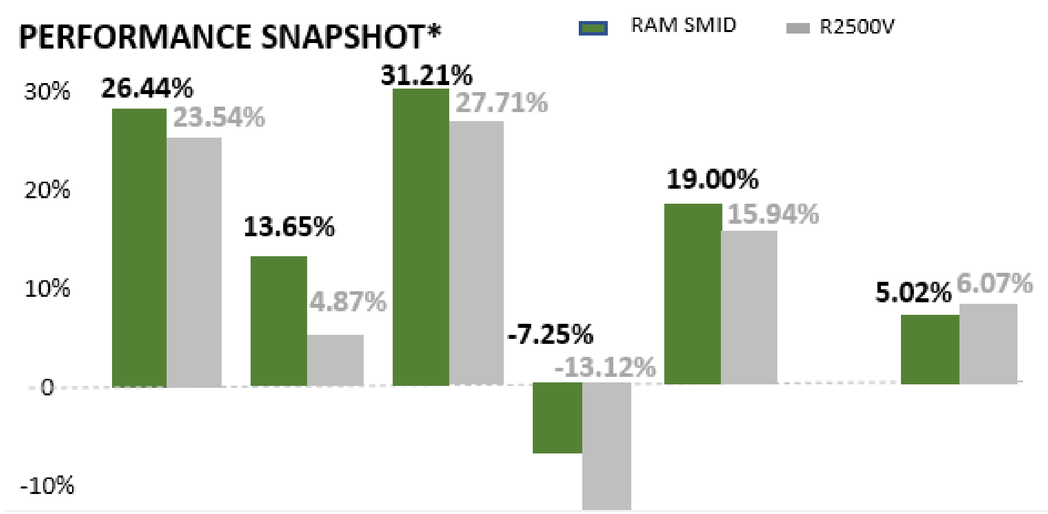
April 2024

The market indices continued their march higher in 1Q24, overcoming investor fears of a potential recession and fears the Fed might delay its expected interest rate cuts. The 1Q24 rally generally was led by larger cap stocks, with the S&P 500 index gaining 10.55% the Russell 2500 Value index (small/mid stocks) gaining 6.07% and the Russell 2000 Value index gaining 2.9%. The top-down nature of 1Q24's returns is seen in the performance of the S&P Equal weight index (SPW) which gained a more modest 7.91%, as the ten largest companies in the S&P 500 represent a cumulative 33.38% index weighting.

Our RAM Smid composite gained 5.02% in 1Q24. Both our RAM Smid and the Russell 2500 Value index got off to a weak start in January, perhaps digesting the very strong 4Q23 returns, before powering ahead in March for the best month of the quarter.[1,2]



Source: Rewey Asset Management, Index returns sourced from Bloomberg 03/31/2024.

**Note that there are material limitations inherent in any comparison between RAM Smid strategy and the R2500 Value Index. The R2500 Value Index is unmanaged, and you cannot invest directly in an index. The RAM portfolio is actively managed and holds concentrated investments in the equity securities of small-mid capitalized companies.*

The Paradox of a Strong Economy

The reported economic data continued to be strong in 1Q24, with the final 4Q23 GDP report increasing 3.4%, up from a previous estimate of 3.2%. The Atlanta GDPNow forecast for 1Q24 has continued to climb as well and stands at 2.82% as of April 1st. February non-farm payrolls strengthened too, rising 275,000 from 229,000 in January. This data served to quelch most remaining fears of a recession in early to mid-2024.[3,4,5]

While typically the market would cheer these strong statistics, especially as they represented an upside surprise to most forecasts, there is a paradox for investors who have now built in a consensus for three rate cuts in 2024. This paradox is that if the economy remains healthy, and inflation does not cool to the Fed's target of 2%, the Fed will likely delay rate cuts, which would likely serve as a headwind to the general stock market's performance.

Inflation is Cooling, But Fast Enough?

