Valara
Capital Management, LLC

October 7, 2021

Dear Friend of Valara Capital Management,

For the third quarter and nine months ended September 30, 2021, Valara Partners, LP. produced returns, net of fees, of -5.10% and 12.36%, versus 0.58% and 15.92% for the S&P 500, respectively. Value stocks lagged growth in a quarter that saw a number of surges back and forth between the two styles - a little more color on this below.

QUARTERLY REVIEW

Corporate fundamentals have remained a key bright spot for markets. Second quarter earnings were better than expected and the outlook for the third quarter was raised. The global economy continues to recover but with an apparent loss of momentum. Much of this could be attributed to Delta variant concerns and cautious measures taken to mitigate infections. Pandemic related government support has also been withdrawn, for the jobless and renters, and will be a factor going forward. The non-farm payrolls report for July was very strong but August was disappointing. In the meantime, inflation remains a hot topic. While the Federal Reserve continues to express the view that it will prove transitory, they admit to being at a loss with regards to the supply chain issues that are ongoing, and in some cases getting worse. One CEO (who was not alone) made headlines in August saying that cost pressures are unprecedented and coming faster than they can pass it along to the consumer – we haven't heard that for decades. Usually, this type of statement is an intentional hint that margin compression is coming but so far there have been no specific warnings. China is cracking down on their lending and technology sectors amidst evidence that their economy is slowing. Evergrande, China's largest builder filed, for bankruptcy during the quarter after the Chinese authorities declined to bail them out. Global politics continue to be a mess. Relations between China and Taiwan are increasingly strained, relations with US are not much better, the withdrawal from Afghanistan was extremely poorly handled giving rise to concerns about our vulnerability to domestic terrorism and there are ten thousand immigrants stacked up at one town on the Mexican border hoping for entry with 400,000 expected (along the southern border) in the next month. Back in Washington, Congress is tied up trying to address the debt limit law that will require the Federal Government to shut down if it is not revised or pushed off into the future, as has been done in the past. When they get past that they can resume discussion on spending an additional $4.5 trillion on physical and human infrastructure and how that will be funded. One idea that hit the press is that the government could just mint a single platinum coin with a face value of $1 trillion (platinum value of $1000?) and sell it to the Fed for cash. After a former head of the US Mint (Clinton era) commented that the coin could be produced in a few hours, Janet Yellen the secretary of the Treasury was asked publicly if this was a viable plan. Thankfully she dismissed it as a "gimmick" but the fact that the proposal was received seriously by anyone, was surprising.

US equity markets took their cue from earnings and low interest rates and eked out a small gain. Other global market returns were distributed around the breakeven level with India, Russia and Argentina being the strongest and Korea, China and Brazil the weakest. In the US, growth led value but there were two rotations back and forth between styles in the quarter. This kind of indecision is not unprecedented but worth noting. There is an underlying contest for leadership that is ongoing. The US bond market topped out in early August when interest rates began to back up. The ten-year treasury yield rose 30 basis points from its lows as concerns about inflation and US Government financial disfunction reasserted themselves. Corporate bond spreads (to treasuries) were stable, near record lows.

PERFORMANCE COMMENTARY

From a sector performance perspective, the variances between groups were narrower than usual. The leading sectors were Financials, Technology and Healthcare – with Financials (the strongest group) up 2.29%. Our overweight in financials helped. The weakest sectors were Transportation, Industrials, Materials and Energy. Transportation (the weakest group) was down 6.45%. With the exception of Financials, the leading groups favored growth. Overall, sector weighting was a detractor from Valara's performance.

In terms of individual stock selection our results were mixed. We had plenty of winners including Quanta Services +28%, AIG +15%, Mosaic +12% and ConocoPhillips +10%, but we had a handful of big laggards as well. These include GAP Stores -33%, Pan American Silver -19% and Discovery -17%, among others. To be fair to our underperformers, they had all been substantial contributors in recent quarters and I expect them be so again in the future. The net result of stock selection was slightly negative for the quarter.

Our trading activity in the quarter was fairly normal and reflected our fully invested position in individual stocks. Our ongoing activity will be a function of movement in stock prices and/or changes to our investment thesis. In the period, we sold out of our last remaining position in Quanta Services as it reached our target price, while we reduced our position in Pfizer into its rally to $50 per share. We invested the proceeds of these sales in Discovery, Gilead, Viatris and Pan American Silver – all on weakness. Discovery has essentially round tripped from its incredible rally in the first quarter. I remain very enthusiastic about the company's prospects and it is once more one of our larger positions.

OUTLOOK

In the past few weeks the Federal Reserve has suggested that it may start tapering its purchase of bonds as early as November. While this is sooner than commonly thought six months ago, the Fed needs to find a window to transition away from its present accommodative stance. There is already a risk that they are moving too late. As previously noted, the economy is looking less robust than anticipated, the Treasury has just withdrawn a lot of fiscal support, China's economy looks weak and inflation is dragging on consumers like a tax. If things don't go right the Fed may find the window closing on them and the stimulus will continue. Assuming things go well, the economy and markets are strong and inflation persistent, they will proceed with their "tapering" of bond purchases. Once the Fed begins the process of normalization, we will see how much withdrawal of stimulus the markets and economy can stand. The problem we have is extremely high indebtedness at all levels of the system – private, public and individual. Higher interest rates and/or less robust income/employment will become a challenge sooner than it otherwise would. If/when that happens its back to the drawing board for the Fed and the Treasury – more accommodation. What we really need is for Congress to cut red tape, simplify regulation and reduce the costs to business and let private enterprise thrive. That does not seem the mindset at the present time.

The above is now an established pattern for at least the last three cycles. I believe we are going down the same path, but, as always, I will be watchful for reasons to change my mind. Even if the path is the same this time, I do not pretend to know how long any of the above will take. I have said in past letters that, ultimately, I expect investors to move away from the US dollar forcing the Fed to change tactics. There is no sign of that yet.

The above might give the impression that investing is only about central banks and governments – it clearly is not. Valara LP. has a portfolio of investments, purchased at attractive prices, that are positioned to prosper because they provide good products that people need and are well positioned to compete in their respective industries. By sticking to our disciplined investment process, I am confident Valara will produce strong results over cycles. Thank you for your continued confidence.

Sincerely,

Robert W. Simmons, CFA, Principal