Welling on Wall St.

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VOLUME 15
ISSUE 1
January 30, 2025

INSIDE

Listening In

Want To Get Invested In Firms With Long Runways For Profitable Growth — Without Paying An Arm And A Leg? Bob Robotti Has Accomplished Just That For Clients Through Value Investing With A Contrary Bias, Very Often In Highly Cyclical Commoditity-Sensitive Industrials Few Investors Deign To Touch. Warning: Deep Research, Patience And Perseverance Essential

listening in

Value Is The New Growth

Bob Robotti Reflects on 50-years Focused on Deeply Out-of-Favor stocks

Robert Robotti

One might, if inclined to a congenitally dyspeptic view of our world, say it was dumb luck that got Robert Robotti's investment career off on the right foot back in 1975. Robotti himself (pictured here) cheerfully admits that when he stumbled into the offices of Tweedy Browne & Co., — as an auditing intern — he had scarcely a clue about what he was doing, much less about the legendary value shop's business.

While Bob's official major at Bucknell was accounting, his real focus on campus had been football. In fact, it was a bum steer from other footballers that convinced Bob to go into accounting, as an "easier" route to his degree than general business. And it was Bob's own fondness for pigskin over books that produced the very undistinguished GPA that, as graduation approached, had him feeling lucky he'd wrangled an internship with even a small New York City-based CPA firm. Big Eight material, he definitely was not.

But the stars were aligned for Bob. He walked into Tweedy Browne just as the great small-cap bull market of the mid-to-late-1970s was blasting off and the market's excitement and energy were palpable. Even better, his auditing work gave him access to Tweedy's books, so the could see Tweedy's numbers, and puzzle out what this thing called investing — and more particularly value investing are all about. To top it off, Bob found that the investment luminaries at Tweedy willing shared their acumen when asked. Particularly, Joe Reilly, a retired partner, who became his mentor, Bob recalls, in investments, business and life.

Today, Bob himself is a value investing luminary, serving as the President and Chief Investment Officer of New York City-based Robotti & Co., a classic value-focused boutique asset manager which he formed more than four decades ago, and of its Robotti Advisors LLC and Robotti Securities LLC units, which offer private funds, separately managed accounts as well as research and brokerage services to investors as contrarian and relentlessly long-term focused as Bob himself.

Welcome, Bob, to *WOWS*. I've been derelict in not reaching out to you long, long ago.

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Welling on Wall St.

Published exclusively for professional and/or avid investors who are paid-up subscribers by
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ISSN 2332-161X

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Bob Robotti: I wasn't going to say *that*, but it is a little unusual, considering our many mutual friends.

I'm sure I was told to look you up many, many times and failed to follow up. My embarrassingly bad memory for names goes back decades.

Bob: I know that knucklehead feeling only too well. It's even more awkward when recall goes poof on a second or third meeting.

Let's not even go there. I'm delighted to meet you *now*. I rarely run into anyone anymore who's spent as much time on Wall Street as I have.

Bob: I imagine you're actually a year younger, but that you also are really smart — so you got out of school two years ahead of me.

A gallant try, but no. I graduated with my Northwestern class in 1974, but did finish classes an academic quarter early – to skimp on tuition – and so I could take a job at Dow Jones in New York that March. I got lucky. DJ froze hiring soon after that.

Bob: It makes sense. That *was* the second year of the 1973-'74 bear market. The worst, at that point, since the Great Depression.

I was so green that I wasn't fazed by watching the DJIA retreat daily or by every other story crossing the newswire being about a company invoking force majeure one step ahead of the sheriff. My journalistic inclination was to follow the stories. You were much smarter – following the numbers.

Bob: It only looks that way. I totally stumbled into my career, beginning in college. I became an accounting major only because I was on the football team.

Come again?

Bob: I didn't want to do heavy academic lifting and the guys on the team all said the professors in the accounting department were the easiest. That's why I selected accounting over management and became an accountant.

Things really were different back then. But I have to ask. Have you ever again believed anything you heard from a football player?

Bob: I will say, the joke was on me. Bucknell actually reorganized its accounting program while I was there. The course work and professors suddenly became very demanding, so it didn't work out the way I had hoped.

But, well as I often reflect these days, things did eventually work out. I wasn't much of a student in college; stayed more focused on football than accounting. So my C's weren't going to open doors in the Big Eight. But during my senior year, I wrangled a short internship with a very small NYC accounting firm. That was how I happened to spend January of 1975 working at 67 Wall St., — in the offices of Tweedy Browne & Co. — I was interning for Tweedy's auditors.

"I fell into my career in investing. And [Tweedy Browne] was an incredibly good place to be bitten by the bug."

So there I was — in the office with Howard Browne and Ed Anderson and Walter Schloss and Tom Knapp. Now, I had no idea who these people were or what value investing was — or even what investing was!

Dumb luck plopped you down among those legendary investors with exquisite timing?

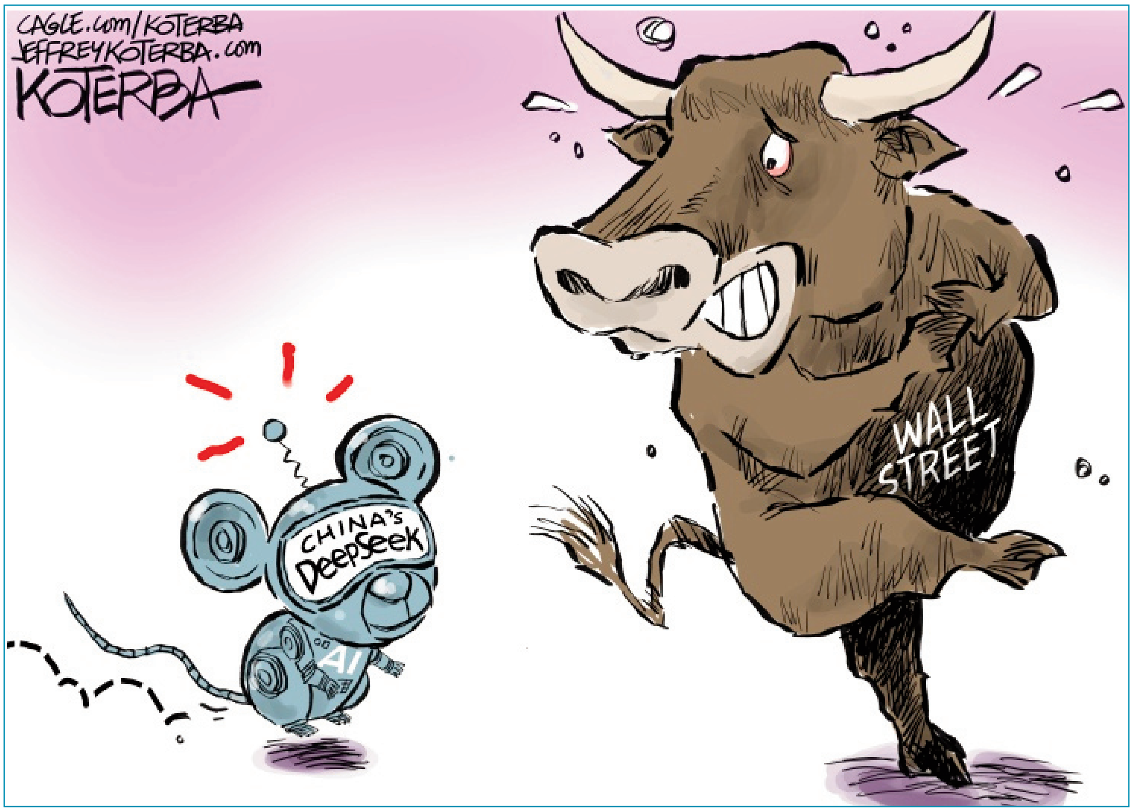
Bob: Yes, that was when it all took off. It was the starting gun, really, for a great new bull cycle in value investing. That rotation happened very suddenly — almost as I happened to walk in the door at Tweedy. Getting that view, not only of what investing involves, but also of how those legends went about value investing at that pivotal time — I was incredibly fortunate.

Sure, but evidently also very curious – primed to learn. You got yourself hired by that same auditing firm after graduation, so you could continue getting paid to observe Tweedy Browne's inner workings.

Bob: As I say, I fell into my career in investing. And that was an incredibly good place to be bitten by the bug.

Auditing Tweedy's books as their positions rocketed into orbit must have been mind-bending. But I can't imagine those lumi-

naries had a lot of patience with questions from a newbie at that juncture.
Bob: Certainly not during business hours. But that was another aspect of my luck. It turned out that when we auditors periodically showed up to work out of Tweedy Browne's offices, we shared a space that most of the time was reserved solely for a retired partner, Joe Reilly. (Joe Reilly had joined Tweedy, along with Howard Browne, in 1945, to form Tweedy, Browne & Reilly.) When he retired early, Reilly had ended up with one-third of every securities position Tweedy had held — an extensive and odd collection of pink sheet securities that he continued to manage in his "retirement."



China's AI Meets Wall Street, by Jeff Koterba, '
patreon.com/jeffreykoterba

So I had a retired founding partner sitting right there in the room with me and, after 6:30 or so, when I was done with all my ticking and tying and footing and whatever other auditing chores I'd been given, I would ask Joe about investing.

