TOWLE & CO.

January 21, 2025

"Investing requires a great deal of patience and discipline. The important thing is not to get too discouraged when things go wrong, or too euphoric when things go right."
-Sir John Templeton

Unshakeable! For the Towle team, 2024 was a year defined by adversity, reflection, and resolve. It began with the passing of our founder, Woody Towle, whose confidence in our unique investment strategy and resilience during periods of underperformance remain at the heart of our firm. Woody's optimism in America, trust in human progress, and steely discipline continue to inspire and guide our decisions. His enduring influence reminds us that long-term success is built on a repeatable process, unwavering conviction, and ironclad perseverance. Standing on these giant shoulders, we remain intensely focused on executing our investment process.

The Towle Value Composite (TVC) delivered a net full-year performance of -9%, significantly underperforming the Russell 2000 Value's 8% return and the S&P 500's AI-driven 25% gain. **While periods of stark underperformance can be jarring, history shows that disciplined adherence to a low EV/sales strategy *in the face of underperformance* has often set the stage for exceptional multi-year returns.**

The past year also brought opportunities to reconnect with many of our valued clients and partners. These discussions reinforced our shared commitment to long-term value creation and the importance of patience and discipline. They also underscored concerns over the S&P 500's high valuation and extreme concentration risk, clarifying the role of Towle Value in a diversified portfolio. With small-cap performance stabilizing and consensus estimates projecting double-digit earnings growth for the Russell 2000 in 2025, we're pleased to see some investors increasing their Towle investment.

Towle Value Composite returns are highlighted below with periods greater than one year annualized:

Periods ending 12/31/24	*TVC (Gross of fees)*	*TVC (Net of fees)*	*Russell 2000 Value*	*S&P 500*
3 months	1.05%	0.79%	-1.06%	2.41%
YTD	-8.12	-9.04	8.05	25.02
1 year	-8.12	-9.04	8.05	25.02
3 years	2.81	1.80	1.94	8.94
5 years	8.18	7.11	7.29	14.53
10 years	6.90	5.84	7.14	13.10
20 years	8.20	7.13	7.01	10.35
30 Years	12.03	10.92	9.67	10.92
Inception (1/1/82)	14.55	13.42	11.21	12.10

Returns are preliminary and subject to change. Past performance is no guarantee of future outcome. Please refer to the last page for additional disclosures.

Takeaways from 2024

While relative underperformance on the order of 15-20% is undeniably challenging, it is not unprecedented in our history. The Towle Value Composite underperformed the Russell 2000 Value by 15% or more in 1990, 2000, 2008, 2018, and now in 2024. **Of those years, 2000 is the only other year that saw TVC fall while the Russell 2000 Value rose. And from 12/31/00 to 12/31/05, we achieved a remarkable 239% return compared to the Russell 2000 Value's 89%.** Perseverance and discipline through tough periods are critical to long-term investing success. And stock market favor can swing violently! From 12/31/00 to 12/31/05, the S&P 500 rose by just 3%.

While staying the course is critical, difficult years like 2024 also offer invaluable opportunities for growth and reflection. Each test strengthens our discipline and reinforces our commitment to delivering world-class small-cap value performance. With this in mind, we present our **Top 10 Takeaways from 2024**, organized to flow from market challenges to portfolio strategy and lessons learned.

1. **The pain stems from the duration, not just the severity.** The extended underperformance in small-cap and value stocks has been notable for its extraordinary duration in addition to its severity. While time weighs heavily, history reminds us that periods of significant underperformance eventually yield to recovery. The current environment highlights opportunities that emerge from such prolonged challenges. Our looking ahead section includes a chart on the current small-cap doldrums' duration, and it is the second-longest in almost a century.

2. **Overtly speculative behavior persists—for now.** Ill-advised riskiness continues to influence markets, with passive flows and brazen retail traders fueling frothy valuations in AI, quantum computing, crypto, and beyond. As Strategas Research notes (*Things I Think, I Think*, 10/25/24), even institutional investors seem to care less about valuation today than at any point in the past 30 years. Inevitably, this environment will shift and create openings for disciplined, valuation-driven strategies to thrive.

3. **Politics and economies evolve.** The 2024 elections marked a year of widespread political change, with voters in more than 60 countries heading to the polls. Economic frustrations, rising prices, and dissatisfaction with the political status quo fueled a challenging environment for incumbents, with many nations favoring fresh leadership. Globally, economic instability drove policies prioritizing energy security, supply chain resilience, and industrial self-reliance. In the United States, Donald Trump's return to the presidency signaled a sharp pivot toward pro-energy policies, deregulation, and a renewed focus on domestic manufacturing and infrastructure investment, reflecting a broader global recalibration of economic priorities.

