3Q21 Commentary

Contents

"In the field of monetary and credit policy, precautionary action to prevent inflationary excesses is bound to have some onerous effects - if it did not it would be ineffective and futile. Those who have the task of making such policy don't expect you to applaud. The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has **ordered the punch bowl removed just when the party was really warming up**."

-William McChesney Martin, Former Chairman of the Federal Reserve

"The road goes on forever and the party never ends."

- *Robert Earl Keen, country music singer*

Welcome

COVID is in full retreat and the un-masked US economy is growing by leaps and bounds. Meanwhile, fiscal and monetary stimulus are adding fuel to the fire. Against this backdrop, we strongly believe the outlook for the US economy over the next 12-18 months is incredibly positive.

Fiscally, the government is spending more money than ever to support the economy. Generous child tax credits in 2H21 will add more cash into the pockets of consumers. This comes at a time when businesses are reopening, and the labor market is tight. In aggregate, this fiscal support is so generous that it goes beyond replacing lost income and represents additional spending power for consumers. On top of this, Washington continues to negotiate a comprehensive infrastructure bill. President Biden is aiming for $2.3 trillion while Republicans are looking for a 'measured' $568 billion package. Government spending fuels economic growth but also requires raising additional debt. In the long term, we are concerned with the US government's ability to finance this ever-growing debt.

On the monetary front, the Federal Reserve continues to support the economy by setting the Fed Funds rate at 0% and by buying treasury bonds and mortgage-backed securities. Through these actions the Federal Reserve is keeping interest rates artificially low. Low interest rates let borrowers pay less to borrow. Indebted companies that might have gone out of businesses can survive. Low interest rates also let homeowners afford larger mortgages and thus, bigger, nicer homes. It's no wonder that home prices are rising so fast! But what comes next? How much longer can the Federal Reserve suppress interest rates? During the crisis in March 2020, these emergency policies made sense, but are they necessary now? Longer term, there is a risk that these policies cause the economy to overheat.

In these heady financial markets where every asset seems to rise in tandem, we caution investors against getting caught up in the psychosis of the times. Instead, investors should take a methodical, unemotional approach. Investors should address bullish excesses the same as bearish excesses. When the markets were in free-fall in February and March of 2020, we advised against taking drastic action. Instead, we recommended taking a long-term view, grounding decisions in careful analysis, and focusing on maintaining allocations. Just as we cautioned against selling at the bottom, we now advise against chasing returns with speculative instruments like SPACs and unprofitable companies with abstract business plans.

As always thank you for your business. We appreciate and are humbled by the trust you place in us to manage your investments.

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3Q21 Review

Supply Chains

A little over a year ago, we wrote about the fragility of increasingly globalized supply chains. Through the 1990's and 2000's, multinational corporations optimized supply chains by finding the cheapest viable location for each step of production. To wring additional efficiencies from the production process companies emphasized just-in-time (JIT) inventory management which keeps inventories lean and increases cash flow. This strategy works great in spreadsheets and slick PowerPoint presentations, but it is prone to break down in a dynamic, real-world environment.

A recent McKinsey report estimated that over the course of a decade, supply-chain disruptions cost an average company 42% of one year's earnings.[1] We appreciate McKinsey's attempt to quantify the problem, but supply-chain disruptions are not a small, annual tax on profit margins. Major supply chain disruptions are, almost by definition, tail risk events. Additionally, the opportunity cost of lost revenue is nearly impossible to quantify.

For example, we spoke with the head of sales at a local Toyota dealership. Demand is very strong but difficulties procuring inventory are impacting sales. The dealership simply cannot get enough cars to meet demand. There is also a difficulty getting the right kind of cars. Customers are asking for trucks and SUVs like the 4-Runner and Tacoma, but the dealership is lucky to get a mid-size sedan like a Camry. Compounding the issue is that customers typically service new vehicles at the original dealership. Service is high-margin and a key driver of dealership profitability.[2] Losing a sale today impairs future profitability too!

The disruptions of the pandemic are still reverberating through economies, but companies are already taking steps to strengthen their supply chains. For example, during the 1Q21 call, Ford's CEO James Farley discussed how Ford was "taking this opportunity to revamp our supply chain to eliminate vulnerabilities down the road."[3] Rather than just focusing on profitability alone, companies are taking a renewed interest in the durability and sustainability of their supply chains. We expect this deglobalization of supply-chains to continue.

Student Loans: The Glacial Crisis Pt 3

In previous outlooks, we examined the $1.6 trillion student loan crisis. This burden impacts the economy by delaying a generation of consumers from buying homes, cars, and starting families.

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[1] https://www.mckinsey.com/business-functions/operations/our-insights/risk-resilience-and-rebalancing-in-global-value-chains
[2] https://asburyautomotivegroupinc.gcs-web.com/static-files/51160d64-ba4a-4e65-aced-6b858d54ad75. Slide 14.
[3] Ford Motor Company. 1Q21 Earnings Call. 28 April 2021.

