SILVER RING
VALUE PARTNERS

October 23rd, 2020

Dear Partners:

I hope that you are staying safe and healthy. I greatly appreciate the confidence that you have placed in me by entrusting me with your capital, and I appreciate your continued support. At the end of Q3 2020 the **portfolio was very attractively priced, with the Price to Base Case value ratio at 55%.** The portfolio had 13 investments, cash at 0% and option-adjusted net exposure at 88% at the end of the quarter. The ratio of Price to my estimate of Normalized EPS was 7x for a collection of businesses that I expect to grow profits at low-single digit rates on average over the long-term.

Partnership Performance			
	Last 12 Months	Since Inception (9/1/2016, Cumulative)	Since Inception (9/1/2016, Annualized)
Silver Ring Value Partners (Net)*	6.9%	29.9%	6.6%
Average Cash Levels	5%	22%	22%
Average Option-Adjusted Net Exposure	75%	64%	64%
Russell 3000 Index	15.0%	65.4%	13.1%
MSCI World Index	11.0%	51.7%	10.8%

*Results are net of all fees and expenses and use the 20% performance fee level above a 6% hurdle that represents the substantial majority of partnership assets over these periods
Partnership Results are audited through 12/31/2019 and unaudited afterwards

The quarter was surprisingly uneventful. Expensive glamour stocks continued to stay expensive. Select out-of-favor companies continued to be valued very cheaply by the market. During the quarter, I added two new positions in special situations that were out of the market's limelight and continued to execute my disciplined investment process. I also filed a form 13D and wrote a letter to the Board of one of our companies, Charles & Colvard (CTHR), in order to express my views as a major shareholder on the path towards optimizing long-term value.

The longer irrational stock prices persist, the more normal they seem to the majority of investors. The longer that value investing continues to lag the market, the more skeptical investors become that this is only a temporary phenomenon. I do not share their skepticism. Two quotes come to mind:

"Many shall be restored that now are fallen, and many shall fall that are now in honor."

Horace – Ars Poetica

"A lot of other people are trying to be brilliant and we are just trying to stay rational. And it's a big advantage."

Charlie Munger

Executive Summary

At the end of Q3 2020 the portfolio was very attractively priced, with the Price to Base Case value ratio at 55%. The portfolio had 13 investments, cash at 0% and option-adjusted net exposure at 88% at the end of the quarter. My investment decisions are driven by bottom-up considerations, and cash is a residual of that bottom-up investment process. I do not seek to time the market, and I continue to rigorously stick to my criteria for quality and discount to intrinsic value.

	Portfolio Holdings			
			9/30/2020	9/30/2020
	Security		% Portfolio	% Delta-Adjusted
1	**Hopes and Dreams Puts (TSLA, SHOP, ROKU, SNAP, WORK, BYND, CMG, AAPL Put Options, Jan 2021)**		**5.6%**	**-24.6%**
2	**Owens-Illinois Position**		**13.3%**	**22.6%**
	OWENS-ILLINOIS INC	OI US	11.2%	11.2%
	Owens-Illinois Call Options		2.1%	11.4%
3	**Qurate Retail Position**		**7.2%**	**18.3%**
	QURATE RETAIL INC-SERIES A	QRTEA US	4.9%	4.9%
	Qurate Retail Call Options		2.3%	13.3%
4	**Liberty Latin America Position**		**3.2%**	**18.0%**
	Liberty Latin America (LILAK) Call Options		3.2%	18.0%
5	**COVETRUS INC**	**CVET US**	**16.6%**	**16.6%**
6	**Undisclosed Position 4**		**15.5%**	**15.5%**
7	**DISCOVERY COMMUNICATIONS-C**	**DISCK US**	**12.9%**	**12.9%**
8	**CHARLES & COLVARD LTD (previously Undisclosed Postion #2)**	**CTHR US**	**14.0%**	**14.0%**
9	**Tail Risk Hedge (MAT, TEVA, HTZ, NFLX and THC Put Options, Jan 2021)**		**3.0%**	**-8.7%**
10	**FOX CORP - CLASS B**	**FOX US**	**7.4%**	**7.4%**
11	**Cintas (CTAS) December 2020 Put Option, Strike = $260**		**0.5%**	**-5.1%**
12	**Carnival October 2020 Call Option, Strike = $22.50**		**0.1%**	**0.8%**
13	**BRISTOL-MYERS SQUIBB-CVR**	**BMY-R**	**0.5%**	**0.5%**
	All Investments		**99.8%**	**88.3%**
	Cash & Equivalents		**0.2%**	

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Investment Activity

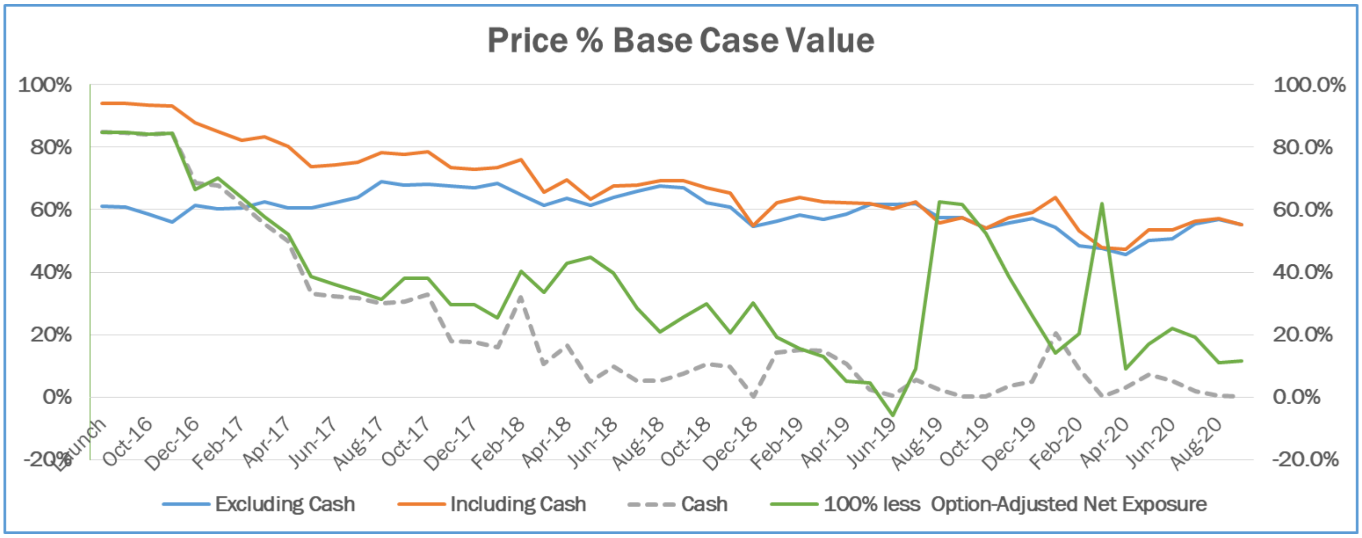
I made the following changes to the portfolio during Q3 2020:

- **Started** positions in Qurate Retail (**QRTEA**) and Liberty Latin America (**LILAK**)
- **Exited** positions in Arcadis (**ARCAD NA**), Berkshire Hathaway (**BRK/B**) and **Carnival Corp bonds**
- **Added** to positions in Fox (**FOX**), Discovery Communications (**DISCK**), Charles & Colvard (**CTHR**) and **Undisclosed Position #4**
- **Reduced** the position in Covetrus (**CVET**)
- Changed the Owens-Illinois (**OI**) position towards more equity and less call options
- **Added put options** in Apple (**AAPL**), Shopify (**SHOP**) and Chipotle (**CMG**) to the **Hopes and Dreams basket**

Investment Thesis Tracker

Ticker	Company Name	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	4Q 2019	1Q 2020	2Q 2020	3Q 2020
DISCK US	DISCOVERY INC-C													
AMT US	AMERICAN TOWER CORP													
INVA US	INNOVIVA INC													
CTHR US	CHARLES & COLVARD LTD													
GILD US	GILEAD SCIENCES INC													
CMPR US	CIMPRESS PLC													
ARCAD NA	ARCADIS NV													
GOG LN	GO-AHEAD GROUP PLC													
HIL US	HILL INTERNATIONAL INC													
CHUBA US	COMMERCEHUB INC-SERIES A													
RCL US	ROYAL CARIBBEAN CRUISES LTD													
AGN US	ALLERGAN PLC	Start->												
	Undisclosed 4				Start->									
OI US	OWENS-ILLINOIS INC					Start->								
EBAY US	EBAY INC					Start->								
FOX US	FOX CORP - CLASS B								Start->					
CRCM US	CARE.COM INC									Start->				
CTAS US	CINTAS CORP									Start->				
CVET US	COVETRUS INC										Start->			
BRK/B US	BERKSHIRE HATHAWAY INC											Start->		
BMY-R	BRISTOL-MYERS SQUIBB-CVR											Start->		
MED US	MEDIFAST INC											Start->		
CCL US	CARNIVAL CORP											Start->		
LILAK US	LIBERTY LATIN AMERICA CL C													Start->
QRTEA US	QURATE RETAIL INC-SERIES A													Start->

- White: thesis is tracking roughly in-line with my base case
- Orange: thesis is tracking somewhat below my base case
- Red: thesis is tracking significantly below my base case
- Dull Green: thesis is tracking somewhat better than my base case
- Bright Green: thesis is tracking significantly better than my base case
- Black: Investment exited



- The portfolio is attractively priced at 55% of Base Case value
- Option adjusted net exposure is at 88%, reflecting option-based hedges

Operational Update

- I switched Audit and Tax firms for the partnership from KPMG to Weaver. KPMG has done an excellent job and I have nothing but good things to say about the firm and the professionals there that I have worked with over the last few years. However, KPMG's fees have risen substantially, and I reached the decision that the benefits were no longer worth the cost. Weaver is a growing national accounting firm founded in 1950, with 800 team members and 100+ partners. The audit partner who we will be working with at Weaver was previously an audit partner at KPMG, and the tax partner at Weaver was also previously at KPMG. I believe that we will receive a high quality of service for a substantially reduced fee.
- I continued posting educational **investing videos** on my **YouTube channel**
- I wrote several articles on general investing-related topics at the ***Behavioral Value Investor***, a publication of Silver Ring Value Partners**, including** 5 Bubble Signs That Should Make You Cautious

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Portfolio Update

Investing Environment

I wish I had something clever or particularly insightful to say about the current investing environment. Alas, it remains more or less unchanged from the last time that I wrote to you a quarter ago.