Joe actually became my mentor in investing, in my business — in everything. It turned out Joe loved the chance to unload his perspective and enormously valuable vault of knowledge —

On your eager young ears. Clearly, you soaked it up like a sponge. But I've also heard that you then knuckled down, working nights on an MBA in accounting at Pace University, auditing during the day.
Bob: Guilty! For me, at least, it's one thing to learn something in an academic setting, quite another to be able combine classroom theory with practical work experience — as I could by studying nights at Pace early in my career. It became a big factor in my success, I think, particularly because of the insights and influence of an outstanding accounting professor I was privileged to work for, as well as study under at Pace, named Tony Pustorino. The professor had a private accounting firm in the City and sometimes hired to students to help handle assignments. It turned out that one of Tony's smaller clients at that time was another former student of his, named Mario Gabelli, who'd recently started his own company. When Mario decided he needed to hire a CFO, he asked Tony for advice —

And there you were? Poor, hungry and driven — like Mario himself at that juncture.
Bob: Well, that's right. When I started in 1980, Mario managed $7 million. When I left to start my own firm in 1983, his AUM was still only $77 million. The main part of his business back then was still the brokerage business; selling institutional equities research.

Good old auto parts.
Bob: Well, when I started he had already migrated into also following cable and entertainment stocks, which of course became the real market opportunities — and what he catapulted himself on.

Indeed. But Mario's always been careful to remember his origins in fundamental research — his analysts still cover auto parts.
Bob: The three years I spent there, working very closely with Mario, were another graduate education — invaluable to me. There weren't a lot of other people in the firm. The breadth of the things that Mario does is astounding, and the detail with which he does them well, is as well. Just keeping up is challenging.

Tell me about it. I can't tell you how often I've interviewed him, since his first sit-down with *Barron's*; that's a mind that doesn't miss a thing. Always racing ahead. I noticed some similar speech patterns when I listened to a few of your podcasts. Do you also come from the Bronx?
Bob: No, I'm from Queens. But I have to say, there aren't many honors I'd consider higher than being compared with Mario on any score — much less speaking.

I always say I'm not even really proficient in English. I don't know any other language. When a young colleague many years ago suggested that we should go invest in Asia, I responded, "Isaac [Schwartz], I don't even speak English that well. How am I going to speak a foreign language?

Much less conduct your granular research in one? Even the numbers — accounting standards do vary —
Bob: Yet, my experience, after I was persuaded to give global investing a go, was that I learned so much. We opened a fund, Isaac moved to Asia to run it, and I would regularly visit him and we'd go meet companies. Over a six-year period, I went over five times a year and I found it actually easier to travel to Asia for business than to Europe, because the flights are so long. I'd leave on a Saturday, get there on a Sunday, meet up with Isaac. We'd go out to dinner, then I'd go to sleep — and be ready to work the next morning. Anyway, I met with 500 different public companies over six years and found universally — other than in South Korea and Japan — that they speak English — relatively proficiently. So I jumped to the mistaken conclusion, that they understand me and I understand them. Oh, no, no, I quickly learned then. You may understand the words they say, and they may understand the words you say, but you don't really understand what they mean!

Yet that didn't scare you away. Robotti Advisors has continued to invest globally —
Bob: Absolutely, and Isaac still runs our global fund — though he does it from here, after moving back several years ago. But he does a lot of investing overseas. And I still do some investing in companies overseas.

A lot of the stuff I invest in tends to be in the industrial sector, which is North America-centric. But broadening our investment horizon to encompass the globe has paid unexpected dividends, because Tom Friedman really is right. The world is flat. The process of investing abroad has taught us a lot of specifics about the international companies and markets we've invested in. Even more significantly, it has given us a greatly enhanced appreciation of how the world is really interconnected in so many ways.

Surely you've heard, globalization is so yesterday. *De*-globalization is trending now.
Bob: That's nonsense. De-globalization isn't a thing. Globalization, all the interconnections, aren't going away. What *is* going on is that globalization is *evolving*. *Who* has the competitive advantage is what is in the process of shifting, changing. That moves the nexus of globalization and its manifestations, but it doesn't *eliminate* globalization. It's foolish to just write off globalization. You're foolish not to think about who the new beneficiaries of globalization will be — and about who might be seeing advantages that they enjoyed until recently melting away? What are the implications of this evolution?

What are *you* suggesting?
Bob: What Friedman's message that the world is flat really teaches me, especially in looking at the industrial businesses, the commodity-based businesses that the first waves of globalization so thoroughly disrupted, is that what they do in China really does have impacts on what happens in the U.S. (and elsewhere) — albeit with lags.

Now, I'm scarcely the only person to recognize that, but I'm not sure how many investors have thought through its implications. In the last couple of years, any time I've brought up the idea of investing in any of the very undervalued industrial stocks, the first refrain I've heard has been along the lines of "Oh, but what happens if the U.S. economy falls into a recession? We're bound to have one sometime."

Isn't that a pretty typical cyclical worry?
Bob: My quick response is, "Wait a second, *the economy that matters cyclically on a global basis* for industrial businesses and commodities *is China* — and China has been in a recession for two years.

It sounds like you pay a lot of attention to macroeconomic cycles for someone who bills himself as a bottom-up stock picker.
Bob: We have to. A key theme in our investments is what are the implications of those changes in macroeconomics; of the evolution of globalization? Yes, in the past, when asked about the economic cycle, the typical bottom-up stock picker has probably said something like, "Oh, I don't know anything about macroeconomic cycles, I don't know

what's going to happen, therefore that doesn't enter into my equation."

It's still being used as an excuse —

Bob: But the fact today is that macroeconomics probably have more impact on what's going to happen to your stock investment than events on the micro level. Understanding the macro and the micro — and their interplay — really are critical. That's a big part of what we do. We have a phrase we use a lot here: "Grassroots macroeconomics." That is, by looking at bottom-up stock research on a company, you can come to understand not just a single company, but its industry. You can also understand how that industry is positioned worldwide. That same process can lead you to understanding related parts of the economy —the companies' suppliers and customers. That's the way we build out an understanding of the key drivers that are affecting that particular industry and industrial businesses in general.

For instance?

Bob: Well, one of our key investment themes now is that the evolution of globalization we've been watching at the grassroots level is making energy-intensive businesses competitively *advantaged* — if they're domiciled in North America — because energy costs here have become, and will continue to be for an extended period of time, disconnected from those in the rest of the world.

Disconnected? I think we both probably remember the Arab oil embargo —

Bob: But so much has changed since then. Particularly in the oil and gas markets and, most importantly, in terms of our ability to produce natural gas substantially beyond our domestic needs — and to economically transport it and connect it to rest of the world. The nature of natural gas, it turns out, makes it a very long-dated resource. But the process of producing, transporting and connecting it to global customers likewise is a very long-dated process. So our ability to produce significant natural gas, in excess of our needs, at low cost — and even to export that excess without those transportation costs making our gas uncompetitive in the rest of the world's markets — is a tremendous competitive advantage for North American companies in energy-intensive industries. That competitive advantage probably translates into those companies generating excess profits — because world markets will set the world price of the commodity predicated on their higher cost structures.

That flips the plot of the last 20-30 years —

Bob: That's how it works. The guys with the low cost structure reap the excess profits — and that's really what's causing the brightening prospects for energy-intensive North American industries. That's what people are characterizing as "re-shoring," and *mistakenly* calling de-globalization. The evolution of who is competitively advantaged is what's bringing industrial activity back here, whether it's from Asia or from Europe or other places. They are increasingly competitively disadvantaged, relative to North American industry. In most cases, this continent also happens to be the largest end market for most industrial products, as well. So industrial producers here enjoy the additional competitive advantage of not having to ship their output very far — lower transportation costs.

I can barely remember the last time industrial stocks stirred any investor interest —

Bob: Something else we like. An important theme of our investing has been "Gee, we think these companies' shares are cheap because they're cyclical industrials and nobody in recent memory has wanted to invest in those companies. Even most traditional value guys have pretty much given up on them.

No small amount of investor capital got trapped in those "wasting assets." Value investing's salad days in the mid-late 1970s are remembered by vanishingly few.

Bob: Yes. Just look at the ranks of top value investors who have given up the annual performance derby that is managing public funds to run their own portfolios as they see fit. Even someone like Leon Cooperman doesn't have a public-facing business anymore. His is a family office.

Has been for quite a while — Lee doesn't miss the hassles, as far as I can tell.

Bob: He's still doing what he wants to do. There are far, far more former money managers from the value space who weren't nearly as fortunate, whose funds went out of business. The shrunken universe of value investors/fundamental stock pickers who survive as managers of public funds today tends to be dominated by people who gravitated to or were fortunate enough to buy Apple and Microsoft shares when they were statistically cheap — and then were smart enough not to sell just because the tech cycle turned, those companies did very well and the stocks appreciated dramatically. Essentially, the well-capitalized value investors in the business today are the ones who learned early on to invest in better businesses, or great businesses at fair prices, with barriers to entry, moats, and all of the other pet phrases that people have selectively picked out of Warren Buffett's annual letters.

And worship every year in Omaha, praying to be spared temptation by "cigar butts."
Bob: Exactly. For most of the folks in the value space today, that's the *only* way to do it.

You dare to differ?
Bob: Don't misunderstand. I'm in no way denigrating what Warren and Charlie [Munger] have achieved. I'm disputing today's consensus view that there's only one profitable way to do value investing.

