TOWLE & CO.

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Top-heavy! The S&P 500, concentrated to a degree not seen for 50 years, returned 10.6% in the first quarter. Meanwhile, after a strong finish to 2023, the Towle Deep Value Composite took a breather with a 2.7% net return, keeping pace with the Russell 2000 Value while maintaining meaningful long-term outperformance.

Today's herd-like investor behavior and valuation levels remind us of the Tech Bubble and Nifty Fifty eras. As was the case then, we wonder if the fear of missing out on large-cap growth is creating a significant opening in small-cap value. We believe prudent investors will seriously consider their allocations amid a small-cap value opportunity that seems as relatively attractive today as any time in the last two decades.

Towle Deep Value Composite returns are highlighted below with periods greater than one year annualized:

Periods ending 3/31/24	*Towle DVC (Gross of fees)*	*Towle DVC (Net of fees)*	*Russell 2000 Value*	*S&P 500*
3 months	2.92%	2.66%	2.90%	10.56%
1 year	22.74	21.53	18.75	29.88
3 years	6.41	5.37	2.22	11.49
5 years	12.74	11.62	8.17	15.05
10 years	8.44	7.37	6.87	12.96
20 years	10.12	9.03	7.47	10.15
30 Years	12.36	11.25	9.48	10.66
Inception (1/1/82)	15.14	14.00	11.29	12.01

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

Investment Environment

"The accuracy of a group's aggregate judgement rests on the participants *not* behaving like a crowd."
William Bernstein, *The Delusions of Crowds*

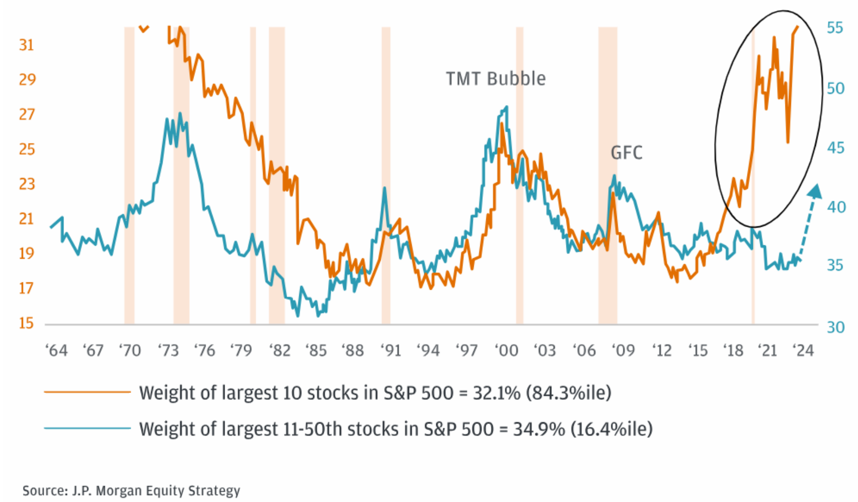
"We may never know where we're going, but we'd better have a good idea where we are."
Howard Marks, *It Is What It Is*

Let's consider where we are in the general context of stock markets.

1. **Passive:** According to a recent Morningstar report[1], passive fund assets now surpass active fund assets. Most passive assets are managed in market-capitalization-weighted ETFs which ignore underlying company fundamentals and valuations. If a company is overvalued, passive inflows amplify that error by over-allocating to it. Conversely, if a company is undervalued, passive inflows under-allocate to it and drive it further from fair value. Passively managed assets naively buy what has worked and neglect what hasn't. Consequently, the opportunity set of neglected, small, undervalued companies expands for active managers.

2. **Concentrated:** Driven by multiple factors including the buzz over artificial intelligence and the continued growth of passive ETFs, market concentration has reached highs not seen since the 1970s. As calculated by J.P. Morgan, the weight of the largest 10 companies in the S&P 500 approaches a 50-year high:

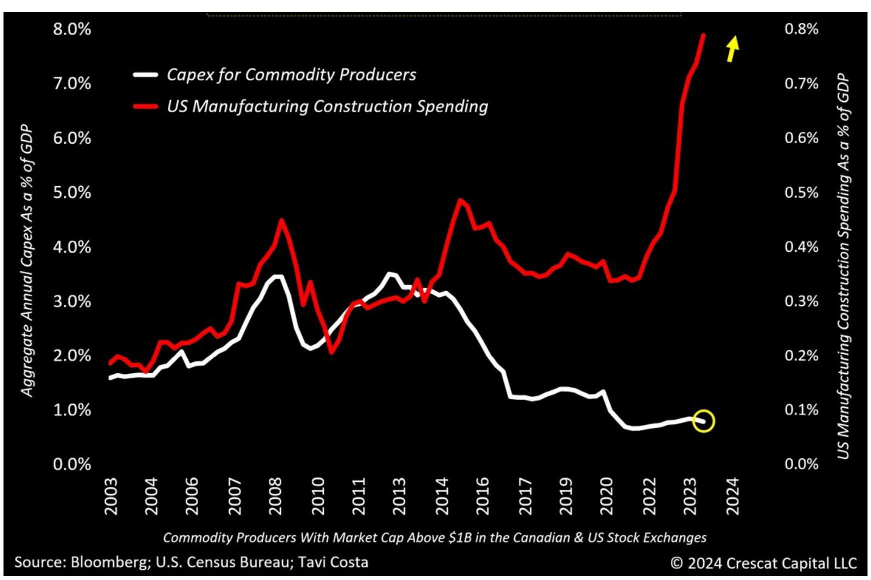
[1] "It's Official: Passive Funds Overtake Active Funds," January 17, 2024, Morningstar