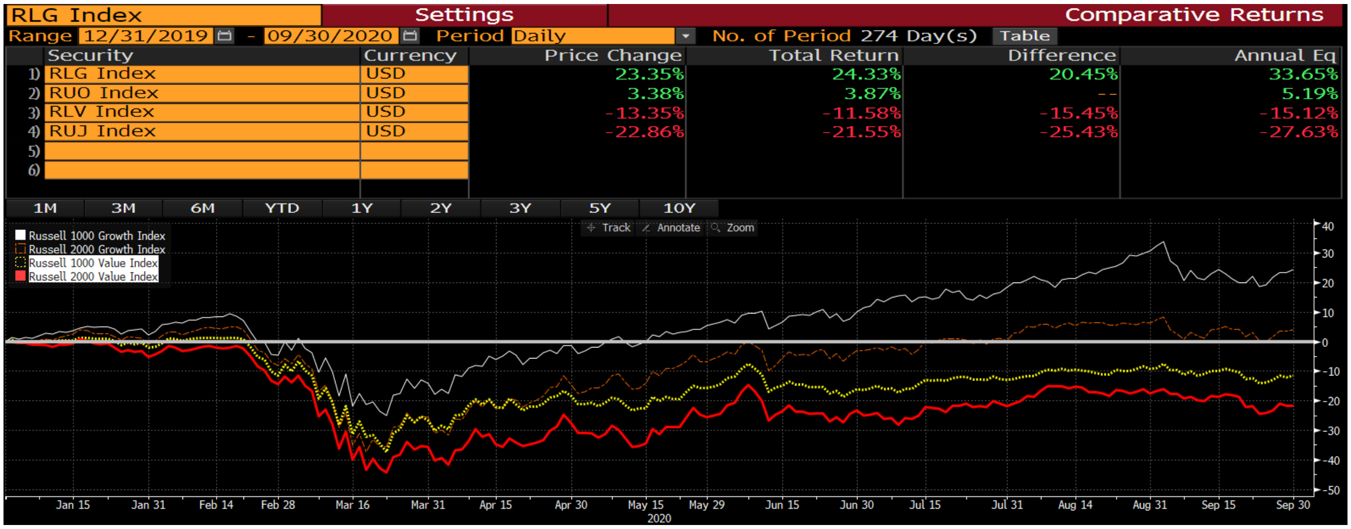
The fundamentals facing many companies are still highly uncertain. This is due to a combination of:

- the current recession, of which nobody can be sure about the course
- the COVID-19 pandemic, which, while better understood than at the beginning of the year, still presents substantial uncertainty in terms of how it will impact our society and businesses
- government intervention, in the form of a very active Federal Reserve, and if the Democrats win the Presidency, the House and the Senate, higher corporate and individual taxes

Contrasting with that fundamental uncertainty, we have a tiered equity market. In the upper tier, there are the companies perceived to be beneficiaries of COVID, as well as many companies that have a good story to tell or current revenue growth to show. For these, no price seems to be too high, and valuation is once again deemed to be an exercise performed by those who "just don't get it."

In the lower tier of the market, we have companies that are negatively impacted by COVID and those who face secular concerns. In some cases, there is almost no price that is too low for some of these stocks. Just like in the upper tier, arguments centered on valuation are swept aside by many market participants who point out the imperfect fundamentals that these companies possess.

This has resulted in a tremendous gap between the market's darlings and out of favor stocks this year, perhaps best illustrated by the chart from Bloomberg showing the YTD performance of Large Growth, Small Growth, Large Value and Small Value indices as measured by Russell. The almost 50% difference in the performance this year between large growth companies and small value companies should catch your attention.



	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	RLG Index	USD	23.35%	24.33%	20.45%	33.65%
2)	RUO Index	USD	3.38%	3.87%	--	5.19%
3)	RLV Index	USD	-13.35%	-11.58%	-15.45%	-15.12%
4)	RUJ Index	USD	-22.86%	-21.55%	-25.43%	-27.63%
5)						
6)						

I have no idea when the market's preferences will change. All I can do is stick to my long-term investment process and seek out companies with cash flow streams that present a compelling value relative to current market prices. In the long term, if I do my job well, the agreement of other market participants will not be required for us to succeed. Strong cash flow streams in the hands of competent management should allow us to realize attractive returns. My job is to be approximately right on those cash flow streams and make sure that they are being handled by those who are both competent and whose incentives are aligned with ours. Time will do the rest.

Portfolio Activity

Charles & Colvard (CTHR)

The company has been handling the COVID pandemic relatively well, all things considered and the new CEO has taken some promising operational steps to move things in the right direction. With the downside protected by cash plus inventory and the upside substantial, I continue to view this investment as having a very attractive risk/reward ratio.

That is why I was unpleasantly surprised when management started talking about doing acquisitions on its most recent quarterly call and in its form 10-K. Dissipating our cash on uncertain ventures would substantially change the risk/reward profile of this investment, as well as have the potential to distract management at a crucial time for the company. This led me to file a form 13-D and write a letter to the Board articulating my views on the best way forward for optimizing long-term value. I am attaching the letter for your information.

Qurate Retail (QRTEA)

The company's business is primarily interactive selling via the QVC and HSN brands. Despite the rise of Amazon and online retail, sales have been relatively stable over the last 5 years. The key to this business is a loyal cohort of customers that account for ~85% of sales. These customers are incredibly sticky and have formed a strong recurring habit of shopping on the company's platforms. They make ~20 purchases per year and their habit of shopping with QVC/HSN has not been meaningfully disrupted by the growth in other forms of retail. It is this cohort that makes this business predictable and makes any rapid declines in revenues unlikely.

The business is not without its challenges. The integration of HSN over the last 2 years has caused issues, and led to a low single-digit decline in sales in 2019. The previously acquired Zulilly business has not done well, although it now accounts for less than 10% of profits and is not material to the overall value of the company. Also, as pay TV loses subscribers in the U.S., it becomes harder for the company to acquire top-of-funnel customers via its TV networks.

On the bright side, the company has benefitted from the COVID pandemic, which caused a spike in demand in Q2, which likely continued into Q3. The reason this is important to the long-term value of the business is not the temporary bump in sales, but the increase in top-of-funnel customers. Historically there has been a steady relationship between top-of-funnel customers and the number of loyal cohort customers which account for most of the company's value. So far the new cohorts are showing similar behavior to those of the past, suggesting a permanent step-up in value from the impact of COVID on the company.

The opportunity came about as a result of management taking an unusual capital allocation step. They announced a two-part special dividend, the first in the form of cash and the second in the form of preferred stock. The remaining equity component will have reasonable leverage (around 3.25x Debt to EBITDA, and around 4x Debt + Preferred to EBITDA). By separating the equity into a fixed component (the preferred equity) and the remaining variable component (the common equity), management was highlighting the absurdly low valuation on the equity. At the time the special dividends took place, the equity was valued slightly above **3x EPS/FCF**. To be clear – that's not based on some theoretical future number, but on the actual run-rate results that the company has achieved in the first half of this year, during a recession.