My argument is along the lines of, "Wait a second, doesn't Warren Buffett own Chevron? Doesn't he own Occidental Petroleum? Doesn't he own these companies that you won't own because they are "commodity businesses," or "bad businesses," lacking some or all of what you suppose are Warren's favorite stellar attributes? Could it be? Maybe there's more *complexity* to investing than just finding "the better businesses. Especially if there's more risk in owning better businesses that have all those attributes you can identify in the rearview mirror — when you don't necessarily know what's going to happen in the *next* 10 years. Therefore, are you paying a richer price than you should? You're justifying paying a richer price because a company *has done* well and its prospects are good. But how much of that is reflected in the price you're paying? *Because valuation matters*. Even if many people who know better have gotten discouraged, have given up on that idea.

You still believe market valuations can be a two-way street?
Bob: Yes, even though the markets have unquestionably demonstrated, time and again, that they can stay irrational longer than any value investor can stay convincing!

Or, solvent, sometimes, alas. Let's talk about that market complexity you alluded to. If there's anything I've learned it's that there's no one surefire path to investment riches.
Bob: Well, so it's interesting. If I look at a CapIQ report from S&P Global Market Intelligence, and focus on the column that says what kind of investor I am, I'm told that I'm a growth investor. Here, for all of my career, I've been a bottom-up stock picker, a dyed-in-the-wool value guy. Yet when I think about it, I realize that maybe I *do* fall into their definition of growth investing.

How so?
Bob: We do look for companies that are really beaten up and out of favor — *but* where there's potentially something about the company, the management, the product that should really differentiate it in the eyes of investors. What we're looking to do is to buy into those companies when there is no obvious catalyst — other than Economics 101. And so we never know the timing on these investments. But, eventually, capital and the capital markets do get it right — and readjust the market valuations. The catch is that the process potentially takes a very long time. Again, the timing is absolutely uncertain. It most always takes longer than you'd hoped.

So you're a marketing rep's nightmare. Investors today are rarely long patience. Back-to-back index gains of 20%-plus don't condition anyone to waiting.
Bob: I admit that, as what I still consider faithful, practicing value investors at Robotti, we pretty much watch every stock we buy get even cheaper before we see it starting to appreciate. So there's no doubt — even though we pretty much have our act together — that we're still working on making our timing a little bit better.

But, because we understand that our timing tends to be early, we don't, as a rule, sell positions when they've dropped, say, 20% from our entry price.

You don't believe in cutting your losses?
Bob: Not if our investment thesis is intact. We've learned to pretty much expect stocks to drop 20% after we initiate a position. So, instead of selling if that happens, we look for opportunities to buy more shares, should the stock continue tumbling. Maybe it will drop 50%, and we'll want to buy more shares.

Being patient and staying with a stock as it continues to drop ensures that you do eventually capture the upside benefit. Our experience also tells us that the longer a recovery takes to happen, the larger the benefit; the more cathartic the bad times prove to be. More competitors go out of business, more people shutter operations as consolidation happens. In certain cases we've been invested in businesses that have been fundamentally transformed from what they were when we first took a position — a cyclical commodity business with a lot of competitors — into a dominant company in a concentrated industry with very few participants. Also, with significant barriers to entry (and other of the Buffett catch phrases people love to see today) and with the sort of glowing reputations they never had in the past.

Like what?
Bob: The example I always use is the railroads. When I got out of college in 1975, I interviewed with a railroad company, and I thought, "Oh, what a horrible business this is. There's a huge amount of invested capital, no returns, high labor costs, competition from every side." The litany went on and on.

Penn Central had already collapsed in 1970 —
Bob: It took years, but the consolidation and reorganization of the industry eventually transformed it. Today, surviving railroads by their nature are monopoly businesses whose competitive advantage is the ability to efficiently move goods over long distances at low costs. Then, of course, the other example I often use is the *Wall Street Journal*.

In 1975, the *WSJ*, and its corporate parent, Dow Jones & Co. — my first employer — had probably seen the peak in *their* power and influence. But it seemed they had a lock on business and financial news.
Bob: Exactly. There were no rivals working across the street from the *Wall Street Journal* back then. Now, the *WSJ* is not a business. It's a vanity trophy. When certain people occasionally decide they want one, they buy a newspaper. My point is that businesses transform. Economics do really happen. Things do change over time.

I learned that only slowly, from the inside out. I don't have a lot of regard for Rupert Murdoch on most scores, but I owe him a debt of gratitude for buying DJ — and turning long-underwater employee options I'd been "awarded" into a tidy sum.
Bob: The takeover didn't put the Murdoch family in the poor house, either. They got what they wanted, so it worked well for most everybody.

Okay, but those sorts of transitions generally take decades. Investors willing to play that kind of long ball are rare today.
Bob: To says least. Everyone's time horizon continues to get shorter and shorter. It's a function of having so much unfiltered information coming at you, so quickly.

Every day, there can be, say, five random data points that could have some impact on what the next quarter's earnings might be. The temptation is to get consumed with focusing on the latest data points, analyzing them and forgetting everything else. If it's a piece of news you think is really bad, the impulse is to sell the stock. But if you think about it in the context of what it means for that potentially very solid business on a three-to-five-year horizon, you may actually find that the "bad news" is a catalyst for transformative changes. Meanwhile, that stock just got discounted based on a bad factoid.

But cheap stocks s often get cheaper.
Bob: If you don't want to own the stock because it'll probably drop in the next three months, you'll probably be right. But if I take advantage of that discount, over the next three to five years, I'm going to make an awful lot of money because our investment process concentrates on understanding the normalized earnings power of a troubled or beaten down or even a long-ignored business — well before the rest of the market gains interest. That perspective often takes us to very different and non-conforming conclusions about stock valuations.

Spurs you to run contra to the herd?
Bob: Yes, we view our ability to adhere to our investment process and maintain conviction during times of strong market volatility – without blinders or stubbornness – as a sustainable advantage. That's the impact of industrial transformations, that's how the economics end up manifesting. There's actually a reasonable level of predictability on that happening. Still, I don't know what happens in the current quarter. Getting focused on short-term earnings forecasts is fast and furious speculation. What I'm talking about is investment thinking, which is a very different, and long-term, process.

Which is the bailiwick of Robotti Advisors. But Robotti & Co. also has a brokerage arm. How do you survive in a market dominated by robo advisors and nanosecond arbitrage?
Bob: Well, I founded Robotti Securities in 1983 to bring thoughtful ideas to like-minded value managers because I believe there is a place for investment ideas which are out of favor, misunderstood, or simply neglected by the conventional sell-side — and so I made generating actionable long-term investment ideas the core focus of Robotti Securities — even though I knew well that buy-and-hold was not the conventional brokerage model. That hasn't changed.

But our goal has always been the long-term success of our clients. Over the years, we've continually focused on the merits of long-term investments, instead of on generating trades. We've cultivated long-standing client relationships — treating them as more important than any single transaction. And we've accumulated decades of knowledge and insight into the companies we follow closely, which we share with clients. So now we have solid relationships with highly respected (and successful) value investors who keenly appreciate what we do and how we think.

Then there still is a place for high-touch execution services, in the jargon of the trade, even in markets run by algos and mindless passive strategies?

Bob: Yep. These days the flow of capital and the pricing of securities are done by those mechanisms. Not by someone doing thoughtful research coming to conclusions on companies' valuations. But that's an advantage for us, right? Mr. Market is looking at something else.

He's punted his duties to faceless computer programmers — single-minded AI, basically. Focused on nothing but the next tick. But doesn't that play hob with the market's pricing mechanism?

Bob: You know, the market has always been a popularity contest in the short term and weighing mechanism in the long term. Now, the weighing mechanism of the market is definitely suppressed. It takes longer for it to manifest. But manifest it does.

Is that pure faith or do you see evidence?

Bob: What I always point to are instances like what happened when ExxonMobil got kicked out of the DJIA and Salesforce.com replaced it. While Salesforce shares bounced initially when the switch was announced, they have essentially gone nowhere but sideways since then. Meanwhile, the price of XOM, which took a hit on the announcement, has doubled. And it's not that people are suddenly buying Exxon because they've fallen in love with fossil fuels. Nor is it because investors have fallen in love with the evil empire — because, if there's a company out there that people love to hate *and* that goes out of its way *not* to discourage people from hating it, that company is ExxonMobil.

Which kind of makes you wonder —

Bob: Not me, really. It's clear from my perspective that the enormous cashflow they've been generating is what is making the stock go up a lot. Eventually, people who can identify where the money is going see that, and get into the stock, for the cashflow. That's increasing XOM's valuation.

That doesn't surprise you a bit?

Bob: I mean, it was entirely predictable. When a stock gets knocked out of an index, there's immediate selling of it, more or less matched by immediate buying of its replacement. Many institutions and investors are not able or willing to own something that isn't in their mandate, which is often index-specific. But long term, it's generally a great sign for the market prospects of whatever is kicked out — and a bad omen for the shares of whatever is put in. It is basically the same phenomenon that made the Dogs of the Dow strategy work for decades. The behavior is created by people being people. And people haven't changed. If anything, as investors, people are more hyperactive today than they were in the past. Predictably acting on short-term news, instead of thinking about the long-term prospects of a business.

So you're optimistic about the world staying relatively flat, despite the current political vibe, and on an improving outlook for companies based here that make things needed in global markets?

Bob: Well, of course, the political climate — fluctuates. But an important premise of ours is that we are witnessing a reascendance of the idea of the revenge of the old economy. And in it, North America's positioning could scarcely be better — because of our energy advantages, our commodities advantages, even geographic advantages. In very many ways, North America is rich in natural resources. There are finite resources produced by companies that investors haven't really appreciated or cared about for the last number of years, because the businesses are not high-tech or computer-related and certainly not asset-light. "Why worry? Computers and AI will figure something out so we won't really need physical materials."

