April 21, 2021

If something can't go on forever, it will stop.

Herbert Stein, Chairman of the Council of Economic Advisors to Presidents Nixon and Ford

Dear Fellow Investor,

I am pleased to report—in case you did not notice—that the bull market in stocks continued in the first quarter of 2021 despite the chaos, induced by a global pandemic and the accompanying economic disruption, a summer of rioting in American cities over racial injustice, and an unusually bitter general election, in 2020. Last year was uniquely tough and, the aftermath, unfolding today, fraught with uncertainties. But it was a good time to be invested in U.S. equities.

The same is true of the first quarter of this year. The Standard & Poor's 500 Index returned 5.77% (6.15% with reinvested dividends) in Q1 2021.

The first quarter of 2021 was also a good time to be a client of Weybosset Research and Management LLC (WRM), as the accounts for which we are responsible generally outperformed the benchmark by a respectable margin.

The first quarter saw the continuation of a bull market that began, depending on how you measure it, either in March 2009 or March 2020. But beneath the surface, a significant and long-anticipated change may be taking place, and that is the shift in market leadership from so-called growth stocks to value stocks. (My partner Justin Deutsch alludes to the change in his message to you this quarter.)

As Justin says, Wall Street likes to take complicated things, like the workings of any given business, and simplify them so that they may be packaged and sold more easily to people like you, Fellow Investor. The growth/value dichotomy is one such example.

According to this paradigm, there are companies making and selling new products or services that transform ("disrupt") the world, resulting in sharply growing revenues and earnings for these companies, enriching their owners. These are the growth companies. Their stocks tend to be expensive by traditional valuation methods because buyers are willing to pay up for *future* earnings. How much buyers are willing to pay up is a function of 1) the level of interest rates—a whole separate topic, and one highly pertinent to current circumstances, but too convoluted for the present presentation; and 2) how optimistic buyers are feeling about the future.

Then there is just about everyone else, companies that may drill for oil, may write insurance, may sell groceries, etc. The stocks of these businesses fluctuate in the normal course of market activity and the business cycle. At times may be priced below their true value (however you define "true value"). These are so-called "value stocks." If purchased at a low enough price and patiently held, their return to "true value" can result in a nice payday indeed for the intrepid investor. Added attraction for the value investor: risk tends to be lower than for the growth investor.

The distinction between “growth” and “value” stocks has been around for as long as I have been in the investment business, and occasionally it seeps into the popular press. A long-standing characteristic of Wall Street also applies to the growth/value dichotomy, and that is the tendency of Wall Street to take a good idea and take it so far that it is no longer a good idea. In the case of the growth/value dichotomy, this means a “growth investor” will pay *any* price, no matter how high, for *anticipated* future growth. A “value investor”, on the other hand, owns cruddy companies, but at least she did not pay too much for them!

Over the course of stock market history, there are times when growth stocks outperform and times when value stocks outperform. Over long periods of time, value stocks on balance win.

Until recently. In the aftermath of the 2008 financial disaster, market leadership passed to a fairly small list of large technology and consumer companies, including the so-called FAANG—Facebook, Amazon, Apple, Netflix, and Google—stocks. If you wanted to make money in the stock market for the past ten or twelve years, owning items on this list, at any price, was the way to go because prices of the market leaders only went in one direction, up. Meanwhile, the price of almost everything else lagged, especially in relation to underlying earnings, which generally went up as well.

The gap between the valuation of market darlings, the growth stocks, widened to an unprecedented degree, and kept widening year after year, such that one began to wonder if the condition would ever revert to the mean, if one should throw in the towel, sell everything, and put the proceeds into FAANG stocks. But Herb Stein must be right in this case, the disparity has to end at some point.

With considerable trepidation, I suggest we may, just may, have reached that point. If so, this is great news for WRM. We own no FAANG stocks or anything like them as we have never been willing to pay the very high prices at which they trade. The neglect by the market of almost anything not connected to the glamor of high tech means we have had years to buy truly first-rate businesses at prices patently too low. And they have treated us well, I must say. But if they were to be revalued by the market at anything approaching what is being paid for the market leaders, or even in line with the level of interest rates, we have a mighty handsome reward coming our way.

Even a grizzled old money manager can get starry-eyed at times.

But enough fantasizing on company time! Justin has a few words for you.

Thank you for your continued support and please do not hesitate to get in touch with me, Justin, or Jeannine with any and all comments, complaints, or requests,

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Business Driven Investing

Investment is most intelligent when it is most businesslike.

-Ben Graham

Dear Fellow Investor,

The first quarter of 2021 started pretty much where 2020 left off in financial markets. However, underneath the surface there were some major differences.

You may have heard through the media much about the shift from growth to value and the upcoming rise of inflation. Wall street loves to categorize investors, investments, and risk-taking by putting them into separate shiny boxes and selling them to the general public.

Here at Weybosset we categorize all intelligent investing as value investing: we try to pay less for what the business might be worth in the next few years.

The media and Wall Street's mode of business is to generate fees by getting you to act. This is exactly the wrong thing needed to compound and build great wealth over decades.

Thinking, decisive action, and patience is what the money mind needs.

Quick buck schemes are prevalent now as investors look to make easy money. Think Gamestop, Spacs, and Hot IPOs. Sure, there will be a few that walk away unscathed but en masse periods of excessive speculation do not end well.

We at Weybosset have developed a proven investment philosophy, one that builds the portfolios you are invested in to endure various states of the world; one that provides resilient wealth creation.

We start from the premise of what is our downside risk? Is this a good business? Is this something we need in our everyday lives? Will this business model endure for future generations?

We never pause to make a decision because the stock market is up or down, growth is beating value, the economy is growing or contracting, or interest rates will rise because inflation will pick up. If it is a phenomenal business at a good price, we will take action.

To us, beauty lies in the mundane. Can this business be easily replaceable? Think toothpaste, wrecked cars, electrification, agriculture, and specialty composites to name a few.

Over the last five years, if one were to worry about the Presidency, the economy, China-US relations, the pandemic, one would have missed out on Weybosset's compound annual returns of roughly 17%.

The greatest investors have kept to one philosophy over time. They find a system that works and they stick to it through thick and thin over the long term. As the music artist Sting so eloquently put it, "be yourself no matter what they say".

From time to time the markets may make us look foolish or even out of step, but in time the earnings power of the wonderful gems we have selected will prevail and those returns will become our shareholder returns.

With two vaccines deployed, the economic and health recovery is starting to take shape. The world is beginning to normalize. I always like to say that bull markets start with a crisis. We had, and still have one around the world.

The next ten years of investing will most likely not look like the last, as new challenges and the economic landscapes develop.

We anticipate that our companies will continue to adapt and thrive. We will continue to monitor our businesses and look for new opportunities to compound your wealth with the largest amount of safety employed.

The business of Business Driven investing is our game, NOT The Greater Fool Theory.

Thank you for your continued trust and support. We look forward to hearing from you. We hope that you and your families continue to stay safe and healthy during these challenging times.

All the best,

Justin E. Deutsch

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