TOWLE & CO.
DEEP VALUE INVESTING
(314) 822-0204

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Encouraging! The Towle Deep Value Composite (DVC) experienced a sharp rally in September bringing year-to-date returns to what we see as a more respectable level. While this price improvement is promising, our portfolio holdings remain underappreciated in our view. As we enter the final stretch of 2019, the global trade war weighs heavily on investor sentiment and CEO confidence, holding back risk-taking and capital spending plans. These dynamics threaten the economic outlook and have caused manufacturing to weaken. Nevertheless, we still expect that the durability of the U.S. consumer, low inflation, low commodity prices, stable credit markets, supportive central bank policy, and advancing trade talks should sustain the economy's expansion. Considering this investment backdrop and the potential that investor confidence will improve from here, we believe the Towle portfolio is markedly undervalued.

Historical performance is presented below with periods greater than one year annualized.

Periods ending 9/30/19	*Towle DVC (Gross of fees)*	*Towle DVC (Net of fees)*	*Russell 2000 Value*	*S&P 500*
3 months	2.06	1.87	-0.57	1.70
9 months	12.21	11.62	12.82	20.55
1 year	-21.22	-21.80	-8.24	4.25
3 years	2.78	2.02	6.54	13.39
5 years	6.03	5.26	7.17	10.84
10 years	10.45	9.66	10.06	13.24
20 years	11.65	10.82	9.05	6.33
30 years	12.57	11.77	9.88	9.72
Inception (1/1/82)	15.23	14.41	11.57	11.62

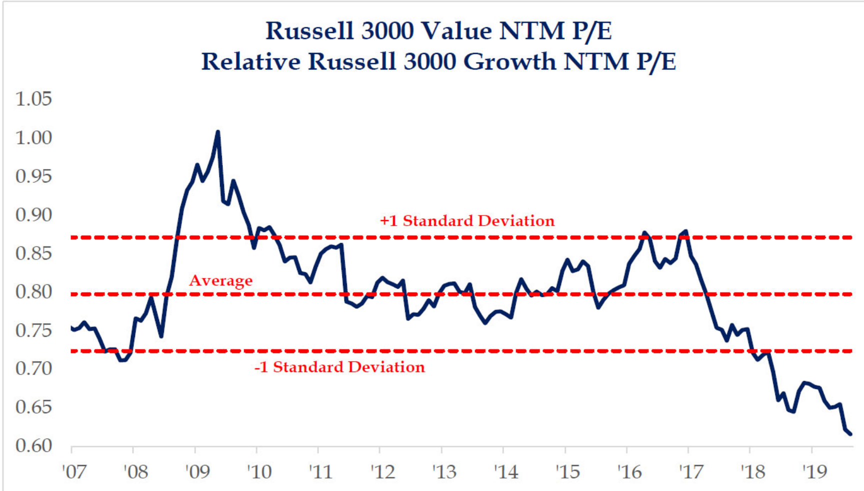
Returns are preliminary and subject to change. Past performance is no guarantee of future outcome.
Please refer to the last page for additional disclosures.

Historic Valuation Gap

In our second quarter investor letter dated April 11, 2019, we referenced the wide valuation gap between value and growth stocks. We alleged that such an extreme dispersion appeared unsustainable and might spell opportunity for long-term value investors.

On July 16, 2019, JPMorgan's Global Quantitative and Derivatives Strategy Group issued a research report with the subtitle, "*Largest divergence ever presents opportunity for Value and High Volatility stocks.*" In the report, Marko Kolanovic stated, "we think that the unprecedented divergence between various market segments offers a once in a decade opportunity to position for convergence. Currently, there is a record divergence between value/cyclical stocks on one side, and low volatility/defensive stocks on the other side." He went on to say, "The bubble of low volatility stocks vs value stocks is now more significant than any relative valuation bubble the equity market has experienced in modern history."

On October 1, 2019, Strategas Research Partners wrote, "we know not the time or the hour, but the undervaluation of Value stocks relative to Growth appears to be extreme – globally. Those believing in the concept of reversion to the mean might want to lean the other way." The following chart from Strategas illustrates the magnitude of the valuation gap by displaying the ratio of the next twelve month (NTM) P/E of U.S. value stocks divided by the NTM P/E of U.S. growth stocks.



Source: Strategas October 1, 2019. The Russell 3000 Index represents the U.S. broad stock market and is comprised of the 3000 largest U.S. publicly traded companies.

Wall Street's rejection of the proposed WeWork IPO and shaky reception to the IPOs of Postmates and Peloton may be an early indication of a waning investor appetite for richly-valued, high-growth companies and a harbinger of better times ahead for value investors. Like Strategas, we know not when a sustainable rotation into value stocks will commence, but conditions appear ripe.

Portfolio Review

This section has been removed for compliance reasons to exclude discussing specific securities transactions.

Road Ahead

Doubt and uncertainty seem to rule the current environment. Using Google Trends, August marked 5-year relative highs for the search terms "yield curve" and "recession". Are these apparent fears justified? The Leading Economic Indicators remain at modestly positive levels. Housing starts in the U.S. were up 6.6% year-over-year in August. Inflation is low and stable, as are interest rates. Jim Paulsen of the Leuthhold Group notes that productivity growth has recently exhibited a positive tone, and Ed Clissold of Ned Davis Research states, "There are initial signs that the economy is emerging from a deceleration." (*Barron's* 9/23/19) We believe that the level of negativity regarding the prospects for the U.S. economy is unwarranted.

We also note that steep market declines have historically followed periods of excess. Currently, we find few excesses on Main Street. The personal savings rate as measured by the St. Louis Federal Reserve was 8.1% in August versus a reading of 3.1% just prior to the Great Recession. Mortgage underwriting standards have tightened considerably with 59% of origination volumes registering a FICO score above 760 versus just 27% in the pre-crisis years. A similar pattern exists in auto loans. Prudence seems to be the norm on Main Street.

Will the earnings power of Towle portfolio companies remain underappreciated indefinitely? We believe that global growth should accelerate over time, supported by a positive outcome from the trade talks between the U.S. and China. Together, the two countries make up 34% of global economic activity, and the incentives seem ripe for a constructive conclusion. With a median 2020 P/E of only 7.5x for the Towle portfolio, an historic valuation divergence between growth and value, and surplus fear surrounding global economic growth, we remain optimistic about our portfolio. We are reminded of a favorite thought from Peter Lynch: "Remember, things are never clear until it's too late."

Towle & Co. fully recognizes that the past 18 months have been difficult. However, stock markets tend to operate in cycles, and we plan to overcome the current downturn by remaining fully invested in our undervalued holdings.

J. Ellwood Towle
Christopher D. Towle
Peter J. Lewis, CFA
James M. Shields, CFA
Wesley R. Tibbetts, CFA

DISCLOSURES