As an interesting aside, and a possible explanation for why the opportunity exists, I mentioned this special situation to 3 smart, experienced investors at different large firms. As far as I know none of them invested or decided to do serious work on the company. Why? My sense is that their analysis stopped at "isn't this a declining business?" Maybe, maybe not. However, none of the three came back with an analysis of why the plausible rates of decline would make the equity worth less than where it is today, even in the worst case. Given that 85% of sales comes from a loyal cohort of customers and is largely recurring, it would be hard for the business to decline at a rate that would make the company worth only 3x free cash flow. I suspect their reaction was caused by a combination of visceral revulsion to a business that does have some secular challenges combined with a mental fatigue with value stocks that are cheap, but where it's not clear how/when the market will re-rate their valuation higher.

On the last point, I suspect that management is not done. Having isolated the common equity from the preferred, I would expect them to use the free cash flow stream to aggressively buy back shares. If I am right, then we are rooting for the stock to not rise too rapidly, so as to allow them to retire as many shares as possible cheaply.

I rate **Business Quality as Above Average** (2 out of 5) due to the predictable demand from the loyal cohort of customers. **Management as Average** (3 out of 5), and the **Balance Sheet as Average** (3 out of 5). At the time of initial purchase the stock was at **36% of my Base Case value** and was trading **below my Worst Case value estimate**.

Liberty Latin America (LILAK)

The company provides cable TV, broadband, telephone and wireless telephone services in Puerto Rico, Virgin Islands and a number of Latin American markets such as Chile, Costa Rica and Panama. The company also has valuable underwater data cables connecting some of these markets to the internet.

Prior to the COVID pandemic this was a moderately growing business that had predictable, utility-like characteristics. The company's strategy is to combine cable and wireless services under one roof via acquisition. The biggest acquisition that is currently in the process of closing is the purchase of AT&T's wireless business in Puerto Rico. This was done at a very attractive price and is both a strategic fit with the company's existing cable business there and is very accretive to free cash flow.

The markets where the company operates have been heavily impacted by COVID, and business is down. I believe that these are temporary issues given the inelastic nature of demand for the company's services, but there is a real risk of a prolonged recession in the region. Furthermore the company is highly financially levered, the AT&T deal could fall through, and there is always the risk of a stray hurricane devastating one or more of the company's markets.

The company decided to do a moderately sized rights offering to raise capital for future acquisitions. This created a special situation where there was tremendous artificial selling pressure on the stock over a short period of time, dragging the stock down almost 20% on top of an already depressed price. At the recent low **the stock was below 40% of my conservative Base Case value and below my Worst Case.** I view **Business Quality as Above Average** (2 out of 5), **Management Quality as Above Average** (2 out of 5) and **Balance Sheet as Average** (3 out of 5).

I decided to use options instead of purchasing the equity because my analysis suggested that the options were more mispriced. You can refer to my Q2 2020 letter where I explain the rationale for occasionally buying "extreme call options" – options that are out of the money, but with a strike price still well below my Base Case value estimate. These situations are infrequent, but when they occur they set up very attractive risk/reward ratios of 10x-20x. Clearly there are many reasons why this might not work out, but given that the risk-reward ratio of the options to my Base Case value was 15x+, this investment had a very attractive expected value. In the short-term, absence of devastating hurricanes and the AT&T deal closing could serve as the catalysts for the price/value gap to close. Sizing the options position at 3% provided for an acceptable level of loss while allowing us to benefit substantially if the price to value gap closes.

Sale of Arcadis (ARCAD NA), Berkshire Hathaway (BRK/B) and Carnival Corp bonds

In each of these three cases the sale was primarily motivated by the fact that the price/value gap had partially closed and I needed to source funds for much more undervalued investments. If I didn't need the capital for more attractive investments, I would have left each of these investments untouched. If you recall from the Owner's Manual, *significantly* better investment opportunities is one of my reasons for selling investments.

Performance Discussion and Analysis

I encourage you to consider the results summarized below in conjunction with both the investment thesis tracker as well as the discussion of the individual companies in this letter. Price volatility usually far exceeds the changes in underlying business values, especially during a crisis.

Any investment process that is judged over less than a full economic and market cycle is liable to appear better than and worse than it really deserves at different points. When markets are going straight up, risk management and careful attention to valuation might look like an unnecessary drag on returns. On the other hand, when security prices are collapsing across the board, it might temporarily seem like we are permanently losing capital while in reality we are not. The benefit of measuring results over a full cycle is that it allows us to better separate the skill with which an investment process is applied from the violent fluctuations of prices caused by a manic market.

Performance Analysis (9/30/2020)

	Last 12 Months	Inception - 9/30/2020 (cumulative)
Net Return (after all fees)*	**6.9%**	**29.9%**
Hurdle Rate of 6% per year	6.0%	26.9%
Russell 3000 (total return)	15.0%	65.4%
MSCI World Index (total return)	11.0%	51.7%
Average Cash & Equivalents % Portfolio	**5%**	**22%**
Average Option-Adjusted Net Exposure**	**75%**	**64%**
Contribution to Gross Return (before all fees)		
Positions (including equities and options that were part of each position)		
Covetrus Inc	24.3%	27.2%
Owens-Illinois Inc	4.8%	2.5%
Gilead Sciences Position	4.0%	1.0%
Allergan Plc	3.0%	8.3%
Care.com (previously Undisclosed Position 5)	2.0%	2.4%
eBay Inc	1.7%	4.2%
Caesars Entertainment	1.4%	1.5%
Medifast	1.3%	1.5%
Tail Risk Hedge	1.2%	1.6%
Carnival Corp Position	1.0%	1.2%
Cintas Put Position	0.6%	0.7%
Arcadis NV	0.6%	5.9%
Fox Corp	0.3%	-0.2%
Berkshire Hathaway	0.2%	0.2%
Liberty Latin America	-0.3%	-0.3%
Qurate Retail	-0.3%	-0.3%
Bristol-Myers Squibb CVR	-0.4%	-0.4%
Royal Caribbean Position	-1.2%	-2.6%
Discovery Communications Position	-5.8%	-4.0%
Charles & Colvard (previously Undisclosed Position 2)	-7.0%	-0.2%
Hopes and Dreams Put Options	-9.8%	-11.0%
Undisclosed Position 4	-11.1%	-12.1%
American Tower Position		5.1%
Cimpress NV		3.1%
Hill International (previously Undisclosed Position 3)		1.5%
Go-Ahead Group		0.2%
CommerceHub Inc		1.9%
Innoviva (previously Undisclosed Position 1)		2.7%