4. **Growth and value are symbiotic.** While AI, electrification, and other transformative technologies dominate the spotlight, the undervalued industries supporting them—raw materials, durable components, and infrastructure—stand to benefit as productivity gains from these technological advances ripple across the economy. Over time, capital should naturally flow from the richly valued *creators* of technology to the undervalued and more tangible, asset-intense *supporters and users* of technology.

5. **Active management stages a comeback.** ETF flow data indicates an increasing interest in active management, as investors look beyond valuation-blind passive instruments. This trend highlights the growing importance of rational, value-driven strategies, setting the stage for disciplined managers to excel.

6. **Portfolio companies deliver solid results.** Despite market headwinds, 85% of our portfolio companies were profitable over the past year, far outpacing the mere 40% of Russell 2000 Value constituents reporting profits. This reinforces our confidence in the quality of our holdings and their ability to generate long-term value.

7. **Our buys show discipline, while our sells could improve.** The portfolio exceeds cost basis, reflecting our successful buying strategy. However, in hindsight, more proactive selling in late 2023 or early 2024 could have mitigated some of this year's pressures. Cyclical investing is inherently difficult. Improving our sell discipline by continuing to refine our understanding of industry cycles and margin changes is a key focus going forward.

8. **Inflation will likely be stickier than anticipated.** Despite aggressive central bank actions, inflation remains persistent with Strategas Research projecting a second wave and stating, "once an economy experiences one wave of inflation of over 6%, the chances of a second wave of over 6% are roughly 9 in 10."[1] Commodities, which have typically performed well in inflationary environments, are a key part of our portfolio strategy, positioning us well for an environment of persistent price increases.

[1] Jason De Sena Trennert, *Most Non-Consensus View: A Second Wave of Inflation*, September 27, 2024, 32.

9. **The U.S. economy is incredibly robust.** The U.S. economy continues to defy recession fears. GDP growth remains solid, with forecasts of 2.7% in 2024 and 2.2% in 2025. Unemployment is low at 4.1% as of December 2024, and corporate interest payments as a percentage of operating profits are at historic lows. These indicators highlight the underlying strength of the U.S. economy and its capacity to support long-term growth.

10. **We have amazing clients.** We deeply appreciate your patience and trust during this period of underperformance. We understand the challenges of sticking with a manager when times are tough. Your steadfast support—and, in many cases, your confidence to add capital—inspires and energizes us as we remain true to our disciplined investment approach.

Quarterly Portfolio Review

This section has been removed for compliance reasons to exclude discussing specific securities transactions.

Looking Ahead

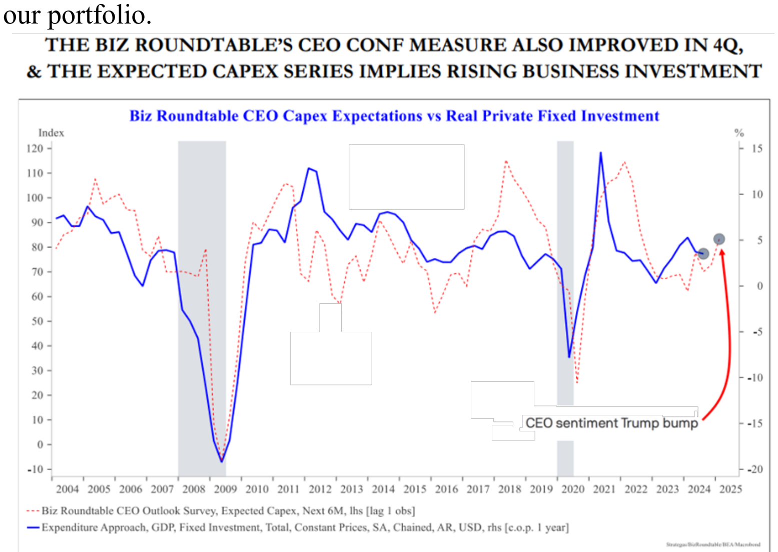
"The big money is not in the buying and the selling, but in the waiting."
-Charlie Munger

As we step into 2025, we believe the stage is set for small-cap stocks, particularly those in the Towle portfolio. Our companies stand to benefit disproportionately from several key trends:

1. **U.S. Remains the Global Growth Engine**: Small-cap stocks, deeply tied to the domestic economy, are poised to gain from a renewed capital investment cycle, accelerating earnings growth, and higher M&A activity in the coming year.

2. **Favorable Business Cycle Dynamics**: While the cumulative effects of inflation continue to pressure the consumer, US households, bolstered by a tight labor market (4.1% unemployment) and record wealth gains (+$10T over the past year), underpin healthy spending, investment, and cyclical tailwinds.

3. **Deregulation and America First**: The recent election and associated "red sweep" create fertile ground for small caps. The new administration's desire for an "Industrial Renaissance" in America is especially encouraging for our industrial, materials, and energy holdings. With the potential for tax cuts, deregulation, and a more business friendly environment, CEO confidence is on the rise. As Strategas Research highlights in the below chart from their December 14th Weekend Reader, this renewed confidence could mark the beginning of a broader shift in capital flows toward the very sectors that form the backbone of our portfolio.



