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Dear PVP partners and friends

It was another volatile quarter, as the market continued to try to get a grip on a number of important and interrelated macro questions: Are we in recession? And if not, will we be soon? Has inflation really begun to taper? What will it take for the Fed to back off on its unprecedented rate hikes that attempt to tame inflation but also increase the likelihood and severity of recession?

There were a variety of seemingly conflicting data points during the quarter. With the contrarian underpinning of very negative sentiment that we discussed at the end of last quarter, the fourth quarter began with a strong rebound, buoyed by a host of relatively dovish Fed comments. Yet in November the Fed continued its hawkish turn, raising the Fed Funds rate by 0.75% for the fourth consecutive time. In December, shortly after the release of a more benign CPI reading (up only 1.2% for one month annualized) that would strongly suggest that inflation had already peaked, the Fed at last slowed down the pace of rate hikes to 0.50%.

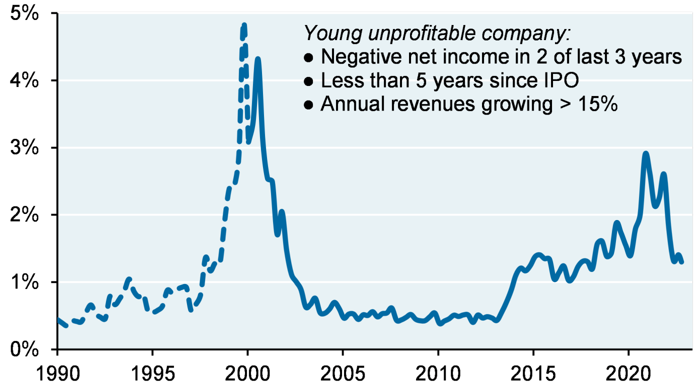
With the Fed Funds target rate now at 4.25-4.5% and the Fed's median estimate of 5.1% by the end of 2023, the Fed expects to continue hiking – notwithstanding that peak inflation is seemingly in the rear view mirror. The bond market, however, begs to differ, and as a result the yield curve has become quite inverted. This inversion is a strong signal of recession, a suggestion that sometime soon a recession (perhaps caused by the Fed) may well force the Fed to reverse course and actually cut rates.

On the topic of recession, a near-consensus has developed that one will arrive in 2023. Indeed there is a clear slowing in many sectors, especially real estate. Technically, with two consecutive quarters of negative real GDP growth in 1Q-2Q, we did actually have a recession in 2022. Recently revised 3Q22 real GDP growth, however, was a robust 3.2%. Employment and other economic indicators have remained relatively strong. So we shall see. As we said last year: If we are indeed headed toward (another?) recession, it certainly is a strange one.

As we have discussed previously at great length, the correction that was 2022 was preceded by numerous indications of market froth. The anecdotes and the acronyms change, but the propensity for speculative excess to raise the eyebrows of seasoned investors does not change. We remember well the stock tips from cabbies and press releases announcing that a company would be adding ".com" to its name in the late 1990s, and the perceived wisdom in 2006 that "housing only goes up" along with the theory somehow peddled with a straight face that a portfolio of poorly underwritten subprime mortgages should be rated AAA simply by virtue of its diversification. So in recent years we have had new terms like "TINA" (there is no alternative) and "FOMO" (fear of missing out) and SPACs and crypto.

JP Morgan has even lumped some of this excess into two humorous categories, YUCs (young unprofitable companies) and MUCs (mega valued or unprofitable companies). In the charts below we can see that the recent speculative froth was not nearly as pronounced as it was in the dotcom bubble, and also that, while some correction has clearly occurred, it still currently remains elevated, suggesting more pain yet to come potentially for these asset classes.

The YUCs: Young Unprofitable Companies
% of equity market capitalization



Source: Factset, JPMAM. November 28, 2022.

The MUCs: Megavalued (P/E >50x) or Unprofitable Companies, % of total US market capitalization

Source: Factset, JPMAM. November 28, 2022.

On the topic of crypto, the bursting of financial bubbles, such as we have been experiencing, is also typically accompanied by major scandals and sometimes crises brought on by the sudden changes. Bernie Madoff in the 2008 Global Financial Crisis and Enron/WorldCom/Tyco in the wake of the original early 2000s dotcom bust are some recent examples. (To paraphrase Warren Buffet, it is only when the tide goes out that we discover who has been swimming naked.) Most recently it was in the highly speculative and unregulated area of crypto currency. It turns out that FTX, until recently the third largest crypto exchange, valued at $32 billion, was likely fraudulently misallocating customers' funds.