The most recent reading of the Core PCE price index (generally believed to be the Fed's favorite measure of inflation) on March 28th came in at 2.1% for 4Q23, just slightly over the expected 2.0%. However, the Bureau of Labor Statistics CPI price index continues to run hotter, reported at 3.2% for February. The fear that inflation will be stickier than the market expects continues to weigh on market sentiment, and most investors, while sticking with three rate cuts for 2024, have now pushed back their expectation of a first cut to June 2024.[6,7]

Make Time Your Investing Ally

While we track market expectations for inflation and rate cuts, we do not build our investment cases based upon such short-term measures that are prone to fluctuate wildly. We take a longer and more focused view on a company's ability to grow over time, regardless of whether rates are cut in June, July, December, or January. Investors who position themselves for a certain data point outcome on inflation, or any other economic datapoint, serve to make time an adversary in their investment decisions. If the data comes in as expected, they will likely exit the trade and seek a new short-term option. If the data comes in negatively versus their positioning, they will likely exit in a hurry, likely selling at a loss.

On the contrary, RAM seeks to make time an investing ally, by focusing on companies i) that have a strong balance sheet that can weather periods where economic or other data is bumpy, ii) that have the ability to grow over our 3-5 year investing horizon, regardless of short term data points, and iii) that are significantly undervalued versus our assessed fair value (AFV). Indeed, in periods where the market weakens on short-term data related bumps, we lean on our long-term view with time as our ally to build positions at attractive prices.

Portfolio Highlights

We have built our RAM Smid portfolio based on our 3-pronged investment philosophy of 1) Financial Strength, 2) The Ability to Grow and 3) Discounted Valuations.

Five of our composite holdings have net cash on the balance sheet and eleven others have net debt to EBITDA under 1.5x. Thirteen holdings are trading at less than 1.5x book. At quarter-end, our RAM Smid cash level averaged 3.94%. We added two new companies to the portfolio in the quarter and sold out two positions.[8]

ARIS Water Solutions was our strongest performer in the quarter, up 71.99%. You may recall we featured ARIS in our 4Q23 letter. We felt ARIS was extremely undervalued and misunderstood by the market, as it was likely lumped into the oil and gas group, while its business has less to do with oil and gas prices but instead is focused on recovering and recycling water associated with production. We also saw, and still see, a credible path to improving revenues and margins in its core operations. ARIS's financial strength should allow it to continue to pay a strong dividend and potentially pursue bolt on acquisitions in its core Permian basin footprint.[9]

Columbia Banking Systems (COLB) was our weakest performer in the quarter, falling 22.91%. We see palpable neglect and undervaluation in COLB, as general fears of commercial real-estate have become overdone. Columbia Bank is the renamed Umpqua Bank, which took the Columbia name when combined in early 2023. As a commercially focused bank in WA, OR, ID and Northern CA, COLB does have more commercial loans when screened against consumer peers, and this in our view has led to selling by those who don't understand the bank. COLB is extremely profitable with a 15.14% 4Q23 ROTCE and a 11.9% total RBC ratio which is forecast to exceed 12% at 1Q24, allowing for the potential to restart share repurchases that were halted with the merger. Its loan portfolio is diversified and, in our view, high quality, and we think the fears of its non-occupied CRE portfolio are misplaced as it had a 51% loan-to-value and had a 0.00% charge-off rate in 4Q23. We see a very attractive valuation profile at .81x book value, 1.2x tangible book value, 8.2x consensus 2024 EPS and it has a 7.63% dividend yield.[10]

Richardson Electronics LTD (RELL)

We added shares of Richardson Electric Company (RELL) in 1Q24, as we see a strong balance sheet, compelling upside potential with multiple avenues to grow, a solid financial profile with net cash on the balance sheet and significant investor neglect.

Richardson's products include electron tubes and microwave generators, old technologies that are finding new life in the semiconductor manufacturing industry and in multiple green energy applications.

