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Southeast Asset Advisors, LLC

Investment Management & Consulting

Thomasville – Atlanta – Tallahassee – Mobile – Charleston

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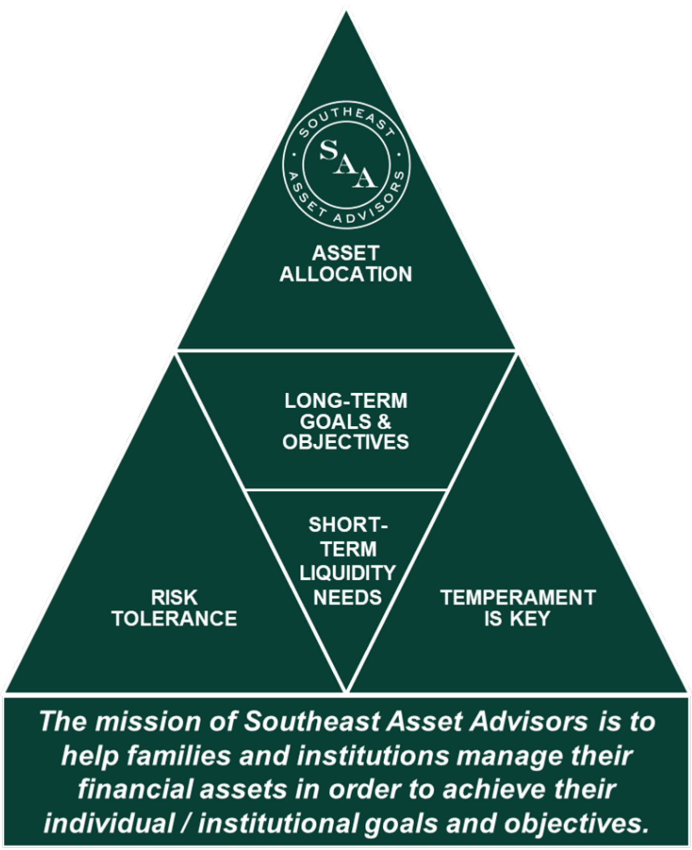
The Margin of Safety Quarterly [1]

3rd Quarter 2024



SOUTHEAST ASSET ADVISORS

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.

[1] Margin of Safety (MOS): Many investing greats have said these are the most important three words in investing. We agree and call our quarterly letter accordingly. MOS is key in determining anything with variables occurring in the future, i.e., price to future value, all future outcomes, etc. Its magic is that the higher your MOS, the smaller your edge needs to be to have a favorable outcome.

TO: Clients and Friends
FROM: SAA Managing Directors
RE: 3rd Quarter 2024 Commentary
DATE: October 2024

Market Update

The S&P 500 (Market Cap Weighted) achieved ~21.6% return year-to-date as of September 30, 2024. In contrast, the S&P 500 Equal Weighted Index posted a return of about 15.2% for the same period. Notably, during the third quarter, the equal-weighted index outperformed the market cap-weighted index by around 5% (10.5% vs. ~5.6%), suggesting a pause in the dominance of large-cap stocks and the "Magnificent 7".

The "Mag 7"—comprising Apple, Amazon, Alphabet, Meta (Facebook), Microsoft, Nvidia, and Tesla—continues to hold a considerable share of the S&P 500, roughly 36%. Year-to-date returns for these companies stand at approximately 35%, representing 45% of the Index's total return of 21%, compared to the 11% return for the remaining 493 stocks in the index. From a valuation perspective, the "Mag 7" appears overpriced, trading at about 29 times next year's earnings, while the entire S&P 500's PE ratio is around 22x. Excluding these seven companies, the other 493 stocks have a PE ratio of 20x. With the Federal Reserve's promise and the prospect of decreasing rates, the overall market might be reasonably priced, albeit on the higher side. The S&P 500's overall Earnings Yield is 4.5% (22x PE), compared to the current 10-Year Treasury Yield of ~4%, with most Fed watchers anticipating further rate reductions.

Diversification away from the "Mag 7" has not benefited most portfolios until recently. Small-cap and International stocks have returned approximately 10% and 13%, respectively, year-to-date. Nonetheless, we believe it is prudent to maintain some degree of diversification while including the "Mag 7" in most portfolios.

Investors welcomed the Federal Reserve's interest rate cut in mid-September, which affirmed the sentiment that further rate reductions are likely in the coming months. This comes after a period of more than two years of rising interest rates, the highest since 2007, based on the benchmark 10-year U.S. Treasury note. We recognize the

Fed's challenging dual mandate and are cautious about the ongoing market "melt-up" as the Fed appears to be engineering a soft landing, avoiding a recession through both interest rate cuts and balance sheet initiatives.

As we have continuously indicated, we aim to maintain exposure to some of the "Mag 7" companies as they are fundamentally strong businesses worthy of inclusion in most portfolios. We utilize a "look-through" or "X-ray" approach to estimate our portfolios' exposure to these companies.