Except for roofs over our heads, something to eat, transit equipment and by the way, a ton of the often-exotic stuff that makes tech work — plus energy to fuel it all.

Bob: The reality is, advanced economies are resource-intensive economies. Now, I've been a fossil fuel investor since 1976, and if there's one thing I've learned it is that meaningfully reducing our reliance on fossil fuels — much less getting off of them entirely — is a much longer and more difficult process than anyone believes. It already has been and will continue to be. The mere fact that we, as a society, believe we can get off fossil fuels, guarantees that we *under-invest* in them. Meanwhile, we are investing in renewables, and we'll continue to do that. But the irony is that when you invest in creating renewable energy resources, you invariably create strong demand for all of the finite physical resources required to build them. Think of how much steel you need, how much copper you need, how much of all sorts of exotics, uranium, even crop land. You need a whole bunch of things. And producing all that requires lots and lots of oil and gas, which people are basically under-invested in. That's what's creating an interesting opportunity for the stuff we're investing in.

All that resource demand has me thinking the respite from inflation we've been enjoying will prove lamentably short-lived.

Bob: Clearly, there are inflationary pressures, the way the world is evolving and the way America is evolving. And if you kickstart that with some accelerants, things like the tariffs the new Administration has bandied about, it's hard to envision that *not* adding to inflationary pressures. Now, we do think that inflation is part of the normal course of events in a growing economy. We've just happened to have recently lived through a really odd period where it went away.

Which you've written was "Brigadoon," so you're not holding your breath for its return. That also implies upward pressure on interest rates, does it not?

Bob: The thing about interest rates is that we've been extremely fortunate so far. The reason that cryptocurrencies gained popularity starting a decade or so ago was an emerging consensus that the government piling on unprecedented amounts of debt would mean that, eventually, we would have to devalue the dollar. Suddenly, investing in a stable currency alternative became attractive.

Crypto is many things. Stable isn't one of them.

Bob: Cryptocurrencies have been anything but stable. Their premise was faulty, but that's okay while the coins keep rising 20% compounded per year. Investors don't need stability, as long as crypto is appreciating like that, they'll take the appreciation. Still, their base premise was to buy crypto for stable valuations. That didn't work even though the other part of that decade-old premise *has* played out. Governments worldwide, not just the U.S., have continued piling on debt. This hasn't, yet, led to currency crises — but at what point does it really start to take a toll?

If we're *not* in an alternative universe, where money, like truth, is whatever it's convenient to say it is in the moment, I suspect there will be a tipping point.

Bob: Well, the Treasury over the next couple of years will have to regularly go into the market to issue new debt, raise new money, just to pay existing obligations — much less to fund new ones. I think that is going to (finally) create price discovery in the fixed-income markets. People are going to say, "*No más.*" At the very least, no more at these rates. "If you want more money from me, then I want more in return." I can't help but think that the continued growth in government debt issuance is likely to accelerate the process — so change finally comes. If not, the other premise I have is that I don't understand monetary policy at all.

I suspect monetary practitioners work really hard to confuse most people.

Bob: Well, the way I've looked at the world through my adult life tells me that the cure to the inflation of the 1970s was not Paul Volcker's interest rate hikes.

Heresy! If not Volcker, who or what?

Bob: The cure to that bout of inflation was China's rapid evolution. Let me explain. Around then, China started making everything that the rest of the world needed, because (in part) it could do so for far less money than the rest of the world could. When its new leader, Deng Xiaoping, took control at the end of 1978, he focused on reversing Mao's disastrous "Cultural Revolution" by industrializing the country and its enormous population as quickly as possible. As a result, China provided us decades of lower and lower-cost goods and, basically, price stability.

Alas, nothing lasts forever —

Bob: China's evolution to where it is today means they have a population that's no longer growing; it's declining. They are facing rising wages, they have different economic drivers. China used to be a self-sufficient economy. It could make all that steel because they had the iron ore, they had the metallurgical coal, so they had the energy. Now, they have to *import* all three of those things, and many others, to make the products they export. China has become a net importer of raw materials and they have a huge appetite. They need to buy stuff on the global market — *and that is inflationary*. China's role is just different today. Instead of eating inflation, they are pumping it into the system.

Still, inflation *has eased* over the last couple of years —

Bob: Only because China has been acting to suppress inflation *temporarily* because their economy has been so weak. Yes, they report that their nominal GDP has been positive. But they have really been in deep recession there. It is hard to see in the statistics, except in the property sector, but the way the government has been trying to deal with the recession is by just keeping their industrial base producing things — for which they're seeing little or no demand — and by the selling the stuff that they don't know what else to do with at whatever price it will bring, anywhere. They can "afford" to dump it, and depress global prices, only because they're not in it for profits. They are in it to keep Chinese unemployment from spiraling out of control. The social cost of that eventuality is perceived as just too great. The last thing the CCP wants is too much joblessness destroying social harmony.

It seems obvious that can't go on forever,

especially with demographics shrinking the nation's labor pool.

Bob: True enough. So, while it is China's dumping around the globe that has depressed inflation for a few years (and nothing the Fed's done), it's highly uncertain how long China will play that role and also how long China stays mired in recession. Now, I don't think that's a new permanent state of affairs — although I *don't* know what China's new "permanent" state of economic growth will be. Clearly, it's not going to be what it was for all those years. It's a different place today.

Geopolitically risky, too. What is it going to do to get out of that bind?

Bob: It's an odd world. We all know there's a technology war between us and China. We don't sell them advanced chips; they don't sell us rare earth resources. But it is not just that. It does seem, to me, concerning that this resource competition with China has the risk of broadening out.

In what way?

Bob: Well, take copper. It is a commodity resource we keep thinking a lot about at Robotti. What role does it play? Where do we get copper from? How much copper do we need? I have visited the copper mines in Chile and done lots of research; it's a very intricate global system. The ore is mined in the Congo, in Chile, and in some other places in the Global South, like Mexico and Peru. Then, today, the vast majority of it is shipped to China, where it is refined and processed into copper cathode, the pure form of copper that's used to make wire, ingots and alloys. Chinese industries typically buy a lot of it to make the copper products that you and I and other industries use, and the rest it exports. It's a very intricate and integrated global supply chain.

But fragile you're suggesting? Copper is essential in everything from EVs and wind turbines to household plumbing and wiring.

Bob: What I am getting at is that all those things are going to cost more and it's going to take longer than expected to scale up their production. When I was in Chile —

That's not a quick trip. What got you to go all the way down there?

Bob: Finning (FTT:CA) is the largest Caterpillar dealer in the world, founded in 1933. Its head office is in Vancouver and operating headquarters in Edmonton. Historically, Finning's market is Western Canada. But over the years they have acquired other dealerships. Today, they own pretty much the entire U.K. market, including Scotland, Ireland, England. In addition, they own the Caterpillar dealerships in Chile, Argentina and Bolivia. They held their late-2023 investor day down in Antofagasta, Chile, and I was invited. I visited their facilities and then eventually went to an open pit copper mine to see the process from beginning to end; all the equipment they supply actually digging the ore. I always find it interesting and informative to go see and touch things — and it's fun.

I assume you spent more than a day there?

Bob: Yes, I spent three days there and then, as long as I was in Chile, I spent a couple of other days around Santiago, visiting other companies. One is a copper recycling operation that takes newly produced tailings out of mines but also harvests the tailings that mines generated 30, 40, 50 years ago and extracts incremental copper from them. I wanted to see how that process works. Then I also visited with Capstone Copper Corp. down there, which is building a new extension to a mine they have in the Atacama Desert. I talked to them about what they are doing and learned some interesting things.

Go on —

Bob: Well, in my last meeting with them they said that since the government had just, in effect, banned miners from using the groundwater produced by their excavation work in any of their mining processes, all the mines in Chile (most located in its famously dry Atacama Desert) are going to have to depend on using desalinated water to run their mining operations. In that light, they were pretty happy to be able to tell me that one of their assets is a desalinization plant located on Chile's coast. They boasted that it will be providing its state-of-the-art desalinized water to their new mine extension. They also told me that there's another mine near the one they are expanding that is also planning a next phase — and that Capstone will be expanding its desalinization plant to supply the neighboring mine, as well. But of course, desalinated water is 10 times the cost of ordinary water —

And takes a lot of energy to produce —

Bob: It's significant. The energy footprint for the copper project is now 30% higher than the original estimate because the desalinated water costs so much in extra energy and money. Therefore, Capstone is going to need to consume more energy and invest more capital in the expansion project. And it will take a longer time to get from the point when the project was officially sanctioned into production.

Now, Chile has significant lithium resources, as well. An American company, Albemarle (ALB) right now has the second-largest lithium concession down there. The largest is a owned by a Chilean company, Sociedad Quimica y Minera (SQM), but a Chinese company, Tianqi, is its second-largest shareholder. Anyway, the Chilean government now has gone to both of its lithium producers said, "Hey, listen, when your current deals run out, you can renew, but we're going to take half-ownership of the project. And, if you want to do any new lithium projects, we'll own half of those, too."

Isn't that what's used to be called expropriation of private capital?

Bob: At least in part. These governments now typically want to control the development process, to try to control the environmental impacts that result from development, and to own part of the economics of it. They're in a position to demand that equity and control for their citizens in their negotiations with potential developers — because their resources are scarce and very much in demand. With such strong hands at the bargaining table, they can command better economic returns for their citizens and the projects developed will probably be much better for the environment.

