January 15, 2023

For the year ended 2022, client accounts, in aggregate, performed several points worse than the S&P 500, which fell 18% for the year. The down year followed two years of moderate outperformance.

Stocks began the year priced for sustained economic growth and low interest rates, reflecting a view that high inflation was temporary. However, as the year progressed inflation remained high, leading the Federal Reserve to raise interest rates several times, reaching four percent by December. Further rate hikes are likely. Higher rates increase the returns that investors require to buy stocks and bonds, which pushes their prices down. That accounted for much of the decline in stock prices last year.

Higher rates also slow economic growth, partly by increasing the cost to finance housing and other large purchases. That will hurt corporate earnings this year and may hurt stock prices. That said, looking out over the next few years I remain optimistic about the businesses we own. As a group they continue to generate high and consistent profitability, face manageable competition, and invest their earnings strategically. As such, I think it's likely that they will trade for higher prices in the years ahead.

Our investments in fixed incomes, which represented roughly 19% of your portfolio at year end, held their value in 2022, a good result relative to the broader fixed income market. I've carefully selected the issuers of these securities for business resilience, and I am confident they will continue to make payments in a recession. That said, in past periods of market volatility securities like these temporarily fell in price, and that could happen again. We've historically done well buying fixed income securities on weakness, and I am closely monitoring the space for opportunities.

Economy/Market Notes

Investors continue to focus on whether the Federal Reserve can tame inflation without causing a deep recession. Recent inflation data suggests that prices of goods, commodities, and housing have stabilized, in some cases falling from the prior year. At the same time, wages growth remains well above the Fed's 2% target. The Fed has indicated it will raise interest rates further to slow that wage growth.

There are anecdotal signs that the Fed's efforts have already resulted in slower hiring, which would help stabilize wages. Large technology and financial firms have announced hiring freezes and layoffs. Notably Amazon is reducing its workforce size by 18,000 employees. It's likely that the construction industry, which employs about five percent of the US workforce, will contract, given a substantial slowdown in the US housing market. A concern though is that higher rates can take a year or longer to fully show up in the economy. That makes it more likely that the Fed will do more than it needs to, slowing the economy to a degree that results in lasting job losses.

Alphabet (Google)

Alphabet (Google) shares, one of our largest holdings, fell 39% in 2022, after several years of gains. The down year reflected concerns that the company has been slow to reduce expenses even as its sales have slowed. Alphabet's slower growth reflects both a weakening of the broader economy and a maturing of Google's search advertising business, which accounts for most of the company's profit. Google's search revenues now represent 20% of the global advertising market, making incremental gains more difficult.

There is also growing concern about future competition. Google search has historically had an advantage over competitors because its results improve with use, and it's used far more than competing products. Investors are now worried that artificial intelligence (AI) will erode that advantage by enabling accurate searches based on widely available data. Apple, among others, has been working to develop competing search capabilities, and AI could accelerate those efforts. Were Apple to launch a search engine on the iPhone it would represent a significant competitive challenge. It should be noted though that Google pays Apple billions of dollars annually for its preferred position on iPhones; were Apple to compete directly it would reduce Google's costs, offsetting some of the loss of revenue.

Under most scenarios I believe that Google will maintain its leadership in internet search. However, given the maturity of that business as well as the evolving competitive risks, I am likely to reduce the size of our investment this year in favor of businesses with more certain growth outlooks.

Limbach

Our investment in Limbach, a servicer of commercial heating and cooling systems (HVAC), performed well in 2022 after a weak result in the prior year. Limbach installs and services commercial heating and cooling systems. Historically the company build HVAC systems for airports, hospitals and other large enterprises. Over the last few years Limbach has shifted its focus towards smaller projects and recurring maintenance work, that bring more predictable profits and require less upfront investment. Limbach's earnings should benefit from the continuation of that shift. Further, Limbach's stock remains quite cheap compared with peers and the broader market, leaving substantial upside if the company continues to execute well.

Issuer Direct

Issuer Direct owns AccessWire, a newswire that publishes press releases on financial websites for business clients. AccessWire provides similar capabilities to its three larger competitors, PR Newswire, Business Wire, and Global Newswire, but at a much lower price. In addition, Issuer Direct bundles the newswire with website hosting and webcasting, creating an attractively priced bundle for public relations departments. Issuer Direct has steadily grown its customer base. That appears likely to continue given the company's discounted pricing versus peers. In addition, Issuer Direct recently

acquired a competing newswire, iNewsWire, at what I view to be a good price. The integration of that business should expand Issuer Direct's earnings and support share price gains over time.

Rush Enterprises

Rush Enterprises shares outperformed the broader market last year, reflecting the combination of a discounted valuation and strong operating results. Rush owns 130 tractor trailer (large truck) dealerships across the US and Canada. While demand for new trucks goes up and down, Rush earns far more repairing trucks than selling them, and repair work tends to hold up well in recessions. Management has done an excellent job growing the repair business, leading to steady gains in profitability.

Part of Rush's growth has come from acquiring other dealers. Currently Rush represents roughly 6% of US Class class 8 truck sales, leaving substantial room for further acquisitions. The company has a particular opportunity in Canada, where it has a smaller presence.

Infusystems

Infusystems' stock was among our largest holdings and had the single biggest negative impact on our performance last year, although it remains one of our better performing investments over several years. Infusystems leases infusion pumps used for the treatment of colon cancer. This is a predictable but low growth business.

More recently the company has taken on significant costs to expand into wound care and hospital equipment repair. Earlier this year the company signed a large contract with GE Healthcare to repair pumps and related hospital equipment. In addition, the company announced a partnership with Sanara Medtech to distribute a broad array of wound care products. These are encouraging developments, yet it's not yet clear how profitable these new business lines will be. Infusystems' management has stated the new businesses will operate at attractive profit margins, but they've lost some credibility on their forecasting. If they are right, the stock should perform well from here. I continue to closely monitor the company's progress.

As always, please contact me with any questions.

Sincerely,

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