Fortunately, we have steered clear of the crypto mania. Our one material exposure to crypto was our former position in Signature Bank (SBNY), an otherwise very high quality institution that in 2021 began sharing with investors the growth of its "crypto deposit" base. This of course scared us but also juiced the stock, affording us the opportunity to exit at $203 for a very healthy profit even in the middle of the pandemic. Of course the stock continued to rise, peaking at about $365 around year end 2021. In the wake of the FTX scandal, that stock is now trading below tangible book value at $113.

In terms of stylistic and sector performance, after a brief hiatus last quarter, value returned to its recent pattern of materially outperforming growth. While every major sector showed positive performance, both the "offensive" (energy, industrials, consumer discretionary, financials) and "defensive" (consumer staples, health care) value sectors outperformed the major growth sectors, such as technology and communication services. Size was a mixed factor this quarter: large value outperformed small value, but small growth outperformed large growth.

Looking ahead, we will reiterate what we said last quarter: We believe our portfolio is built to weather an economic downturn, but it also contains the requisite "juice" to participate fully in a market recovery. As the market continues to sort out disparate economic data, and speculate about the Fed's possible responses, we would expect volatility to continue to be elevated, and you should expect us to continue to capitalize on Mr. Market's moodiness.

In aggregate **PVP was up 10.8% in 4Q22 but down 8.5% for the year, with an annualized return since accepting our first partner capital in February of 2016 of 10.4%.**[1] Looking forward, as discussed above, our portfolio's current Equity Risk Premium (ERP) of 4.7% (8.7% portfolio FCF yield, less 4.0% 30 yr UST) remains extremely attractive in our view, even in a rising rate environment that is generally a headwind for equities.

In terms of performance, we were slightly behind our primary all cap value benchmark (Russell 3000 Value) for the quarter and for the year, though well ahead of the S&P 500 and growth indices in these same time periods. Though we did not exactly – to quote a favorite expression of a former mentor – "cover ourselves in glory" in 2022, the leadership shift from growth to value that continues to take root has been enough of a tailwind for **us to overtake in performance the major US equity indices on a three year basis:** Our primary benchmark, all cap value (Russell 3000 Value); the S&P 500; and even the formerly highflying all cap growth (Russell 3000 Growth). [2]

These style leadership regimes are typically multi-year affairs -- with recent growth leadership lasting from 2008 through 2021, for instance. With higher rates, we would expect the recent value leadership to continue, and we believe we are well positioned for that scenario. In the following chart, our friends at JP Morgan provide another graphic representation of this change in investor preferences in recent years, comparing the ARK Innovation ETF (perhaps the poster child for all that bubbles) with a basket of "old economy" stocks.

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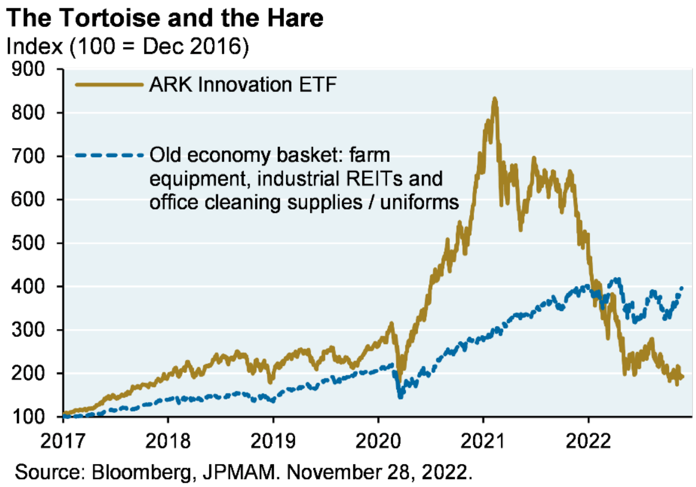
[1] *Returns are net, and assume a 1% annual management fee. PVP defines "long term" as an entire market cycle.*

2	2022	*3 yr (annualized)*
PVP (net)	*(8.5)%*	*7.7%*
Russell 3000 Value	*(8.0)%*	*6.0%*
S&P 500	*(18.7)%*	*7.2%*
Russell 3000 Growth	*(29.3)%*	*7.4%*



Actions taken in 4Q22

Buys in the quarter

In early 2021 we sold our **Allscripts (MDRX)** position for just over $17. This quarter we bought MDRX back at about $14.50. While the ticker is the same, it is quite literally a different company, now known as **Veradigm**. Between then and now the company divested its largest business, the mature electronic medical records unit for which it was best known, in order to focus on the unique Veradigm business. Veradigm captures patient data at a very granular level, organizes it into usable form, then sells that information to life science companies and also payors. The business model is extremely attractive, and the divestiture proceeds also put MDRX into a substantial net cash position, giving it flexibility to buy back stock, acquire complementary businesses, etc. Stand-alone Veradigm, which ended the year back over $17.50, expects healthy annual top line growth of 6-7%, EBITDA growth of 10-15% and robust FCF, and trades at a FCF yield relative to enterprise value of about 6%.