But be higher-cost, in time and money.

Bob: As I said, development projects will take longer. The costs to do most everything will be higher — and it won't be just because the highest-grade ore was processed long ago. Everything involved with these industrial commodity processes, whether for lithium or copper or any of the others, is going to cost a lot more while we are bringing on the incremental supply the world needs to be able to decarbonize. What's more, because of the very nature of the processes we'll be expanding to produce those incremental supplies, we'll probably be consuming a little bit *more* energy to get there, too. Initially, at least, it's likely to be one step back for two steps forward.

You make resource investing sound like a veritable minefield.

Bob: Still, we see clear and obvious long-term drivers for natural resource companies. Then the question becomes how do we participate, invest to capture their advantages — and avoid the pitfalls in that process. Finning, the big Caterpillar dealer out of Vancouver, we think is interesting. It trades at like 10 times earnings and is the exclusive Caterpillar dealer in a lot of these countries, including Argentina.

You haven't mentioned Argentina before. Did you add it to your trip to Chile?

Bob: No, but Argentina is another country we think probably will do really well. Jeffries had a trip down there last April, and I went. Part of the country's advantage is that they are natural resource-rich, in every way. And the next 10 years, we think, will be good for all those things.

Go on —

Bob: Well, Argentina not only had a business- and development-favorable change in government in 2023, but it really has underlying economics that facilitate new investment coming in for development. So now, economically positive events are happening — in places where you *kind of knew* there likely were significant resources, but they were never commercially exploited. For years, there really was *just no way* to do business there.

You're betting it's finally turned the corner?

Bob: Well, that's definitely what's happening in oil and gas in Argentina. Its Vaca Muerta shale lands hold the globe's second-largest shale gas reserves, and drilling activity there is going to double in the next two years — which is just the beginning of the opportunity. That means that [Javier Gerardo] Milei, Argentina's newish president (and an economist by training, by the way) probably has something to work with. He is going to get both revenue and drivers of economic activity from that development, which should enable him to implement the plans he was elected on. If he had tried doing it 10 years ago, he wouldn't have had that backdrop of economic support. He's running a natural resource-rich country at a time when the call on those resources is clear, obvious — and will continue to grow for a number of years.

Very much a long runway, as you like. So how are you participating? Investing in the local companies, or via multinationals?

Bob: We'll invest in local companies and also in multinationals. We have no predetermined roadmaps we follow: "This is how you do it." Clearly, our capital can go anywhere — in large part because we don't have that much capital. It's not like we have to take enormous stakes to move the needle for our investors. Even companies with market caps of only $200 million or so, we can take reasonably meaningful positions in. And, since we tend to own them "forever," we're not concerned about daily liquidity or lack of liquidity. In fact, we're used to running into "lack of liquidity" frequently when deciding to enter into positions. It's a function of buying stocks when nobody else is interested in them. That manifests as nobody buying or selling. Listings just languishing.

Another place patience figures into your work —
Bob: It does. I will say that we occasionally get a bit frustrated when we're advising beaten down companies we've invested in, where we see opportunity sets ahead of them that are much better than the market is currently perceiving. We tell them, "You should buy back your very undervalued stock, given the economics of your situation." But they frequently say things like, "Well, we don't really have much float and we think a buyback will affect the market price of the stock."

Isn't that generally the point of a buyback?
Bob: They're focusing on the wrong thing. I tell them to forget about the float impacting the stock price; to forget about their quote. Their stock is not going anywhere until they are making money."

However, given their valuable resources, assets and long-term prospects, they *should* take advantage of their financial capacity to reduce the number of the company's shares outstanding. That way, in three, four or five years time, when the company's earnings power finally manifests, the per-share profits numbers it will report are going to be much higher. Meanwhile, the reality is that the stock will never become actively traded until that happens — then, its price will go up 2, 3, 4, 5 times. Suddenly people will want to buy and sell the stock, volume will show up and they will have market liquidity.

So companies are not going to create or discourage market liquidity by buying back shares that really don't trade today. All they are doing is throwing away an opportunity that's clear and obvious. When you've been dealt a hand and you have the low cards, you *bet* the low card — not the high card. You're *not* going to win that game. You're going to win the low-card game.

Play the hand you're dealt. It's so simple.
Bob: Well, we've invested this way for 50 years, and seen these stories again and again and again.

Still, your clients must be an iconoclastic crew — to persistently stick with a strategy so deeply contrary to what the crowd has been chasing. Granted, their numbers are dwarfed by the mobs at a Fidelity or a Robinhood.
Bob: We've never competed for fickle, performance-chasing capital. That money is a mismatch with our strategies, how we do things. Our clients are basically friends and family, stretching back 50, 40, 30 years, whose investment thinking aligns with ours. That's why when we've had lean periods — and we definitely did have one, post the GFC — they were patient. Which was crucial. You really can't manage investments if the capital you are entrusted with is not aligned with how you think about investing. Alignment with our investors has been critical to enabling us to do what we've done.

You've never been tempted to take the easy road, just invest in a passive index and ride a rip-snorting bull market?
Bob: That has worked for some folks, too. That's perfectly fine and that's great, we think. Because we think that's what sets up the landscape for us. What I've realized, on reflection, is that I was fortunate in starting my investing career in 1975, precisely *because* the market had corrected so severely in 1973-'74 — though I didn't realize that at the time. What's more, that painful bear market was the market's way of correcting the considerable of excesses of the late-'Sixties mania for the Nifty 50, which supposedly made "one-decision" stocks the only things worth owning. Just buy them and hold them because they'd always make money — and so would you, *no matter what entry price you paid.*

A pleasant illusion while it lasted —
Bob: But, boy, if that isn't a really loud rhyme to where the world lives today!

Gee, you've noticed?
Bob: Oh, yes. This is not really like the internet bubble, that was a different phenomenon. But if you look back to the Nifty 50, man, if we're not set up for a rerun of sorts.

In what sense?
Bob: When the Nifty 50 market broke, lots of investment capital (that wasn't instantly vaporized in the crash) got reallocated away from the large-cap stocks that had been the market darlings. Capitalizations had gotten so inflated during the bull market that even when the capitalizations of many of the Nifties were chopped in half, there was still a huge amount of investment capital in them, in the market. The thing was that, as that (largely institutional) capital was reallocated, it in effect poured into really cheap stocks —

The value stocks you had started buying —
Bob: Which then did very well. Today I am even more excited by a similar opportunity — because at this point so much investment capital is not only in the "Magnificent Seven," stocks that have done supremely well, it's also locked up in this other asset class, called private equity.

I'm so glad to hear you bring PE up. Institutional and high-net-worth money has been scrambling to pay any price to get into PE deals like they ensure perpetual Nirvana, for what seems like forever, now.
Bob: The ideas behind the private equity business gained currency starting someplace back in the very much deal-driven markets of the 1980s. People started PE businesses with the idea they could identify companies trading in the public market at prices far below what the assets and the earnings power of the companies were.

Rather like you do.
Bob: Up to that point. But the business model is entirely different. PE businesses were basically private partnerships set up to opportunistically buy very undervalued companies at depressed market prices — acquisitions often accomplished by using public money raised in the junk bond market — to substantially lever up the very assets they were buying. When all went as planned, the acquired companies' inherent earnings power then threw off sufficient cashflow to repay the high-yield acquisition financing in relatively short order. And as the companies' earnings power resurfaced, the lucky few equity owners of the PE firms reaped great returns on the very little capital they'd invested — most often because the acquired companies were then sold again at much higher valuations.

The strategy was basically just buying cheap companies and accelerating the process while using leverage to turbocharge insiders' returns. But this new asset class over time came to look like it had a huge tailwind that just wouldn't quit. Which is interesting in and of itself.

Elaborate, if you will —
Bob: The idea that for 40 years, we've lived through *one part of one cycle* during which probably the most important economic metrics, inflation and interest rates, have been suppressed, is just unbelievable on its own, in my view. But what does that mean in regard to the tremendous success this new asset class, private equity, has had in attracting capital over that same span? Well, by definition, all the capital that has been attracted to private equity is *not* in the public markets. Instead, it's in a business model that is fundamentally flawed because there is no market mechanism to price those assets. The assets are marked to a model. Which is as if students were allowed to mark all of their own grades.

Which is why many institutional investors love it — no inconvenient interim drawdowns in NAV to report. Besides, what could go wrong?
Bob: Yes, many investors love private equity today — though they should know better — because they've convinced themselves that since PE valuations don't fluctuate with the market, they have *no* volatility — which equates, they've been convinced, with *no risk*.

You sound a mite incredulous.
Bob: Those assets are invested with *no risk*? Despite the fact that they are invested in levered companies that are probably competing with publicly traded business that *aren't as leveraged*? The institutions are thrilled not to worry about their asset values fluctuating; not to have to mark to market their portfolios. They tell themselves that they kind of know what is going on, so it's okay; that they are smart enough to manage any issues that arise within the anticipated durations of the investments.

I hear a big "but" coming —
Bob: *But* the sheer amount of capital that has flowed into private equity at this point is *so* significant, it's staggering. And any notion that the institutional assets in those private equity deals were invested with big margins of safety built in — is nonsense. I argue that private equity is an *efficient market* in the sense that when you buy or sell a business in a private equity transaction, you get or receive a fair price. There's no buying at a big discount to intrinsic value, or selling at a huge premium, which can happen in the public markets.

