Valara
Capital Management, LLC

October 11, 2024

Dear Friend of Valara Capital Management,

For the third quarter and nine months ended September 30, 2024, Valara Partners, LP. produced returns, net of fees, of 9.12% and 11.33%, versus 5.89% and 22.08% for the S&P 500, respectively.

QUARTERLY REVIEW

Second quarter US GDP growth came in at 3.0%, better than the 2.0% originally anticipated. Under the surface the statistics were less convincing. While jobs and unemployment beat expectations, the Bureau of Labor Statistics revised the number of jobs created over the last year (March 2023-March 2024) lower by 818,000. With revisions that large, Bloomberg (and others) called out BLS credibility. It would appear that the BLS is a serial jobs over-estimator (14 out of the last 20 months revised down). Other statistics like retail sales, consumer and business confidence remain subdued and growth in consumer and government debt is the leading explanation for continued economic strength. Unfortunately, that hardly seems sustainable. Despite better-than-expected current growth and markets at all-time highs, the Federal Reserve proceeded to cut interest rates by 50 basis points at their September meeting. Earlier in the quarter, at a Central Banking Conference in Portugal, Jay Powell, again, expressed alarm at the growth in Federal borrowing. The US Federal debt increased $2.3 trillion for fiscal 2024, with FEMA running out of money for storm relief and the Strategic Petroleum Reserve yet to be refilled. A final hint that the reported GDP growth may not be as good as it looks comes from our trading partners – Japan, China and Mexico. All three countries derive a significant percentage of their GDP from exports to the US and all three have expressed caution, verbally and with their policy choices, over the last few months.

Gold remained remarkably well bid during the quarter, generally a reflection of geopolitical uncertainty. Many of the brokers have been raising their price targets as they increasingly concede that demand is being driven by central banks – a reversal of a multi-decade trend of dishoarding. Poland officially announced that they have accumulated a position larger than that of the UK, historically a benchmark holder (Gordon Brown sold half of Britain's gold for under $300 an ounce in the early 2000s). Poland's logic was that it added significantly to the credibility of their reserve position – politely leaving out "it's better than the US dollar." The decision in 2022 to penalize Russia, by seizing their US dollar reserves, was one of the worst the US has ever made. While an unwelcome surprise to Putin, it was a warning to all our creditors that the dollar has political risk. With the rise in the gold price since March, it appears overdue for a correction, possibly of some magnitude. That said, current interest rate swap-spreads suggest that the bond market remains wary regarding the return of inflation. Over the longer term, the price of gold will be a function of its cost of production, as influenced by how much global currencies are devalued by poor policy/management.

US politics continue to make major headlines. The only other president to be the target of two assassination attempts was Gerald Ford. I don't remember him being that controversial. While Trump is certainly polarizing, it was a "Wild West," "guns blazing," summer. Joe Biden did in fact step down as the presumptive Democrat candidate, yet oddly not as President. I believe the experts are correct that it's not illegal for Harris to take over, which happened by delegate vote at the Democratic Convention, but it is awkward. Nobody explicitly voted for her and there appears to be some lingering dissent. It is hard to imagine either side being happy about whatever outcome occurs on November 5th - or after the weeks/months it takes to sort it out. The political backdrop remains worrisome.

PERFORMANCE COMMENTARY

Value led the US indices, for a change, rising 9.43%, with the S&P 500 and Russell Growth lagging at 5.89% and 3.19%, respectively. The leading sectors were Utilities, Gold Miners (not a sector but important to us), Real Estate, Industrials and Financials. The laggards were Energy, Technology and Transportation. The favorable impact of our overweight in gold miners and underweight in Technology was somewhat offset by our overweighting in Energy. On balance our sector weighting was a clear positive. Our stock selection was also favorable with Mohawk up 41%, Newmont up 28%, Agnico Eagle up 23%, Gilead up 22%, and another eight stocks up double-digit percentages. Our two biggest laggards were in Energy – NOV and Murphy. Other notably weak names were Franklin Resources and Mosaic. Our trading in the quarter was very light. We trimmed Fidelity National Information Services as it rallied and invested the proceeds in Mosaic.

OUTLOOK

The US economy is still a question mark. The data is mixed and, in some cases, suspect (quality). Oil, copper and steel (hard commodities) surged in reaction to China's announced economic stimulus, but their plan is already being questioned by the market (as inadequate). Aside from that surge, industrial commodities prices have generally been subdued. As noted earlier, all our largest trading partners are cautious, implying some doubt about our growth. One of my favorite, under the radar, statistics, US Government Receipts (basically tax collections), has been flat for two years, despite what must be very strong capital gains revenues. The growth we have experienced has surely benefited from record debt issuance and heavy spending on AI infrastructure. It is questionable whether the pace of either is sustainable. AI is a possible game changer but so far it has followed a typical path – over promising and under delivering. I am watching it closely; meanwhile, my Microsoft software still can't find my new printer when it is hard cabled to my PC and/or it can't find the driver online and get it to print. One will know that AI is moving to the next level when basic tasks such as this are seamless. My outlook for GDP remains the same – low single digit growth with the risk of slowing into a recession.

I have repeatedly written about my concerns regarding US budget deficits and their long-term consequences. Last quarter I openly wondered how the bond market might react to any future rate cuts. The concern continues to be whether at some point our creditors balk at our fiscal irresponsibility. If they do it would likely be reflected in rising longer-dated bond yields as short-term yields were cut. The Fed announced their 50 basis point reduction on September 18, when the ten year treasury yield was 3.70%, and it has risen 35+ basis points as of today. While that is not exactly a rebellion, and there are other explanatory factors, it is not what you hope for either. One possible interpretation is that patience is wearing thin. Regardless of who wins the Presidency, it is going to be an enormous challenge to right our fiscal ship.

Finally, I want to reiterate that value stocks, by nature of their shorter duration, should outperform in a weak bond market. This is simply a function of the math of discounted cash flows. Valara's portfolio does have exposure to economic cyclicality, but I have been careful to emphasize strong financial positions and/or sustainable cash generation. While that may or may not matter in the short run it should matter with time. Most importantly, the companies we own are cheap to perceived future fundamentals. If things play out more favorably with interest rates, all the better. One way or another, I expect the valuation gulf reflected in our portfolio to close – in other words, that we outperform. We will pursue this outcome by sticking to our discipline, as always. Thank you for your continued confidence and support. Please call or email me with any questions or concerns.

Sincerely,

Robert W. Simmons, CFA
Managing Member