* Performance fee is presented based on the Founder's Class, which reflected the majority of the assets during these time periods

** Option-Adjusted Net Exposure adjusts for the use of options by replacing their weight with the delta-adjusted notional value for each option. While imperfect, it takes into account both the use of put

Disclaimers: Please see the "Disclaimers" section at the end of this letter

Your Questions

As I have committed to do in the Owner's Manual, I will use these letters to provide answers to questions that I receive when I believe the answers to be of interest to all of the partners. This quarter I received one question that I thought it would be helpful to address in this letter. (Please keep the questions coming; I will do my best to address them fully.)

You don't have any prior experience with activist investing. How are you approaching it and how does your prior experience prepare you for it?

Prior to starting Silver Ring Value Partners, I spent 15 years investing at large investment firms. Activism was not really a viable option there. While the reason was never stated explicitly, I suspect several factors were at play. First, management access was highly prized as a core part of the research process. I suspect there was a fear that becoming an activist might dissuade management teams from continuing to provide that access. Second, the bureaucracy was just not set up to handle such situations, and a portfolio manager would have to push through layers in the organization to even attempt activism. Finally, there was the mentality that the right solution was to just sell and move on if something was happening at the company that you seriously didn't like.

On the other side of the spectrum, there are activist firms whose whole process centers around finding companies that can benefit from change. In their case, they are mostly going in with an activist approach, hoping to be the catalyst that closes the price to value gap. They are organizationally prepared for activism, and all that it entails.

Activism is about advocating for change. In order to be a thoughtful advocate, one needs to have a deep understanding of the company. It is also desirable to have a mentality of a long-term owner rather than of someone looking for a quick pop in the stock. My investment process fits both of those criteria.

That does not mean that I want to or plan to be a frequent activist investor. I am not seeking companies in need of a change in direction. Ideally, I am looking for good businesses run by competent management teams that are mis-priced for temporary reasons.

However, over the course of ownership of a company there are times when legitimate disagreement over the path forward arises. If the stock is deeply undervalued, simply selling and moving on would be a big dis-service to the partnership. Not speaking up and allowing actions that I consider to be sup-optimal for the company's value to take place would also not be properly discharging my responsibility to the partnership. That leads to the occasional activist situation where, despite not having originally come in with an activist agenda, activism becomes the best path forward to create value for the partnership.

You might call what I described above as "reluctant activism." However, once I decide that activism is appropriate, there will be nothing reluctant about my tactics. I will not pursue activism lightly, but once I decide to do so, I plan on using all legal and ethical means at my disposal to achieve my objectives. As a long-term investor in companies with an owner's mentality, I believe that an agenda that I choose to vigorously pursue would likely appeal to many other long-term investors in the company, creating a natural alignment with other shareholders without any explicit collaboration.

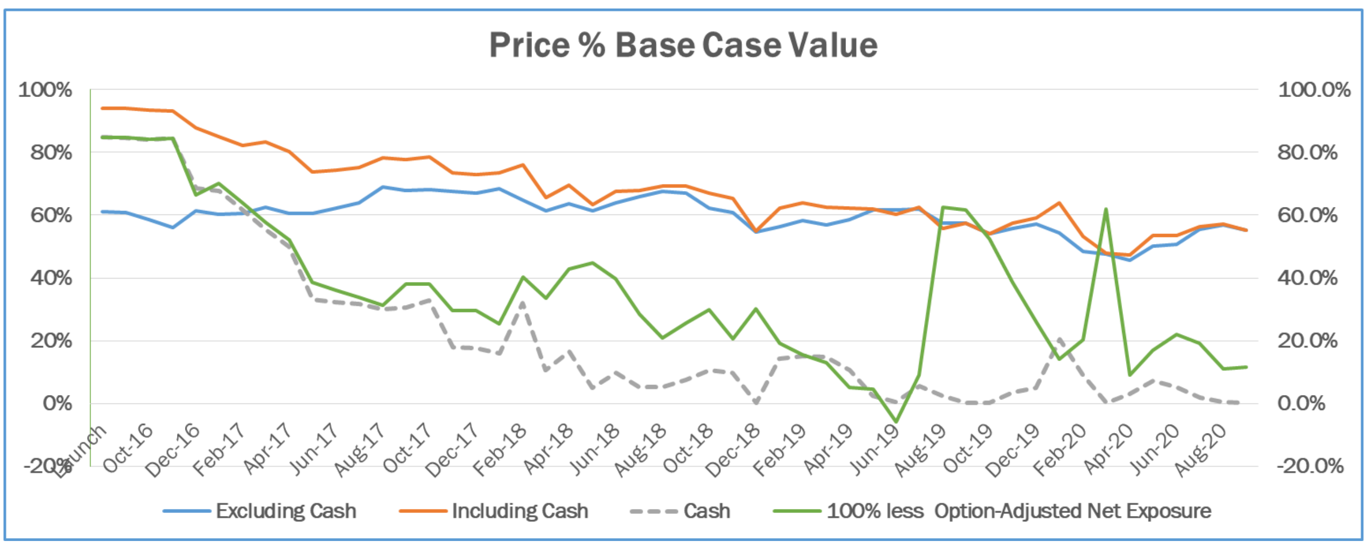
There is a real cost, in time and in funds, to activism. I will only pursue it when the position is substantial for the partnership and the difference that I hope to effect via activism has a substantial impact on value realization. In short, I don't expect to be doing this all that much, but when I do, I intend to play for keeps.