Subsidized loans, a lack of price competition, and rising tuition create a vicious cycle of growing debt balances. Despite most colleges and universities avoiding taxes as non-profit organizations, higher education costs have compounded at 5-8% per year, far outpacing inflation.[4] This is a complicated and politically knotty issue with no easy solution.

President Biden voiced his support for debt-forgiveness, but as we discovered last quarter in Pt 2, much of the student loan burden is carried by very high debt individuals. These high debts come from advanced degrees like MBAs, law school, and medical school. These high-income borrowers do not need government support. Loan forgiveness provides politically popular stimulus but does not address the underlying issues of why debt balances got so high in the first place. To effectively engage this problem, a comprehensive solution must address the following:

- **Accountability for Outcomes**- Schools are not directly impacted by student outcomes. If students graduate with a degree that does not allow them to bear a heavy debt load, the school is no worse off. Restructuring the system so schools have "skin in the game" would better align the incentives of the schools to provide a meaningful education and job placement to better ensure students earn employment in fields with income congruent to the debt burden.
- **Improved Pricing of Loans**- In many cases, a college education is a terrific investment. For this reason, subsidizing student loans is a very popular policy. But these subsidies are also creating perverse incentives and contributing to the problem. Pricing of loans should favor in-demand degrees. Students who chose to study an in-demand field like nursing should face lower interest rates than students studying a less in-demand field like anthropology.
- **Transparent Tuition Pricing**- Currently, it is nearly impossible to understand exactly what a degree will cost. Students often focus on getting admitted to the best college possible and *then* figuring out how to pay for it. Stated tuition is rarely applicable- after aid, grants, scholarships, and work/study programs students pay vastly different prices. Most students do not pay the full tuition price advertised by the school. How can students make educated decisions without understanding the final, net price after aid, grants, and scholarships? Better pricing information will empower students and families to make more educated decisions earlier in the college search.

It is encouraging that the student loan crisis is getting attention at a national scale. This debt burden impacts the economy by encumbering a generation of consumers. Instead of buying cars, homes and starting families, millennials are paying down debt. Addressing student loans can unlock a major cohort of consumers and provide a significant lift to the economy.

[4] https://nces.ed.gov/fastfacts/display.asp?id=76

ESG Investing

We are fielding more questions about ESG Investing, or, investing while considering environmental, social, and governance factors. There are many misconceptions about what ESG investing is and what it means. ESG investing is often lumped in with other similar styles of investing, but it is important to understand its differentiating attributes. Compared to other investing styles, ESG lies between Socially Responsible Investing (SRI) and Impact Investing. ESG investing evolved from SRI. SRI is an exclusionary process that avoids certain companies, so portfolio holdings do not contradict one's values. For example, a health-focused foundation or hospital might not want to own companies that market tobacco or liquor. An historical example is universities and pensions divesting from companies that tolerated apartheid in South Africa in the 1980's. By applying a set of standards, SRI excludes certain companies or industries from the universe of investable stocks.

While SRI is exclusionary, Impact Investing is inclusionary. Impact Investing aims to generate explicit benefits to society and is usually an extension of philanthropy. For example, offering microfinance loans in the developing world or investing in a malaria vaccine might offer a financial return that is poor compared to alternative investment opportunities. When the perceived societal benefits are accounted for, the total "impact" of something like microfinance loans or a malaria vaccine is convincing. Thus, Impact Investing is more strongly influenced by the societal benefit than a financial return.

ESG investing lies between SRI and Impact Investing and means that environmental, social, and governance factors are incorporated into the research process. The idea behind ESG investing is to generate long-term, sustainable value, a business must navigate these types of risks. By way of example, on the environmental front, companies that are reckless polluters could eventually face lawsuits or environmental remediation costs which is borne by shareholders. Socially, companies with questionable supply chain relationships (slave labor/sweat shops) could face significant costs or permanent damage to their brand. From a governance perspective, if shareholder rights are not protected, insiders might exploit the business and destroy long term shareholder value. By considering these factors, ESG investing offers a framework that can work in conjunction with traditional equity analysis.

In future Outlooks, we will follow-up with additional research on ESG investing. We will cover the strengths, weaknesses, and future opportunities as this investing trend accelerates.