RELL has a strong financial profile. RELL has over $22 million net cash on its balance sheet and no debt. RELL has $116 million in inventory – a level exceeding its March 31st enterprise value of $110 million – with roughly 90% in finished goods inventories. Importantly, these inventories are supported by long-term orders, such as supplying GE windmill battery replacement units. RELL forecasts returning to a positive free cash flow position in FY25 (May), as sales recover, and inventory is delivered. Further, although we do not ascribe any value to this in our valuation, RELL's headquarters and main facility in La Fox, IL sits on 125 acres, much of it unused. We estimate that RELL could monetize roughly 100 acres if desired. RELL's management team has been a good steward of capital and has further indicated that it will sell or shut its smaller health care unit if it does not begin to show profitability as it exits this fiscal year.

RELL, in our view, is suffering from significant investor neglect currently, due to the downcycle in the semi-conductor capital equipment cycle. RELL's largest customer is Lam Research (LRCX), but RELL sells to most of the major suppliers in the industry including Applied Materials, MKS Instruments and Tokyo Electric. Due to limited sell-side coverage, we think investors are misunderstanding the decline in RELL's earnings from semi-equipment suppliers in 2024 due to the cycle, and have ascribed no value, or vision, to the ability of RELL's sales and earnings to recover with the eventual cycle recovery. We see substantial neglect in the fact that RELL's customers, e.g. LRCX, are trading at near all-time highs as RELL trades near multi-year lows. We see the CHIPS Act, the Inflation Reduction Act, artificial intelligence, a PC refresh cycle, 5G, EV's and autonomous driving and the internet of things all as drivers to the semi-cycle over time. RELL's products are essential and proprietary and should continue to capture significant orders. Further, LRCX believes the pending up cycle will be stronger than any past peak and is offering financial support to suppliers (RELL does not need this support) to keep their capacity in place.

We see RELL's emerging Green Energy Solutions, or GES unit, as another source of strong earnings upside for RELL, that is significantly neglected by investors. RELL has developed engineered solutions for multiple uses in the replacement of lead acid batteries in green energy offerings like windmills and locomotives. RELL's battery replacement modules are approved for GE wind turbines and are an aftermarket solution offered on the GE marketplace site. There are up to 18 modules in each GE windmill, and RELL's units last up to 10-years, vs. 2-years for lead acid batteries. These units are plug-and-play replacements for lead acid batteries. As it is incredibly expensive to service these windmills, up to 300 feet off the ground, RELL's units are not only more efficient, but also a better cost of service for the operators. There is an in-place market of roughly 35,000 GE windmills worldwide. RELL is also working with Suzlon Energy in India on a similar pitch energy module, where battery life for windmills can be as short as 6-months due to humidity. RELL has also designed back-up battery replacements for generators in the base stations of Siemens and GE windmills.

RELL is also working with both Progress Rail (CAT) and Wabtec (with a GE joint venture) to replace lead acid batteries in the starter unit of diesel trains. Additionally, RELL has completed battery module shipments for its first delivery of an all-electric train, used on-site in a mining operation, and longer-term could benefit from the increase in electric train utilization, likely first for subway and commuter rails.

RELL also is a leading supplier of magnetrons used to grow synthetic diamonds, very high-quality real diamonds that are increasingly preferred by consumers due to the i) lower cost ii) clean ESG profile due to no mining and iii) conflict free nature versus natural diamonds.

Our AFV driven price target is up over 100% from its quarter-end price of $9.13 per share. We base this target only on a recovery to FY2023 revenue and earnings levels. We view this near term AFV target as extremely conservative, as it is under RELL's 2023 $24.97 share price in February 2023. This AFV target is supported by its current balance sheet, its earnings recovery power and its growth potential. However, we do see a significant multi-year growth opportunity for RELL and think management can achieve its long-term goal of $500 million in revenue in a few years, vs. the FY23 reported $246 million.[11]

Looking Forward

While we think the Fed will eventually cut rates in 2024, the timing and magnitude of rate cuts is not a critical factor in our view on the strong outlook for the Smid cap value sector, where we see significant undervaluation and investor neglect. We see the strength in the economy and the likelihood of lower rates having a disproportionately positive benefit towards the Smid value space, especially in comparison to what we see as the concentrated and expensive larger cap sectors of the market.

