REPRINTED FROM JANUARY 11, 2021

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Respecting the Disrespected: Embracing Out-of-Favor Stocks

PHIL GRODNICK founded Minneapolis Portfolio Management Group in 2004. Earlier, he was Senior Portfolio Strategist for Minneapolis Portfolio Management Group at Wachovia Securities and was a Senior Portfolio Management Director at Salomon Smith Barney. Previously, he managed equity and balanced portfolios at Dean Witter Reynolds, where he also was director of the institutional and retail municipal bond departments and assistant branch manager in Minneapolis, Minnesota. Mr. Grodnick oversaw portfolios at EF Hutton & Co., Bache Halsey Stuart and El DuPont & Co. In 1966, Mr. Grodnick was admitted as an Allied Member of the New York Stock Exchange with Loewi & Co., of which he was a principal. He began his career at Piper Jaffray & Hopwood. Mr. Grodnick is a graduate of the University of Minnesota and the New York Institute of Finance.

HARRISON GRODNICK, CFA, founded Minneapolis Portfolio Management Group in 2004. Earlier, he was Senior Portfolio Manager for Minneapolis Portfolio Management Group at Wachovia Securities. Previously, Mr. Grodnick was an Assistant Account Manager in the institutional trust department of Firstar Bank of Minnesota. Mr. Grodnick has been on the board of directors for several organizations in the Twin Cities, including the Minneapolis Jewish Community Center (JCC) and The Center of the American Experiment, a free-market think tank, which focuses on improving education, strengthening the economy, and reducing poverty and crime in Minnesota. He is also a member of the CFA Society of Minnesota. Mr. Grodnick is a graduate of the University of Wisconsin – Madison with a degree in international relations/global economics and political science.

ROB BRITTON, CFA, joined Minneapolis Portfolio Management Group in 2011. Earlier, he was a vice president with GLP, an international merchant bank whose minority investors are Goldman Sachs and Oaktree Capital Management. He worked in both London and New York City during his tenure with GLP, where he analyzed and sourced distressed debt and special situation opportunities on behalf of some of the world's premiere financial institutions. Before joining GLP, he was an investment banker at Citigroup and structured high-yield financings in support of leveraged buyouts. Mr. Britton received an MBA from Columbia Business School with a concentration in finance and economics. He also received a B.A. from the University of Wisconsin – Madison. He is a member of the CFA Society of Minnesota.

SECTOR — GENERAL INVESTING

TWST: Could you provide an overview of the firm?

Mr. Harrison Grodnick: I'd be happy to. Minneapolis Portfolio Management Group is a value-based money management firm that has been managing money for individuals, institutions, foundations, and municipalities for over 25 years. During that period, we have utilized the same value-based philosophy, which is built around the concept of price is everything. We believe that any business can be a lousy investment if you pay too much for it. And on the contrary, there could be wonderful opportunities in things less covered and sometimes misunderstood, if you pay the right price for them. So we are a value-based money management firm with over $1 billion in assets under management and have a 25-year Global Investment Performance Standards — GIPS — compliance track record, which we're pretty proud of.

TWST: Why, especially now, might value-based investing be a smart idea for investors as we look to 2021?

Mr. Phil Grodnick: Because, by and large, it's been a peculiar market the last 10 years as the value has been ignored. You are now able to buy assets for much cheaper prices. You're getting earnings without paying up for them. And you're getting very good companies with good balance sheets that have been somewhat disrespected in the marketplace.

Mr. Harrison Grodnick: It's important to appreciate that creating wealth over the long term is as much about avoiding large losses as it is achieving large gains. And throughout the history of our markets, there have always been periods of time when going with what's popular — being part of the herd — has been fun on the way up. But in each of those moments, the pain has been immense once the music stopped playing, and everyone was fighting to find a chair.

This latest decade of popular investing, where you have a handful of companies dominating the S&P 500, has been wonderful for those who have been along with the herd. It makes you feel comfortable. But trees do not grow to the sky and valuations always have to have meaning. And value investing today is probably more important from a wealth preservation standpoint, given the risks that are associated with all of those popular names that are so heavily weighted in all of the popular indexes today.