2021 Outlook: Where Do We Go from Here?

Conviction Level

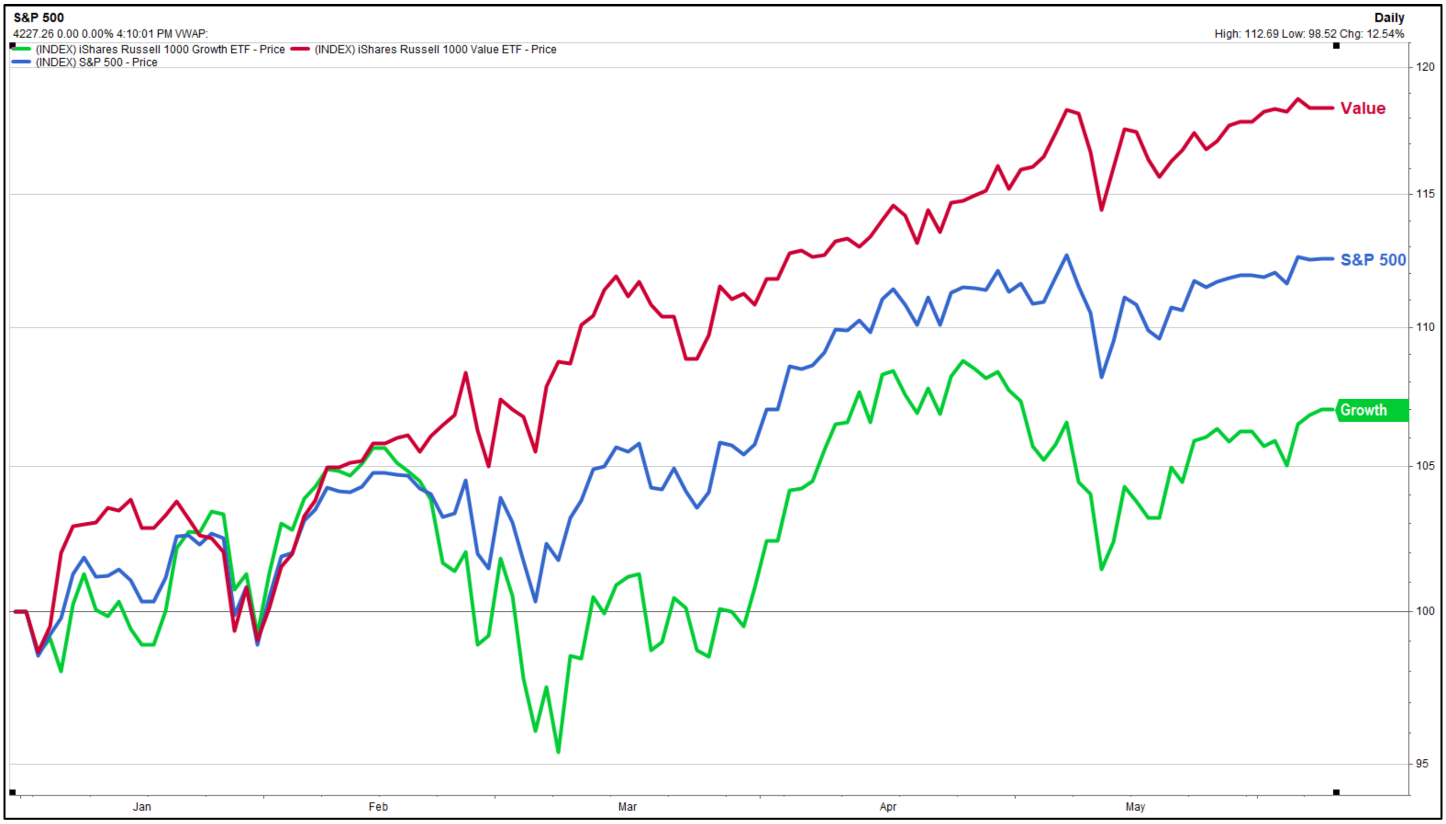
Our conviction indicates how we think asset classes will perform against the broader market.

	High Conviction	Moderate Conviction	Neutral	Low Conviction	Very Low Conviction
Large Cap Equities					
Small Cap Equities					
Short-Term Fixed Income					
Long-Term Fixed Income					
High Yield					
Municipals					

Conviction levels are for illustrative purposes only and should not be relied upon as investment advice, research, or a recommendation by Novem Group regarding (i) the asset class, (ii) the use or suitability of the model portfolios or (iii) any investment. Only an investor and their financial advisor know enough about their circumstances to make an investment decision.

Large Cap Equities – Moderate

For the first half of the year, value outperformed, up over **18%.** The S&P 500 is up over **12%** while Growth is trailing at **7%**. We continue to favor companies with strong balance sheets and lower levels of debt. Especially companies that are well positioned to benefit from the continued reopening. For the past few years, growth stocks performed exceptionally well but Value has seen a resurgence. Based on current valuations and our economic outlook, we believe value stocks can continue to outperform.