Portfolio Metrics

I track a number of metrics for the portfolio to help me better understand it and manage risk. I track these both at a given point in time, and as a time series to analyze how the portfolio has changed over time to make sure that it is invested in the way that I intend for it to be. Below I share a number of these metrics, what each means, and what it can tell us about the portfolio. As time passes, you should be able to refer to these charts and graphs to help you gain deeper insight into how I am applying my process.

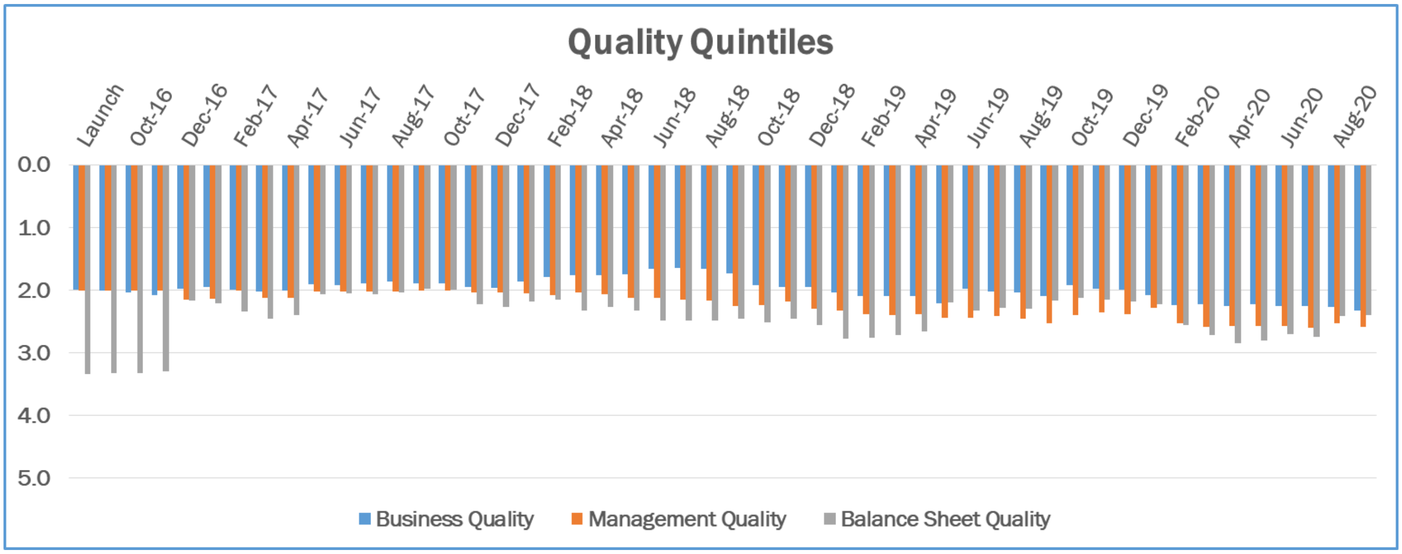
Price % Base Case Value

This metric tracks the portfolio's weighted average ratio between market price and my Base Case intrinsic value estimate of each security. This ratio is presented both including cash and equivalents, which are valued at a Price to Value of 100%, and excluding those. All else being equal, the lower these numbers are, the better. Excluding cash and equivalents, a level above 100% would be a red flag, indicating that the portfolio is trading above my estimate of intrinsic value. Levels between 90% and 100% I would characterize as a yellow flag, suggesting that the portfolio is very close to my estimate of value. Levels between 75% and 90% are lukewarm, while levels below 75% are attractive.



