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July 16, 2021

"The stock market is filled with individuals who know the price of everything but the value of nothing." – Phil Fisher

Dear Clients and Friends,

As we reach the midpoint of 2021, we continue to see the global economy recover from the ravages of COVID-19. Although the recovery has not been evenly experienced around the world, the stock markets have generally performed quite well this year. Here in the United States, the markets have been particularly strong, as the S&P 500 returned 8.5% for the quarter ending June 30th, and 15.3% year-to date. Despite the appearance of new COVID variants, life for most of us seems to be moving back towards normal. Businesses are reopening, restaurants are filling, travel is normalizing and it appears that vaccines are performing as hoped.

Focusing on the U.S. economy, the recovery has been quite strong. Gross Domestic Product (GDP) grew at a very strong rate of 6.4% in the first quarter of this year and most economists expect it to grow around 10% for the second quarter. Unemployment rates have been dropping, although still much higher than pre-pandemic levels, but should continue to fall as generous supplemental unemployment benefits expire in the fall. Additionally, consumer spending has been on the rise during 2021 and should continue showing a strong recovery from depressed pandemic levels last year.

With consumer behavior returning to normal, we have also seen significant price increases in certain areas of the economy such as fuel, building supplies and food. This has been measured by a spike in inflationary numbers that could register over 3% for the first time in a decade. This coupled with a rise in interest rates has given consumers and investors a reason for pause despite all of the positives in the recovery. Interestingly, the stock market has generally ignored these risks. There is a strong thought that these inflationary numbers are simply "transitory" in nature, meaning that they are temporary and short-lived. Many believe that great pent-up demand from consumers who were shut in during the pandemic has created short-term spikes in demand for many goods and services. This along with global supply chain disruptions has led to temporary shortages of many raw materials and products. Once these disruptions subside in the economy, the hope is that inflation returns back to lower levels.

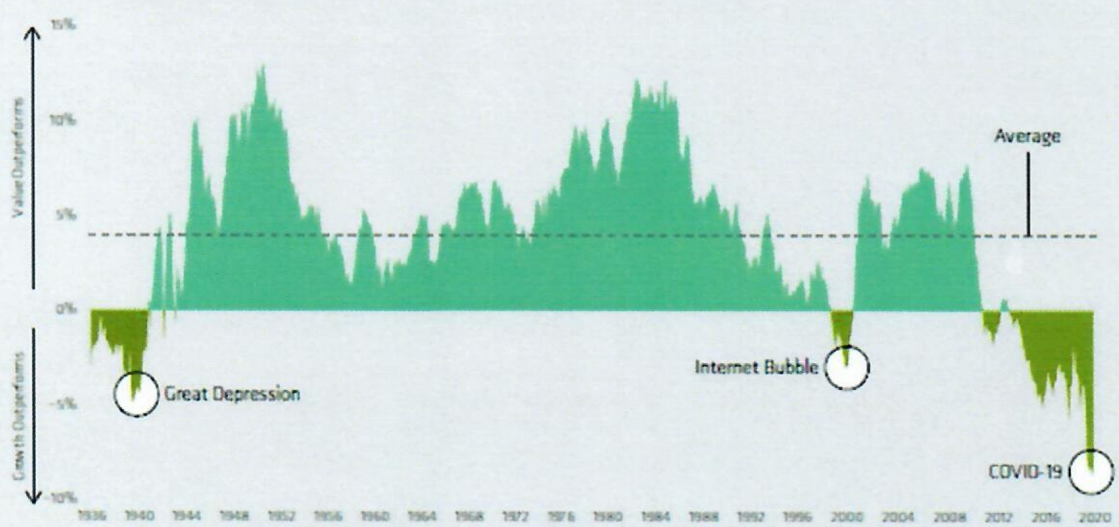
Just as the recovery has not been proportionate across the globe, nor have the returns in the market. Although we are beginning to see a change so far this year, there has been a vast disparity of returns for more than a decade between growth stocks and value stocks. In our last client letter, we discussed that growth stocks as measured by the Russell 1000 Growth Index returned 38.5% while value stocks measured by the Russell 1000 Value Index only returned 2.8% during 2020. Generally speaking, growth stocks are businesses that focus primarily on growing their earnings and are priced higher than the average market, while value stocks are businesses that trade at a discount to the earnings of their business and are priced below the average market.

