Valara Capital Management, LLC

January 14, 2025

Dear Friend of Valara Capital Management,

For the fourth quarter and twelve months ended December 31, 2024, Valara Partners, LP. produced returns, net of fees, of -2.90 % and 8.10%, versus 2.41% and 25.02% for the S&P 500, respectively. For perspective, the returns on the equal weighted S&P 500, for the fourth quarter and full year, were -1.87% and 13.01%, respectively. It continues to be a large-cap growth market.

QUARTERLY REVIEW

The US economy perked up a little in the fourth quarter, as did pockets around the globe – the EU and Japan most notably. It was nothing dramatic, but included improvements in consumer and business sentiment, holiday spending and the broader job market. A bit ominously, it was enabled by a continued increase in revolving credit card balances – the most expensive category of consumer debt. There were also upticks in the rate of consumer and business inflation.

Easily the most impactful event in the quarter was the US Presidential election. The market's immediate reaction to Trump's victory was very positive, which probably had a lot to do with the fact that the result was clear and uncontested. Markets hate uncertainty. In the weeks after the election, the markets continued to rally. Concerns regarding tariffs and retribution were overwhelmed by hope for greater focus on business, economic competitiveness and fiscal discipline. It will be interesting to see how the issue of tariffs is resolved. As a degreed economist, I am generally of the "free trade" school. That said, in the real world you can't have fair/sustainable free trade without a common global social/environmental/regulatory contract. Sweatshops with forced and child labor are a competitive advantage (but social atrocity) to any business that utilizes them – Apple and Nike, for example. Businesses are created to maximize profits in any legal way that they can, so they go where the labor is the cheapest. Tariffs are a controversial solution. Since business has a very strong incentive to get around them, it tends to find a way (see the Russian sanctions). If tariffs do work, the result is higher cost of associated goods for all, better jobs for some and, hopefully, improved intangibles (national security, social balance, etc.). A better answer would be global labor, environmental and regulatory standards. That is a pipe dream at the moment, but you never know where this goes.

It was disappointing to find that Trump has no better grasp of the requirements for the reserve currency than Biden did. He seems to think that you can threaten your way to success – demanding the BRICS show total commitment to the USD or face 100% tariffs. Hopefully this is a political statement (for the home crowd), nevertheless, it shows ignorance and weakness. The only reason the US dollar has been "king" is that it gained the world's respect by minding the fundamentals. Neither people nor currencies are given respect. Curtesy is given, respect is always earned. Always. That said, I don't think an important role for the dollar, in global trade, is going away anytime soon. The role of US Treasuries as reserves is a different story – it's already fading and only a prompt return to fundamentals can stop it.

On a related note, US Treasury bond term-premia rose significantly in the quarter – buttressing my concern that excessive Treasury issuance is becoming a critical issue. The T-bond term-premium is the extra yield that the market demands for buying longer maturities. It rises as the market incrementally loses confidence in the management of government finances/inflation or general government stability – anything that increases uncertainty surrounding the present value of a bond's future payments. The rise in longer-term yields (2-30 year) as the Fed cut its funds target is a sign that the market is worried about a return of inflation. As the Fed cut short rates by 100 basis points, the yield on the ten-year treasury rose by 100 basis points. The warnings are getting louder.

The geopolitical backdrop is still a mess. It remains a critical factor, but the world is waiting to see what happens when Trump takes office.

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PERFORMANCE COMMENTARY

Large cap growth led the equity markets for the quarter. While the magnificent seven accounted for more than all of the return for the S&P 500, it wasn't just Technology that worked. The leading sectors were actually Consumer Discretionary, Communications Services and Financials. Materials, Health Care and Real Estate were the laggards. At the risk of over simplifying, it was a relief rally quarter. As the Fed embarked on its rate cutting cycle (September), the prospect of lower rates, and optimism regarding a soft landing, drove the themes in the period. Gold, which typically would benefit from declining interest rates, consolidated (held) its significant gains but the mining stocks reported mixed quarterly earnings, burdened by rising labor costs, and their share prices declined. Our top three performing stocks were Warner Brothers Discovery, Baker Hughes and Citigroup. Our laggards were Newmont, Mohawk and Barrick Gold.

In the quarter we reduced our positions in Newmont (before it sold off), Fidelity National Info Services and Fluor Corp - all into strength and in accordance with our risk/return parameters. We reinvested the proceeds from these sales into Amgen, Viatris, Mosaic and Warner Brothers Discovery. The net effect was an improvement in portfolio expected return. Our portfolio turnover continues to be extraordinarily low. We continue to favor the positions that we have established and we don't trade unless we can improve our risk adjusted outlook.

OUTLOOK

Despite the slight improvement in the fourth quarter, I believe that we are late in an economic cycle that is being sustained by fiscal largess, AI spending and "irrationally exuberant" markets (classic Alan Greenspan). We have a low savings rate, high leverage (private, corporate and government debt), cautious consumer/business sentiment and unstable interest rates as we try to refinance or borrow yet more. At some point an imbalance or shock will come along and tip the economy and/or markets down. Fed and Treasury micro-management, along with improved technology, has extended cycles, but not repealed them. The kind of market behavior we have seen, in particular the headlong rush to build AI capacity (arms race), typically sets the table for an unwelcome rationalization. The extreme valuations of mega-cap stocks and low credit spreads (corporate bonds) will magnify the reaction in markets. When a risk-off environment comes, it is likely that the financial authorities will double-down on plan A – cut interest rates and flood the economy with liquidity - to minimize the damage. If the bond market is cautious now, it will only get more so after that. With no imminent disruption visible, the easy and safe prediction is to declare "all clear, steady as we go." For the immediate term that may well be right – things can go on for longer than one thinks. However, the vulnerabilities, high leverage and complacent valuations, suggest that the risk of disruption is elevated. Any progress that Trump can make in reducing our annual budget deficit, without causing a recession or degrading corporate profitability, would be helpful.

Meanwhile, our portfolio is "steady as she goes." I remain confident in our positions and their potential to outperform over the market cycle. In today's intensely competitive market environment, our greatest advantage is the willingness/discipline to be assiduously patient. As the market chases immediate returns (trading) we look for the long term misvaluations that result (investing). It is my belief that these are significant and that identifying them and diligently monitoring their progress will be a rewarding strategy. As always, I appreciate your steadfast support and welcome any questions you may have.

Sincerely,

Robert W. Simmons, CFA
Managing Member