ACADEMY
CAPITAL MANAGEMENT

August 8, 2022

Enclosed is your statement for the second quarter of 2022.

As we have opined in the past, continued high inflation is unlikely because of the Fed's commitment to its reduction, the public's support of the Fed and a post-COVID return to capitalistic competition. However, the medicine to treat high inflation is not much less painful than the disease. To combat high prices driven by excess demand, the Fed gradually reduces liquidity until demand abates and prices stabilize. In order to achieve a "soft landing" the Fed must balance supply and demand perfectly. That rarely occurs. Instead, a recession normally ensues. As Ben Bernanke famously remarked, "economic expansions do not die of old age, they are murdered by the Fed."

Our primary approach to dealing with the economy's ups and downs is not to predict these cycles but to use them to identify and purchase superior businesses at reduced prices. A superior business is marked by strong earnings growth which is the focus of our second quarter's letter. Increasingly, our emphasis has been on "compounders" – a designation we use to characterize that rare trait of being a "defensive grower." At the same time, we have reduced our exposure to "deep value" cyclical stocks. While we look for earnings growth of 6-8% per year, the prior five-year EPS growth of our portfolio companies was a surprisingly strong 15.3% per year, with a prior five-year price return averaging 16.6% per year. While not all current companies were held equally or fully for the entire five-year period, this survey supports our belief that earnings growth is what drives market value as well as illustrating the impact of "compounders."

One drawback is that despite these "compounder" companies being competitively stronger than the "deep value" variety, their prices (relative to their earnings and other metrics) are higher and more susceptible to price drops in a period of rising rates. Despite that drawback, we have chosen to invest in the best businesses – as time is the friend of the good business and the enemy of the bad one. For that reason, we welcome periods such as the current one in order to increase our stakes in our favorite companies at rarely reduced prices.

*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.

Our approach to the current Fed tightening is threefold. First, we have been raising or maintaining cash positions. The Fed is lowering demand by restricting liquidity. Most of the damage of a Fed tightening is for those who have inadequate cash and experience forced liquidation. Increased cash allows us to meet client obligations as well as be capable of "bargain" purchasing. Second, we have narrowed the number of companies in our portfolio to allow greater concentration within our top holdings. Third, while raising

500 NORTH VALLEY MILLS DRIVE, SUITE 200
WACO, TEXAS 76710
254-751-0555 P 254-751-0611 F

cash and narrowing holdings, we try to minimize taxation not only in portfolio construction but also by practicing "tax loss" harvesting.

"Tax loss" harvesting is an attempt to "make a stepping-stone out of a stumbling block" by realizing tax losses on market downturns without forgoing our investment opportunity. There are two methods. One is to take a loss by simply selling shares of a stock with the intent to repurchase later. To fully realize a tax loss, the government requires that there be at least 30 days between the sale and repurchase of a stock. If the stock rises during that 30-day period, the attempt to "tax loss" harvest may become an inferior investment decision. As a result, we generally choose the second method of purchasing additional shares of a depressed stock with the intent to sell that amount on a price recovery after 30 days. If the stock subsequently rises, then it can become a trading profit as well as tax loss harvest. We have been successful with this approach several times this year.

The noun "recession" originally was defined as "the act of ceding back to a former possessor." In order to avoid that pattern by "selling low," we suggest that our clients make some preparations in addition to those we are taking with the portfolios. These include making sure cash is available for emergency needs, selling assets that are burdensome while prices are still reasonable, and minimizing discretionary purchases. These actions are not only useful for "peace of mind" but also for planning on the possibility that this recession may be deeper or more prolonged than normal.

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 Derek Richards at our office.

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

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