Continuing the conversation from our last letter, the outperformance of growth versus value stocks has been particularly outsized since the end of the financial crisis in 2008. In fact, the performance of growth stocks has almost doubled the performance of value stocks during this time period. This has led many investors, both novice and professional, to assume that this trend will never change. We believe that this is a faulty assumption and one that is not rooted in fundamentals or history. Simply taking a step back and viewing a much longer time frame can quickly show how this could be a costly investment mistake for the future.

The longstanding investment firm, AllianceBernstein, recently wrote extensively about this subject and one of their charts explained just how odd this divergent performance has been if viewed in a historical context. The chart below illustrates how significantly value has actually outperformed growth over the last 84 years. Specifically, this chart shows that the cheapest 30% of stocks (value) has outperformed the 30% most expensive (growth) by an average of 4.1% annualized on a rolling 10-year average since 1936.

DISPLAY 1: PANDEMIC PUSHES VALUE STOCKS TO HISTORIC SLUMP

10-Year Rolling Average Relative Return*



Past performance and current analysis do not guarantee future results.

* Return of the lowest-priced 30% of stocks relative to the highest-priced 30% of stocks, based on price-to-book, using the Fama French database of US stocks from June 1, 1936, through October 31, 2020.

Through October 31, 2020

Source: Center for Research in Security Prices, FactSet, MSCI and AB

We bring these facts to your attention now because we believe there is a large universe of stocks that have not been properly recognized in the market, meaning their stock prices have not appreciated as much as they should have based on the performance of their actual business. We also believe that the opposite is true for many businesses whose stock prices have dramatically outperformed the results of their business operations.

As most of you well know, we have a distinct bias towards value investing. While value is at the core of our philosophy, we employ many different investment strategies including growth in order to create portfolios that are durable in all market environments. As the chart above shows, different investment strategies outperform others depending upon many market forces. When we see such a large divergence of market opportunities as we do now, we want to make certain that we emphasize the correct strategies while still maintaining a proper balance of strategies within our clients' portfolios. As value investors, we invest in great businesses that have good prospects for growth and we seek to purchase these stocks only at the right price in relation to their future earnings. Many growth focused investors might purchase these same businesses, but might do so at any price. As legendary investor, Phil Fisher, author of *Common Stocks and Uncommon Profits*, so eloquently stated many years ago: *"The stock market is filled with individuals who know the price of everything but the value of nothing."*

We believe that he was correct and this disparity of returns in the market was exacerbated during COVID as many growth oriented stocks experienced stratospheric returns while a much larger group of excellent businesses saw their stock price appreciate at a slower rate. Many of the businesses that are classified as value are those involved in sectors of the economy such as banking, retail, consumer and industrial to name a few. Growth focused businesses tend to be more focused in areas such as technology, communications, and biotechnology.

COVID turned our world upside down with retail stores and restaurants shutting down, employees working from home and travel coming to a standstill. Some of the great technology businesses helped keep us working and entertained (think Amazon, Netflix and Zoom) and their stock prices skyrocketed. However, many other growth focused businesses saw sharp stock appreciation perhaps only because of their industry, while numerous strong businesses with a consumer, industrial or retail focus saw their prices decline or modestly appreciate. Many well know "Blue Chip" dividend paying stocks fit into this category.

As our economy continues to improve, we believe that this vast and lengthy disparity between growth and value stock performance will revert back to more normalized levels. In fact, it has already started since the beginning of the year, with the Russell Value Index up around 17% through the end of June, while the Growth Index is up around 13%. A new environment of rising interest rates, higher inflation and slowing fiscal stimulus should be contributing factors in seeing the earnings of some growth companies slow down, while the earnings of some value oriented businesses should appreciate. As a result, not all stocks will progress at the same rate, as some will do better than the markets and some will do worse. We will continue to invest our client's capital in many great businesses that are focused on both growth and value. We simply look forward to a more even playing field with a growing universe of potential investment opportunities.

We wish you and your families continued health and prosperity and we hope that you are able to enjoy the rest of the summer. Please do not hesitate to reach out to any of us with questions or comments.

Best regards,

Bob

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Chuck

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