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The Margin of Safety Quarterly
Southeast Asset Advisors, LLC
Lanigan Wealth Management

Investment Management & Consulting
Thomasville – Atlanta – Tallahassee – Mobile – Charleston
www.assetadvisor.com

TO: Clients and Friends
FROM: SAA Managing Directors
RE: 3rd Quarter 2021 Commentary
DATE: October 2021

WE STRIVE TO PROTECT AND GROW OUR CLIENTS' CAPITAL OVER THE LONG TERM BY:

(1) Focusing on individual client goals and objectives.
(2) Having the proper asset allocation to reflect each client's tolerance for volatility (i.e., temperament).
(3) Stress testing short-term liquidity needs.
(4) Investing with a value orientation and utilizing managers who understand the intrinsic value of a business and margin of safety along with passive strategies as appropriate.
(5) Rebalancing portfolio holdings/managers when appropriate to take advantage of underpriced and to avoid overpriced assets based on the client's profile of asset allocation ranges.

Market Recap

September was very volatile, and the worst monthly performance seen since March 2020. The S&P 500 still edged out a very small gain for the quarter. After a huge year-to-date run, we expect continued increased volatility in the coming months.

We are attaching our worry list as Exhibit A, appropriately titled "There's Always Something to Worry About." This worry list may be a little longer than normal. However, as one of our partners recently stated, "The last 18 months have the potential to be the largest leap over the "news headline hurdle" in our lifetimes."

Our enclosed list of worries is in the order roughly of the degree of our concern. Some of these are macro in nature and many are "unknown unknowns." Others are short term and could be opportunities for the long-term investor who does not let the headlines cloud their thinking.

We cannot help but have our opinions (and our biases) on the potential outcome of the "worry list" items and maybe even "stronger opinions" than normal. Number 1 - Washington Drama – Geopolitical Risk; Number 2 - High Spending & Tax Proposals; Number 3 - Inflation; Number 4 - Interest Rates Increase / Fed, etc.; and Number 5 - Government Debt – Future Interest Cost, which are real and more mid-term or long-term concerns.

Number 7 - Valuation, (on this list) remains a concern and would be "Number 1" on our worry list, but as we have written, "low interest rates have raised the price of virtually all assets;" some far in excess of their long-term intrinsic value if interest rates do indeed rise significantly. As we repeatedly have said, in simplistic terms, all earning assets (i.e., stock, business, farms, etc.) are worth the discounted present value of their cash flow. The coupon (FCF) and interest rate used to discount are the big variables (unknowns). It is hard to believe real interest rates will stay as low as they are now. Time will tell!

Outlook

We rarely read articles that we believe are actually on point. However, a recent outlook by one of our favorite managers was especially good. It is quoted below in its entirety.

"Our opinions on the US macro environment remain the same: We believe that the US economic rebound will continue despite the COVID-19 Delta variant and many poorly conceived government policies that have kept many able-bodied employees from reentering a tight labor force, causing havoc for many businesses. We expect that elevated levels of inflation will persist and, with them, upward pressure on interest rates. With the upward pressure on interest rates, we expect a greater gravitational pull to be exerted on the previously untethered valuations of many companies that, despite running fundamentally attractive business models, are trading at valuations that fully discount optimistic assumptions.

We believe that many pandemic-induced changes in corporate and consumer behavior will remain after the pandemic has ended (at least in short-mid-term.) We *believe that the economic recovery will not be uniform in its distribution of corporate profits and that supply chain, labor cost and freight cost vulnerabilities will expose meaningful differences between those companies—which we broadly favor—that have pricing power, and those that do not. For the latter, we expect unpleasant profit surprises in the coming quarters for many businesses, even those enjoying robust demand for their goods and services.*

We believe that most US corporations are entering an extended period of higher structural costs, including those associated with heightened government regulations, taxation, and the costs of serving a broader constituency of stakeholders beyond stockholders, with greater corporate spending going towards social and environmental issues.

In a macro environment in which outcomes may be more dispersed than is popularly anticipated, we believe that we are well-positioned to discern prospective winners from losers and to position our portfolios accordingly."

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We think, as always, and especially now, that buying "quality-value," and being a long-term investor are key strategies in this uncertain macro environment. We favor companies that can pass through increased cost on to their customers if indeed inflation is not transitory. We also favor companies who have low variable cost i.e., certain technology as well as sustainable advantages. This continues to be our path at SAA. We view increased volatility as an opportunity for a long-term equity investor.

