CANNELL
&CO.

October 7, 2021

WHAT'S IN A NAME? THAT WHICH WE CALL A ROSE BY ANY OTHER NAME WOULD SMELL AS SWEET.
— William Shakespeare

Dear Clients,

A little over two-and-a-half years ago we wrote to you about our return to a private partnership. We believed that this structure would ensure that we could continue to serve you in the manner to which you were accustomed while allowing us to be able to adapt to whatever the future might hold. Since then, we have been able to add financial planning services, grow our portfolio management ranks and plan for the future of the firm.

To better reflect who we are and will become, the firm will now be known as CANNELL & CO. This change of the firm's name pays homage to our founder, Peter, while also conveying the evolution of the firm he started almost 50 years ago. To make it more tangible, you may notice the change to the letterhead upon which this letter is written. This updated aesthetic will flow through to our website as well, Cannellco.com, where we will provide financial insights, links to important thought leadership and timely market observations. As before, you will continue to be able to access your account information.

These changes are evolutionary not revolutionary. We have maintained an investment discipline that has been grounded in fundamental principles for the last 48 years. However, as you have experienced, our view of what makes an investment opportunity has evolved over time to reflect the everchanging global economy and financial goals of our clients. Our investible universe has transitioned from small-cap to mid-cap to all-cap and includes a wide range of companies. We have always adapted our search for investments to where they present themselves, knowing that no single opportunity is permanent. What has not changed is our focus on longer term opportunities that individual companies present.

As we discussed in our second quarter letter, markets can often be misleading when you merely look at them on the surface. What may appear to be tranquil often hides greater turbulence as one looks deeper into each particular stock. Many of the forces at work last quarter continued through the third quarter with the Delta variant increasing the level of anxiety about the health of the global economy and the potential influence on companies' earnings.

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The impact of Delta on the stock market has been masked to a great degree by a small sub-section of stocks. This group, technically described as long duration stocks, are companies whose future earnings are expected to be more than exceptional: high growth stocks.  Like longer dated bonds, these companies' stock prices increase meaningfully during periods when interest rates moderate. The economic concerns brought on by Delta caused interest rates to drop this summer, thus providing a lift to this group of stocks. In fact, it would seem many investors were so confident this summer that low interest rates were here to stay that their enthusiasm for these companies resulted in the highest relative valuations over the last 30 years.

EXHIBIT 1: **US: Valuation of long duration stocks relative to market is the most extreme it has ever been**

**Relative 12m fwd P/E of stocks with most positive correlation to bond returns**

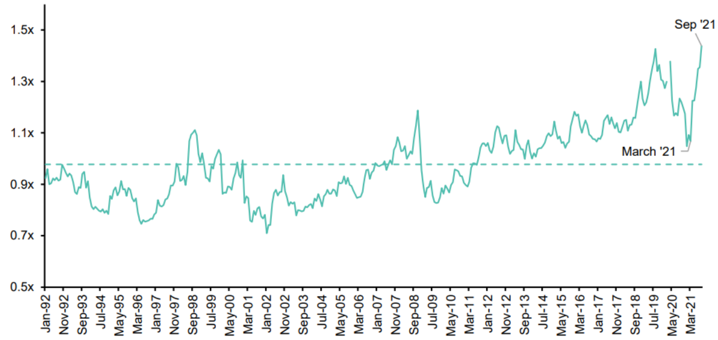


Chart shows the median 12m fwd P/E of the quintile of stocks with the most positive correlation to US Treasury 10-year bond returns (i.e. those most negatively exposed to rising bond yields) relative to the median P/E of the market, rebalanced quarterly. Monthly data over a rolling 3-year period. Universe is the MSCI US. Note the data point from March 2020 has been removed as it distorts the chart.
Source: MSCI, Factset, Bernstein analysis

The impact of this group was so great that the S&P 500 Index's .23% positive return for the 3rd quarter of 2021 was disproportionately due to this small cohort of companies. In fact, the average company in this index was down for the quarter.

The narrowness of the market's strength reflects a single view of the future: the global economy will be negatively impacted by COVID for the foreseeable future and low interest rates will continue to be the policy response. While we agree that there are distinct economic headwinds resulting from the Delta variant, we also believe that there are many countervailing forces that are likely to cause interest rates to rise as economic activity bounces back.

With an increase in interest rates, this small set of stocks is likely to have a more difficult time as their similarity to long bonds not only holds true during falling interest rate environments but also when they rise. In a rising rate environment where higher yielding alternatives exist, future earnings become less valuable and these stocks inevitably suffer. We saw this trend begin to take hold in the final week of the quarter after Fed Chairman Powell discussed a timeline around lessening monetary accommodation, which led to a spike in interest rates and a decline in this group of stocks.

We have been focused on compelling investment opportunities outside this cohort. Our companies, with solid current cash flow, improving balance sheets and reasonable growth expectations over the midterm, are likely to benefit under a normalized interest rate environment.  While we cannot predict when this will happen, we do expect that when it does, we will be rewarded.

Our continued focus on companies, as opposed to markets, has guided us forward since our founding.  Combining this with a fiduciary and advisory commitment to our clients allows us to help you preserve, protect, and grow your wealth. While our name has changed to better reflect who we are today, it does not change that promise.

Sincerely,

The Partners of CANNELL & CO.