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Dear Client,

## **Navigating a Stormy Sea**

We are in an era where capital flows are increasingly dictated by passive capital, momentum traders and short-term performance chasers. This may be emotionally exciting, especially if it's working out, but it is NOT investing. We believe that disciplined public market investing - based on company fundamentals and, importantly, valuation - remains a very reliable compass for long-term success. This remains true despite the market's recent volatility. We do not mean to imply that the public markets are perfect. If we believed in market efficiency, we wouldn't be active investors. Ben Graham famously said that "in the short run the market is a voting machine..." driven by sentiment and popularity, "but in the long run it is a weighing machine," eventually reflecting a company's true intrinsic value, defined as the present value of all future cash flows the company will generate. Today we see an environment where Graham's voting machine is overclocked while the weighing mechanism has been delayed and obfuscated.

Public markets have once again become increasingly dominated by narrative, momentum, speculation, and short-term sentiment, which makes sense in an environment where critical economic policies are stopped and started frequently. One of the most notorious examples of this is the "tokenization" in public markets, and financialization of attention, as we have seen from companies like Gamestop, AMC, and Bed Bath and Beyond. This is to highlight that these companies are trading not based on fundamentals,<sup>1</sup> but rather on headlines, meme sharing and

<sup>1</sup> There were some real legitimate reasons why these stocks may have been cheap in the beginning, but that was quickly overshadowed by the momentum trading and short squeeze hunting that occurred after.

attention. Humans are hard-wired to like a good story, especially those that promise quick riches, and in times like these a good narrative often trumps a spreadsheet full of numbers. It shouldn't come as a surprise then that capital chases these stories over substance. This is nothing new to public markets, it's just one of the repeating periods of speculation. The very forces leading to volatility in the markets are, in fact, what allows us to buy value at a discount, as long as we remain patient and selective.

## **The Weighing Machine Still Works**

For the last two decades, low-cost/no-cost passive investment vehicles have been a capital vortex. At the opposite end of the spectrum, very high cost, low liquidity private equity (PE) has been a 40-year juggernaut. The pull of capital into PE is evidenced by the substantial reduction in the number of public companies.

We believe the shifting balance between narrative and fundamentals in both public and private markets, while often frustrating, has also presented exceptionally attractive opportunities. While the voting machine may currently be on steroids, the weighing machine still works, it's just on a delay, and has adopted a firm "show me" mandate. Public equities, though often mispriced in the short-term, remain tethered to real economic output. In contrast, that tether has frayed in many areas of private markets, where valuations are increasingly constructed rather than discovered through open-market pricing.

The FT recently noted *"Private equity firms made record use of a controversial tactic to cash out their clients by selling assets to themselves in the first half of the year, as they struggle to find external buyers or list holdings... Private equity groups sit on more than \$3tn in unsold deals and are nearing four consecutive years in which they have returned only about half the cash investors traditionally expect. We're in our third or fourth year of low distributions, the exit environments are challenging, and the IPO market is dormant," said Todd Miller, Jefferies global co-head of secondary advisory.*"<sup>2</sup>

<sup>2</sup> Private Equity Firms Flip Assets To Themselves In Record Numbers, Financial Times, July 22, 2025

In contrast, public companies report regular results. They report cash flows, face daily market feedback, and must earn their valuations. Markets are constantly repricing share prices and, not so infrequently, substantially mispricing them. Good for the analytical investor as well as the well-managed and well-capitalized companies which can respond to market mispricing by repurchasing undervalued shares or pursuing accretive investments when others are retreating.