The value-based names that have been unloved carry, as Phil mentioned, we believe have enormous potential going forward, but at the same time with substantially less risk. I just want to add that we are witnessing one of the wider valuation gaps in history between the value stocks and the growth stocks.

I don't think that value investing ever is really out of favor. It's the most classic style and proven style of investing throughout time. You're looking to buy good assets at a discounted price. That's always a good idea. And the fact that now, where you have the S&P selling at north of 21 or 22 times earnings, many value stocks are selling much, much, much lower. I believe the Russell 2000 value index is at around 15 times. So while we're individual stock pickers, and talking about market and index multiples isn't how we think about investing, it's a good barometer to show that there is tremendous opportunity in the many ignored value-style names that are out there.

Mr. Phil Grodnick: There's a lot of similarity which is going on now — and the Nifty Fifty that took place in the 1960s and 1970s. The Nifty Fifty's popularity lasted for about 10 years. Everyone accepted that's where you had to be. And I'll never forget, I was a young broker then and struggling to build a client base. And the largest trust department in the United States had an interview after 1974's decline of the Nifty Fifty and indicated they lost 50% of the asset value of the trust accounts they managed. And in response to the question, "what happened?", they said, "we're reevaluating our investment philosophy."

Highlights

Phil Grodnick, Harrison Grodnick and Rob Britton discuss adhering to a value-based approach in today's market. They say the popularity of growth stocks has created opportunities to buy overlooked companies with good balance sheets at a discounted price and with substantially less risk. They caution that despite the challenges associated with COVID, investors should remain patient and not try to time the market. They note the possibility of a rotation between growth stocks and value stocks, which would cause deep loses for those invested in just a handful of popular companies. They cite electric vehicles as an area poised for growth, foreseeing an evolution from 2% of electric vehicles on the road today to perhaps 13% in the next decade and over 90% by 2050.

Companies discussed: Microsoft Corporation (NASDAQ:MSFT); Tesla (NASDAQ:TSLA); Orion Engineered Carbons SA (NYSE:OEC); General Motors Company (NYSE:GM); BorgWarner (NYSE:BWA); Corning (NYSE:GLW); Facebook (NASDAQ:FB); Amazon.com (NASDAQ:AMZN); Netflix (NASDAQ:NFLX); Alphabet (NASDAQ:GOOG) and Walt Disney Co. (NYSE:DIS).

TWST: Did you want to talk about the All Cap Value Composite portfolio?

Mr. Britton: We have nearly a 26-year track record, and we claim compliance with GIPS. What I think is relevant to what Harrison was talking about are a couple things. Number one, over that time period, we've never had two consecutive down years. Number two, the longest it's ever taken for our clients to recover from a year-over-year loss was a little less than two years. And that was after the great financial crisis and market correction of 2008. We actually dried off a lot faster. We dried off faster than the S&P 500 did for people who got S&P 500 market-like returns.

And since our inception, we have averaged net of fees above 11% a year. And that's across different interest rate cycles, market corrections, and an extended period of value being incredibly unpopular. For the past 10 years, we have continued to create meaningful wealth for our clients over this time period.

TWST: Are there certain sectors within the strategy that you tend to favor or some individual stocks you wanted to highlight?

Mr. Phil Grodnick: We never look at sectors. We try to look at promising companies that make sense. Unlike Wall Street today, we don't look at sectors for our selection process. We try to find great businesses that are interesting and are available at what we think are outstanding prices.

Mr. Harrison Grodnick: First, I think it's important that my dad mentioned earlier the period of time of the Nifty Fifty. And then of course, we had the late 1990s with the dot-coms. Avoiding large losses is very important to value investors. And, as Rob mentioned, we have never required more than two years to break even from a year-over-year loss in our portfolio.

But specifically, during the period of time between 2000 and 2010, which some claim to be the loss decade, the average investor not only lost a decade of their investing life, but they lost about 10% if they got S&P-like returns during that 10-year period, including some dramatic declines. The Nasdaq was down 78% from peak to trough. During that same 10-year period, we're very proud of the fact that our clients were up about 9% per year, during that same loss decade, if you will.

And it was because during the previous decade when the excesses and the popularity were running rampant, we did not subscribe to overpaying for the popularity. Instead, we bought old-school brick-and-mortar companies that were trading at deep discounts to their intrinsic value when the world was rushing towards dot-coms.