Small Cap Equities – Moderate

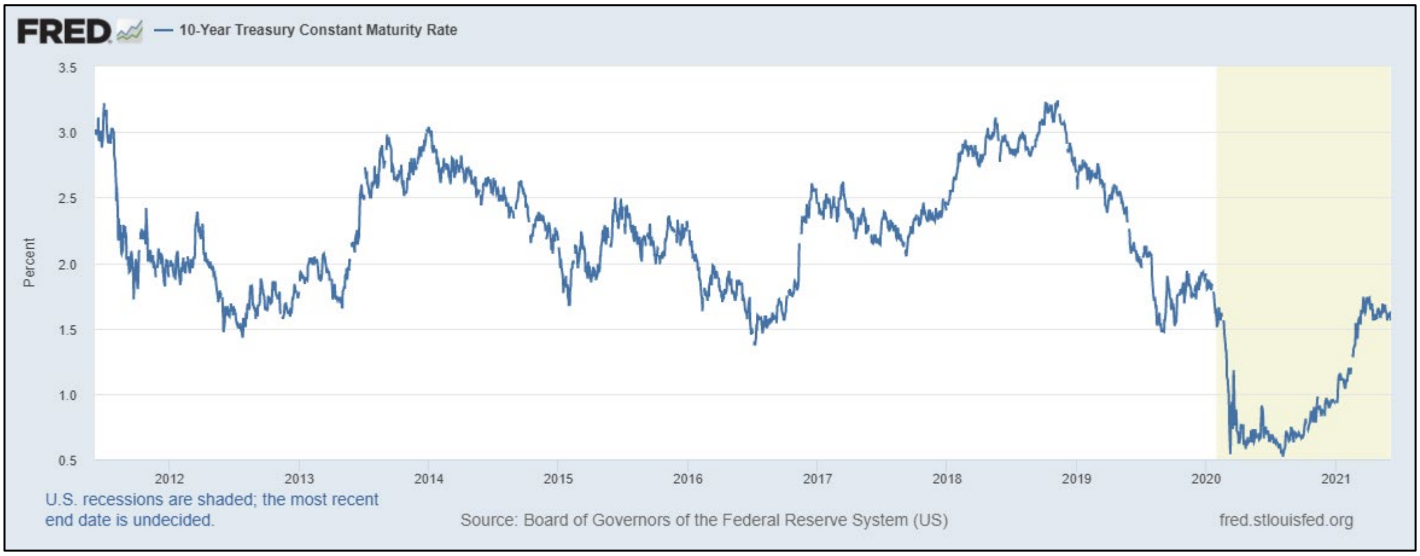
Small cap equities continued their strong Q1 performance, up almost 20% year to date. After years of lagging, small stocks are now strongly outperforming the S&P 500. Academic research shows that over the long term, small cap stocks outperform because they are more dynamic and enjoy better growth prospects. The past few years, this has not held, and the S&P 500 strongly outpaced the Russell 2000. Going forward, we prefer leaning towards smaller capitalization equities.

Short Term Fixed Income – Neutral

Short term fixed income continues to be uninspiring. Yields on short term fixed income continue to remain paltry. Until the Federal Reserve makes substantial changes to their monetary policy, we expect this trend to continue. Other than protecting principal and dampening volatility, we do not see an investment thesis for owning short term fixed income.