To justify this level of concentration one must believe the valuations of these largest 10 stocks are reasonable. Should Nvidia be worth 34x sales and command a 5% weight in the S&P 500? Should Amazon be worth 63x earnings and command a 4% weight? How about Eli Lilly, the 8th largest weight in the S&P 500, currently trading over 120x trailing earnings? Apple's sales are now in decline, but it's still a 6% weight. It is hard for us to imagine that these stocks can keep outperforming from here.

3. **Underexposed to Small-Cap Value:** As passive flows have surged over the past decade, providing robust support for large-caps via market-cap weighting, small-caps have struggled to keep pace. For instance, an ETF that tracks the S&P 600 Small-Cap Value Index (ticker: IJS) posted a 10-year annualized return of 6.1%, compared to the S&P 500's return of 13.0% over the same period. Given this notable underperformance, investors are likely accepting significant underrepresentation in small-cap equities, especially small-cap value.

4. **Underexposed to Hard Assets:** Investment dollars that flow to technology companies cannot flow to energy production, mining, manufacturing, steel production, or a multitude of other economic necessities. And while underinvestment leads to underexposure in portfolio terms, it creates undersupply in real economy terms. The chart below from Crescat Capital shows commodity producer aggregate capex vs. construction spending on manufacturing in the U.S. Do investors have adequate exposure to the raw materials needed for all this building?



Piecing it all together, the past decade has been characterized by passive overtaking active, large overtaking small, growth overtaking value, and intangible overtaking tangible – a bear market in diversification with the majority of gains concentrated in a select few stocks. **"Where we are" is a disregard for hard assets and small-cap stocks, a proclivity to invest through valuation-agnostic vehicles, and a ravenous appetite for anything involved in AI.**

There are historical precedents for times like these. In 1999 small-cap value was unpopular, valuation agnosticism was widespread, and fervor over new technology crowded out slower, more rational judgement. It was correct in 1999 to think that the internet was going to change the world – but not by 2001 or 2002. **Meanwhile, from 2002-2007, value handily outperformed growth as previously misallocated capital found a home in assets with real earnings and cash flows.**

The human tendency to misjudge the speed of change is something Bill Gates once noted: "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten." Perhaps, instead of AI taking over the world in short order, we're still going to need steel, oil, natural gas, metallurgical coal, and a host of other real assets to keep industrial economies humming.

In conclusion, stock markets today seem passive, crowded, unconcerned with valuation, and display the same human emotions that tend to coincide both with overextended markets and with the start of great value returns. Of course, time will tell. All we can do is urge investors to examine the risks within their portfolios and weigh the potential consequences of overlooking the opportunity in small-cap value. A century of market history teaches that large vs. small and growth vs. value ebb and flow. We don't think it'll be different this time.

Quarterly Review

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

Looking Ahead

Shrewd investors and allocators face an important choice today: maintain heavy exposure to popular, over-allocated segments of the market or reallocate funds towards less crowded, undervalued opportunities. We like how Jim Furey puts it in a recent research note: "to believe the current large-cap cycle will never end, one must accept two premises: (i) the pattern of alternating large-cap and small-cap cycles that has been in place for 100 years is broken, i.e. "this time it's different"; and (ii) large-caps can continue widening their valuation gap versus small forever."

Preferring the safety of the investing crowd is a natural inclination. Stepping out and taking an unpopular position is no easy decision – it carries risk but also the potential for great reward. **For investors and allocators aiming to reduce risks associated with overconcentration and lofty valuation, our differentiated, process-driven value strategy merits consideration.** With significant personal capital on the line, the employees of Towle & Co. and their affiliated entities comprise one of the firm's largest investors. We are strongly aligned both professionally and financially. And we welcome the opportunity to serve investors who share our contrarian mindset and appreciate the potential at hand.

We have one personnel change to share. After two fruitful years at Towle & Co., Jack Gillis, Head of Client Relations, has made the decision to return to J.P. Morgan Private Bank as a Senior Banker. He is excited to reprise his role, leveraging his expertise as a trusted advisor to high-net-worth families. During his time at Towle & Co., Jack always led with integrity, professionalism, and the utmost care. As a revered member of the team, he demonstrated the true meaning of high touch service. While J.P. Morgan must be thrilled to welcome him back, we are most grateful that Jack shared his many talents with us and will remain a 20+ year client of Towle & Co.

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