

AVENIR CORPORATION

INVESTMENT MANAGERS

January 2023

Dear Friends and Fellow Investors,

2022 was a rough year for the stock market, with the S&P 500 down over 18% and the NASDAQ down 33%. The principal driver of the sharp declines in asset prices was the Federal Reserve's unexpectedly aggressive interest rate increases throughout the year. Following an extraordinary period of pandemic-related stimulus, the Federal Reserve was late to recognize surging inflationary forces and thus had to switch gears abruptly mid-year to counter this threat to stability.

As we have discussed in prior letters, the ten-year treasury is effectively the base rate on which asset prices are set. The rise in the ten-year rate from around 1.78% in January to a peak of 4.21% in October adversely affected all asset classes, from stocks and bonds to housing. Speculative assets saw the sharpest declines while businesses with decent current earnings profiles performed relatively better. Currently, the ten year yield is around 3.48%, roughly double that of a year ago. While valuations have come down significantly, stocks in general are not inexpensive at this time, though distress creates pockets of inefficiencies. Further, the Federal Reserve has signaled resolve in continuing its fight against inflation, implying that rates may move higher. It is unpleasant medicine, but, frankly, necessary to combat inflationary forces of unknown duration.

While the U.S. economy has held up well thus far, with low unemployment and continued wage gains, some sectors, notably commercial real estate and housing, are under pressure. Moreover, continued angst about inflation, the war in Ukraine and other geopolitical issues, make the global outlook as unpredictable as ever. Businesses are adjusting to the more uncertain outlook by cutting costs and managing for leaner times.

Though the winds have shifted, our approach remains the same: invest in great businesses with secular tailwinds and excellent management teams with demonstrated superior capital allocation skills. As discussed in some of our recent letters, we have been wary of the easy money policies of the Federal Reserve which clearly led to excesses in many corners of the market, as well as in the broader economy. In a higher rate environment, high quality businesses with secular tailwinds should continue to perform well regardless of the Federal Reserve's actions.

Portfolio Review

Amidst the uncertain economic outlook, our largest holdings, American Tower and Microsoft, continue to perform well operationally, though the share prices of each business declined roughly in line with the market. The build out of 5G networks both domestically and abroad remains the primary driver for American Tower. Similarly, the continued movement to the cloud is propelling Microsoft's enterprise software business. In both cases, we think excellent secular growth trends will lead to continued long term compounding for years.

A few of our holdings encountered challenges in 2022, and the two most significant detractors for the year were Amazon and Digital Bridge. Amazon's principal businesses grew tremendously during the first two years of the pandemic, with AWS up 34% and Amazon.com up 23% annually. This enormous growth

in turn necessitated a doubling of the size of its fulfillment network that had been built over 25 years in just 24 months – an outstanding achievement under unprecedented circumstances. As the economy “re-opened” in early 2022 and consumers reverted to pre-pandemic behavior, Amazon’s higher cost structure stemming from its pandemic-related growth weighed on profits and cash flows, as well as the share price, as the year progressed. Amazon’s core online and cloud services franchises are still growing impressively, and the company continues to invest in new growth areas, most notably healthcare, but it will take a few quarters for the businesses to absorb the excess capacity which will ultimately result in improved profit margins and cash generation. We think the shares are now attractive and view recent prices as an opportunity to buy a truly terrific franchise on sale and have added to positions.

Digital Bridge, which is in the final stages of transitioning to an asset manager focused on digital infrastructure, also started 2022 on a strong note, only to be upended by rising interest rates. Specifically, higher interest rates had a two-fold adverse impact on the valuation of the business, namely the assumed growth rate in the asset management business and a reassessment of the value of some of the company’s recent investments. Frankly, we think the market is correct to demand a higher discount rate in light of higher interest rates, but also believe the company’s long term growth prospects remain favorable given the demand for digital infrastructure across the world and management’s track record in this sector. Where appropriate, we conducted tax loss harvesting to lower our cost basis while maintaining our position in a business that has good long-term prospects.

Despite the broad market declines, several of our holdings performed well and contributed positively. Lockheed Martin led the way, benefitting from solid operational performance as well as a renewed focus on national defense. O’Reilly Automotive also posted another strong year and remains well positioned as the fundamental drivers of the secondary automotive parts business remain excellent. Our property and casualty investments in Markel and Berkshire Hathaway also performed well, with each generating positive returns for the year. Lastly, during the year we sold our position in Dollar Tree at a favorable price as the shares reached fair value, and we also exited our small starter position in Duck Creek Technologies.

Summary

The outlook for inflation and interest rates changed abruptly in 2022, and it will likely take several quarters for the full effects of higher interest rates to ripple through the economy. While no one can predict the future course of interest rates and inflation, one can invest intelligently in such a dynamic environment by focusing on great businesses with sustainable growth drivers. For over a decade the nominal cost of capital was extraordinarily low due to Federal Reserve policies designed to keep the economy afloat in the wake of the financial crisis. That “era of easy money” is over, the cost of capital has risen, and investors now have meaningful fixed income alternatives to equities. This environment suits us, and we look forward to finding interesting new opportunities for investment.

We are honored by your trust in Avenir. As always, if you have any questions or would like to discuss your portfolio in more detail, please call us. Meanwhile, we hope that you and your families are healthy and safe, and we wish you all the best in the year ahead.

Best regards,

Peter C. Keefe

James H. Rooney