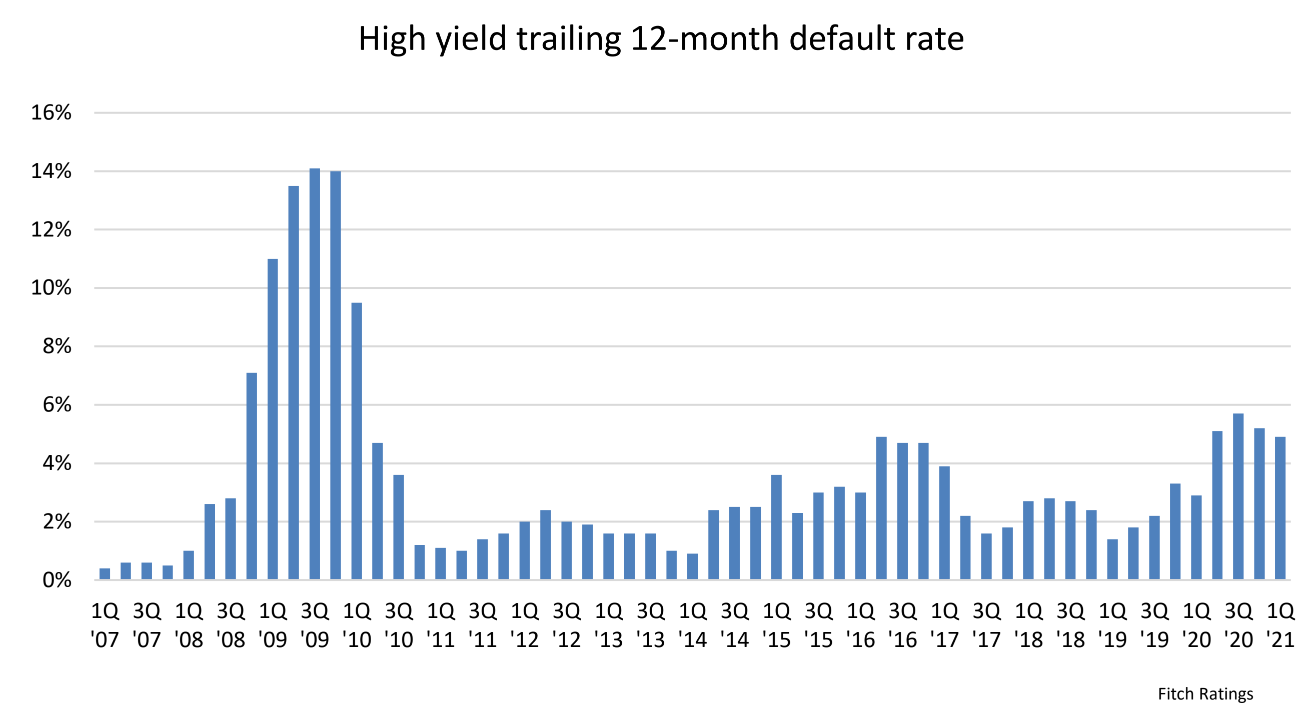
Long-Term Fixed Income – Very Low

Investors are not compensated for the duration risk brought on by long term fixed income. As of May 28, the 10-year treasury was a paltry 158 bps. Rather than reaching for a few extra basis points of yield and exposing themselves to duration risk, investors are better off protecting principal in short-term fixed.



High Yield – Moderate

High yield continues to be one of the few areas that provides income. The Novem High Yield strategy currently provides an SEC yield of 3%. However, it is important to focus on the credit quality in this space and not just chase yield. Although default rates picked up through the end of 2020, they seem to have settled around the 5% level for now. If the economy stumbles, the lowest rated credits will likely suffer the worst.



Municipals – Neutral

Federal spending is boosting municipal credit quality. With strong economic growth, state tax collections are stronger than anticipated. An infrastructure bill could provide huge stimulus to the municipal asset class. These, among other factors, have driven strong flows into municipal ETFs with more than a dozen gathering over $100 million of net inflows through May 2021.[5] Municipal can be an attractive asset class to higher income investor looking for tax advantaged income.

Relative to treasuries, the spread on municipals has decreased considerably but is still not at historical lows. Strong credit quality but narrow spreads lead us to our balanced outlook on municipal bonds.

[5] CFRA, "What's Driving Demand for Muni Bond ETFs in 2021", June 7,2021


Historical Spread
5 Years
ICE/BAML Municipal Composite
vs
ICE/BAML Treasury Composite
350
300
250
200
150
139.20
100
50
0
'16
'17
'18
'19
'20
Historical Yields
Add Yield

Deep Dive: Constellation Brands

This quarter, we decided to analyze one of Rochester's largest and most successful companies, Constellation Brands. Constellation is an alcoholic beverage company whose portfolio includes the above brands. This summer, we hope you have the chance to sample at least one of these- preferably in a beach chair or hammock.

Constellation's roots in the Rochester area date back to the 1940s and the stock was first publicly traded in 1973 as Canandaigua Wine Company. From their humble beginnings in the Finger Lakes, Constellation grew to have a global presence. How did Constellation achieve this growth? How is Constellation positioned relative to its competitors? What is the company's strategy going forward? The easiest way to understand the inner workings at Constellation is to break the company down into segments.

Beer:

Beer is Constellation's largest segment. Constellation has long been the distributor of Modelo brands in the United States through a 50/50 partnership with Grupo Modelo. In 2013, brewing giant Anheuser-Busch InBev acquired Grupo Modelo which was a major catalyst for Constellation. Due to its significant size, AB InBev faced anti-trust concerns from regulators and sold Grupo Modelo's 50% interest for $1.85 billion to Constellation. The acquisition gave Constellation full importation and distribution rights for Modelo brands, which includes the Corona, Modelo, and Pacifico beer families.

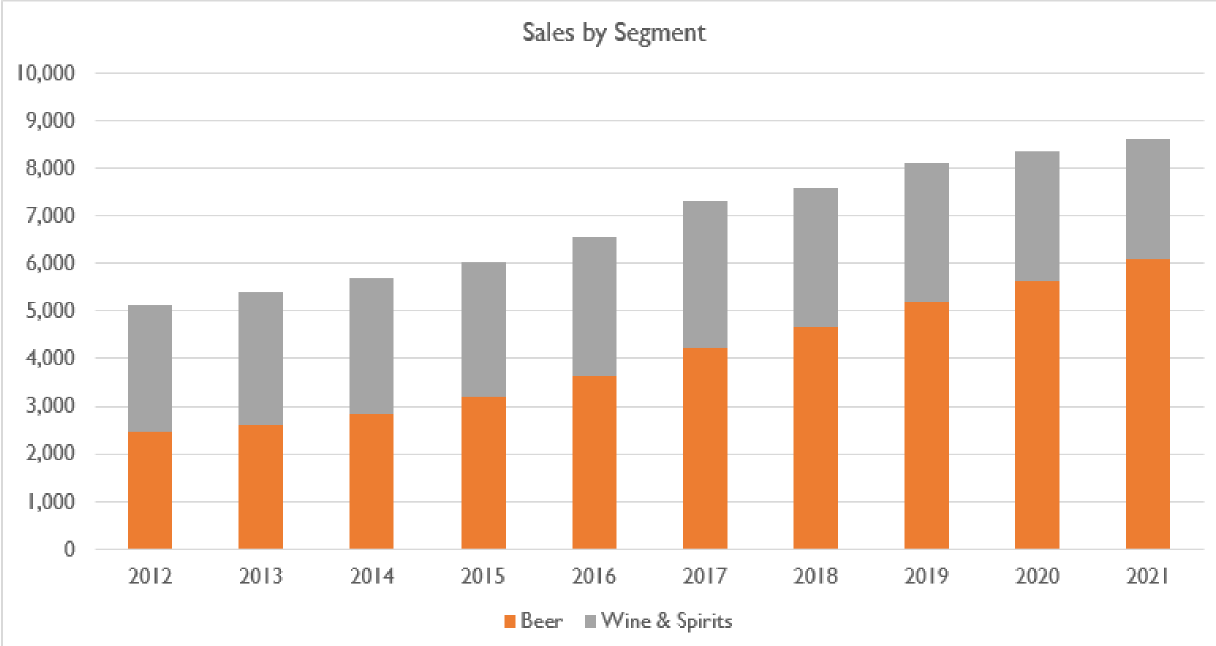
Under Constellations' stewardship, the value of these brands increased dramatically. From 2012 through 2019, Constellation's beer revenues compounded at an impressive 11% rate. Constellation's portfolio accounts for 8 of the top 15 imported beers and some of the fastest growing brands in the US.[6] These brands offer Constellation a solid foundation, but beer is constantly threatened by substituted products. Constellation swiftly launched Corona Hard Seltzer in response to the growing number of consumers seeking a lighter and lower calorie alternative to beer.