At the same time, recent political and economic surprises have added a layer of uncertainty to the outlook. Hotter-than-expected employment data combined with the anticipated tariff-driven trade policies of the incoming Trump administration have led markets to aggressively price in higher-than-expected inflation and significantly higher long-term interest rates. **In recent memory, the last time markets were shocked by high inflation and unexpectedly tight Federal Reserve policy in 2022, the diversification benefits of a small-cap value strategy like Towle's were evident:**

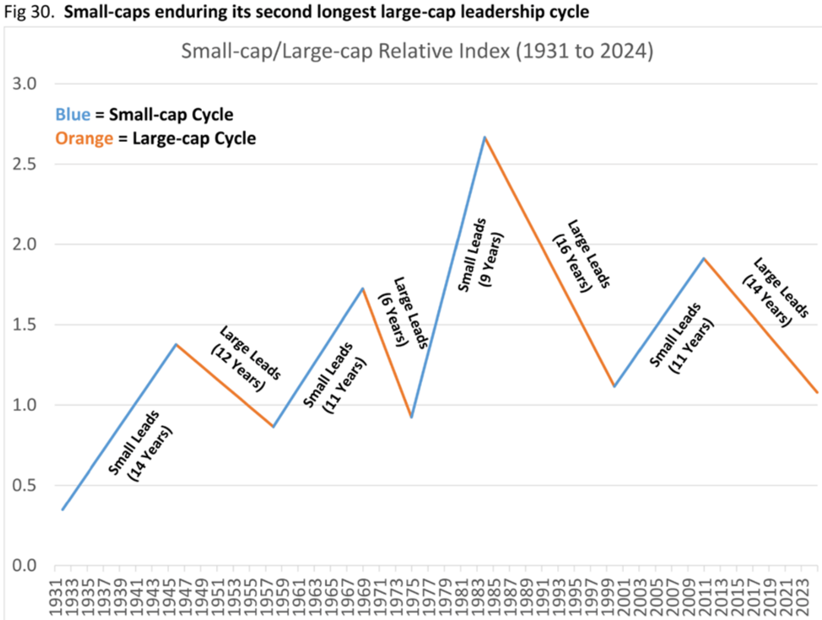
	2022
Towle Value Composite	-3%
Russell 2000 Value	-14%
S&P 500	-18%
Apple Inc.	-26%
Microsoft Corporation	-28%
Amazon.com, Inc.	-50%
Alphabet, Inc.	-39%
NVIDIA Corporation	-50%
Meta Platforms, Inc.	-64%
Tesla, Inc.	-65%
Magnificent 7 Average	-46%

Towle Value Composite is net of fees. Past performance is not indicative of future outcomes. Please refer to the last page for additional disclosures.

This environment raises critical questions: Can investors afford the concentration risks of today's market? Will 2022 conditions repeat? **Could renewed underperformance in overpriced large-cap growth finally trigger the long-anticipated leadership shift? While time will tell, the Towle team believes change is afoot.**

We're not alone in this view. A recent Barron's article agrees: "Now it may be time to play catch-up. A broad group of value stocks tracked by SentimenTrader senior analyst Jason Goepfert is near its lowest level versus growth in over two decades. The last time relative prices were at these levels in the early 2000s, value stocks went on to outperform growth over the coming years." [2] **A shift in leadership may be overdue.** According to Furey Research Partners, small caps are nearing the end of one of the longest cycles of large-cap dominance in history, second only to the 16-year run-up to the Tech Bubble.

Fig 30. **Small-caps enduring its second longest large-cap leadership cycle**



Source: Furey Research Partners, Ibbotson and FactSet. Data thru Dec 2024.

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[2] Jacob Sonenshine, "The Fed Crushed the Stock Market. Where to Find the Best Value Now.," *Barron's*, December 20, 2024.

Today, we see similar catalysts emerging for a potential regime shift. Against this backdrop, the 2025 outlook—marked by robust domestic growth, favorable monetary conditions, and policy-driven catalysts—strengthens the case for small cap equities and underscores the strategic position of the Towle portfolio.

Looking ahead, we are reminded of Charlie Munger's admonition to keep waiting. **In the face of uncertainty, it takes discipline to stay patient, to trust in time-tested principles, and to endure the storms that inevitably arise. Yet, it is precisely this resolve that has proven to be the foundation of success in our space.** By adhering to our valuation framework and staying resilient in the face of short-term market fluctuations, we focus on executing our investment discipline for the long term. Though difficult, this approach has historically yielded meaningful rewards for those willing to persevere.

We are also delighted to introduce our refreshed website at www.towleco.com. Let us know what you think.

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