Courtesy of Mr. Market's mood swings.
Bob: Now, today, things are probably trading in the public markets at somewhat inflated prices, given investors' tendency to be bullish. "I think interest rates will come back down, because inflation is dissipating again, and therefore these multiples probably makes sense — I can rationalize them." But of course, we also know what's going on in the PE space, with the pace of transactions slowing at the same time that a lot of the PE funds are trying to extend their durations. It's clear that the bid/ask spread between where many PE deals would be priced in private transactions, and where they've been marked — and where their investors would be willing to sell — are very wide. The upshot is there's no liquidity because there can be no transactions without agreements on price.

Sounds like you expect air pockets —
Bob: I don't know the timing. *Maybe* PE investors

gets bailed out temporarily because inflation has come down and therefore interest rates have come down and maybe private market multiples move back up, so some PE investors can exit their positions without losing *too much* money and move on to their next new things. But at some point there's clearly a huge risk. When inflation stays more persistent and rates go higher to reflect that fact, the multiples that all of that private equity capital is able command will go much lower. At least some of that capital really needs to be reallocated someplace else before then.

Let me guess, you're suggesting equities would be a lovely destination.

Bob: Well, yes. PE is a second huge pool of capital that potentially could be reallocated into cheap, small-cap equities, as institutional money was, after the 1973-'74 bear market.

The other pool of capital that I see potentially coming into small-cap equities is in fixed income. There's still no margin of safety in the fixed-income market, that's for sure. It *may* not be mispriced, though I actually think it is, a little bit. But if inflation does become more persistent, rates will have to adjust, and that price discovery will be aided and abetted by the fact that the Treasury will be regularly going out into the market to issue new debt — and discovering what rate has to be attached to sell it.

So what you delicately call price discovery in bonds will then make undervalued equities look a lot more attractive?

Bob: My point is, all that means there now are three huge pools of capital struggling, to one degree or another, with troubled valuations — Surely, some of the asset managers responsible for all that capital are going to look around for alternative places to stash it at higher prospective returns. They'll wonder: "Where can I start to recirculate my capital back into something that's currently cheap? What can I buy that really *does* make sense? Those are really powerful forces.

Indeed. And it's not a happy prospect for private equity land —

Bob: Very true. I've been around. I've known the folks at one or two private equity funds for a long time. They invested with me a long time ago. Recently, I've pitched them on a beaten-up company.

Tell me more — did they bite?

Bob: "Look at this company," I said. "When you started your business 40 years ago, this would have been an obvious candidate for you to buy. Why don't you buy it now? Look at the balance sheet and look at how you could leverage it. Look at the cashflow it generated two years ago. Think about it, was that an anomaly? Or a manifestation of something repeatable? It wasn't a fluke, so why wouldn't you want to buy it at this very depressed valuation and leverage it up?

I take it your pitch fell on deaf ears?

Bob: No interest. They've gotten so huge, the company I was pitching wasn't big enough to "move the needle" *instantly*. Instead, they're going to buy some service company with a big multiple on it, which will cost a lot of money. That's the kind of deals we're seeing more and more in the PE space, often one PE firm buying something from another PE fund. In this case, the PE guys are actually going to be buying the high-priced company, in effect, from themselves — because they haven't been able to monetize the asset as quickly as planned. But now, they need to monetize some of their investors — so they're rolling the asset over into what they call a "continuation fund" — and putting more of their own money into it.

So at least some PE investors are getting out while the getting is good —

Bob: I don't really know. But at Robotti, we have solid reasons to think that things are happening in certain of our portfolio companies that mean their latent earnings power will really start to manifest in the next year, two or three. When that happens, probably within two years, it won't even take something like a sector rotation in the overall market for investors to realize these things are all *very* cheap, based on those resurgent earnings. The stocks will do well. It will become obvious that, "Oh, yes, if they have done *that,* in two years' time, they're going to be *there*, doing *that*. So these things are *cheap*." We've already seen a couple of companies we were holding go through that progression.

Which explains how you can be classified as a growth investor, these days, I guess.

Bob: Again, I don't know the timing more specifically. More likely than not, it'll be kicked off by something happening elsewhere in capital markets — something that prompts investors to reassess asset valuations and realize what really is cheap. It's never that a guy who owns Nvidia wakes up one day thinking, "Let me sell my Nvidia to buy this commodity cyclical stock because it's cheap"— that just never happens. That guy probably never takes his profits off the table, and if he does, he likely buys another stock like Nvidia.

Investor Psych 101: He *knows* what works.

Bob: Precisely. He's not looking for stocks with modest valuations, whether in commodity cyclical businesses or any others. No. He *knows* those kinds of stocks aren't investible. That's not what savvy investors do. *Nobody* invests in those things. So the enormous pile of capital devoted to the "Magnificients" won't break — nor will its holders even think about reallocating — unless and until something happens to force that reckoning.

You, by contrast, are primed and ready, I take it, for stocks like the Cat dealer, Finning, to shine?

Bob: Yes, Finning is an example, especially with its South American unit's exposure to Argentina, Bolivia and Chile, where there are world-scale projects in lithium, copper and oil and gas still in the early stages — but really coming together — and for which there will be enormous demand.

Yet Finning's valuation is modest?

Bob: Yes. It trades at 10 times earnings; it pays a reasonable dividend. They buy back stock on a regular basis. That's a modest valuation for a business that I believe is structurally set up for a huge cyclical increase in demand. What's more, Finning's is a service and parts business: A dealership, not the manufacturer. So its model is more recurring-business, higher-margin than many commodity cyclicals'. Finning's attributes, its geographic positions, its business model all make it more desirable. It's a stock that should do well over the next three-plus years.

Then you see a long growth runway in companies like Finning?

Bob: The commodity cycle has taken a very long time to come around to turning, therefore, the upturn should be underway a long-time before investors have to anticipate the inevitable risk of the process turning the other way.

Which is, alas, baked in the cake. Unlike many tech investors, buyers of cyclicals can't easily get carried away dreaming of growth "to infinity and beyond."

Bob: *Everybody knows* how the commodity cycle traditionally manifests — that in commodity cyclical businesses, the cure for high prices is high prices, right? Because high prices mean high profits. High profits mean attracting new capital. New capital means new capacity. New capacity inevitably is never added in the right amount. Eager new competitors overdo it — kicking off the next down cycle.

It has *always* been thus —

Bob: Today is very interesting, I think, because it's been a very long time since the last up-cycle in commodity cyclicals, as we've said — and, in the meantime, global economics have matured, developed in various ways, the inputs affecting them have changed and the impact of economics has broadened. Certainly, the scale of global economies has become just so massive —

You're *not* saying, "This time is different?"

Bob: I know better. But there are *a lot of unknowns*. Just actually implementing the bunch of copper projects that it's anticipated will be required to transition from fossil fuels will take a very long time *and use up* enormous stores of fossil fuels, at immense cost, as we've discussed. And the Global South, the developing nations in the geographies where that can happen, will likely be in better positions than they've ever been to command more ownership in the projects. They likely will set the terms.

I can't imagine owners of capital exactly welcoming that, if history is any guide.

Bob: I'm aware. But I tend to look at the world through rose-colored glasses. So yes, historically the Northern Hemisphere has taken advantage of the Southern. They have lots of natural resources in the South, but we've just taken the resources away and left the people there with little opportunity to develop. In that process, the Global South has stayed poor and we've done what we wanted to do with the resources. Of course, we've ended up with the inflation; we've ended up with most of the pollution, while they've just kind of suffered through the process.

You are suggesting that shifting the pattern in place since 1492 is a good thing?

Bob: Good or bad, for the first time, people in the Global South are in a position to say, "No, no, no. We know exactly what is fair and equitable treatment in this world; you can't get away with what you could have gotten away with 50, 70, 100 years ago." They'll be at the bargaining table, and well-positioned to negotiate more environmentally-sensitive developments — with a much larger share of the economics flowing back to geographies originating the resources.

But can they get their acts together to pull that off? Become stable economies built for world-scale business?

Bob: Can't really say. But if, somehow, the Global South can just capture *more* of the economic benefits of their natural resource base, a lot of good things potentially happen. I know, somebody should pinch me, tell me to return to the real world. But those are plausible scenarios that would be for good mankind, even if "sharing the wealth" isn't the first choice of some. And the mere fact that these scenarios are now plausible means that the pace of very-much-needed development can't be as fast as it once was.

Why? If existing producers won't play ball, AI can tell would-be rivals how to step in.

Bob: It's not a knowledge problem. You can see that — or I see it — in the oil and gas industry's moderated response to rising demand. As you know, supply and demand visibility for that industry now is extremely foggy. That is a serious issue in a highly capital-intensive business in which assets have 20- or 30-year useful lives. The question becomes, "Do I want to spend all that money to build new capacity, when I have conviction that the new assets will be economic only for five years? I can't predict what the next 25 years of those assets' useful lives will look like."

The reality is, even if the energy producer decides to take the risk — and can get the necessary financing — that the added uncertainty will have the producer — and its lenders — demanding a lot more money up front. They'll insist on getting their return much sooner to compensate for the less-certain future.

Now, if that happens broadly in an industry like oil and gas, I can't say if the impact is that the supply/demand cycle will be *eliminated*. But we will have definitely *deferred* what normally might have happened and whatever the responses might have been. I suspect that's likely to produce an industry with a more persistent, recurring, predictable earnings stream for a lot longer than anything it has ever generated in the past.

Perhaps the energy industry is just so chastened by the shale oil boom/bust that it's finally learned to pull in its horns?