In beer, Constellation's core customer is Hispanic and represents over half of overall volume.[7] Favorable demographic trends and sales numbers suggest this penetration will increase. Identifying the present opportunity, Constellation runs significant Spanish speaking advertising to lean on this strength. Further, they have lined up partnerships for their brands with upcoming sporting events. Modelo is the official beer of the UFC, one of the fastest growing sports, and the official sponsor of the Gold Cup while Corona will be a distinguished sponsor of the US Open at Torrey Pines in June. Pacifico is the fastest growing Mexican import, and its advertising strategy focuses on Gen-Z with ads on Hulu, Instagram, Snapchat, Twitter, and Twitch. "Found in Baja. Imported by surfers.", Pacifico advertisements cater to an adventurous audience and it's fittingly the official beer of the X Games. As you watch the Summer Olympics this year (knock on wood), keep your eyes out for ads from the Modelo brand family!

Beyond TV and sporting events, Constellation is boosting their online presence and increasing spending in digital, social, and eCommerce media by 50% versus 2020. This will allow them to address their target market further and more directly with targeted advertising. The pandemic helped accelerate digital trends and younger consumers are comfortable making purchases online or in-app increasing the importance of digital strategy.

Constellation's advertising strategy seeks to emphasize the niche position of its brands. Constellation's beer brands do not fit the "macro" mold of Budweiser, Miller, or Coors. Nor do they fit the mold of the hyper-differentiated local craft breweries. As the below chart illustrates, this niche position allows Constellation to grow beer sales at a time when competitors struggle.

[6] CFRA Research Report (STZ), https://services.marketscope.com/micro-services/SP/msa/reports?reportURL=/stars/usa/21036P10&region=US%27,%20%27STZ
[7] STZ Earnings Call 8 April 2021.



	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total	5,124	5,384	5,681	6,028	6,548	7,332	7,585	8,116	8,344	8,615
Beer	2,470	2,588	2,836	3,189	3,623	4,229	4,659	5,202	5,616	6,075
Wine & Spirits	2,654	2,796	2,846	2,839	2,926	3,102	2,927	2,914	2,728	2,540

All figures in millions of U.S. Dollar. All figures are trailing 12 months as of February. Data from FactSet.

Wine & Spirits:

Constellation's Wine & Spirits segment is pivoting from low-margin products into higher-margin premium products. In January 2021, Constellation reached a deal to sell off roughly 30 low-end wine brands to E&J Gallo for ~$810 million.[8] The company has divested other low-end spirits, including Black Velvet Canadian Whiskey for $266 million. On the Wine side, the portfolio includes Robert Mondavi, Prisoner Wine, and Kim Crawford. The Spirits business is highlighted by SVEDKA and High West Whiskey. By divesting underperforming low-end assets, Constellation can focus on their higher margin premium brands with a medium-term goal of having operating margins at 30%.

Constellation's effort is also aligned with middle-market consumer tastes, which are trending towards premium brands. The premiumization strategy in Wine & Spirits is also defensive as consumers shift toward mixed drinks and premium spirits at the expense of beer. With the lower-end brands divested, we would not be surprised to see Constellation make targeted investments to strengthen its Wine & Spirits division soon.

[8] https://www.marketwatch.com/story/gallo-completes-810-million-wine-megadeal-with-constellation-11609904113

Other:

While separate from the core business, Constellation's $4B investment in cannabis company Canopy Growth is significant. Canopy is attractive given their exclusive rights to purchase the leading US cannabis license holder, Acreage Holdings, in the event of US federal legalization. Constellation currently owns 37.2% of Canopy and has the rights to purchase an additional $3.4 billion in stock.