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Of course, our opinions, on a macro forecast or anyone else's for that matter, are "unknown unknowns." We make few decisions based on our "macro-opinions" or anyone else's, as we think no one knows the future with any reliability. Having said that, we do think that we are in an unusual time of high equity valuations and very low interest rate that create a "TINA" (<u>T</u>here <u>I</u>s <u>N</u>o <u>A</u>lternative to equities) environment for equities. We also see continued speculation in housing real estate and general speculation in many other assets. This gives us concern for sure. Many assets today have too much money chasing a limited supply, which temporarily drives prices up beyond their value. This does not last, or it has not in the past irrational exuberant periods.

Our game plan remains the same, although in a more cautious mode. We continue to stress test each client's liquidity needs and especially their long-term temperament, as we anticipate increased volatility as inflation and real interest rate increases look inevitable. The key question for many things on our worry list, is whether they are short-term, mid-term, or long-term issues? And which short-term issues create an opportunity to acquire / hold great companies at good prices?

We are in a low return world, not only in fixed income, but also in equities due to valuation. Of course, we continue to think there is more risk in buying long-term fixed rate bonds than value quality equities.

In Closing

As always, we thank you for your continued support and for entrusting us with your investment assets. Deserved trust is very important to us. Lastly, the best compliment we can receive is a referral from a satisfied client. We appreciate your referrals and handle them with the utmost of care.

Congratulations to our SAA team as we were selected on the CNBC "Top 100" List of Best Advisors!

Enjoy the balance of your Fall!

Your SAA Team

Attachment: Exhibit A "There's Always Something to Worry About"
Exhibit B "Remembering 9-11"; A devotion written by Phillip Danner

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"If you believe everything you read or hear, better not read."

- Unknown

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"Prediction is very difficult, especially if it's about the future!"

- N. Bohr

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"One of the tests of leadership is the ability to recognize a problem before it becomes an emergency."

- A.H. Glasow

Exhibit A

There's Always Something to Worry About!

"Key question is which of these are long-term and which of these are short-term issues?"

1. **Washington Drama – Geopolitical Risk**
2. **High Spending & Tax Proposals – Incentive not to work?**
   a. **Fed Chair Powell Reappointment?**
3. **Inflation – what is transitory or permanent?**
4. **Interest Rates Increase / Fed, etc.**
5. **Govt Debt – Future interest cost?**
6. **Global Energy Crisis / Prices?**
7. **Valuation remains elevated**
8. **Supply Chain – issues; transportation**
9. **Evergrande scare / headlines? China vs. USA? Taiwan, etc.?**
10. **Margins? – Cost increase vs. earnings growth?**
11. **Covid – but still there**

Exhibit B

Here's a devotion Phillip Danner wrote on Remembering 9-11.

Remembering 9-11

In the 3rd quarter we remembered the 20th Anniversary of the Terrorist Attacks on the United States. For everyone younger than 20 there are no memories of 9-11, and for many others the memories are vague or non-existent. For all adults in America the memories of that day are etched into our minds. September 11th around America is a day of remembrance. Three thousand people lost their lives in that attack, and hundreds of thousands have died as a result of the wars that ensued from that attack in Iraq and Afghanistan. For the families of those lost in the attacks and in those wars, this was a very difficult day. We should remember those who died that day and their families. We also want to remember those thousands upon thousands who have died in the last 12 years of war, and for those they left behind, both Americans and others, in our thoughts and prayers. But we want to do more than remember, we also want to learn something from this day of remembrance.

Here are just a few lessons I think we can learn from this tragedy.

1. Life is a gift – every moment of it. Don't take it for granted. 3,000 people went to work at the World Trade Center on a beautiful September day 20 years ago, not knowing that it was their last day on this earth. Cherish life.
2. 100s of people trapped in the World Trade Center made phone calls to their loved ones before the buildings crashed down around them to say "goodbye" and "I love you." Cherish those who you love and who love you. Tell them often that you love them.
3. Remember that human beings are capable of great evil and great good. On that day 20 years ago, we saw examples of both of these capabilities. 19 men intent on the destruction of innocent human life and 100s and 1,000s of men and women who rushed in to save human lives.
4. Remember that you and I are called to overcome evil with good and the power of love.

The Bible puts it this way in Romans 12:9-21 "Love must be sincere. Hate what is evil; cling to what is good. Be devoted to one another in love. Honor one another above yourselves. Never be lacking in zeal, but keep your spiritual fervor, serving the Lord.

Be joyful in hope, patient in affliction, faithful in prayer. Share with the Lord's people who are in need. Practice hospitality. Bless those who persecute you; bless and do not curse. Rejoice with those who rejoice; mourn with those who mourn. Live in harmony with one another…. Do not repay anyone evil for evil. Be careful to do what is right in the eyes of everyone. Do not be overcome by evil, but overcome evil with good."

May God bring peace to our hurting world and may He use us to that end. Think about it.

Written by Phillip Danner, and it is reprinted with his permission.