July 27, 2021

Enclosed is your statement for the second quarter of 2021.

We typically use the second quarter's letter to highlight our focus on earnings. We look for long-term aggregate EPS growth of 6-8% per year in the companies that we hold in our portfolios. This growth is what ultimately increases market value. However, last year's shut-in created EPS that make for meaningless comparisons and so this quarter's letter will not address earnings.

In general, we prefer to limit any economic discussions to company specifics as we have built our portfolios from companies selected for their capacity to navigate the ups and downs of the economy. For the past five years, our focus has been on "compounders" – a designation we use to characterize that rare trait of being a "defensive grower." In conjunction with this focus, we have been reducing our exposure to "deep value" cyclical stocks. While these "defensive grower" companies are competitively stronger than the "deep value" variety, their prices are higher. The greatest risk to these higher prices, beyond typical competitive dynamics, is sustained inflation – a prospect we monitor closely.

The current monetary and fiscal support combined with pent-up demand has created overall inflation that is high in some areas. Given our democracy's reluctance to diminish government support, the arguments for "durable" (rather than "transitory") inflation are sensible. Additional arguments supporting such sustained inflation are: 1) the workforce has enjoyed its "staycation" and will require greater payments to return to work, 2) global supply chains have been disrupted and are likely to stay locally focused, and 3) the transition away from carbon-based energy due to concerns about climate change is expensive - akin to the "oil shock" of the 70s.

*It is important to reiterate that because we manage individual portfolios but write a general letter, your portfolio may vary from the stocks assumed in our discussions.

If these impacts combined to drive "durable" inflation, then long-term interest rates would rise. If those rates were to rise, the price of bonds, stocks, and housing would drop. If the drop were precipitous, subsequent support by the Federal Reserve might only exacerbate the problem and induce a revisiting of the "stagflation" of the 70s. While such an outcome is possible, we do not see it as likely.

Instead, our outlook is that this heightened inflation is "transitory." Since 2010, fiscal support has been crucial to avoid deflation. One of Trump's most powerful legacies was

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to demonstrate that fiscal deficits do not necessarily create excess inflation. In 2019, a trillion-dollar deficit plus record low unemployment did not spark inflation. We believe that the workforce will go back to work, as it always has, to earn more spending money. Technology improvements will cause labor to lose pricing power in services as it already has in manufacturing. Amid new localizing regulations, global supply chains will be restored in the world's relentless search for efficiency. Finally, the race against climate change energizes a global and competitive use of new technologies which is far different than the monopolistic shock of OPEC price-setting.

We view the competitive forces of capitalism as superior for raising standards of living, removing barriers to fairness, and improving the environment. Even the "communists" of China have seen the benefits of capitalism. As long as regulatory and monetary policies do not inhibit these dynamics, the impact of high levels of indebtedness should be limited to increased bankruptcies, reduced growth and reduced inflation – not the dreaded return of the 70s. Our portfolio of companies, especially the "compounders," will continue to compete successfully and increase their market value even though inflation fears will stoke price volatility.

We hope that this brief discussion illustrates why we have been emphasizing our approach and where the risks to our approach may lurk. We want you to stay informed and feel comfortable about our investing discipline. In communicating, we try to "do unto others as we would want done unto us." If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or from our office. In addition, our website (at www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio. If you would like a copy of Academy's updated Form ADV Part2A Disclosure Brochure, please contact our office.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management

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