TOWLE & CO.

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What a mess! Markets struggled throughout the first quarter as contentious trade policy, stubborn inflation, weakening consumer confidence, and renewed recession fears fueled broad-based equity declines. Rapid-fire policy shifts only deepened the uncertainty, complicating decision making and rattling investor confidence. Market returns reflected the growing strain.

The Towle Value Composite (TVC) declined 14% net of fees, while the Russell 2000 Value Index and the S&P 500 fell 8% and 4%, respectively. April extended the selloff. Former market darlings – long immune to valuation concerns – finally cracked. The "Magnificent Seven" are now down nearly 25% year-to-date, underscoring how quickly sentiment can shift when valuations are stretched.

TVC returns are highlighted below, alongside benchmark results, with periods greater than one year annualized:

Periods ending 3/31/25	*TVC (Gross of fees)*	*TVC (Net of fees)*	*Russell 2000 Value*	*S&P 500*
YTD	-14.17	-14.39	-7.74	-4.27
1 year	-23.39	-24.15	-3.12	8.25
3 years	-2.99	-3.94	0.05	9.06
5 years	20.10	18.91	15.31	18.59
10 years	5.34	4.29	6.07	12.50
20 years	7.32	6.25	6.80	10.23
30 Years	11.08	9.98	9.24	10.42
Inception (1/1/82)	14.06	12.93	10.93	11.92

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

The Case for Optimism

In our letter from the fourth quarter of 2008, we wrote that capitalism "runs on confidence, trust, and sensible financial management." Today, our country faces a deficit in all three. Yet markets don't always need good news to recover – just fewer negative surprises. We believe our portfolio started discounting the current economic slowdown over a year ago. If conditions stabilize, even modestly, we believe it stands to benefit meaningfully. While the headlines remain bleak, several developments lay the groundwork for a more constructive small-cap market:

- **Excesses Are Being Flushed:** Recent historic volatility has unwound many speculative excesses and reset expectations, often marking the start to a bottoming process. As mega-cap tech faces pressure, investor focus is shifting toward undervalued, domestic small caps.

- **Private Sector Strength Endures:** Consumers and businesses remain on solid footing. Low debt and high liquidity indicate underlying resilience. The banking system is well capitalized. AI-driven efficiencies are also starting to take hold, bolstering productivity and growth.

- **Sentiment Is Washed Out:** Pessimism is extreme. The University of Michigan's Consumer Sentiment reading sits in the 1st percentile – lower than the fall of 2008. Bank of America's Fund Manager Survey shows the weakest professional sentiment in over 30 years, while March's Economic Policy Uncertainty Index spiked to the 99th percentile. As Warren Buffet reminds us, fear can create opportunity for those prepared to act.

- **Small Cap Safe Haven:** As trade tensions rise and the dollar weakens, foreign investors are pulling back from U.S. assets – primarily large-caps and Treasuries, where their exposure is most concentrated. Small-cap stocks, with minimal foreign ownership and a domestic revenue base, may prove to be a relative safe haven in the face of these outflows.

Tariffs, Turmoil, and a Path Forward

Coming out of the 2024 election, we expected markets to rally as uncertainty gave way to renewed investor confidence. **Instead, clarity has only diminished, driven by escalating trade tensions and rising recession risks.** The inconsistent implementation of trade policy – captured aptly in Scott Bessent's comment that "everything is on the negotiating table" – has added to the confusion. Markets appear to be grappling with peak uncertainty.

It would be irresponsible to write an investor letter in April of 2025 without addressing tariffs. **At a high level, we understand the objectives: encouraging domestic manufacturing, securing fairer trade terms, and addressing fiscal imbalances. But the implementation has raised serious concerns.**

To borrow a popular metaphor, this policy rollout resembles a costly own goal. In the short term, it has eroded global trust, weakened U.S. corporate profits, cornered the Fed, and set back export prospects. Contrary to political rhetoric, it is American consumers and businesses – not foreign exporters – who will pay the higher tariff revenues to Washington. Early signs point to an international shift away from purchasing American goods and services. The Fed is also in a difficult position: tariffs are likely to slow growth, which would typically call for lower rates, while simultaneously driving prices higher, which would normally prompt rate hikes. Fiscal policy, in effect, has left monetary policy trapped between competing imperatives.

We cannot predict whether these tariffs will become a permanent fixture or merely serve as an opening gambit in negotiations. **But the stakes are high, and we believe a reversal or compromise remains likely.** In the meantime, we must prepare for the possibility of extended disruption.

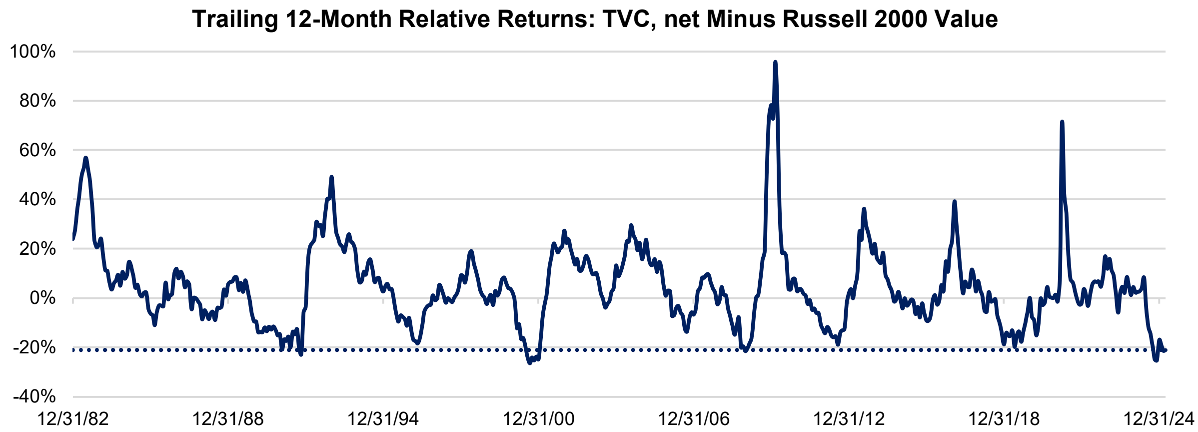
The good news is that beneath the volatility, conditions are starting to improve. Several of the forces that drove the downturn – tight financial conditions, stretched valuations, and excess speculation – have eased. Market leadership is broadening, sector performance is becoming more balanced, and investors are returning to fundamentals. Economically, key pressures are also softening: falling asset prices, lower bond yields, and declines in energy and commodity costs all point to moderating inflation. CPI and PPI have surprised to the downside, and liquidity remains supportive. These shifts offer early signs that the foundation for a recovery is being laid – supporting our case for optimism.

