ADKINS SEALE CAPITAL MANAGEMENT, LLC
Investment Commentary
October 4, 2021

Dear Clients:
Benjamin Graham was a professor of finance at Columbia University in New York. He is also known for being the grandfather of value investing and teaching his fundamental approach to Warren Buffett and many other well-known money managers. Graham described the markets as such: "In the short term, the market is a voting machine, but in the long run, it is a weighing machine. The weight of future cash flows are the most important factor in determining the price of a security; however, imagine the difficulty of determining those cash flows with the influences of innovation and disruption. We agree with Graham and believe markets eventually will reward investors owning the most profitable companies.

Disruption is not a new concept in a capitalistic society, but the pace of disruption and innovation due to the internet and new technology seems more chaotic today. Entire industries such as media, healthcare, automotive, etc. are undergoing immense change which has created more opportunities for new competition. We have all witnessed the impact of ecommerce and the Amazon effect on brick and mortar stores such as Barnes & Noble, Sears, and JCPenney. Legacy cable providers are experiencing high amounts of "cord-cutting" as consumers migrate to multiple streaming services offered by Netflix, Disney, Apple, etc. A noteworthy example in consumer staples was recently discussed on a podcast by Tom Russo, a highly respected long-term investor/partner of Gardner, Russo, & Quinn. The disruptor, Dollar Shave Club (DSC), was founded in 2011 as a subscription service for razor blades and other grooming products to be delivered directly to a consumer's doorstep. Industry leader Gillette, owned by the multinational consumer goods corporation, Procter & Gamble, placed its products in department stores and drugstores usually in tamper-proof packaging. The difference in buying experiences helped create an opportunity for DSC to change consumer preferences. Although Gillette has had assaults to its business franchise over its 100 year existence from competitors like Unilever and Schick, these efforts were unsuccessful and Gillette had built up market share in the razor blade industry greater than 70%. That once insurmountable lead doesn't appear to be safe anymore as Gillette's market share has dropped from more than 70% to near 50%. DSC's business model of lower cost of distribution, lower price of razor blades, and a convenient experience of purchase appears to be the best formula currently for gaining market share. Gillette is attempting to pivot from its current strategy, but there are multiple challenges such as: reducing margins, channel conflict, and cannibalization. Time will tell if Gillette can regain market dominance once enjoyed.

As the internet and technology continue to create large scalable platforms, investing in market-cap weighted indices such as the broad US market and non-US market ensures investors are buying companies that are gaining momentum and selling companies who are losing momentum. As of the end of August, the top 10 holdings of the S&P 500 had a cumulative weighting of near 30%. This level of concentration can come with greater volatility due to those 10 stocks being heavily weighted. History has shown us time and again that the forces of capitalism and fair competition can change a company's growth trajectory quickly. We believe holding a combination of indices, active managers who emphasize margin of safety and capital preservation in their security selection, and a few carefully selected stocks is a prudent long-term strategy.

Investors have witnessed an extraordinary recovery within the markets over the last 18 months with very few bumps along the way. Confidence has been running high as drug companies brought a vaccine to market faster than ever before as well as global federal governments adding unprecedented amounts of liquidity to the economy and financial system. Lyrics from a late 80's rock band, Timbuk 3, seemed to fit the attitude of the market – "Things are going great, and their only getting better…The future's so bright, I gotta wear shades." Pent-up demand unleashed quarterly GDP numbers not seen since mid-2014. Unfortunately, markets are starting to show signs of higher volatility as COVID variants and fed tapering discussions are occurring. Additionally, there are obvious challenges when economies and businesses are turned off then turned back on which include labor shortages, constrained supply chains, impacts to the healthcare system, etc.

We expect the next 6-12 months to experience elevated levels of volatility, but our long term outlook is unchanged. Returns from cash investments are near zero. Fixed income, which traditionally serves two roles (capital preservation and stable income), is providing only capital preservation with limited upside. The 10-year US Treasury nominal interest rate was virtually unchanged during the quarter and ended around 1.5%. However, with current inflation measurements near 5%, the earnings from "safe" securities are buying less today. Lastly, large cap stocks managed to produce a positive return for the 3rd quarter (S&P 500 returned 0.58%) even while overcoming September (-4.65%) which was the worst month so far this year. Non-US stocks produced slightly better quarterly returns (MSCI ACWI 1.41%). The acronym TINA, which stands for "there is no alternative" to stocks, has minimal opposition currently. Non-traditional investments such as private equity and special purpose acquisition companies (SPACs) have held moments in the spotlight, but we do not believe these risk reward attributes align with our valuation approach in addition to being more costly and illiquid.

Detailed total net of advisory fee return data by portfolio/account and total gross of advisory fee return data by asset class, segment, and individual holdings are included in this report starting on page 3. We encourage our clients to review this data prior to our review session.

Our Look Forward

In his book The Intelligent Investor (1949), Professor Graham advised investors to overweight equities when fear was high and the opposite when equities were seemingly the only game in town. At that time, the expected returns for both equities and bonds offered more attractive rewards than what appears available today. Are today's ultra-low interest yields sufficient to support continuing high equity returns from earnings multiple expansion for this "new age" of innovation and disruption? Perhaps, but we are more persuaded by the wisdom of Sir John Templeton who defined the four most dangerous words in investing as "this time is different." Our counsel is to maintain a reasonable balance of equities and bonds sufficient to absorb unexpected shocks in market asset prices while maintaining the capacity to meet the spending/distribution requirements of the portfolio.

One of the more important unknowns for investors is the future trend in prices for products and services – aka INFLATION! Market signals from US Treasury Inflation Protected bonds (TIPS) suggest a future annual increase in the Consumer Price Index of about 2.5%. Such a rate is roughly half of the observed rate of change over the last twelve months. We believe bond yields will eventually price in the actual forward rate of change in the CPI plus a real return premium (historically near 2%). The resulting higher yield (4-5%) would have an inverse impact on both equity and bond prices. Investors should keep a keen eye on this important signal.

In Closing

We look forward to visiting with each of you about your investment results and expectations for the future and to make sure your portfolios are aligned with your specific circumstances. We greatly appreciate the opportunity to serve as your investment adviser and pledge our best efforts to meet your expectations.

P. Michael Adkins, CFA
mikeadkins@ascm-llc.com

J. Richard Seale, CFA
dickseale@ascm-llc.com

Jay K. Binderim, CFA
jaybinderim@ascm-llc.com

333 Texas Street, Suite 2235 Shreveport, LA 71101 • 318-703-3641 • 800-304-6588 • www.ascm-llc.com