Moreover, we think our portfolio companies have a visible path to outperform even if the economic data continues to come in lumpy, given our focus on each company's individual financial strength and growth opportunities. Having a strong investment case and a long-term view creates time as an ally for value creation.

We thank you for your trust and support. As always, please do not hesitate to contact us for client service, to discuss our commentary or to simply opine on the market and stocks.

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1. Past performance is no guarantee of future results. The RAM SMID Value Composite schedule of net investment performance of Rewey Investment Management LLC (the "Schedule") represents the activity of separate customer trading accounts managed collectively (collectively the "Accounts") for the annual and cumulative periods from January 1, 2019 through March 31, 2024. 2022-2024 performance unaudited. Please see full Marcum footnotes for RAM Smid composite 2019-2021 at Microsoft Word - {A44BB912-3141-4B59-AE8E-3D695C6B8BD4} (reweyassetmanagement.com). Performance graphic not to scale.
2. The Russell 2000 Value, Russell 2500 Value, the S&P 500 Index and the S&P 500 equal weighted index market cap information and performance levels are sourced from Bloomberg. The Russell 2000 Value, Russell 2500 Value, S&P 500 index and the S&P equal weighted indices are each an unmanaged group of securities considered to be representative of the small and mid-cap stock market, and the large-cap stock market in general, respectively. Indexes are unmanaged and do not incur management fees, costs, or expenses. It is not possible to invest directly in an index. There are material differences between the RAM SMID Value Composite portfolio and the indexes used for comparison purposes. The RAM portfolio is actively managed and holds concentrated investments in the equity securities of small-mid capitalized companies. An index is generally designed to illustrate the performance of a specific asset class (i.e. small cap) but is not actively managed and the index performance does not reflect the impact of advisory fees and other investment costs.
3. US 3Q GDP sourced from the Bureau of Economic Analysis and Bloomberg.
4. Atlanta Fed GDPNow forecast sourced from Bloomberg.
5. U.S. non-farm payroll data from Bureau of Labor Statistics and Bloomberg.

6. Core PCE inflation statistics sourced from the Bureau of Economic Analysis and Bloomberg.
7. US CPI Urban Consumers less Food and Energy y/y sourced from the Bureau of Labor Statistics and Bloomberg.
8 All portfolio discussion is based off our model RAM Smid portfolio of separately managed accounts. Company financial estimates sourced from Rewey Asset Management proprietary analysis, and Bloomberg BEST company estimates. Historical pricing and company financial data sourced from company 10Q and 10K filings, and Bloomberg. Individual portfolios may hold slight deviations in position sizes, cash levels and positions held. Portfolio statistics discussed are from December 29th, 2023. These statistics will likely change over time. Debt/EBITDA ratio comments exclude financial companies due to non-comparability.
9. ARIS Walter Solutions-Inc class A (ARIS) quarterly performance information sourced from Bloomberg. Other ARIS commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.
10. Columbia Banking Systems Inc. (COLB) quarterly performance information sourced from Bloomberg. Other COLB commentary sourced from company earnings releases, 10Q, 10K filings, company presentations, RAM discussions with management, Bloomberg and Rewey Asset Management proprietary analysis.
11. All financial ratios, statistics, and projections discussed in the Richardson Electronics, Ltd. commentary are sourced from RELL 10-K, Proxy, 10Q filings, company press releases, company public conference calls and webcasts, company slide presentations, Bloomberg, RELL company webpage and Rewey Asset Management proprietary financial analysis and Rewey Asset Management industry due diligence. Historical share price information sourced from Bloomberg.