ACADEMY
CAPITAL MANAGEMENT

October 18, 2019

Enclosed is your statement for the third quarter of 2019.

In our third quarter letter, we have a tradition of addressing broader issues that go beyond specific portfolio holdings. In last year's letter, we discussed the impact of investor "mood" and the challenges presented by Fed tightening. In this letter, we will discuss underlying economic trends and their impact on portfolios at Academy.

As long-term clients know, we are not "top-down" investors. "Top-down" investors are those who begin with an economic overview and then move to smaller components of the economy, such as industries and companies. Instead, we are "bottom-up" investors, spending the majority of our time studying individual companies. But the Great Recession forced us to step back and evaluate the big picture. Today's low interest, inflation and unemployment rates seem incompatible with huge government, corporate and individual debt. As Warren Buffett noted, "No economics textbook I know that was written in the first couple thousand years...discussed even the possibility that you could have this sort of situation continue."

Bewildering dislocations are the norm when major changes are occurring. Last century's Great Depression caught America by surprise. The immediate outcry and historical narrative of the Great Depression is often attributed to moral failings: excess speculation by stockbrokers, greed by bankers and simply having too much fun. However, close inspection reveals that our farm economy was going through profound technology-based changes. For years, agriculture's gains in output had grown faster than gains in demand. For example, one of our great-great grandparents came here from Poland in 1870. He joined the 50% of the population employed in farming. At that time, one farmer fed 5 people. His great-grandson still works the same farm, but now only 2% of the population farms. Today one farmer feeds 155 people. The Great Depression was capitalism's way of painfully reallocating resources from agriculture to manufacturing.

In our opinion, this century's Great Recession has the same dynamics as last century's Great Depression. Again, it was a surprise, prompting Britain's Queen Elizabeth to sternly ask a gathering of economists, "why did nobody see it coming?" And again, moral failings have been blamed: greed and speculation by mortgage brokers and housing investors. Yet a deeper look shows that those significant financial losses were not the cause, but the symptom of our economy's major transition from manufacturing to services. As occurred with agriculture 100 years earlier, long term gains of 5-7% per year in manufacturing productivity have overwhelmed the demand growth of 1-2%. As a result, manufacturing jobs are going away – not due to a "giant sucking sound from the south" but due to massive technology improvements. Manufacturing may come back to

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the US, but those wonderful, high paying manufacturing jobs will be performed by robots.

The Fed has been overzealous, fighting an inflation that manufacturing productivity is keeping in check. Starting from 0% in December of 2015, the Fed's Open Market Committee began a tightening phase that resulted in five consecutive 25 basis point increases by the end of 2017. During 2018, as the Fed implemented four additional 25 basis point increases to 2.50%, we expressed our belief that the Fed had tightened too much. After a particularly volatile December 2018, the Fed began to loosen and has delivered two 25 basis point decreases this year. We applaud these moves and look for more.

Capitalism is risky. Our mantra is "capitalism competes to zero profits." In this process, capital is placed at risk of permanent loss. A recent cartoon that stated, "EZ Money – the cause of – and solution to – all of life's problems" captures the enigma. Low interest rates are helping smooth the transition from manufacturing to services, but creating increased competition that lowers profits. Recent letters have explained our preference for "compounders" as opposed to "cyclical" and "equity bond" companies. We believe that "compounders" are better able to weather this transition, despite their higher valuations and price volatility.

If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Joyce Bell at 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 Derek Richards at our office.

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

Academy Capital Management

*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.