In contrast, private assets often sidestep scrutiny through infrequent disclosure, discretionary valuations, and “mark-to-model” accounting practices. Despite public messaging that private assets offer long-term opportunities, it is evident that much of their historical performance came in an era of steadily declining interest rates, boosting present values and allowing for multiple turns of leverage. Of course, this is also true for public markets, but the daily repricing of public markets today is very different than it is in the world of PE. The frequent footnote that an advisor’s past performance is not a prediction of future results appears well apt here. Today, you may see a proliferation of unsold companies, continuation funds, and recently, secondary funds. Many of these focus on “NAV squeezing” (buying assets at discounts, marking them up to official NAV, and booking unrealized gains), and fee extraction (by collecting incentive fees on paper gains rather than realized profits). This form of financial trickery allows managers to quickly monetize inflated asset values. Now marked, these assets continue to be assigned increasingly inflated values. The increased use of these tactics may be a signal that managers have waning confidence in future performance and are looking to lock in compensation before market realities catch up.

Private equity is now embracing its latest evolution: Democratization. What began as a tool for sophisticated capital with a large number of target companies has evolved and is now being repackaged and made available to the masses, often with added layers of structural complexity and fees. The result is a proliferation of perpetual funds marketed to a broader investor base, often under the banner of access and innovation. But history reminds us: what wise capital does first, retail capital often does last. This may delay the day of reckoning, but when it arrives, we are likely to discover that far more investors were “swimming naked” than previously thought.

## **Why We Stick with Public Markets**

What we have experienced is a cultural shift as much as an economic one. The mindset driving cryptocurrencies, “meme stocks,” and “YOLO” (You Only Live Once) investing is seeping into all corners of the investment universe, public and private alike. Amid narrative churn, public markets remain uniquely suited for investors who value transparency, discipline, and the chance to act when others are distracted by the latest shiny new thing. We remain focused on buying cash flows at a discounted price. Even if the market fails to recognize their value and multiples do not quickly expand, buying a company for less than it’s worth means you still acquire those cash flows. While it may take a bit more time, prudently allocated cash flows will eventually become the catalyst, all the time providing added opportunistic allocations to share repurchases or value accretive acquisitions and investments, which further expand value. Public equities provide the cleanest view into actual economic performance. Public price volatility allows us the rare ability to act when prices diverge from economic reality. For all its short-term noise and inefficiency, over time, the public market forces real decisions based on real data.

## **Volatility In Action: Mr. Market, Our Manic-Depressive Partner**

Two of our top positions are Tidewater (TDW) and Builders FirstSource (BLDR). Both companies are in cyclical businesses, which Mr. Market continually falls in and out of love with. For BLDR, the market goes through periods where they believe cash flows will implode leading to a market price that reflects these expectations. Expectations often change, sometimes quickly, and frequently the expectations are overshot. At times, they get it right but then price in a transitory cycle as the new norm. Eventually the economic reality manifests and often drives valuations to readjust, lock and step. Last week two public homebuilders, Pulte & D.R. Horton, were up 12% and 16% respectively in just one day. Dragged along with the road flares, BLDR was up 6%. Results have not been as bad as originally feared. Once again, the market overshot. As for TDW, we have seen shares soar from \$30 to over \$100 over the last 2 years, only to road trip back down below \$40. All along, cash flows have continued to grow. Today, shares trade at \$50, with a 15% free cash flow yield. Not bad, especially given the 4.4% 10-year treasury yield. As for the opportunities market volatility

provides for good capital allocation, TDW bought back \$90m worth of their shares at \$39 so far this year.

These are just two examples of the opportunity Mr. Market's emotional swings can provide, but they highlight a recurring feature of the markets: the frequent failure to price economic reality with precision, particularly in the short term. This is not a flaw we fear, rather it's the source of our opportunity. Market misjudgments, sentiment swings, and short-lived narratives are what make long-term outperformance possible for those with a patient, disciplined approach.

We agree that these periods of dislocation can be uncomfortable. We also believe they are essential. Otherwise, there would be no opportunity to buy good businesses at great prices. Our work remains focused on identifying real cash flow, allocating capital prudently, and trusting that, over time, fundamental value will be recognized because the weighing machine always shows up, even if it's running late. These are exciting...and profit providing times!

Thank you, as always, for your trust and partnership. We welcome your questions and look forward to discussing our views further. We wish you a restful and joyful end to the summer.

All the best,

A handwritten signature in blue ink, appearing to read "Bob" followed by a stylized flourish.

Bob

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