We took a deep dive into the cannabis industry back in our 1Q20 Quarterly Outlook and cited how recreational cannabis could undermine legacy alcohol businesses. The long-term potential of cannabis was the impetus behind Constellation's deal with Canopy. At the time, CEO Rob Sands, was quoted describing cannabis as a "logical fourth leg" as Constellation builds a "total mood-modulation portfolio" across beer, wine, spirits, and cannabis.[9]

Canopy has successfully rolled out the top 3 recreational beverages in Canada and they are looking forward to rolling out products in the US.[10] It is early, but ultimately Constellation's move into cannabis could be very accretive to long-term earnings.

Comparison:

Constellation is often classified as a Distiller & Vintner like Jack Daniel's maker Brown-Forman but given the company's product lineup and revenue split, they are arguably more comparable to the brewing industry. In comparison to major beer companies, Constellation has impressive margins and a reasonable P/E valuation.

Company	Notable Brands	Gross Margin	EBIT Margin	P/E NTM	Market Cap (in $ millions)
Constellation Brands (NYSE: STZ)	**Modelo, Corona, Pacifico**	**52.8%**	**34.4%**	**22.70x**	**46,415.9**
Boston Beer (NYSE: SAM)	Sam Adams, Dogfish Head, Truly Seltzer	47.1%	15.8%	38.22x	13,931.5
Molson Coors Beverage (NYSE: TAP)	Coors, Miller Lite, Blue Moon	36.8%	14.3%	14.99x	13,146.9
Heineken (OTC: HEINY)	Heineken, Amstel, Dos Equis	29.2%	10.2%	27.64x	68,319.4
Anheuser-Busch InBev (NYSE: BUD)	Budweiser, Stella Artois, Michelob Ultra	58.1%	25.3%	23.41x	152,233.9

If anything, Constellation's non-beer business pulls their valuation down. The stand-alone EBIT margins of Constellation's beer segment are an impressive 41.1%! This is far ahead of other companies like Molson Coors or Anheuser Busch InBev. Moreover, Constellation is using divesture proceeds to expand capacity and lower long term operating costs, thereby further increasing profitability. At 22.7x forward earnings, Constellation is trading at the higher end of its historical range, but it is not necessarily overvalued. The significant strength of their Beer business, paired with the streamlined Wine & Spirits portfolio, and a significant investment in Canopy Growth leave Constellation in a unique competitive position.

[9] https://www.wsj.com/articles/constellation-brands-expands-investment-in-cannabis-company-canopy-growth-1534332997
[10] STZ Earnings Call 8 April 2021.

Risks:

Like any company, Constellation is exposed to a variety of risk factors. Some risks are industry specific while others are company specific. Regardless, it is important to understand associated risks before investing. Weather plays a major role in Constellation's operations and adverse weather is a constant threat. For example, droughts and wildfires in California have a material impact on wine operations while droughts elsewhere can lead to shortages in crops that are required to make beer. A supply chain risk the industry is currently dealing with is a glass shortage. Constellation's products primarily use glass bottles, and they rely on a limited number of producers. The glass shortage could lead to increased costs or a shortage of finished product.

The alcoholic beverage industry is highly competitive. Constellation has strong brand recognition, but there are constantly new products entering the market. Also unanticipated shifts in consumer preferences are a major risk. A good example is consumers shifting from beer to hard seltzers. Constellation answered with Corona Hard Seltzer, but consumers are fickle, and the next shift might not have an easy answer. As a side note, we do not think the risk is significant, but Constellation does face legal risk with its use of Corona Hard Seltzer. Earlier this year AB InBev filed a lawsuit stating the Corona brand name can only be applied to beer.

Another key risk is US/Mexico trade. Constellation's customers are in the US, but the company produces a significant amount in Mexico. In the event of a geopolitical conflicts between the US and Mexico, Constellation would be at the mercy of both governments. A few years ago, trade tensions contributed to volatility in STZ shares. Tariffs and trade restrictions would significantly impact Constellation's business.

Constellation's reliance on mergers and acquisitions is another risk. With each deal, Constellation is exposed to integration risk, operational risk, and financial risk. The clearest example is Constellation's 2015 purchase of craft brewer Ballast Point for $1B. The acquisition marked a high point in craft brewery valuations and Constellation's ownership of Ballast Point was short lived. It was sold during 2020 for an undisclosed amount – analysts speculate the sale was for <$100M.[11]

By and large, Constellation's management has done an impressive job adapting and transitioning their business over the years. For a company that has done 82 M&A deals since 1993, it is easy to sit here and cherry-pick a failure.

As we went to press, Constellation was not held in any model portfolios. We have owned Constellation in the past and we may own it in the future.

[11] https://www.yahoo.com/lifestyle/ballast-point-once-valued-1-180831507.html

Advisor Spotlight: Gil Wood

What is your investment approach?

