ACADEMY
CAPITAL MANAGEMENT

May 4, 2023

As we shared in last quarter's letter, we view the current inflation fight to be one with four phases. Phase one is the Fed raising rates. Phase two is the Fed holding rates constant. Phase three is a system-threatening financial breakdown. Phase four is the Fed dropping rates. We believe that the conversations during 2023 are likely to gyrate between "soft landing" and "hard landing" scenarios. At this point, we are ending phase one (with one more, perhaps two, rate hikes likely) and will enter phase two with attractive yields on our U.S. Treasuries and a portfolio of high-quality durable companies. This portfolio composition should position us well for the superior buying opportunities of phase three.

We do not try to forecast the economy or stock prices. However, we did utilize the upswing in stock prices during the quarter to trim our stock positions and raise our allocation to U.S. Treasuries. This was not a predictive move and was made in early March just prior to the most recent banking mini-crisis. Our reallocation was mathematical, and we present here the reasoning from our Investment Committee meeting at that time (for the mathematically averse, please skip the following three paragraphs):

"In general, the easiest measure to compare stocks and bonds is to contrast the dividend yield against the 10-year USG bond yield. Typically, the measure for 40 years or longer, has been Aesop's "a bird in the hand is worth two in the bush" – meaning that the earnings yield should be twice that of the bond yield. Another way to state this is that the *dividend yield should be roughly equal to the bond yield* as the dividend yield generally represents half of the earnings yield. This relationship has proven true – especially when one adds back roughly 30 basis points to account for share buybacks (using Shiller's studies on his website).

Here are the past 10 years:	**Div. Yld**	**Bond Yld**	**Adj. Div. Yld**
2013	1.94%	2.90%	2.24%
2014	1.92%	2.21%	2.22%
2015	2.11%	2.24%	2.41%
2016	2.03%	2.49%	2.33%
2017	1.84%	2.40%	2.14%
2018	2.09%	2.83%	2.39%
2019	1.83%	1.86%	2.13%

2020	1.58%	0.93%	1.88%
2021	1.29%	1.47%	1.59%
2022	1.64%	3.62%	1.94%
Now (3.6.23)	1.67%	3.97%	1.97%

During Covid, dividend yields were actually higher than bond yields – an indication of how dangerously high bonds were priced. This created a TINA moment for stocks – There Is No Alternative.

Takeaway: Currently, the pricing is basically "*a bird in the hand is worth one in the bush*." This occurred previously during the Volker tightening. Subsequently, bonds generated stock-like returns despite having far less risk – an environment in which balanced portfolios thrived."

Our spring quarter's letter addresses the businesses of the stocks which were newly purchased over the prior year. Last year's list was unusually short with only one new company purchased. Purchasing stock in a company is attractive when we have identified three conditions: first, the company's earnings have a healthy long-term outlook; second, the company allocates its excess cash flows intelligently; and third, the stock of the company drops or languishes in price for an extended period. The rising rates of 2022 combined with a pricey stock market gave few new opportunities.

Hsinchu City, Taiwan-based Taiwan Semiconductor Manufacturing Company (TSM) is the leader in the all-important semiconductor space. As we have shared in prior letters, one of our primary investment themes has been "digital" real estate. TSM is one of the critical generators for the expansion of that space – we find ourselves akin to being a real estate investor who can purchase a real estate creator. TSM has grown to dominance by a business model that is foundry-centric. By focusing narrowly instead of vertically integrating (like Intel) or diversely manufacturing (like Samsung), TSM has pulled away from the competition and built a strong competitive moat. The combination of geopolitical concerns and a post-Covid drop in device sales has dropped TSM to a stock price that we consider compellingly cheap.

The purchase we made during 2022 highlights our increased emphasis on company dominance. As one of our clients noted, "life is better at the top of the food chain." We continue our shift in emphasis from buying good companies at great prices - with the prospect of three to five-year investment holds - towards buying great companies at good prices - with an eye on "forever."

Our holdings are in stocks of excellent companies. Some of these companies are huge; some not. Some are global; some not. Some pay dividends; some don't. Some are widely diversified; some not. As highlighted here, the common denominator is a set of competitive strengths that allows them to be durable as well as growing during the difficult times that perennially lie ahead.

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