Valara
Capital Management, LLC

October 9, 2020

Dear Friend of Valara Capital Management,

For the third quarter and nine months ended September 30, 2020, Valara Partners, LP. produced total returns, net of fees, of 3.66% and 3.45%, versus 8.93% and 5.57% for the S&P 500 index, respectively. Aside from Energy, our stock selection and sector weighting were favorable, yet, we continued to suffer for our value focus and our underweight of large-cap technology.

QUARTERLY REVIEW

The George Floyd inspired protests/riots died down over the summer, but the underlying tensions remain. The economy continued to recover from the Spring closure but seems to be losing some momentum as bailout largess fades. Jobs have rebounded but are nowhere near their pre-pandemic levels. Covid-19 was brought under control in early hotspots in the US and Europe only to bloom in Florida, Texas, California and Arizona on its way back to Europe, the upper Mid-Western states, and who knows where next. The duration of this health crisis has begun to sink in and exhaust communities trying to go back to work, worship and school. The headlines do suggest that a vaccine may be forthcoming in the months ahead, with progress being made at several companies, while treatment options continue to improve. In the background, trade frictions with China are still simmering and the US election is just four weeks ahead. Both sides seem to be reassuring themselves that it will all work out as they wish. One way or the other roughly half the country is going to be severely disappointed. The US Federal Reserve, while having tempered their activities over the summer, continues to speak dovishly and urge the Federal Government to act with more fiscal support. Markets have become extremely emboldened, apparently confident that the issues, above, are behind us, courtesy of the economic authorities. I hope that is correct but see little evidence of any real progress on the actual issues. The sign that we have turned the corner will be a meaningful contraction of total US debt to GDP (instead of plateauing between major crises), while the economy expands with rising productivity and labor share of GDP. It will be extremely important that any solution strengthens the wealth generating ability of the economy and is not merely a redistribution, as is today's vogue. Highly productive people have historically flocked to the US because they can reap the rewards of their efforts. They can leave just as easily. Defending property rights, the returns to innovation, hard work and sacrifice cannot be overemphasized. I do not know a single poor society that prioritizes the environment – they are usually too busy trying not to go hungry.

Equities remained strong – particularly the more established markets. India, Korea and China led, followed by the US, Germany and Japan. In the US, growth stocks continued their dominance, leading value by more than 8% in the quarter (Russell Indices). For those not used to looking at things this way, I will note that these are historically unusual variances in performance. For the nine months ended September 30, 2020, Growth has outperformed Value by more than 35%. There continues to be a strong preference for perceived competitive advantage, balance sheet quality and cash flow stability. US Treasury bond yields, while at the top of their recent range at quarter end, have basically traded sideways for the last six months as corporate bond spreads (to Treasuries) continued to inch lower. While Technology performed well, it was only the fifth strongest sector, behind Transportation, Consumer Discretionary, Materials, and Industrials. Growth's dominance was more of function of a small group of large stocks dominating the results. Apple, Amazon, Facebook, Tesla and Nvidia added a combined 7.35% to the Russell Growth Index, alone. At some point these stocks will reach prices that give buyers pause but, apparently, not yet.

PERFORMANCE COMMENTARY

The narrow nature of the market this quarter made it tough to keep up with – not just for Valara but for all active managers. Our Materials sector overweight helped but our energy overweight (weakest sector in the quarter) was a significant drag. Our stock selection and weighting were positive but not enough to keep up with the strong moves in the big five stocks, mentioned above. The portfolio's five strongest positions were: Mosaic +46%, Gap +35%, Quanta Services, +35%, Agnico Eagle Mines, +25% and Kinross Gold, +22%. Of these, you will remember that Agnico Eagle Mines, Kinross Gold and Mosaic were all on our top ten positions list at the end of Q2 2020. The factor that tipped the balance to the downside was our handful of disappointments: Murphy Oil, -35%, Fluor -27%, National Oilwell Varco -26% and ConocoPhillips -22%. Note that all but one of these are Energy companies that got caught in the sector's downdraft. Importantly, none of these stocks are among our largest positions nor did any encounter issues that would threaten our long-term thesis for owning them.

Our trading activity for the third quarter quieted down significantly. I have been cautious in vetting new additions to the portfolio in light of the still uncertain backdrop. As surprising as it may sound, it is not all that easy to find balance sheets with abundant (conservative) tangible equity after so many years of merger and share repurchase activity. Why the focus on tangible equity? Simply because with so many business trends in flux the values placed on acquired intangibles assets (customer lists, brand value, for example) are increasingly proving too optimistic. This issue has been a large part of GE's balance sheet troubles (see Altsom acquisition). In the third quarter, we added to our positions in AIG, BorgWarner, ConocoPhillips, Discovery, Mohawk, Mosaic, National Oilwell Varco, Ralph Lauren and Textron. In turn, we trimmed our positions in Pan American Silver and Wheaton Precious Metals into strength and eliminated our positions in Capital One Financial and Intel – in both cases on concern that fundamentals were drifting from our investment thesis.

OUTLOOK

Of course, the outlook is always the hard part. These days it is made somewhat more challenging because of the extreme involvement of governmental bodies. We have reached this point through an evolutionary process. The late 1980's banking crisis was the last time that the Fed and the Treasury collaborated to support a quasi-capitalistic resolution to an economic crisis/market imbalance. By this I mean they seized bankrupt banks, put them in receivership and liquidated the non-performing assets at the industry's expense (through the FDIC). Shareholders were wiped out, bond holders took losses and the criminal element went to jail, but the operating entities survived, usually as part of another bank. Jobs were lost but not as many as one might expect and they were jobs that never should have been created in the first place and were destined to disappear. Ever since this time, the crisis play book has morphed in the direction of socializing losses – making taxpayers (directly) and savers (through artificially low interest rates) pay the bill rather than those who willingly assumed the busines risk and its potential reward. The 2000 tech stock bubble was too large to ignore, so the Fed rescued reckless investors by cutting rates to new record lows, blowing another bubble/crisis in housing and stocks which burst in 2008. Having learned nothing, they did it again over the last 12 years only to be confronted with Covid-19 as their "whatever it takes", QE, experimental strategy was failing with the economy slowing down. It is no surprise that we are now on round three, with Government debt stacking up around our ears and interest rates at zero. The lesson of the past 20-30 years is that this can go on for a while – or at least until it can't (which is tough to predict). It is hard to be optimistic that any politician is going to voluntarily break the cycle. They tell you that they have no choice and that it is for the common good but how is that working out for us? Look around.

While this is frustrating to watch, because the ultimate resolution is uncertain and likely to be challenging, the task of daily investing goes on. Here there is some genuinely good news. As previously noted, the market is as unusually polarized today as is US politics. On the one hand you must pay 70x earnings for a share of Amazon and on the other you can buy Discovery, AIG, Mylan or Gilead for less than 10x. I think Amazon is a great company but, in investing, the price you pay matters. I am very comfortable that Valara's portfolio of strong companies at less than

10x earnings will produce good results over time. I cannot say as much for the top five tech companies because their stocks are so expensive.

Where the economy and markets go from here, in the months directly ahead, will reflect the path of Covid-19, the upcoming election and related fall out and, of course, Federal Reserve and Treasury actions. The elevated level of/and reliance on debt keeps me cautious on the economy in the intermediate and longer term. As always, Valara will meet the future with the consistent application of our investment process and I remain optimistic that results will follow. As always, I appreciate your support and welcome your questions or concerns.

Sincerely,

Robert W. Simmons, CFA
Principal