It has been my experience that having the proper asset allocation held consistently over time produces the best results. Sectors and individual stocks can be used to compliment the basic investment framework.

What are your thoughts of the market for the rest of 2021?

Stock market growth through the remainder of 2021 will likely be dependent on the continued opening and growth of the U.S. economy. From the current stock market levels, we will need further real earnings growth to push stocks higher. Additionally, the Federal Reserve will need to continue with its very accommodative monetary and fiscal policies. If both scenarios continue positively, we should have a positive end to the stock market for 2021.

How does Novem Group benefit you as an advisor?

I have been associated with Novem Group for over 5 years. Novem Group has been a great environment to be a part of and affiliated with. It has allowed me to be independent and manage my clients how I want.

What financial mistakes do you see people of any age making?

Not taking enough risk. Being too conservative can be just as detrimental to long term success as being too risky. It is important to realize that if you buy CDs, you are going to get a CD return. Additionally, people get too focused on watching the nightly news and forget that it is entertainment not necessarily facts. Finally, focusing on too short term of a horizon. Warren Buffet refers to compound interest as the most powerful factor behind his investing success. For compound interest to be most effective it helps to have a long-term view.

What is your favorite restaurant in Rochester?

Olive's Greek Taverna in Schoen place in Pittsford. I have been going there for many years. I enjoy how it is a modest place and everything on the menu is great. At the end of the day if I am full, then I am happy!

What We're Drinking

Copper Leaf Brewing is what we are drinking this quarter. This new brewery is conveniently located in Schoen Place in Pittsford. They offer a unique variety of brews from pilseners, stouts, to an India Pale Lager (IPL). An IPL is a less popular, unique spin, on the extremely popular India Pale Ale (IPA).

The two main differences between IPLs and IPAs is the amount of hops used and the style of fermentation. Typically, less hops are used in an IPL which leads it to have a less bitter flavor profile versus an IPA. The second difference, the fermentation process, is why most breweries do not offer IPLs. Lager fermentation needs to be done at cooler temperatures which causes the process to take significantly longer than it does for Ales (IPAs). Therefore, it is typically more efficient for brewers with limited tank space to brew IPAs and why you do not see many IPLs in the market.

At the end of the day all the beers are fantastic, so we recommend trying it!

After having a few pints, you can head right next door to the highly recommended Olive's for a quick bite. If you are lucky, you may even see Gil there!

Historical Perspective

"It's all about the long term."
-Jeff Bezos, Founder of Amazon.com

The CEO and founder of Amazon, Jeff Bezos, recently announced his retirement. As of July 5th, he will step down from his role as CEO.

Jeff Bezos will go down in history as one of the greatest CEOs of all time. Reading and rereading his shareholder letters is an intriguing and helpful exercise for any student of business or financial markets. Bezos' clearly defines Amazon's strategy and provides commentary on successes and failures alike. As we navigate uncertain and volatile markets, we draw numerous lessons from these letters. These can be accessed on Amazon's investor relations webpage here.[12] A few of our favorite lessons are below.

[12] https://ir.aboutamazon.com/annual-reports-proxies-and-shareholder-letters/default.aspx

Lesson 1: Don't get caught up in success- focus on what matters.

In 1998, on a split-adjusted basis, Amazon's stock rose from $4.55/share to $53.54, an annual return of over 1,000%! Bezos, while upbeat, remains grounded in the fundamentals of the business. He discusses sales growth, customer accounts, and the balance sheet. **The stock price is not mentioned once.**

Lesson 2: Don't get caught up in bad news- focus on what matters.

In 2000, the tech bubble burst and Amazon's stock crashed from over $80/share to $15.50 taking Bezos' net worth with it. Many of Amazon's peers went out of business. Bezos acknowledges the pain of the sell-off but provides clear data to show that despite the stock performance, Amazon is a stronger company than the year prior. As a leader, Bezos remained grounded in fundamentals and focused on long term success.

Lesson 3: Admit your mistakes, clearly analyze them, learn, move on.

Facing the hyperbolic growth of the internet, Amazon invested in companies adjacent to its core business. Among others, Amazon had investments in living.com and Pets.com, both of which shut down in 2000. After this error, Bezos admits the mistake, stating that Amazon "believed passionately in the 'land rush' metaphor for the Internet" but significantly underestimated how much time Amazon would have to grow and develop these businesses. Taking this lesson to heart, Amazon moved on. Amazon did not invest additional capital to try to rescue these failed businesses but doubled down on its core business.

Lesson 4: Stay hungry. Success is not a finish line.

In 1997, after plenty of early success and a successful public offering, Bezos refused to take a victory lap, instead proclaiming that it was still "Day 1" at Amazon.

In just 27 years, Bezos grew Amazon from nothing into one of the most successful businesses of all time. Despite this unprecedented success, Bezos uses his final letter to draw attention to areas where he thinks Amazon should improve, specifically the company's responsibility as an employer and a steward of the environment. His final sign-off encourages Amazon to continue treating today as "Day 1".

Disclosures

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