

July 10, 2024

Dear Friend of Valara Capital Management,

For the second quarter and six months ended June 30, 2024, Valara Partners, LP. produced returns, net of fees, of 0.26% and 2.03%, versus 4.28% and 15.29% for the S&P 500, respectively.

QUARTERLY REVIEW

The US economy and markets continued to perform well in the second quarter. First quarter GDP expanded by 1.4% and it appears likely we will see a similar result in Q2. This is a notable slowing from the pace in 2023, but, in light of certain headwinds (more below), a respectable result. Inflation has stabilized but remains above target. US stocks performed better still, as technology, led by mega-cap AI darlings, reasserted its recent dominance. While the Fed continued to shrink its balance sheet, and pushed back expectations for rate cuts, the public and private markets remained enthusiastic and accommodating on terms, as indicated by the Chicago Fed's Financial Conditions Index. The equity and fixed income markets are still hopeful that the Fed will cut – now expected in September. A handful of the Fed's global peers have already made the move (Canada, the EU, Switzerland, Mexico...), hinting that the world is entering an easing trend. The Japanese must be particularly relieved as they sat out essentially all of the tightening cycle and their currency has lately been in free fall. One is inclined to wonder if their extreme experimentation with quantitative easing is in the process of melting down spectacularly.

Gold surprised everyone by decisively breaking its historic relationship (inverse) with real interest rates in the quarter. It would appear noteworthy that it did so – possibly portending a change in the prevailing winds. That said, gold is a tricky thing to interpret because it is such a political hot potato. The US dollar is the global reserve standard, and the US Treasury does not appreciate being challenged. Our global allies (that rely on US protection) recognize that it is considered good form (by us) to hold reserves in US Treasuries. The ability to print money, that the reserve currency conveys, allows us the financial wherewithal to fund our military/protect our friends – but only to the limits of credibility. Central bank gold purchases suggest that our allies' confidence is ebbing, and that gold may finally be regaining some stature as a reserve asset/wealth preservation tool. One can hardly blame them for their interest, as the CBO (Congressional Budget Office) just increased its estimate for the 2024 US budget deficit from \$1.5 to \$1.9 trillion. Accounting for off budget items, US debt growth will comfortably exceed \$2 trillion.

That leaves the geopolitical realm. As hard as it is to believe, last week the US presidential election (debate aftermath) upstaged both Ukraine and Israel. After years of glossing over it, the media was forced to confront President Biden's diminished cognitive ability. Everyone, if they are lucky, gets old, but Presidents have profound responsibilities. It now appears that the Democrats are going to try and replace Biden at this late stage in the campaign, with the administration as much as saying "over his dead body." What a mess. I am certainly not the arbiter, but our country needs adept leadership on some pressing and nuanced problems which will call for inclusive and frank discussion, deliberation and diplomacy. See above, for the ebbing confidence in the US dollar. Globally, the confrontation between the West (not just Ukraine) and Russia and Israel and the Arab world have settled in for what appears to be the long haul.

PERFORMANCE COMMENTARY

Growth, technology stocks in particular, led the market returns. Once again, the drivers of upside were heavily concentrated in a handful of mega-cap names. Four stocks, Nvidia, Apple and Microsoft and Alphabet, accounted for essentially all of the S&P 500's return in the quarter. The Russel 1000 Growth was up 8.15% (price only) and the Russell 1000 Value fell by 2.59%. While there is nothing to gain in saying it (because no one knows) – this looks like a blowoff top for growth, if only because everyone seems so confident it isn't. Global stock markets mostly lagged the S&P 500.

Other than Technology, the leading sectors were Gold Miners (a component of materials, but important to us) and Communications Services. All other sectors lagged the S&P. The biggest laggards were Materials, Energy and Industrials. Our significant exposure to the gold stocks helped but was more than offset by our overweight in Energy and underweight in Technology. Our stock selection was neutral, with big winners (Kinross Gold, +36%, Pan American Silver, +32% and Newmont, +17%) and big losers (Franklin Resources, -20%, Warner Brothers Discovery, -15% and Mosaic, -13%).

Our trading in the quarter was limited to trimming Fidelity National Information Services and TechnipFMC into strength and redeploying the proceeds into Warner Brothers Discovery and Mosaic.

OUTLOOK

The economic downshift experienced in the first half of 2024 comes with a plausible backstory. As we ended 2023, most, if not all, of the Covid 19 consumer windfall (rent/student loan moratoriums, etc.) had ended, the benefit payments spent, the consumer relevered and inflation was cutting into discretionary income. Interest rates, which take time to filter through the economy, were starting to have an impact and the year-over-year increase in fiscal spending was slowing. With that, it is not surprising that consumer spending slowed also. I believe that the bulk of the impact of higher interest rates is still ahead of us. The possible offset is the continued munificence of the credit and equity markets (primarily into the AI related boom). Unless one of these variables changes, I expect to see the economy move forward at a moderate pace or slow into stall speed (economic concept that if growth slows below 1% economic participants become risk adverse resulting in recession). In the latter instance I would anticipate the Fed to react promptly and follow their global peers by easing. The big question remains: “how will the US Treasury market respond?” Everyone seems to think it will be positive. I hope so but am not sure of it.

I would like to remind our partners that, despite headlines that over-simplify it, there is not really one “stock market.” The market is a collection of stocks with different attributes (growth, return on investment, risk) grouped into various indices through various methodologies. The indices are meant to provide broad representations of what is going on. Sometimes they do a good job at this, but sometimes not so good. As I noted earlier, Nvidia, Apple, Microsoft and Alphabet accounted for all of the S&P 500’s Q2 advance. In this case, they are all large weights (top 10) in the S&P 500. When a handful of stocks that dominate the index materially lead the market it gives the impression that everything is rising. However, the fact that these four stocks account for the quarter’s entire return means that everything else, combined, produced a net zero. It has been, and remains, my assertion that while AI stocks are generating a great deal of speculative interest, on average, there are better opportunities elsewhere. Considerably better. With all the enthusiasm and rising stock prices it is hard to remember that what you pay means everything in investing. That is the core premise of any value strategy.

In other words, we are sticking to our discipline; and, despite sounding like a bore, I remain excited about our outperformance prospects. As always, I appreciate your support and interest and am available to answer any questions you may have.

Sincerely,



Robert W. Simmons, CFA
Managing Member