Transportation broker **RXO (RXO),** like its sibling GXO in 2021, was spun out in the quarter by former parent, XPO. As XPO shareholders, we received a relatively small position in RXO as a result of the spin. Business prospects appear exciting, valuation appears interesting, and we are currently evaluating our options.

We also did a good deal of "capital recycling" in the quarter – trimming and selling our "winners" (see below) and using those proceeds to add to our stocks that had been weak but for which our conviction remains strong. For instance, we added to specialty insurer **Enstar (ESGR),** one of our largest holdings, after it was one of our weakest stocks last quarter. As shown below, ESGR was our biggest contributor this quarter. Likewise, we added to the plastic company **Berry (BERY),** also one of our largest positions, and have already been rewarded quickly with the stock up 15%. Ditto **GXO Logistics (GXO),** a relatively recent purchase that had been languishing, which moved up 17% from our add. On the other hand, our additional purchases of time share operator **Travel & Leisure (TNL),** online reservation provider **Booking (BKNG),** diversified media company **Comcast (CMCSA)** and payment processor **Global Payments (GPN)** did not yield such immediate gratification, but we remain confident that in time those adds will have proven to be opportunistic.

Sells in the quarter

The Russian invasion of Ukraine has resulted in a renewed interest in the defense sector, where until recently we had a rather sizable commitment. In recent quarters we have taken advantage of this re-valuation with exits from Raytheon Technologies (RTX), Lockheed Martin (LMT) and Huntington Ingalls (HII). This quarter we sold federal IT provider **Booz Allen Hamilton (BAH),** showing about a 25% profit in a year that was generally not so rewarding for equities. In the quarter we also sold another service provider to the DoD, **SAIC (SAIC),** for a small profit in approximately a year and a half of ownership. At this point our exposure to defense resides mostly in just one stock, CACI International (CACI), which we continue to like.

We also sold food company **Post (POST)** in the quarter. POST was a "decent" investment for us, up 45% from our original purchase back in 2016 – a smaller return than the market or our portfolio overall since then, but better than its peer food companies, which have generally been quite challenged. POST held up particularly well in these recent turbulent times, and now trades at a valuation that is much less attractive than what we have been buying.

As referenced above, we also trimmed a decent number of our holdings that had performed exceptionally well in the downdraft. Insurance – both life and property/casualty – was a standout in the year, and so we trimmed our **Principal Financial (PFG), Voya Financial (VOYA)** and **Arch Capital (ACGL).** We also trimmed some our still large **Johnson & Johnson (JNJ)** position, as well as our very well-performing **Adtalem Global Education (ATGE)** and **Waste Connections (WCN)** positions.

Strong performers in 4Q22 [3]

Insurers were particularly strong this quarter, with three of our top five contributors in the property/casualty space. **Enstar Group (ESGR),** which has historically acquired and managed the "unwanted" or "runoff" businesses of other insurers, was up 36%. In future quarters Enstar will benefit economically from the effect of higher interest rates on its investment portfolio, and optically as rates stabilize and stop diminishing the company's (accounting) book value.

Expectations going into the quarter were quite sour for engineering and construction firm **MasTec (MTZ).** While it was a solid quarter, with results beating expectations, investors really grew excited by the company's prospects for 2023 and beyond. MasTec's backlog has grown 32% in the past year, and the company will play a major role in the buildout of 5G and renewable energy. MTZ was up 34% in the quarter.

Berry (BERY), which makes plastic containers for consumer and health care applications, is a rather steady business. While the company has struggled somewhat with the impact of inflation on its input costs, overall it has adapted well. In our view the stock was simply way too cheap going into the quarter, and BERY announced perfectly respectable results, leading to a 30% increase in the stock price in the period.