Quarterly Portfolio Review

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

From Drawdown to Recovery: Trusting the Process

Towle Value (TVC) is in a period of significant underperformance, but history has shown that such phases are often followed by strong recoveries, both in absolute terms and relative to benchmarks. **The trailing performance chart below illustrates how past drawdowns in TVC, relative to the Russell 2000 Value, have frequently marked significant turning points.** This pattern reinforces our confidence in the long-term potential of our strategy.



On a trailing 12-month basis, calculated monthly, TVC net of fees has underperformed the Russell 2000 Value by more than 20% in only four periods across our 43-year history: 1991, when we were early buyers of distressed S&L banks; 2000, when technology stocks dominated the market; 2008-2009, during the Great Financial Crisis triggered by the housing bubble; and in the fall of 2024 through today. We are now five months removed from the initial 20% differential observed at the end of October 2024. Here are the three other month-ends that came five months after TVC first lagged the Russell 2000 Value by 20% or more, along with absolute and relative forward returns[1]:

	TTM Returns			TVC, net Forward Cumulative Return (Absolute)			TVC, net Forward Cumulative Return (Minus R2kV)		
As of Date	TVC, net	R2kV	Delta	1y	3y	5y	1y	3y	5y
06/30/91	-12%	2%	-14%	50%	176%	227%	29%	106%	92%
12/31/00	-2%	23%	-25%	41%	128%	239%	27%	80%	150%
03/31/09	-55%	-39%	-16%	140%	153%	328%	75%	56%	142%
03/31/25	-24%	-3%	-21%	?	?	?	?	?	?
Median	**-18%**	**-1%**	**-18%**	**50%**	**153%**	**239%**	**29%**	**80%**	**142%**
Average	**-23%**	**-4%**	**-19%**	**77%**	**152%**	**265%**	**44%**	**81%**	**128%**

Today's performance situation is both familiar and rare. The precedent is clear: forward returns from here have been very attractive. Abandoning our disciplined, process-driven strategy at this stage would likely be a critical misstep. Instead, this moment calls for resolve – remaining steadfast, trusting the process, and leaning on history as our guide.

What could go right? Recession risk has risen, but it remains far from certain. Tariffs may prove less damaging than feared and may be walked back entirely. And with gloomy sentiment it's possible that today's market will recover without overtly positive news. Expectations have reset meaningfully lower, and economically-sensitive equities have been discounting today's bad news for a year now.

Looking further ahead, elements of the current administration's agenda may ultimately support investment and economic growth in 2025 and beyond. Among them:

- Deregulatory momentum, including reductions to permit delays that stifle capital investment
- Incentives for foreign investment, domestic manufacturing, and re-shoring
- Policies aimed at promoting U.S. energy independence, potentially stimulating lower energy prices
- Renewed clarity around tax reform
- Pursuit of trade amendments that should advantage U.S. manufacturers

If even a portion of this agenda gains traction, it could create a constructive backdrop for business formation, capital investment, and job creation. The U.S. economy has demonstrated extraordinary resilience through cycles of inflation, labor shortages, geopolitical instability, and market dislocations. Such challenges have always been the catalyst for American progress. **We echo Warren Buffett's sentiment from 2010: "For 240 years, it's been a terrible mistake to bet against America, and now is no time to start."**

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[1] TTM TVC, net performance minus TTM Russell 2000 Value performance at 1/31/91, 7/31/00, 10/31/08, and 10/31/24 was -21%, -24%, -20%, and -25% respectively; dates shown in table are 5 months following these initial -20%+ trip points

Joel Prather joined us on February 18 as Trading & Operations Manager, bringing nearly a decade of investment operations experience from Paradice Investment Management, Brown Brothers Harriman, and Northern Trust. He will focus on trade execution, process improvements, and operational efficiencies. Joel's expertise and energy are already proving to be a strong addition to the team.

A little over a year ago, Wes Tibbetts signaled his desire to pursue a long-held goal of small business ownership. In March, he officially departed to start his journey as an owner operator with Christian Brothers Automotive. During his nearly 14 years at Towle & Co., Wes developed deep expertise in investment research and proved himself an exceptional analyst and skilled portfolio manager. He brought energy, thoughtfulness, and a strong sense of commitment to the team throughout his tenure. Thanks to Wes's early and thoughtful communication, we had ample time to ensure a smooth transition. Our systematic investment process is designed to operate independently of any one individual, and it continues to support our disciplined approach and decision-making framework without disruption. Wes remains a committed client and a believer in the opportunity ahead for value equities. We're deeply grateful for all Wes has given to the team and are cheering him on as he steps into this exciting new chapter.

Christopher D. Towle
James M. Shields, CFA
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