CANNELL &CO.

April 8, 2022

Dear Clients,

> The greater danger for most of us lies not in setting our aim too high and falling short; but in setting our aim too low and achieving our mark.
>
> -Michelangelo

We open this letter with our prayers for the Ukrainian people. Russia's invasion of Ukraine has created senseless destruction, loss of innocent lives, and displacement of millions of people. The response of Western governments to isolate Russia from much of the global economy has upended energy markets, interrupted regional food production, and further stressed supply chains, all of which are increasing concerns about inflation. This war comes as we were beginning to feel hopeful that we were turning the corner in our two-year fight against Covid 19. For many, these events reignited anxiety as they perceive more risks impacting their lives.

Risk aversion is a natural tendency of human beings. While there are some among us who opt to live life on the edge, most of us seek to find some balance in which we can have happy and secure lives with a modicum of peace-of-mind.

This is especially true when it comes to the financial markets. Most investors look to take no more risk than is required to meet their personal goals. When financial markets are behaving normally, investors of all types have a myriad of financial vehicles across the spectrum of risk from which to choose – cash and certificates of deposit (CD's) for the most risk averse to speculative stocks and angel investing for the most adventuresome. Each investor can tailor their financial strategy to balance risk and return so that they are exposed to only those risks needed.

In 2008, when the Federal Reserve and other central banks coordinated to save the global financial system by driving short-term interest rates to 0%, many investors reluctantly looked for alternatives to what had been their tried-and-true investment strategies. No longer able to earn a return in cash or short-term CD's, risk averse investors looked to corporate debt with longer dated maturities or riskier parts of the bond market. Facing lower yields in their bond portfolios, those investors looked to dividend paying equities to bolster their total return. On the other end of spectrum, aggressive equity investors saw opportunity in speculative companies as the potential of their earnings in the distant future appeared more valuable when analyzed against low interest rates. Simply put, the cratering of interest rates in the post-financial crisis environment caused investors to shift their focus to riskier assets, even if they would otherwise have not. From a policy point of view, this is exactly what central bankers had hoped to accomplish.

545 Madison Avenue, 11th floor, New York, NY 10022, United States ■ +1 (212) 752 5255 ■ cannellco.com

Governments could not have predicted in 2008 that the low-rate environment would last another 14 years as economic growth remained anemic and inflation almost nonexistent. It seems that a global pandemic, and the resulting changes to human behavior, has finally broken this cycle. We now face inflationary pressures not seen in 50 years as central banks rapidly adjust their policies to contain them. The goal is to avoid the painful "stagflation" of the late 1970s. The result is likely to be a world with higher interest rates.

What might this mean for the future of investing? One possibility might be that we see an unwinding of what happened in the post-financial crisis era. Investors could seek to de-risk their investments as a more normalized interest rate environment allows them to obtain the return they desire with less risk.

This would be just fine with us. Many of the companies in which we invest are likely to be more desirable to a broader set of equity investors in a higher interest world. Their *current* cash flow and earnings are more attractive relative to the *future* cash flow and earnings of speculative growth companies. This will also expand our universe of investible opportunities to companies where a more normalized interest rate regime is beneficial to their earnings. The benefits extend to those of our clients who have a portion of their account in bonds. With higher interest rates, yields should rise and result in greater income. And of course, everyone will likely earn more on any cash that they hold for their monthly cashflows or for unexpected expenses.

This is not to say that the transition will be without disruption. Moving from an extended period of exceptionally low to that of higher interest rates is likely to increase market volatility. Because human nature is unlikely to change, we know these periods of transition often promote investor anxiety. Our longer-term view, dispassionate analysis and disciplined value perspective allows us to conclude the opportunities outweigh the near-term risks. Therefore, as Michelangelo observed, the danger is setting our aim too low not too high.

We continue to be thankful for your trust and commitment.

Sincerely,

The Partners of CANNELL & CO.