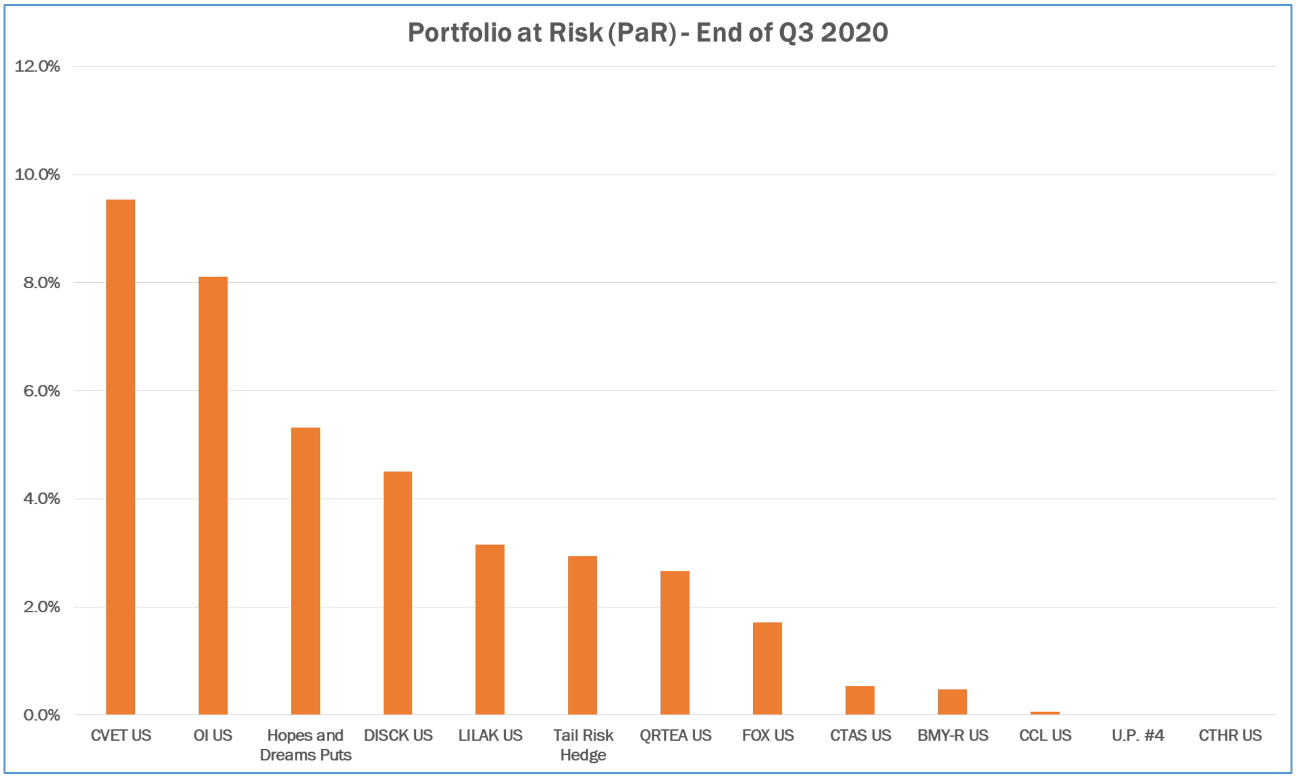
Quality Quintiles

As outlined in the Owner's Manual, I evaluate the quality of the Business, the Management and the Balance Sheet as part of my assessment of each company. I grade each on a 5-point scale with 1 meaning Excellent, 2 Above Average, 3 Average, 4 Below Average and 5 Terrible. The chart that follows presents the weighted average for each of the three metrics for the securities in the portfolio.



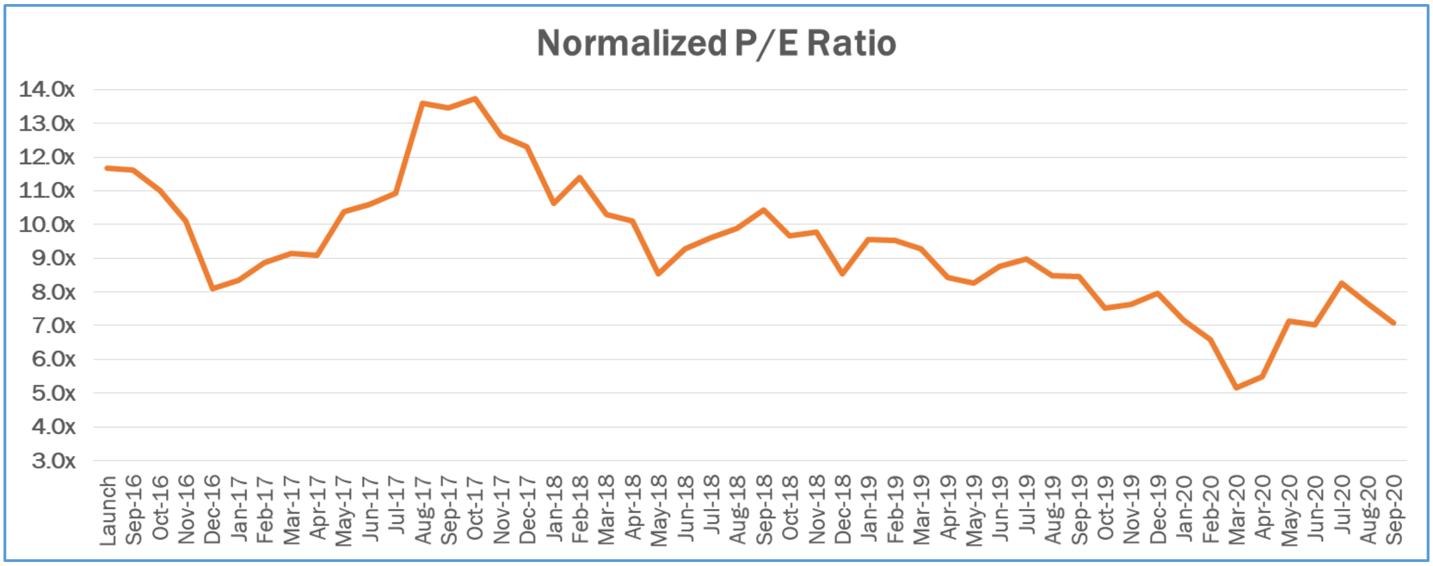
Portfolio at Risk (PaR)

I estimate the Portfolio at Risk (PaR) of each position by multiplying the weight of each position in the portfolio by the percent downside from the current price to the Worst Case estimate of intrinsic value. This helps me manage the risk of permanent capital loss and size positions appropriately, so that no single security can cause such a material permanent capital loss that the rest of the portfolio, at reasonable rates of return, would not be able to overcome. I typically size positions at purchase to have PaR levels of 5% or lower, and a PaR value of 10% or more at any time would be a red flag. The chart below depicts the PaR values for the securities in the portfolio as of the end of the quarter. Positions are presented including options when applicable.



Normalized Price-to-Earnings (P/E) Ratio

I supplement my intrinsic value estimates, which are based on Discounted Cash Flow (DCF) analysis, with a number of other metrics that I use to make sure that my value estimates make sense. One of the more useful ones is the Normalized P/E ratio. The denominator is my estimate of earnings over the next 12 months, adjusted for any one-time/unsustainable factors, and if necessary adjusted for the cyclical nature of the business to reflect a mid-cycle economic environment. The numerator is adjusted for any excess assets (e.g. excess cash) not used to generate my estimate of normalized earnings. One way to interpret this number is that its inverse represents the rate of return we would receive on our purchase price if earnings remained permanently flat. So a normalized P/E of 10x would be consistent with an expectation of a 10% return. While the future is uncertain, it is typically my goal to invest in businesses whose value is increasing over time. If I am correct in my analysis, our return should exceed the inverse of the normalized P/E ratio over a long period of time. The graph below represents the weighted average normalized P/E for the equities in the portfolio.



