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June 30, 2023

Dear Client,

Earlier this month we celebrated 40 years of Robotti & Company. I am immensely proud of our results for you and the team here that has made that possible. The importance of four decades in business is not lost on me. It would not have been possible without clients like you that understand our process and share one of the most important ingredients: patience. For that, I thank you.

Throughout the last 40 years we have experienced many monumental events which have affected our lives and the investment world including: the fall of the Soviet Union, the invention of the internet, the dot com bubble, the launch of the Hubble telescope, the advent of cellphones, 9/11, Hurricane Katrina, negative interest rates and most recently a global pandemic. One of the aspects of our job that I love the most is the constantly changing nature of the world. We are a company of lifelong learners and, luckily for us, there is always more to learn around the corner. Much in the way a spiral moves in a circular pattern without touching the same point, time moves similarly. We can see comparable themes and challenges, but each time they are presented to us slightly differently and with different nuances. One thing that has remained a constant, regardless of the direction the financial markets take us, is that cycles prevail. Understanding echoes of past events helps us frame novel new ones.

Yet through all those machinations, our Separately Managed Account strategy, which we started in 1993, has returned 10.7% net annually, vs. its benchmark return of 8.8%. To remind you of the power of compounding, a $1 million investment would now be worth nearly $21 million vs. $13 million in the benchmark[1].

While we have been investing through myriads of economic environments, our process has remained structurally unchanged. By not reinventing the wheel for each new decade, we are able to continue to hone our skills and ensure that we are focusing on the important facts and then responding thoughtfully and, in doing so, controlling that which we can control. As investors we must have a deep understanding of a business and what its value is. The reason this is so important is that the other constant driver of public market prices is human emotion - namely, fear and greed. Knowing what the "wheat" is and distinguishing it from the "chaff" is critical. Successful investing

[1] Our Benchmark is the Russell 2500 Value. It was changed to this on September 1, 2011 from the Russell 2000 Index.

requires the ability to buy when the current situation is discomforting. In our 2014 year-end letter, we quoted a client who had told us some of our greatest opportunities have emerged from companies facing serious challenges, though it was never pleasant waiting for the pain to subside in the midst of the turbulence. In that letter we said,

> The ability to maintain a high-level of conviction in the face of a market that increasingly disagrees with our investment outlook is a reflection of our behavioral edge. This should not imply stubbornness or blindness. Instead, we remain intensely focused on maintaining the proper perspective as we analyze new information. Sometimes this will result in adjusting the portfolio, but frequently additional analysis confirms the need to remain patient. It is difficult to maintain patience when managing other people's money. Inactivity can imply ignorance or indecision. We can assure you that in our case it means neither. The decision to remain patient is an active decision, no less important than buying or selling a security.

There are few things more dangerous than for investors to assume "this time is different." With the knowledge that emotion largely dictates market prices, it makes it even more imperative that we focus on valuation to cut through the noise. Ultimately, successful value investing boils down to what you buy and how much you paid for it. Valuation matters!!!

We have shown this graph many times, but that is because we believe it is important. You will notice the beautiful symmetry of the graph, but that is nothing like reality. Timing is not symmetrical, the amplitudes not measured, and the direction is not linear, all of which aids the opportunistic allocation of capital for those with understanding decades of experience.

This chart shows all the shades of emotion between the extremes of fear and greed and exists for individual companies, asset classes, economic sectors, and the economy as a whole. Much of our hunting ground is in the "panic" through "depression" section. By focusing on those parts, we ensure another part of our process that is incredibly important – margin of safety. Whenever Ben Graham was asked about his thoughts on the future of the economy or the future profitability of a specific company, he would quip "the future is uncertain." As our good friend, the famed investor Jean-Marie Eveillard, suggests that this is "precisely why there's a need for a margin of safety in investing, which is more relevant today than ever."

When Mr. Market is panicking about a company's prospects it usually is priced as if everything that can go wrong will. That makes a fantastic entry point for those with an understanding and appreciation for the likely outcome, even as it will likely get worse first. More simply said, those with a contrarian point of view forged with the experience of patient capital in the face of the maelstrom have a huge advantage. Good things happen to cheap stocks and any positive surprise can result in outsized return. In contrast, there are quite a few large speculative companies with little or no demonstrative earnings power, several of which are helping to drive large-cap market indexes higher, sport valuations that imply meaningful periods of outsized growth and perfect execution. That can spell disaster if one of any number of things does not go exactly as planned. We thought investors had (*again*) learned the lesson that buying low-to-no profit companies at excessive valuations was fraught with risk. Alas, investors have very short memories, especially when greed for continual gains clouds investors' views.

This is why we look not for investments where everything is going right, but rather ones that the market has priced as if everything will go wrong. When we invest in those kinds of companies it only needs to do moderately well for it to be a good investment. Allowing ourselves room to be wrong gives us both protection on the downside and massive potential on the upside! Margin of safety is both prudent and lucrative. Of course, the focus of our research is to understand and identify companies which capitalize on what is going wrong. Those are great investments.

Conclusion

We must continually evolve with both the financial markets and society. Benjamin Graham's view that "the underlying principles of sound investment should not alter from decade to decade" remains timeless. That is what we have strived to do. In the face of a myriad different economic cycles we have remained steadfastly focused on valuation. Again, this is only possible with clients such as you who have the understanding and the same behavioral edge that we do. For that we thank you. The last four decades truly would not have been possible without you.

All the best,

Bob

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