TOWLE & CO.
DEEP VALUE INVESTING
(314) 822-0204

July 13, 2021

Onward! Following 14 months of market-beating performance, the Towle Deep Value Composite took a step back in June, resulting in a modest quarterly decline. An overweight to Consumer Discretionary plus zero exposure to high-flying meme stocks like AMC Entertainment Holdings accounted for much of the difference. With investors continuing to assess the market impact of lingering economic uncertainties and the upsurge in new variants, choppy stock price action over the next few months should be expected. Looking longer term, we believe our undervalued, pro-cyclical portfolio is well positioned as the U.S. economy continues its transition from recovery to expansion.

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

Periods ending 6/30/21	*Towle DVC (Gross of fees)*	*Towle DVC (Net of fees)*	*Russell 2000 Value*	*S&P 500*
3 months	-0.86%	-1.04%	4.56%	8.55%
1 year	90.93	89.55	73.28	40.79
3 years	6.94	6.13	10.27	18.67
5 years	12.90	12.07	13.62	17.65
10 years	11.49	10.69	10.85	14.84
20 years	12.49	11.64	9.17	8.61
30 Years	15.45	14.62	11.41	10.73
Inception (1/1/82)	15.70	14.88	12.06	12.20

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

Investment Environment

The Covid-19 economic downturn and recovery proved anything but typical. Unlike a "classic" recession born on economic excess and rampant misallocations of capital, the 2020 contraction was the result of a government-mandated shutdown. Aided by unprecedented fiscal and monetary response, the downturn behaved more like a natural disaster where economic activity was interrupted temporarily and underlying demand returned quickly.

Indeed, released pent-up demand now outpaces constrained supply, holding back the full potential of the U.S. economy. Product and material shortages, supply chain bottlenecks, and policy-driven labor disincentives currently impair the economy's ability to meet the revitalized demand for goods and services. Unsurprisingly, these imbalances have resulted in rapidly rising prices in many products, including automobiles, housing, and food. Will this inflation prove long-lasting or will it subside after supply bottlenecks are resolved? We do not know.

In any case, we remain delighted by the strength of today's economic expansion. Key building blocks include:

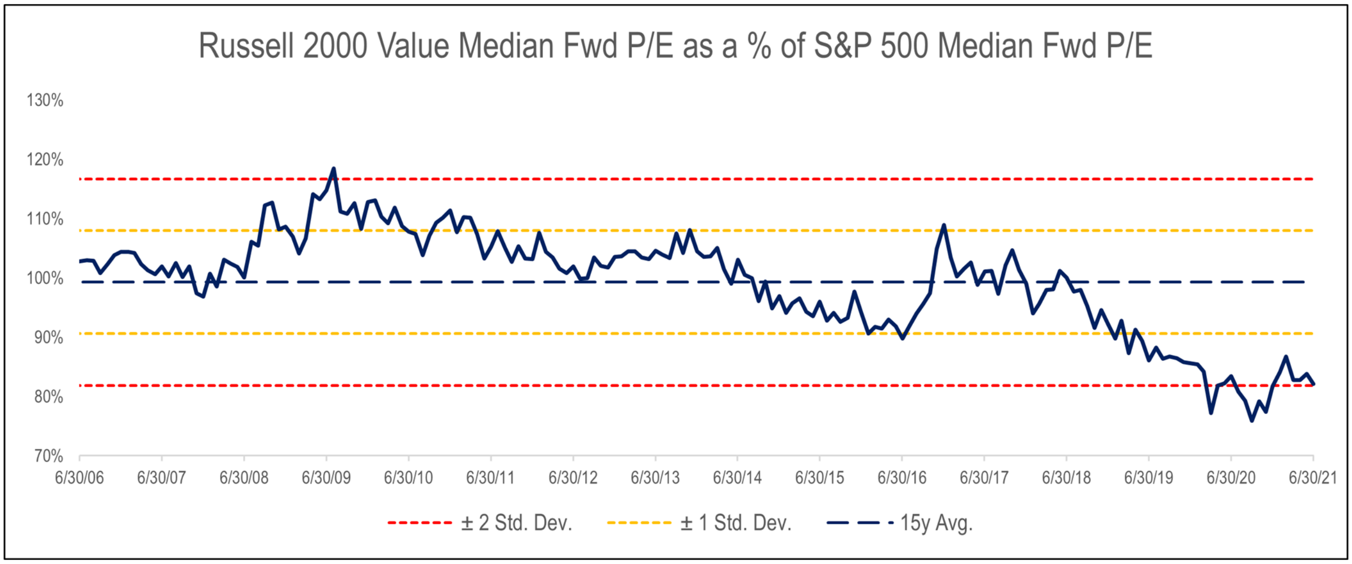
1. **Strong Consumer**: Driving 70% of U.S. GDP, the American consumer's propensity to spend is supported by solid financial health:
   - The ratio of household assets to liabilities currently sits near a 50-year high (*Bloomberg – Conor Sen, 6/23/21*)
   - Compared to 2008, when Americans lost $8 trillion in net wealth, U.S. households *added* $13.5 trillion in wealth last year (*WSJ – McCaffrey and Shifflet, 6/27/21*)

2. **Low Interest Rates**: Headline noise notwithstanding, the Fed's policy stance remains accommodative, keeping borrowing rates in check.

