Market Volatility Letter

VULCAN VALUE PARTNERS

Market Volatility Letter - Tuesday, March 17, 2020

In this difficult time, we write this letter to assure you, our client partners, that we continue to execute in our role as a fiduciary. At the same time, we are very focused on the health and wellbeing of our employees, our clients, our community, and all of our partners. Please take care of yourselves and your families, as we are ours, and stay safe.

As this letter is being written, equity markets around the world are in steep decline due to fears surrounding the coronavirus. The S&P 500 is down 29.41% from its high in February. The FTSE 100, STOXX Europe 600, German DAX, and Nikkei 225 indices are all down over 25%. Interestingly, in China where the spread of COVID-19 has slowed, the China Shanghai Stock Exchange Fund Index is only down 2.89%.[1]

This panic selling is accompanied by a flight to perceived safe haven assets. In sharp contrast to our deeply discounted portfolios, safe haven assets such as the 10-year treasury and the 30-year treasury are dangerously overvalued in our opinion. The 10-year treasury yield is approximately 0.73% and the 30-year treasury yield is approximately 1.32%. At these levels, duration risk is significant. An inevitable upward move in interest rates, even if it is several years out, will cause significant declines in the principal value of these securities. These perceived safe haven assets look very risky to us over our 5-year time horizon.

In this period of great uncertainty, our team is working diligently to quantify the impact that this pandemic will have on our companies. We are meeting with increased frequency to work through each company in our portfolios to both assess the near-term impact of the coronavirus and to confirm that our long-term investment cases are still intact. We expect negative earnings comparisons over the next several quarters for a number of companies that we own. However, pressure on their valuations from declining profitability is offset by consistently high levels of free cash flow production and extremely strong balance sheets. This dislocation is precisely why we follow a dual discipline. We are as disciplined about the quality of the businesses we own as we are about the price we pay for them. Our dual discipline allows us to take advantage of stock price volatility because our values are stable.

It is important to note that we do this work on a regular basis so that we are prepared when a disruption occurs. We have been able to quickly reposition the portfolios to take advantage of recent volatility. In all strategies, we have been selling more fully valued names and adding to positions trading at deeper discounts. As you would expect, the portfolios are becoming more concentrated, and the price-to-value ratios are becoming more attractive by the day .

As a result of our dual discipline and our ability to respond quickly to this disruption, our portfolios are fully invested. The companies we own have stable values. Once COVID-19 runs its course, the values of these businesses will resume growing. Consequently, we believe our margin of safety and our prospective 5-year returns are more attractive now than they have been at any time since the financial crisis.

John Templeton, whose insights and values formed the basis for our Vulcan values, said “the time of maximum pessimism is the best time to buy.” If we are not there already, we are fast approaching the point of maximum pessimism. We believe it is a fantastic time for long-term, intelligent investors to allocate capital to Vulcan Value Partners.

We look forward to updating you again at the end of the quarter to discuss the changes that we are currently making. In the meantime, please reach out to our client service team if you would like any additional detail.

C.T. Fitzpatrick, CFA
Chief Investment Officer

Disclosures

Investing in securities involves risk of loss. Vulcan's security analyses are as of the date of this letter and reflects Vulcan's opinion as of that time. Market action may impact Vulcan's evaluation of securities and its opinion of those securities is subject to change. Past performance is not a guarantee of future results. No statement contained herein is intended as a guarantee the current expectations will be realized in the future. The information provided in this letter is furnished as of the date shown, and no representation is being made with respect to its accuracy on any future date. Vulcan Value Partners does not assume any duty to update any information in this letter. Value is our estimate of the intrinsic worth of a company based on our assessment of certain quantitative and qualitative factors. Vulcan defines risk reduction as reducing the portfolio's price to value ratio by either buying (or adding to existing positions) high quality companies which are trading well below fair value as estimated by Vulcan, or selling positions which are trading at or near their fair values. Vulcan buys concentrated positions for our portfolios, at times averaging 5% in our model portfolios, which may make our performance more volatile than that of our benchmark indices, and our performance may diverge from an index, positively or negatively, as a result. Our focus is on long term capital appreciation, so our clients should consider at least a five year time horizon for an investment with Vulcan.

The S&P 500 Index is an unmanaged index of 500 common stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index. The FTSE 100 Index comprises the 100 most highly capitalized blue chip companies listed on London Stock Exchange. The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom. The Germany DAX is a total return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange. The Nikkei 225 Index is a price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange. The Shanghai Stock Exchange Composite Index is a capitalization-weighted index. The index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. Index figures do not reflect deductions for any fees, expenses, or taxes. Investors cannot invest directly in an index.

Vulcan Value Partners is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. Vulcan focuses on long term capital appreciation; targeting securities purchases that we believe have a substantial margin of safety in terms of value over price and limiting our investments to companies that we believe have sustainable competitive advantages that will allow them to earn superior returns on capital.

[1]Returns are from the period beginning February 19, 2020 to market close on March 16, 2020.