ACADEMY
CAPITAL MANAGEMENT

October 28, 2022

Enclosed is your statement for the third quarter of 2022.

In our third quarter letter, we have a tradition of addressing broader issues that go beyond specific portfolio holdings. In prior letters, we have discussed investment themes, such as “digital real estate.” Last year, we highlighted macro issues such as 1) “price euphoria …in stocks, bonds and real estate,” 2) the existence of “huge debts coexisting with low interest rates,” and 3) low inflation despite huge monetary growth. We theorized that increased monetary and fiscal support had not translated to high interest and inflation rates due to lower velocity of money as money “pooled” into savings and investments. Seasons change.

This year, those “pooled” funds have poured out of savings, as inflation has gone from “transitory” - in the words of Chairman Powell - to the Fed’s top concern. In his speech at Jackson Hole, Chairman Powell said, "Without price stability, the economy does not work for anyone. Without price stability, we will not achieve a sustained period of strong labor market conditions that benefit all. The burdens of high inflation fall heaviest on those who are least able to bear them.” These strong words indicate that the Federal Reserve has the willpower to subdue inflation.

The Fed’s inflation-fighting tool is an indirect one – to raise interest rates. Higher interest rates encourage consumers to increase savings and decrease spending. The Fed’s tightening impact is potent when utilized on the heels of an expansion when consumer debt levels are high. This time is different. The combined fiscal, monetary and social impacts due to COVID drove last year’s savings rates to levels not seen since World War II. With high savings accompanied by at-home restlessness, American consumers have spent heavily – with little sensitivity to interest rates or prices. The battle is on: the Fed’s commitment to slow the economy versus the consumer’s desire for gratification. Victory will be the Fed’s, but that takes time and will generate more market turmoil.

At the risk of sounding like a broken record, we reiterate that the gift of a bear market is the ability to make rare, bargain purchases. Yet, for psychological reasons, bear markets often make the most important thing – capital allocation – into the most difficult thing. Our capital allocation process is systematic so that we are less likely to be affected by the turbulence. We estimate the 10-year relative benefits of cash versus bonds versus stocks and then use these studies to allocate capital. Despite the increased yields on cash and bonds, the decreased values in the stock market cause us to value stocks as the best investment choice and allocate most of our capital towards the purchase of stocks of

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superior businesses. As we've said before, low prices, though unsettling, are the friend of the long-term investor.

The difficult process of capital allocation does not end with our purchase of a stock. At its purchase, we transfer the burden of capital allocation to management of the company whose stock we own. We pay close attention to their practices. Decisions regarding the benefits of paying dividends, issuing or repurchasing shares and selling or buying businesses are often more powerful drivers of long-term results than the more obvious characteristics of their businesses. In some ways the old saying applies: "it's not what you do, but how you do it."

The first area we scrutinize is dividend strategy. In general, the stock market pays out roughly one-third of its combined earnings to fund dividends and retains two-thirds to fund growth. For businesses with high returns on capital, we would prefer to see the reinvestment of all earnings without the payment of dividends. Sadly, increased size often means reduced reinvestment opportunities. In these cases, dividend payments may be appropriate as the result of excess capital. However, in many instances (such as utilities), dividend payments are the result of industry or company norms and seem to have little to do with thoughtful capital allocation.

The second area we closely study is the repurchase and issuance of a company's own stock. Most public companies struggle with the discipline of repurchasing their stock at low prices and issuing their stock at high prices. When the headlines are positive (and stock prices are high), management trumpets their share repurchases and conversely, when headlines are negative (and stock prices are low), management emphasizes a requirement to keep cash on hand or, even worse, to issue more shares. This "repurchase of stock at high prices and issuance of stock at low prices" behavior results in remarkably poor capital allocation (and lowered stock returns) despite fundamental success within the underlying business.

Finally, we analyze a company's merger, acquisition and business-selling activities. Overall, publicly traded companies have a poor record in this category. AT&T's 2016 acquisition of Time Warner for $85 billion and its subsequent 2022 spinoff for $43 billion is an eye-popping example of poor capital allocation. In our opinion, neither a company's industry position nor management's knowledge nor its well-paid consultants can supply the willingness required to patiently suffer through the deep cultural changes required by mergers and most strategic moves. For this reason, we prefer a management led by a "founder's feel" – a set of beliefs and practices which embody the founder's relentless drive for excellence and customer satisfaction.

We look for management teams who 1) understand and communicate the long-term dynamics of their primary business, 2) compete aggressively while being tempered by integrity, 3) exhibit a willingness to suffer adversity with thoughtful conviction and 4) allocate capital patiently as fellow shareholders. With such management teams, we can navigate more adeptly the challenges of global conflicts, domestic unrest and loose monetary patterns while profiting from the wholesale repricing of assets. We are

particularly excited by those compounding growth prospects when our ability to purchase stock at today's lower prices is combined with the companies themselves purchasing assets at lower prices. In times like these, we are fortunate to have some of our best capital allocation role models in the ranks of the managements whose stocks we own alongside yours.

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. Briefly returning to our investment report, we present the results for the third quarter. *

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.