

July 14, 2022

Permanence, Profits, Price, & Patience

Dear Fellow Investor,

The first half of 2022, alas, was not a particularly happy time for investors. The major U.S. stock market averages turned in their worst first half performance in 52 years, with the S&P 500 declining 21.56% and the NASDAQ declining 30.30%. Bonds lost a little over 10%.

We at Weybosset Research and Management performed better than the averages. The accounts for which we are responsible declined in value by mid-to-high teens percentages year-to-date.

A number of issues commanded investors' attention as they attempted to navigate markets in the first half of the year. First and foremost is inflation and the Federal Reserve's policies to combat it. With its most recent rate hikes of 75 basis points (0.75%), the Fed has taken action to dampen economic activity and curb inflation. The process of raising interest has raised the cost of capital and by all accounts wrung much excess out of the economy.

2022 has seen the great unwind of speculative excess.

This has showed up in the major stock market declines, the crashing of speculative assets (unprofitable businesses down 75-90%), crypto currencies, SPACs (special purpose acquisition companies-blank checks to acquire existing businesses), real estate, and commodities (down 25-60% from their highs).

The wealth destruction that has taken place has been the largest and quickest on record, by some measures larger than the financial crisis of 2008. According to Bloomberg a sum of roughly \$14 trillion has been lost by U.S. households' year to date (!!)

Though it has been unpleasant, our portfolios have been dragged down with everything else, we have by in large, held on to recent gains.

The reason: It is just as important what you don't own as what you do own.

We *do not* own any unprofitable businesses, crypto currencies, SPACs, or commodities; we do own companies with little to no debt and clean balance sheets; companies that can withstand any economic environment and provide goods and services for our daily needs.

Our value-based research and due diligence protects us from **permanent loss** of capital, which unfortunately, many who lack this discipline in investing have experienced recently.

The fear in the markets is that the Fed, the War in Ukraine, Covid 19 and other threats herald a significant global economic slowdown, even global recession. This is a hard argument to counter. We believe basing investment decisions on sweeping macro-economic forecasts is a fool's errand. There are just too many variables.

We think investment decisions should be based on an individual company's prospects, management team, and execution-- not macro noise. This discipline has worked well for your money over the last three decades.

The average S&P 500 market decline before a recession or in one is 27%, with the average stock declining 35-60%. At its lows in June, the S&P 500 declined 26.50%. By all accounts it does appear the market has concluded we are in a recession. I agree.

What if the Fed has done its job?

There have been episodes 1985,1994, 2015, 2018 where once the markets realize the Fed will be ending its tightening cycle, a new bull market was launched. This is because the market is a forward-looking mechanism.

The silver lining: one's best forward returns come from investing during a recession. The path to superior returns, however, is by no means a smooth one. "He who has patience can have what he will," as Benjamin Franklin put it.

During these times we look to make intelligent decisions with your capital and to remember the four Ps: Permanence, Profits, Price, and Patience.

Permanence:

By adhering to our criteria, we seek to own businesses that compound our money at satisfactory rates with as little risk as possible. When we purchase a stake in a business, we like to think of it as a marriage, our holding time is forever. This gives us and the market time to distinguish winning companies from losing companies and the freedom to wait out business cycles as skilled management teams at our companies steer their companies to greater profitability.

Profits:

The combination of sound economic fundamentals, good, even if decelerating, profitability, and little to no debt are the hallmarks of companies we like to marry. From time to time the market may forget about fundamentals and throw itself into a tizzy. Profits are the lynch pin of investing and give us the ability to properly value a business even if the market isn't paying attention.

Price:

As in real estate where the three most important attributes are location, location, and location, in the world of securities the word is price, price, and price. The price and valuation at which you purchase a company are your best offense and defense. If investors have little to no expectations that anything good could ever come from a company in which we invest, then who would be left to sell it to?

The slightest change in expectations and better than expected news from a company can give way to dramatic stock gains. You pay a high price for certainty; that is why it is best to purchase these securities in times of distress when expectations and valuations are low.

Patience:

Many of our businesses are now selling at absurdly low prices. We have recently taken advantage of these prices for you with our most recent investments. We have studied these businesses for years, in some cases decades, waiting for the right price. Patience, followed by aggressive action was taken.

As Pascal wrote, “the hardest thing for a man to do is sit quietly in a room”. Now we wait for the market to realize the true worth of the beautifully curated businesses we have selected for you and the compounding of your money to begin.

So, despite a volatile decline year-to-date, we maintain our confidence in the businesses we own and the new additions as a way to capitalize on the turbulence. We think a little patience and a little fortitude will yield highly satisfactory results in the future, despite, or perhaps to a degree because of, crazy volatility.

And above all, we are grateful for your continued confidence in us. We are determined to prove that your confidence is well placed. Please be in touch with any and all comments, questions or complaints.

Sincerely,

Justin E. Deutsch

I have nothing to add but my appreciation, as ever, for your business and the confidence you place in us. We are determined that that confidence prove well placed, Fla

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