Berkshire Hathaway (BRKB), with its diverse array of operating businesses, benefited in the quarter not only from a market tailwind for most economically cyclical businesses, but also from the recent market appreciation of its formidable insurance operations. Like ESGR, investors are

[3] *Top and Bottom Five performers in the quarter defined as the most value added or subtracted, in basis points. Top and bottom stocks are presented, respectively, in descending and ascending order of value added/subtracted.*

likely projecting that the optical pain of the impact of rising rates on BV will give way soon to much higher interest income for Berkshire.

In addition to generally strong results, reinsurer **Arch Capital (ACGL)** was also relatively unscathed by the very destructive Hurricane Ian – a small hit to P/L rather than a more serious "capital event". Moreover, reinsurance pricing continues to be very strong. Finally, Arch was also boosted in the quarter by its inclusion in the S&P 500 when Twitter was acquired by an investor group led by Elon Musk. The stock was up 38% in 4Q22. Arch replacing Twitter in the biggest equity index seems like the perfect metaphor for the leadership transition from growth to value.

<u>Weak performers in 4Q22</u>

We try not to be superstitious, but I suppose it was inevitable that liquid natural gas exporter **Cheniere (LNG),** our largest position and top contributor last quarter, which we highlighted in detail, would give back some of that performance this quarter. Cheniere's quarter was again terrific -- I doubt I could say it any better than one analyst, who penned a post call report entitled, "Cheniere's business is sharper than a Christian Javier fastball." LNG (the commodity) did drop late in the quarter, which likely explains the fall in the stock – even though so much of the company's future business has been locked in that the commodity price has *de minimus* effect on profitability. LNG (the stock) was off 10% in the quarter, and now trades at a yield of about 12% on what the company believes will be its long term normalized FCF. (Note to self: Maybe we should stop profiling our favorite holdings?)

Fertilizer company **Nutrien (NTR)** sold off 12% in the quarter, as investors were disappointed by the company's potash results. Not only did potash profitability miss expectations for the quarter, but the company also announced an expansion of capacity to produce more of it. Nutrien is much more optimistic about 2023 than its investors, and the stock is now staggeringly cheap on most any metric.

PayPal (PYPL) is the former highflying e-payment enabler we bought recently, far off its highs. Even though the company beat expectations and raised guidance for the quarter, its investor base has been in transition, and these situations can result in a wide range of investor expectations. Nor did the general technology downdraft help, and PYPL was down 17% in the quarter. The stock now sits at about a 7% FCF yield, a very reasonable valuation for a leader in an exciting space.

Rackspace Technology (RXT) is the tech consultant which helps small and midsize businesses transition to the cloud. After multiple quarters of missing its targets and generally disappointing investors, the company announced a "reset" on its most recent quarterly call that was credible and actually generally well received. Rackspace now believes it can generate more than $100 mm of FCF this year. With a drop of 28% in the quarter and a market cap now of just over $600 mm, clearly investors are skeptical.

Cyber security software provider **Palo Alto Networks (PANW)** has been a tremendous contributor over time, but -- notwithstanding another very solid quarter -- like most tech stocks it sold off sharply, down 15%. PANW has never been our cheapest stock, but today at just under a 5% FCF yield it is as cheap as it has been in quite some time.

Setup

As discussed above, quantitatively the story remains very much the same: PVP's portfolio is cheaper than both value stocks and the market overall, with superior returns on capital. While rates have risen, our Equity Risk Premium (ERP) remains quite healthy and is well above the market at 4.7% (8.7% FCF yield less 4.0% 30-year UST). At this level we believe we are being very well compensated to bear the risk of equities.

	PVP [4]	Russell 3000	Russell 1000 Value
Free Cash Flow yield (2022E)	8.7%	4.6%	5.2%
Price/Earnings (2022E)	13.1x	17.9x	14.3x
Debt/EBITDA (2022)	3.1x	2.5x	2.7x
EBITDA margin (2022E)	28.4%	19.8%	19.6%
Return on Equity (2022E)	18.7%	19.5%	16.3%
Return on Invested Capital [5]	11.4%	9.6%	8.2%

As always, we are so appreciative of the confidence you have shown in PVP, and we promise to continue to work tirelessly to make you pleased with that decision. As you know, we also want to be as transparent as possible. Please let us know if you have any questions, or if we can help in any way.

Sincerely,

J K Flynn

J. Kelly Flynn

Chief Investment Officer

[4] *Data for both PVP portfolio and Russell indices are generally via FactSet. In a few instances, we have made minor adjustments.*

[5] *PVP data is 2022; index data is 2021 (2022 unavailable).*

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