ACADEMY
CAPITAL MANAGEMENT

October 27, 2021

Enclosed is your statement for the third quarter of 2021.

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 our emphasis on what we term "digital real estate." This year we shift to a macro view and discuss some implications of the high current levels of monetary and fiscal support.

Since the dramatic increase of these supports due to COVID-19, we have observed an unprecedented valuation widening between the stock "haves" and the stock "have nots." In contrast, we have noticed an extreme narrowing in bond prices between the investment grade bond "haves" and the junk-like bond "have nots." At the same time, conversations have moved on from the horrors of COVID-19 to the extremes of the housing market. Price euphoria is erupting in stocks, bonds and housing simultaneously.

We have often proposed that "capitalism competes to zero profits." We could now add that "capitalism competes at a speed inverse to the cost of capital." Low-cost capital accelerates capitalism's rate of dynamic innovation. With post-COVID-19 rates at 4,000-year lows, a troubling reality emerges – the speed of cutthroat, profit-impairing capitalist competition is at its highest. Low-cost capital has provided high levels of funding for disruptive business models. In response, investors are getting out of and staying out of the stock of companies vulnerable to disruption.

When interest rates move towards zero, strange things also happen to bonds. The focus of bond investors is now less about *the difference in absolute yield* and more about the percentage spread between yields. A three-point difference in yield between 3% and 6% bonds is also a 100% spread between the yields. At lower yields, even when differences in yield decline, percentage spreads may still be high. For example, even though the difference in yield is only one-half of a point between 0.5% and 1% bonds, there is a 100% spread. Seen in this light, the convergence in yields between bonds of widely varying investment grades is less surprising.

Low interest rates are also creating price mayhem in housing. Because most home buyers are focused more on the monthly payment than the total price, buyers are engaged in bidding wars without traditional constraints. Yet we don't see "bubbles" here. Typically, such investor manias form around sensible ideas taken to extremes and not as a function of declining rates. In fact, the bubbles which we identified in 1999 and 2007 inflated in the face of rising rates. Although bubbliness may be present within cryptocurrencies, we do not see such a phenomenon within stocks, bonds or housing.

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Basic economic theory has taught that an increase of dollars through monetary and fiscal support is inflationary. Yet defying this basic theory, the economy's interest and inflation rates have gradually declined *for the past 40 years* while monetary and fiscal support has constantly grown. Today's low interest rates in the context of a dramatic expansion of the central bank's balance sheet (to over $8 trillion) and multi-trillion-dollar fiscal deficits are only the latest and most extreme test of this theory. The ability for low interest rates to coexist with huge debts is crucial for everyone with assets and, truthfully, no one knows for sure why this has been and is now working. Given its importance, we outline our thoughts here.

Economists use the term "nominal interest rates" to isolate the "real interest rate" from the effects of its currency. The currency part is called "inflation" – a euphemism for debasement of the currency. The "real interest" part is tied to productivity gains and population growth. These "real interest rates" are stable and low – around 1% over long periods of time. However, the effects of currencies are random and erratic. In the 20^{th} century alone, US inflation has varied from -5% to +20%.

Inflation is driven by two factors – the supply of money and the velocity of that money. The first factor – the supply of money - has been increasing for decades and has recently exploded. If inflation is not going up at the same rate as the supply of money, then the velocity of money *must be slowing*. It is unclear why this velocity continues to drop. Our thesis is that debt levels have an inverse relationship to the velocity of money. Where central banking and treasury powers are kept separate, a pattern emerges: as debt grows, velocity slows. Today's US velocity rates are like those in Japan for the past 30 years.

We think that as velocity has slowed, the increased supply of money has "pooled." This "pooling" has long shown up as "asset inflation" with the side effect of increasing wealth inequality. Recently, such "pooling" has accelerated to a point of increased social and political unrest and even billionaires competing in space exploration. If velocity does not increase, sustainably higher inflation and interest rates cannot occur. Instead, we think that velocity is likely to decrease.

We think that we are caught in a debt cycle where debt is issued to strengthen a weakening economy which, in turn, weakens the growth of the economy. This slowing growth cycle is accompanied by decreasing rates in the velocity of money. Slow growth economies are hazardous as they more easily slip into recession. Lacking political willpower, politicians will apply more monetary and fiscal stimulus when a recession emerges. These patterns increase the frequency of recession. We believe portfolio companies selected for their durable business models, as well as high growth rates, are especially well-suited for the challenges of this environment.

We hope that this discussion has shed some light on what we see as relevant in this environment and how it affects the investment decisions in your portfolio. In the spirit of our partnership, we want to provide insight into our process as if you are present at our investment committee.

If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or 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

*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.