Bob: Whenever I hear that, I think, "Give them three good years and *then* tell me if they're still holding to capital discipline.

And you call yourself an optimist?

Bob: When capital discipline is self-imposed, internally imposed — it rarely lasts more then three years, even if outside investors seem, for a while, to want it to. What I'm talking about is a discipline, or moderation, resulting from *structural* changes. The oil resource in North America is relatively finite. I don't see "drill, baby, drill," or anything else the government might do really changing the domestic oil industry's trajectory much from what it would have been, had Trump not won. Oil production was hitting record levels under Biden. There aren't a lot of untapped oil prospects here to exploit quickly.

And these depressed natural gas prices aren't tempting wildcatters.

Bob: Of course, one of the little ironies or complexities of the industry is that when you produce a lot of oil, as the domestic industry has been, you inevitably also produce natural gas. It's a byproduct that drillers can no longer just flare off — and one that takes a lot of infrastructure to get to market. So too much drilling creates supply gluts that weaken gas pricing and gas markets — and that depresses drilling activity, particularly onshore, which has been moderating. But there really aren't any quick response levers the new administration will be able to pull to change that.

Building gas processing facilities and export terminals takes time —

Bob: Exactly. The new Administration says it will authorize more LNG export projects, but its members are unlikely to be around to cut any ribbons at opening ceremonies or to see LNG exports rise. Even the facilities that were well along in permitting and development when Biden held them up (early last year) can be expected to take four years' work (an entire Presidential term) to get from the word "go" to producing their first LNG for export.

So natural gas demand and prices are going to be predicated on how much we consume here and how much we can export from existing terminals. To be sure, there's a huge disconnect between gas and oil prices in North America. Gas prices here are about $3 a btu, which is equivalent to oil going for $18 a barrel. In other words, a domestic energy producer can sell his oil for $60 a barrel, but for the energy-equivalent amount of gas, he can command just $18 here. They are very different commodities.

Always have been. But the price of natural gas, or LNG, is much higher overseas. Won't more exports from here drive U.S. gas prices higher, and lessen the advantages you see commodity industrials producers getting from cheap gas during the transition to alternative fuels?

Bob: That will take a very long time. The big conundrum in resolving the tension between fossil fuel usage and world escaping global warming by capping atmospheric CO_2 is that the world is flat. We're all too connected. Europe is putting themselves out of business by trying to quickly reduce their CO_2 footprint. To do so, they're just importing a lot more from China — which is burning a lot more *coal* (with its much higher carbon intensity) to make the stuff.

So what are they achieving? The Chinese economy is already multiples of Europe's size and its carbon footprint, far dirtier. So exporting European business to China was an odd decision to make — especially for a benefit (lower global CO_2) that you're not going to be able to derive.

Unless they're erecting a bubble over the Continent, that's Looney Tunes.

Bob: It wouldn't help. Then, when you look at plans to shift a lot of industrial capacity to India, you run into the same thing. India also depends on coal for energy; that's what they have.

In fact, I was shocked in September, when I flew to Mumbai to go with ArcelorMittal (MT) to visit a steel plant in western India that they own with Nippon Steel (5401.T) - ADR: (NPSCY). [The joint venture, ArcelorMittal Nippon Steel India Ltd. (ESTL.NSE) and (500627.BSE) trades on India's National and Bombay markets.] They explained that they bought the plant out of bankruptcy in 2019 and refurbished it, growing out part of its footprint. But they have a planned cap-ex program to double or even triple production out of the steel mill over the next decade.

That's shocking?

Bob: No. The interesting part is that all the new capacity they plan to install will be produced *in blast furnaces* — which are designed to last 40-50 years. Now, producing steel in blast furnaces creates *four times* the carbon footprint as doing it in electric arc furnaces, the newer technology, assuming they consume renewably generated electricity. In other words, here, they are building out a new industrial facility that's going to consume huge amounts of metallurgical coal, creating a huge carbon footprint — on a globe where we're supposedly focused on minimizing that.

"Supposedly" is right.

Bob: People talk about how hard it is to decarbonize, so Europe is pushing carbon taxes to raise costs and force producers to shutter blast furnaces and switch to electric arc furnaces (EAF). Well, that is perfectly fine, but the European steel industry produces 100 million tons a year. And with this new ArcelorMittal project, India is going to be producing 240 million tons, up from 140. It is going to build an industrial base equal in size to Europe's, with all that incremental steel coming out of blast furnaces. Europe can convert all theirs to EAF, at significant cost, then where will they be?

Competing with much-lower-cost steel coming out of India, potentially on the road to bankruptcy, and very likely breathing much dirtier air, along with the rest of the world, you're implying?

Bob: You probably saw news photos of particularly dense smog in some major cities in India last fall. A cloud of brown pollution, which used to be casually referred to as the "Indian Ocean brown cloud" is pretty much an annual occurrence — hanging over the Indian subcontinent during fall and winter months. India got concerned for its image 15 years ago or so, and got UN scientists to rename it "the Asian brown cloud." But if they thought the cloud then, which largely stemmed from the region's farmers burning crop stubble, was unfairly tarring them with a bad brush, oh man, is there going to be *a lot more tar* on that brush from those blast furnaces.

Yet you are essentially optimistic about an industrial revival against the backdrop of so much folly?

Bob: Yep. Because it isn't happening based on political agendas. It is being driven by *economics*. Before you ask, my favorite example of that in action is that over the last 10 or 15 years, the United States actually has significantly reduced its CO_2 production — because we've been decarbonizing our electrical grid. Today, instead of 40% of electricity being generated from coal, only 20% is. And 40% is generated from natural gas. The fracking boom led to an abundance of a low-priced resource with a much lower carbon footprint, and utilities were (relatively) quick to convert their generating capacity. It was the change in the industry's economics, not government regulations that drove a better economic result that also happened to be environmentally better.

I'd argue that utilities were also getting nudged in that direction by liability suits and such.

Bob: But it is the economics that work overtime; economic forces are not controlled by any one individual, or political agenda. As I've said, we do live in a world with an inflationary bias, which will see inflation spikes from time to time, and in which there's movement in the flow of capital and of productive assets to the places where they are now economically advantaged, in this moment. Inevitably, industries highly reliant on energy will move out of China to the rest of Southeast Asia or India or Brazil or Turkey — and North America's low-cost energy resources will rise in value. What's more, as global economic activity picks up, energy consumption significantly increases quickly.

Before we wrap up, can you point to an investment you made over the last 50 years that taught you an invaluable lesson for thriving in value land?

Bob: I'd be hard pressed to make an all-encompassing choice, considering my career spans so much market history. But I did learn one valuable lesson pretty early on, when I did a bunch of investing in bankrupt assets. Back then there was an active arbitrage market — value investors would buy deeply discounted creditors' claims (often from anxious banks that had been left holding the bag for several years as the cases ground through litigation) if their research said those assets were likely relatively soon to be exchanged for valuable equity in a reorganized company.

One situation that caught my eye in 1986 was PHL CORP, which was what the corporate husk of Baldwin United was renamed as it prepared to emerge from the very big and messy bankruptcy it had collapsed rather spectacularly into in 1983. As it turned out, Joe Steinberg and Ian Cumming, the then-young financiers behind Leucadia National (LUK), also saw value in that Baldwin United remnant. At the very end of November, they surprised Wall Street and the bankruptcy court with the announcement that they had quietly acquired creditors' claims amounting to nearly a 40% equity stake in PHL Corp. and intended a hostile takeover the company's management, which they pulled off in short order.

That's a blast from the past. But my old friend and colleague Rhonda Brammer deserves the credit for most of the heavy lifting we did to expose that can of worms.
Bob: Well, Baldwin United had taken over so many disparate assets in so many convoluted transactions during its ascendance that even after the restructuring, the surviving bits and pieces that Steinberg and Cumming's investment company, Leucadia, ended up controlling — at very depressed valuations — looked very interesting from a value perspective.

Bankruptcy investing was a flourishing arb strategy then, thanks to the long bear market and the recession-ravaged economy —
Bob: It wasn't for everybody, but I had become reasonably good friends at that juncture with Alan Kahn, of Kahn Brothers —

Say no more! A "value-able" buddy, indeed.
Bob: Way back then, we shared a fascination with buying all these little stocks no one was interested in — shareholdings in which the big investment risk often was that the controlling interest in the company could get bought by somebody with access to more capital — who realized that the assets were worth much more money than the market price. Once they got control, they would deal out the cards. One for you, one for me, one for you, two for me, one for you, three for me, one for you, four for me. Dealer's privilege.

I suppose, but galling.
Bob: Exactly. Eventually, It would be like, "Oh, come on now. That's not really fair." And it wasn't. But I also had the lack of foresight to decide that I should sue those people when I had cause — an opportunity to bring actions against them. So I actually sued Ian Cumming and Joe Steinberg — a number of different times.

I was unaware. Tell me you bought equity in their law firm first — or something!
Bob: If only that were even possible. Eventually what happened is that we settled the last case. They had all stemmed from what happened after the market crash of 1987. When stocks cratered in that event, Joe and Ian jumped all over the opportunities surfaced by depressed valuations in things like Brae Corp. and PHL CORP — and created so much value in their investment vehicle, Leucadia. Then they demutualized an insurance company that PHL CORP had taken private, called Empire Insurance, at only $6 a share, which we thought was easily worth twice that.

So that's what it was. We saw Leucadia taking advantage of the minority holders and it upset me. We ended up involved in a number of lawsuits.

