

# AVENIR CORPORATION

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## INVESTMENT MANAGERS

August 2021

Dear Friends and Fellow Investors,

We hope that you and your family are healthy as we emerge from the pandemic.

Stocks rose more than 15% in the first half of 2021, following an 18.4% rise in 2020. These are spectacular results that far exceed long-term average returns. Driven by unprecedentedly low bond yields, equities sit near record valuations. One would be hard pressed to guess that this occurred in the midst of a pandemic which has taken more American lives than World War II.

Stocks are not alone. The so-called “everything rally” has carried along residential real estate, commodities, cryptocurrencies, blank check companies, “meme” stocks and more. The cryptocurrency Dogecoin began life purely as a jest but today sports a very serious \$25 billion market value. GameStop’s \$11 billion valuation is supported not by its ability to generate cash flow for its owners, but by the flow of cash from the army of app-based day-traders who have cleverly employed social media to “corner” professional short-sellers, 1920’s style. Special Purpose Acquisition Corporations (SPACs), or blank-check companies, do not have a business purpose other than to raise cash simply because they can, with the idea that at some point, they will use that cash to acquire real businesses. Markets play a serious role in allocating capital, but much of this market behavior is decidedly non-serious.

This backdrop provides a good contrast for discussing the fundamental investing principles in which Avenir is grounded, including margin of safety.

The value of any investment derives solely from its ability to generate cash for the benefit of its owners. We begin by identifying businesses with two qualitative characteristics: superior, durable economic franchises and skillful managers who are people of high integrity. We then conservatively estimate the amount of cash the business can generate for its owners over many years and apply a significant discount for the time value of money. This gives us a rough idea of what the company might be worth today. We then compare this figure to the price asked in the market to determine whether a bargain exists or not. To be successful, this process does not require an opinion on unknowables such as the direction of interest rates, inflation, or the general level of economic activity.

The prices currently asked in the marketplace for these businesses are generally high. The challenge for today’s successful investor is to maintain investment discipline and not compromise on quality or valuation simply in order to “get invested.” It is also important not to become seduced by the apparently easy gains of the past 18 months, as many speculators have. Market dislocations, or narrower dislocations in the prices for attractive individual businesses, always occur and deliver opportunity to the patient and coolheaded.

Avenir's Investment Philosophy includes the following: We seek to "invest with a margin of safety". Margin of safety<sup>1</sup> is always on our minds, but more so these days because it is increasingly ignored. Thousands of pages have been written on exactly what margin of safety means but the best description we have seen is this one: "Don't drive a 9,000-pound truck over a bridge that holds 10,000 pounds. Drive a 5,000-pound truck." In the investment world, this means protecting against the unseen cracks that occasionally reveal themselves suddenly and catastrophically.

We cannot predict the direction of interest rates or the stock market, but by maintaining our strict discipline, we should avoid the costly errors that will surely result in a permanent loss of capital by those who ignore or overestimate margin of safety. By owning superior businesses of enduring value, we expect to be able to continue compounding your capital at above average rates while maintaining that margin of safety.

We remain hopeful for the continued reopening of the economy, the enjoyment of normal summer activities, and a covid-free resumption of in-person schooling this fall.

Best regards,

Peter C. Keefe

James H. Rooney

<sup>1</sup> The term was popularized by investor Seth Klarman's book of the same title, which was published in 1991 and has never been reissued. Copies of "Margin of Safety" typically sell on eBay for thousands of dollars. Klarman himself borrowed the term from Ben Graham's classic, "The Intelligent Investor", first published in 1949.

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