3. **Sound Financial System**: Banks are largely overcapitalized with untapped lending capacity while credit spreads remain tight, signaling calm.

4. **Fundamental Momentum**: Cyclical stocks lead the way on earnings growth expectations into 2022. (Strategas Research Partners, *Quarterly Review*, 7/1/21.)

Furthermore, valuations in our deep value space are comparatively attractive. The median forward P/E ratio of the Russell 2000 Value relative to the median forward P/E ratio of the S&P 500 remains nearly two standard deviations below its trailing 15-year average. We believe small-cap value still looks cheap, and a simple mean reversion of this valuation gap could reward the patient value investor.



Median forward P/E ratios for the Russell 2000 Value and the S&P 500 are calculated using all companies with positive forward earnings estimates in the iShares Russell 2000 Value ETF (IWN) and SPDR S&P 500 ETF Trust (SPY), respectively, calculated on a month-end basis.
Source: S&P Capital IQ, Towle & Co.

Portfolio Review

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

Strategy Review

Given the sensational headlines surrounding inflation, interest rates, Covid variants, cryptocurrencies, and pockets of asset bubbles, we think it is a good time to review the key elements of our strategy and what truly matters to the long-term investor. In summary, our investment framework is based on the following:

- **Buy low**. In achieving market-beating results, we believe that nothing supersedes the necessity to buy right. Uncovering that right investment idea at a toss-away price is the goal. Those who wait for perfectly aligned company results and stock market conditions prior to purchase may find that they paid too much.
- **Total earnings leverage**. Equity values are a function of earnings, and rising equity prices are repeatedly a function of increasing earnings. The Towle team aims to build a portfolio of companies with substantial earnings leverage driven by cyclicality, operating leverage, capable management teams, sound competitive positions, and manageable financial leverage (debt).
- **Long-term investment horizon enables normalized earnings power**. The short-term equity trader reacts to the whims of the stock market. Companies, however, do not invest capital in such a short-sighted manner and neither should the investing public. A real-world view allows time and space for corporations to perform. Our long-term lens lets us focus on what matters – normalized earnings power – and avoid shorter-term distractions.
- **Believe in the certainty of progress**. While far from smooth and uninterrupted, economic progress is enduring and pervasive throughout history. Mankind's productivity and adaptability appear limitless. By almost any set of long-standing measurements, prosperity and progress win out over despair and decline.

The housing sector provides a good illustration of how we put these principles into practice. Prior to 2010, housing had experienced the "dark days of dislocation." Recently, it seems to be the opposite, with a consensus view that the housing market borders on outright euphoria. But in both cases, our investment framework helps us confidently hold a non-consensus, maybe even controversial, overweighting in housing-related stocks. The short-term trader may be alarmed by reports of rising material and labor costs, prospects for higher borrowing rates, or affordability concerns and feel justified in dumping housing stocks. A *long-term* investor *buying cheaply,* trusting in the *progress of mankind,* and focusing on the *levers that drive earnings* can look beyond the headline noise for market-beating opportunities.

And what we see are Millennials, a larger cohort than Baby Boomers, entering the child-bearing life stage and looking to move into new housing. At the same time, in part due to a decade of underinvestment in new construction, we see that the U.S. today has a housing undersupply of roughly 5.5m homes (*WSJ – Nicole Friedman, 6/16/21*). And, finally, we see publicly traded homebuilders adapting their business models and improving productivity via merger synergies and structural cost saving programs. In sum, we see **strengthening demand**, significant **supply constraints,** and **improved cost structures** supporting both our housing-related stocks and our entire economically-sensitive portfolio over a **three-year investment horizon**.

We are delighted to announce that Jessica Kardos joined Towle & Co. on June 1st as Director of Investment Operations. Jessica is a 20+ year industry veteran with extensive knowledge of operations and trading functions. She has been charged with overseeing these areas and guiding their future development. Her expertise and critical thinking are complemented by a joyous attitude and supercharged work ethic. It is already evident she will be a valuable team member.

J. Ellwood Towle
Christopher D. Towle
Peter J. Lewis, CFA
James M. Shields, CFA
Wesley R. Tibbetts, CFA
G. Lukas Barthelmess