GRANT'S
INTEREST RATE OBSERVER®
Vol. 40, No. 5c 233 Broadway, New York, New York 10279 • www.grantspub.com MARCH 18, 2022

Value on the rebound

In the half-year since the Federal Reserve resolved to taper its monthly purchase of $120 billion's worth of Treasurys and mortgages, six-month Treasury bills have delivered a return of four basis points. Over the same span, coffee beans—which, incidentally, when properly stored, have a shelf life of six months—have delivered 19%.

Double-barreled inflation—at the checkout counter and on Wall Street alike—forms the backdrop of this unfolding narrative. In the foreground is Palm Valley Capital Fund (PVCMX), a small-cap equity fund whose portfolio managers sit mainly in cash awaiting the return of valuations at which an unbending, unconventional, uncompromising, value-seeking investor can put other people's money to work.

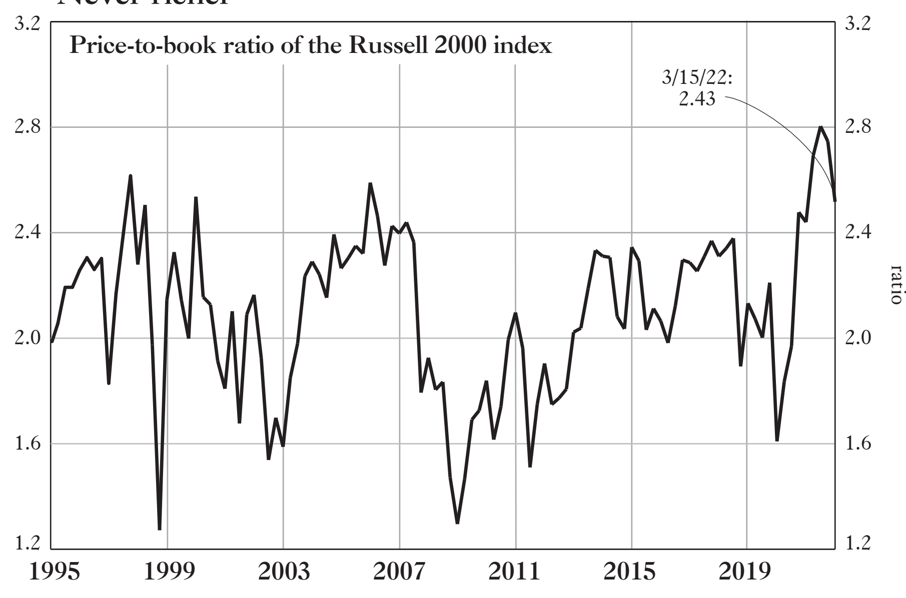
Even so, self-hobbled as it is, Palm Valley has given a more-than-respectable account of itself. Since inception on April 30, 2019, it has returned 8.6% per annum with an average of 25% invested, compared with 11.2% for the S&P SmallCap 600 index, with 100% invested. Year to date, Palm Valley is up by 1.1%, the S&P SmallCap 600 down by 9.2%.

"There are only three of us left in the world that would do this," Eric Cinnamond, one of the portfolio managers, tells colleague James Robertson Jr., "and we started our own firm. Jayme Wiggins is the co-PM, and he's a friend of mine. And he was fired by Intrepid Capital in 2018. And I returned capital in 2016. I returned over $400 million because I wasn't finding value in small caps. I started writing a blog and did some podcasts. I stayed interested and involved. And then Jayme got fired in 2018 for holding too much cash. And he called me, and he's like, 'Let's start our own firm.' And I said, 'Are you crazy? We can't raise any money.' But I knew Frank [Frank K. Martin, a longtime like-minded value-seeker], and Frank's crazy enough to do it. So I called Frank, and he's like, 'I will fund you guys.'

"He funded us with $600,000, and Jayme and I didn't receive a salary," Cinnamond continues. "We worked for free. We did the sweat equity. So that's how we received our one-third ownership. The fund is now almost three years old. We had pretty good risk-adjusted numbers. You know, we came out of the gate with 95% cash, and then we refused to overpay. And then Covid hit in March 2020, and we were able to get half the fund invested. Values began to appear, and we were up 20% in 2020 with an average invested capital of 25%. We didn't take a lot of risks. And then we started getting inflows.

"So now the fund's about $115 million," Cinnamond goes on. "We've got some separate accounts. Not a lot, maybe only $15 million, and then we subadvise some of Frank's money. So we're making a living, but it's not like what we were accustomed to with our old jobs. We both had run over a billion dollars. But you know how this business goes in absolute-return investing—it's feast or famine. And after QE III [the third round of so-called quantitative easing, instituted late in 2012], it was famine. But up to QE III, 2009–13, we did very well. We did very well in the tech bub-

Never richer



source: The Bloomberg

ble, the housing bubble. This last cycle has just made most of us extinct."

Cinnamond and Wiggins have apportioned 3% of their assets to energy and 8% to precious-metal trusts and royalty and streaming companies, including Triple Flag Precious Metals Corp. (*Grant's*, Dec. 10, 2021). They own a position in WH Group Ltd., a Hong-Kong–based purveyor of packaged meats, which trades at 7 times earnings, compared with 27 times earnings for Hormel Foods Corp., an American comp. WH Group outyields Hormel, too, 4.0% to 2.1%.

Cinnamond says that Wiggins and he follow 300 small-cap stocks and that the mosaic of those diffuse businesses tells a story more textured than anything that comes out of the government's macroeconomic data mills.

"What we were seeing about a year ago were significant price increases in the pipeline," Cinnamond says. "So I wrote a blog about this, saying, 'You know, one of the best investments you can make now is to go out and buy paper towels.'" Calculations from Robertson's own drugstore receipts show a year-over-year return on the paper-towel trade of 19% (tax-free, of course). Nor, says Cinnamond, did he stop at paper products but, Soros-fashion, pressed his bets in other product categories, including autos (new and used) and appliances. An air conditioner he purchased one year ago would cost 20% more to replace today, he tells Robertson. "So that's great. It's holding its gain."

Besides superior absolute and relative returns in recent months, Palm Valley produces some of the best and wittiest financial-markets commentary on the web. "The Inflation Headshake," a typical winning example dated March 9, is about shoppers confronting $5 boxes of cereal in the supermarket. The essayist—Cinnamond—reflects on the risks that inflation presents to richly valued consumer discretionary stocks and on the opportunity that will surely arrive to buy those securities on the cheap.

At 59 times, the median price-earnings ratio attached to the Russell 2000 towers over the 17.2 level registered at the peak of the tech bubble in March 2000 and the 25.9 reading set in the heat of the credit bubble in July 2007. "This is the most expensive that small caps have ever been," Cinnamond says. "And we've been doing this a long time. For us, it's a fact. So how can we allocate people's money that they've earned and saved, allocate that and overpay? We will not overpay with other people's money. That is a hard rule."

Cinnamond leaves Robertson with a parting thought: "We are gonna survive. And I'm looking forward to when the cycle ends. We can have another talk, and talk about all the value we're buying."

•