow the economy. With all the potential issues in our closet, from over a decade of zero interest rates, it will be a delicate task to slow GDP growth without revealing past mistakes. Mistakes like the mismanagement of interest rate risk that caused last year’s bank failures. Alternatively, if the economy does not slow, inflation picks up and interest rates aren’t cut, or are moved yet higher, the chance of recession increases. I expect it is going to be challenging to conjure up the Goldilocks outcome that the market seems so confident will occur. That said, I must admit that “so far so good” – hat tip to Jerome Powell and the US fiscal juggernaut.

My suspicion is that inflation drifts higher with rising oil prices and an illiquid housing market. In such case, the Fed is likely to talk reassuringly about future cuts but endlessly delay them. In the meantime, I expect the Treasury market to struggle enough with new issuance that the Fed stops selling their holdings (shrinking their balance sheet). God forbid they have to start buying them again. That would not be good for global confidence in the US.

The views expressed above, while tangentially relevant, are not central to how we invest. Yes, it is important to have an opinion on where you are in the economic cycle, and what macro risks are most pronounced. That said, the core discipline of our strategy is to identify opportunities to buy shares of companies when they are materially mispriced (cheap) relative to the broader market. Frequently that is because they are cyclically sensitive, and the general expectation is that a downturn is coming. In that sense we buy “straw hats in winter.” More broadly, we seek out shares of companies that are misunderstood, for any reason, such that they become cheap. It is important to grasp that a lower share price only makes a stock cheaper if the inherent value of the company is not declining too. Once we take a position, we track the company’s progress and adjust our assessment as needed. It is a long-term, patient strategy – i.e. investing as opposed to trading.

From that perspective things continue to look extremely good. We have a promising portfolio, full of outperformance potential. As always, I appreciate your continued confidence and support. I encourage you to call or email with any questions you may have.

Sincerely,



Robert W. Simmons, CFA  
Managing Member