Lawson Kroeker

First Quarter 2024 Update

April 11, 2024

Dear Fellow Investors,

US Equity markets picked up in the 1st quarter where they left off in the 4th quarter. The stock market produced meaningful early-year gains as the perceived likelihood of a 2024 recession receded. The economy appears to be on stable ground, and it seems that earnings could better sustain themselves going forward than what might have expected a few months ago.

Fueling additional recent optimism, the market still anticipates meaningful interest rate cuts from the Federal Reserve in 2024, even if the number and degree of those assumed cuts has diminished somewhat. As we have discussed previously, falling interest rates are typically bullish for stock valuations, and while fewer rate cuts are somewhat disappointing (from the stock market valuation standpoint), it seems participants are still sanguine about interest rates falling from their peaks.

The equity markets' gains of the last two quarters were encouraging to us, and as seen in the graphs on the left during the first quarter, the rally broadened as the quarter progressed. Going forward, we see both reasons for continued optimism and some caution signs.

Figuring prominently into our equation is that valuation multiples on many businesses have expanded to levels rarely seen. All else being equal, this would give us pause in forecasting attractive forward returns for the S&P 500 in aggregate, and admittedly, we see a lot of fulsome-looking valuations in our universe.

On the other hand, we have been finding what appear to be attractively priced securities in the less trodden areas of the market. Some of these industries are perceived as slower growth, and the companies are generally smaller than the areas where recent stock market success has bubbled. Some of these companies are domiciled outside of the US. Within these sets, we are finding both stable and/or growing businesses, where the players of interest have durable advantages, and we believe the market is overly discounting their prospects.

We wonder if the trend of the last decade toward "quality" and size will continue. The companies with high returns on capital, higher rates of growth, and generally bigger sizes, have been stretched thin.Some longtime stalwarts with these characteristics are trading at valuations that we have not seen for a very long time, even as it might be more challenging to get the growth required to justify those valuations.

In turn, many smaller, less tech-oriented, lower-growth businesses have considerably less demanding valuations. The "stories" backing these companies are not quite as exciting as the "name brand" companies that have seen years of success, but their prospects are interesting, and we believe the math is becoming harder to deny. A relatively inexpensive stock, where earnings are believed to grow less, or even not at all, might have better return prospects than a business with greater prospects if the disparity between valuations is wide enough and market sentiment has reached extremes. We ponder if we might be close to that point of inflection. Recent performance in March may be starting to paint the picture that Value stocks are beginning to attract attention from the larger, Growth names. The largest Growth holdings that continued to outperform through February saw lower returns than Energy, Financials and firms with lower P/E multiples and forecasted growth as we finished the quarter. Accordingly, we have been fishing in the unloved and smaller pools where valuations appear more interesting, and we will see if it results in further actionable investments.

The upshot of all of this is that we have trimmed certain large holdings and/or the big winners in your portfolio and redeploying assets into a few new names. We are doing our very best to be sensitive to potential tax burdens, but we also think that at some point, selling securities that are priced for near perfection and redeploying the capital toward those with undemanding valuations is not only a form of risk control, but also a way to continue to play offense in equities. It is possible that this trend will continue for the foreseeable future.

As always, we are grateful for your confidence in us. We appreciate our long-standing relationships and the newer ones that you have helped us build. We hope that you and your families are having a happy, healthy and rewarding Spring.

Sincerely,

Tom | Chad | Bruce

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