Which were, of course, time-consuming and expensive, not only in terms of what it cost to pursue them, but in terms investment opportunities you probably missed —
Bob: That's what it was. We eventually got decent settlements, in the Empire litigation, for instance, they actually ended up paying us $12 for our shares, vs. the $6 they'd paid the public. But Joe is a really shrewd, smart guy, and really got the best of me in that case, in the end.

How so?
Bob: I had to leave the last settlement meeting early, right after we had agreed on the price. So I said, "Great," and departed. It wasn't until I was gone that Joe said to everyone else, "Oh, just one more thing. The final settlement term is that Bob has to sign this standstill agreement. He can't come to our annual meeting for the next 10 years. We don't want him asking questions about this, that, and the other thing about our business, because we don't want to take that stuff into the public domain. He can't talk to the press about our company. He can't own 5% or more of any of our companies."

He went through a whole litany of things that I couldn't do, if we settled the litigation, and I guess I was too nice a guy. I probably should have said, "No way, we're not settling." Because he effectively put me in the penalty box. So for 10 years I didn't go to their meetings, I didn't speak to anybody. I gave up a huge opportunity to be able to see what some smart people were doing and figure out how to participate and take advantage of that. Now, I still did a bunch of things, but I didn't do anywhere near what I could have done.

Opportunity cost bites. That was quite a lesson to learn the hard way.

Bob: Yes, yes, yes. But that's an old story. I'll give you a more recent one. We invested starting in 2009 in Builders FirstSource (BLDR), which started as a distributor of lumber and of lumber sheet goods, mainly to the home building industry. Over time, it has expanded and even added a fast-growing business doing offsite construction of housing components, which are delivered directly to work sites, reducing labor costs and materials waste for home builders.

What did you see in Builders First back in '09?

Bob: It was a combination of factors: How bad the housing industry got during and after the GFC, how low the stocks got, how much consolidation happened in the industry, how many changes happened. The industry's acceptance of offsite construction was aided and abetted by other factors, including the rising cost of materials because all the suppliers also consolidated. Meanwhile labor costs also went up — if you could find construction labor. We'd cracked down, restricted the inflow of immigrants — and that's who builds homes in this country. People born in America don't pick up a hammer, don't pick up a saw, don't do things like that. Someone who's an immigrant does jobs like that.

So guess what, this lack of labor accelerated the adoption of offsite construction techniques and products. In other words, all of the things we look for in cyclical businesses came together at the bottom of the cycle — capital coming out of the business, consolidation, transformation of the business.

What's more, when we looked beyond Builders FirstSource, at the rest of the industry, we saw that one of the competitors was the old Boise Cascade business, renamed BMC Building Materials and Construction Services, was in bankruptcy. Builders and another company were vying to buy it and Builders had a tentative deal. But just then, Obama got Congress to agree to a five-year loss carryback, instead of three years — and all of a sudden BMC was going to get a $90 million tax refund in a matter of months. BMC tried to raise the price on the deal by most of the amount of that refund, and both of its suitors balked at paying the extra money, so all the deals fell apart

Instead, BMC emerged from bankruptcy in 2010, got its tax refund four months later and became a debt-free company with some net cash on the balance sheet. Because it had gone through the bankruptcy wringer, it had gotten costs down. So it was operating at breakeven at the bottom of the cycle.

I'm sensing you bought it at some point?

Bob: It never re-listed. So what trading in its equity took place back then, happened out there in the net sphere. But we called up SunTrust and we called Raymond James. We called some of the ag banks out in California and elsewhere that were pre-bankruptcy lenders to BMC and had gotten stuck with some of its equity in lieu of getting their money back — and we accumulated 22% of the company. We made a very large investment at a very discounted price at a very low point in the cycle.

Then, for three years, I served on the board of BMC. So we were not only investors, but also gained critical insight from my board work — a better understanding of the dynamics of the business, just how local real estate and construction are in certain markets. In some, BMC would get 2-3% EBITDA margins; in others we would do 15%. And in every market we'd have products in which our margin was 2% and other products on which it was 6% or 7%. We learned to research, what's the product mix? What's the geography? What's the competitive landscape? How much is this business worth, how local it is? Those critical insights enabled us to make much better decisions.

We also benefitted from the long downturn in housing. As I've said, the longer something stays bad, the bigger the opportunity set becomes, because more people capitulate. And that's what happened. After first investing in Builders in 2009, we bought a lot more stock in 2011 at lower prices, because the housing recovery never came, wasn't coming, and therefore things were tougher for the companies. Then, even when it finally started to tick up, it wasn't going fast enough to suit most investors.

That explains what happened in 2015, when the Johnson family (of Fidelity Investments) sold the largest lumber and building products distributor in the country, Probuild, which they'd owned. They said, "That's it. We're not writing another check for $100 million to keep this business going. We don't know when it's ever going to turn." And so they sold

Probuild to Builders FirstSource.

Then a few years later, Builders First added BMC to its corporate empire?

Bob: Yes, they approached BMC with a stock merger proposal. I was on the team that negotiated the merger, then I left the board. With BMC on its team, Builders First now has the two pre-eminent companies in offsite component construction for the building industry — something we have long been clear proponents of, as it has evolved. There's no doubt, either, that the COVID crisis accelerated the adoption of the innovative construction strategy, because of its inherent labor savings.

Just in time. Labor shortage will get really tight if the Administration gets its way.

Bob: My point is that there's finally been a big uptake in acceptance of offsite construction, for lots of reasons, that has transformed the industry. And Builders FirstSource today is the amalgamation of four of the five largest distributors. So there's huge concentration in that business. They won't tell you, for obvious reasons, but if you look at individual markets, the market share of BLDR's core business is very high. And its share in component manufacturing is even higher. So in the best part of the business, their footprint is radically different. As a result, others in the industry don't compete with them — they price off of them. They realize, "We will kill ourselves trying to beat them." The industry has dramatically changed. The trigger was the worst recession that home building had ever been through. Consolidations, mergers, transformative business practices — a phenomenal number of different things all came together

And of course we're still not building enough homes to meet demand —

Bob: That's right. The demand is there and eventually it'll get done — even if mortgage rates go higher and the cost of lumber goes higher and labor costs more money, gets even harder to get. The fact is everyone needs to live someplace, so housing has to be built simply because there isn't existing infrastructure to house everybody. That demand will be met.

So you're still holding Builders First?

Bob: Definitely. It's not that I haven't taken some profits out of the position, but I try to stay long in good companies for as long as I can — a lesson I learned the hard way long ago, in the old Ethyl Corp. I describe that investment as my biggest loser. At first I was very proud of myself. I had taken what at the time was a large position for me when it was trading at a beaten down price. Then, 18 months later, when Ethyl had more than doubled, I patted myself on the back while selling most of my position at 48. But I eventually sold the balance of my Ethyl six years later at 275 — only to watch from the sidelines as it climbed to 500. The moral of the story is that when companies turnaround, when it finally all comes together, the runway of opportunity is long — so parachuting out when you've just taken off is not a good idea. You give up far too much.

When a long cycle finally turns, there's a relatively long period of huge growth, assuming the managements have done the right things and the business really has changed structurally, gotten stronger. The earnings power will be greater. And the business really has changed. The structural change means higher earnings. The company did things like buy competitors at depressed prices, opportunistically increasing its inherent earning power. When all those things come together, their impacts layer on top of the cyclical recovery.

Supercharging it, in effect. So your cyclicals become "growth stocks."

Bob: Yes, that's why I get classified as a growth investor. And when I reflect on it, that's what I'm really looking for. I'm looking to buy a dollar for 20 cents, of course. But I really also want to see that "dollar" potentially growing to be worth two, four or six or eight dollars. Because if you can play the long game and solve that puzzle, you can really make a lot of money for clients. That's the challenge I can't resist.

And one in which it helps a lot to keep patience and the power of compounding on your side. Thanks for sharing so much investment wisdom, Bob.

Welling on Wall St. Interviewee disclosuree: Welling on Wall St. Interviewee disclosure: Robert Robotti is the President and Chief Investment Officer of New York City-based Robotti & Co., and its Robotti & Company Advisors, LLC and Robotti Securities, LLC units. Prior to founding his company in 1983, Bob was a vice president and shareholder of Gabelli & Co. He found his way to Wall Street via an accounting BS picked up as a sideline to his football career at Bucknell, and while he later earned an MBA in accounting at Pace University, and his (currently inactive) CPA credential, Bob did not long focus on pure numbers crunching. Not after he had the great good fortune to find himself assigned to spend part of his auditing internship examining the books at Tweedy Browne & Co. – amid the mid-1970s small-cap bull market. That experience, and mentorship by some legendary value investors charted the course of Bob's career.

Bob serves on the Board of Directors of several publicly listed portfolio companies. NYSE-listed real estate company, AMREP Corporation, located in Germantown, PA, NYSE-listed Tidewater, Inc. which owns and operates one of the largest fleets of Offshore Support Vessels (OSVs) in the industry, and chairs the board of TSX-listed licenser of seismic data to the Oil and Gas Industry, Pulse Seismic. He was previously a board member of BMC Building Materials Holding Corporation, prior to its merger with Builders Firstsource and served on the board of Calgary-based Mineral and Oil and Natural Gas royalty company PrarieSky Royalty Ltd. In addition, he serves on the Boards of many non-profit organizations where he generously donates his time and expertise. Previously, Bob was a member of the Securities and Exchange Commission's Advisory Committee on Smaller Public Companies, established to examine the impact of the Sarbanes-Oxley Act and other aspects of the federal securities law.

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