The Key Questions – Our Answer, "It Depends"

As we transition into late 2024 and 2025, we continue to seek answers to these critical questions and evaluate the probabilities for each one:

- What will the Fed do with interest rates?
- What will future inflation rates be?
- What are the neutral interest rates?
- Is the Fed relying on academic data and missing real-world inflation trends?

- Who will win the elections, particularly the President, and who will control the Senate and House?
- How will investor psychology and market sentiment impact short-term prices, while long-term valuations are controlled by earned profits?
- What are the expected profits and free cash flow priced into the market?
- Will the semiconductor boom continue? (We are diligently learning about semiconductors, production, and innovation, considering them key game changers.)
- Will the U.S. achieve true deficit reduction, or will uncontrolled government spending continue, making more people dependent on the government? (We have further comments on our unsustainable deficits in the next section.)

As always, the questions are straightforward. The answers are complex (some may be unknowable) and often begin with "it depends..." as most future scenarios do.

This is why Ben Graham, the Dean of Investing, articulated many years ago in Chapter 20 of *The Intelligent Investor* that the three most important words in investing are "margin of safety" (MOS). We title our quarterly letter "Margin of Safety" to keep this principle at the forefront. MOS is not only crucial in determining the price-to-value (intrinsic value) per share of individual equities but also applies to a client's asset allocation (equities, fixed income, and cash) based on their individual goals and temperament. The future is unpredictable, especially in the short term, so all projections should be conservative and include an adequate "margin of safety" cushion, as projections are often overly optimistic. Market volatility should be viewed as an opportunity for long-term investors who can maintain the proper temperament. We frequently say that returns are determined "as Mr. Market prices things." Mr. Market can price equities above or below their intrinsic value in the short run, so we constantly ask, "What is the intrinsic value per share range of the company?" while avoiding an absolute figure.

Buying companies with a "MOS" protects your downside even when you do not fully comprehend the business. "MOS" also allows for the time needed to understand a business and its management better. An owner mindset drives one to understand everything, including management, customers, technology, products, manufacturing, suppliers, the political environment, regulations, and crucial capital allocation. Everything! It's challenging to fully understand all aspects of a business without being part of it.

Six Tenets of Global Value Investing

We would like to remind you of the Six Tenets of Global Value Investing identified by Li Lu of Himalaya Capital, which we consider when investing capital:

1) A stock is a certificate of ownership in a company.
2) The market is here to serve you, not instruct you.
3) Margin of safety provides downside protection and better upside return.
4) Circle of Competence allows you to accurately assess the odds and act accordingly.
5) Fish where the fish are and develop competitive advantages.
6) The modern world economy is cyclically secular, exhibiting long-term secular growth with short-term cyclicality. For a global value investor, wealth is their percentage ownership of global purchasing power. We build wealth by owning the most productive companies in the most productive economies.

Deficits, Spending, More Promises by All!

One of our most significant long-term concerns is the U.S. deficit. The ~$36 trillion accumulated deficit is widely acknowledged as unsustainable in the long term. However, the timeline for reaching a crisis point remains uncertain.

All Presidential candidates are making spending promises. At some juncture, our government must halt or at least curtail deficit spending growth. Time will tell! We must reduce spending while maintaining reasonable growth!

We urge you to join us in advocating for reduced deficit spending by both political parties. Many of us are willing to pay higher taxes if it means reducing spending and government waste. That is a big "if."

In Closing

Regarding firm news, we regret to announce the departure of Ned Johnson from our Charleston, SC office, as he is called to assist full-time in a family business. He will always be a cherished friend, and we wish him all the best. We welcome Ariel Bonner to SAA Thomasville, a CPA who will bolster our already excellent Thomasville back-office team of Dana, Lauren, Emily, and Ashlie with Charlotte in Charleston and Dianne in Mobile. Additionally, Jacob Odum, a long-term superstar, will become a Partner and be promoted to Managing Director, continuing to oversee certain operations under Mark Saussy's leadership.

Thank you for your trust and confidence. We strive to make "deserved trust" the most valuable asset we can earn.

Have a wonderful Fall!

Your SAA Team

P.S. Please revisit the cover page of this Margin of Safety Quarterly letter and the diagram as it helps us and you focus on the critical rules for successful investing.

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"Uncommon common sense is most important and hard to learn."

- Charlie Munger

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"If there is one common theme to the vast range of the world's financial crises, it is that excessive debt accumulation, whether by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom."

- Carmen Reinhart and Kenneth Rogoff,
This Time Is Different: Eight Centuries of Financial Folly

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"All my stock picking is 100% based on the concept of a margin of safety, as introduced to the world in the book Security Analysis, which Graham co-authored with David Dodd. By now I have my own version of their techniques, but the net is that I want to protect my downside to prevent permanent loss of capital."

- Michael Burry

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"Investing is not the study of finance. It's the study of how people behave with money. And behavior is hard to teach, even to really smart people."

- Morgan Housel

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"The intelligent investor is a realist who sells to optimists and buys from pessimists."

- Benjamin Graham