Normalized P/E Ratio
14.0x
13.0x
12.0x
11.0x
10.0x
9.0x
8.0x
7.0x
6.0x
5.0x
4.0x
3.0x
Launch
Sep-16
Oct-16
Nov-16
Dec-16
Jan-17
Feb-17
Mar-17
Apr-17
May-17
Jun-17
Jul-17
Aug-17
Sep-17
Oct-17
Nov-17
Dec-17
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Conclusion

"What is going to cause this stock to get re-valued by the stock market?" This is a question that I hear a lot from my frustrated value investor friends. It is asked with equal exasperation about stocks that are incredibly cheap relative to their profit levels and ones that are astronomically expensive relative to any fundamental measure.

I do not know. Nobody knows. In some cases, that valuation might even be appropriate, at both extremes. After all, value investing is not about statistical metrics at a point in time, but rather about weighing the full future cash flow stream of the company.

We humans are social animals. It is ingrained in our brains that prolonged disapproval of our peers is something to be avoided. In the old days that might have meant expulsion from the tribe and likely lonely death. While that is no longer the case for most of our society, our brains still, to some degree, respond to the disapproval of the group with the same trepidation.

The longer the stock market withholds its validation from our investments, the more natural it is for our brains to begin to doubt our conclusions, no matter how rigorously derived. There is a healthy aspect to this self-doubt and an unhealthy one.

It is healthy to use the negative feedback from the market to reassess our thesis. To re-focus on the business and whether or not we are approximately right on our estimated cash flow stream that underlies our investing decision. Just like when driving on a highway in a fog you can keep track of the road by the bright white line on the side, so we can **use the company's free cash flow to help us decide if our thesis is on track**.

It is unhealthy to re-focus on the stock price. Gradually accepting the market's current stock price as the right answer the longer it persists regardless of fundamentals is just mental capitulation to pain. When I have spoken in the past of ***temperament*** being the most important differentiating characteristic of a good investor, this is what I meant.

"Are value investors just missing growth stocks?" That is the question almost everybody is asking, including value investors themselves. Especially as that dwindling group of value investors observes sometimes smug growth investors describe how they had owned yet another stock that went from 5x *sales* to 20x *sales* due to the company's amazing fundamentals. Which, of course, these growth investors foresaw in advance.

Why have growth stocks done so well in the last couple of years? There are three reasons:

- Falling interest rates mathematically increase the net present value of higher-growth cash flow streams by a greater percentage than that of slow-growing or declining ones
- Real value creation by new companies doing things better than their predecessors
- In a time of great uncertainty, investors are looking for a combination of a business model and current results that implies a great degree of certainty about the future

To expand on the third point, think about which business models have gone up in price the most in this stock market. It is companies that are subscription-based ("as a Service"), or have similar economic characteristics, are showing above-average current growth in sales and which have convinced investors that they can sustain that above average growth for a long time. In an uncertain world where not only the economy but also the very structure of our society seems less certain than it has been in a while, those three characteristics have imbued this group of companies with a comforting glow which makes investors not worry too much about price.

Is this time different? Over the last 100+ years we have seen waves of innovation and innovative companies. To list just a few, think about radio companies in the 1920s, Nifty Fifty companies in the 1960s and the internet companies in the 1990s. Technology has changed drastically: from horse buggies to cars to commercial air travel; from telegraph to telephone to smartphone. What would someone 100 years ago think about color TV, which we all take for granted?

Here is the point. **New technology is… not new**. There have been many waves of companies with powerful demand trends driving their sales growth and seemingly unstoppable business models. A few have done marvelously well both as companies and as investments. However, the experience of investors investing in all of these companies as a group has been terrible. Why? Because **in their mad rush to catch the wave, capital was deployed with little regard to the *price*** of the investments.

If you possess the skills to find the few long-term technology winners in advance of the market price becoming so high that future investment returns are likely to be unattractive – then more power to you. I know myself, and I know that I do not have that skill. I suspect that of the investors who are currently patting themselves on the back and enjoying the temporary stock market validation, many also do not possess that skill. Only they do not know that yet.

Benjamin Graham, when he wrote *Security Analysis* in 1934, addressed this well. He had just witnessed the mad rush towards new market darlings of the 1920s followed by the bust of the Great Depression. Having observed human nature up close during this boom and bust cycle, he had this to say about growth investing irrespective of price:

"*Considering the 1927–1929 period we observe that since the trend-of-earnings theory was at bottom only a pretext to excuse rank speculation under the guise of "investment," the profit-mad public was quite willing to accept the flimsiest evidence of the existence of a favorable trend. Rising earnings for a period of five, or four, or even three years only, were regarded as an assurance of uninterrupted future growth and a warrant for projecting the curve of profits indefinitely upward.*" – Security Analysis, 6th Edition, page 364

"*We incline strongly to the belief that this last criterion—a price far less than value to a private owner—will constitute a sound touchstone for the discovery of true investment opportunities in common stocks. This view runs counter to the convictions and practice of most people seeking to invest in equities, including practically all the investment trusts. Their emphasis is mainly on long-term growth, prospects for the next year, or the indicated trend of the stock market itself.*" – Security Analysis, 6th Edition, page 375

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Does any of this sound familiar? **How little things change in investing.**

I am happy to answer any questions you have. Your feedback is important to me; please let me know how I can improve future letters. I greatly appreciate your trust and support, and I continue to work diligently to invest our capital.

Sincerely,

Gary Mishuris

Gary Mishuris, CFA
Managing Partner, Chief Investment Officer
Silver Ring Value Partners Limited Partnership

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