Today, our portfolio is similarly structured. You look at businesses that are wonderful businesses — companies like **Microsoft**

(NASDAQ:MSFT), which is a wonderful business, but trades at 11 times sales, an incredibly high multiple. We're big believers in the future. And one of the big misperceptions of value managers is that they're always investing in buggy whip manufacturers or typewriter companies. But that couldn't be further from the truth.

We are big believers in the future of electric vehicles, for example. We believe that the world will continue to evolve from 2% of electric vehicles on the road today to probably 13%, perhaps, in the next decade, and well over 90% by 2050. The question is, as investors, how do we want to benefit from that? And so, you look at the popular indices and **Tesla** (NASDAQ:TSLA) was just recently added after its historic rise to the S&P 500. I believe **Tesla** trades at about 1,000 times earnings. But I believe **Tesla** probably trades at 22 times sales.

"What's interesting about tires is that it's an interesting way to play the growth of electric vehicles, because there are two things electric vehicles have, compared to the internal combustion engine car. One is that they're heavier because of the batteries. Two, they have tremendously more torque."

1-Year Daily Chart of Orion Engineered Carbons SA

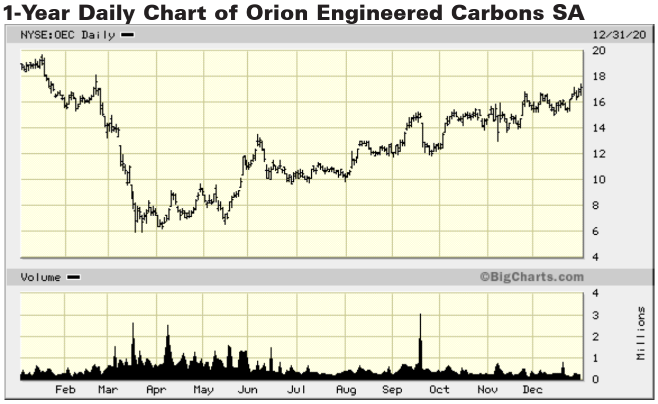

Chart provided by www.BigCharts.com

We ask any business owner in America, if someone knocked on the door and offered 22 times sales, how long it would take him to sell their business. It'd be pretty quick. In our portfolio, you won't find companies like **Tesla** or **Microsoft**.

Instead, you'll find companies like **Orion Engineered Carbons** (NYSE:OEC). This is a wonderful maker of carbon black. Carbon black is a material that is used to — among other things — make tires. Some 70% of it is used to make tires. So, the rubber taken out of a tree is non-shapeable, it doesn't hold its form very well, especially against water and the climate and the sun. But it takes carbon black added to the rubber to make it essentially a tire.

What's interesting about tires is that it's an interesting way to play the growth of electric vehicles, because there are two things electric vehicles have, compared to the internal combustion engine car. One is that they're heavier because of the batteries. Two, they have tremendously more torque. These things result in tires being used up about 30% faster on electric vehicles than a regular internal combustion car.

We buy companies like **Orion Engineered**, which we believe will benefit from this transition to electric vehicles. But instead of paying 22 times sales, or 1,000 times earnings, **Orion Engineered** is trading at less than 1 times sales, and is trading at 10 times earnings. And as a company that has been all but forgotten about by the general market during its time of mega cap U.S.-centric tech domination that's on everyone's lips these days. So those are the types of businesses you'll find in our portfolio.

Mr. Britton: There's also been insider buying by executives at **Orion Engineered**, which we find to be supportive of the thesis.

Mr. Phil Grodnick: And I think you might want to suggest that it's possible that in electric vehicles you may hear the name of **GM** (NYSE:GM) often. Our understanding is that their technology is superior in electric vehicles and batteries, etc. And we have taken a position at a significantly lower price. I think **GM** may be a potential someone to be reckoned with in that area.

TWST: So the electrical vehicle market could be one of their strengths in coming years?

Mr. Harrison Grodnick: No question. In our portfolio over the past 26 years, we tend to have businesses that are out of favor. As my dad would put it, they have warts, they've disappointed Wall Street, and therefore they're cheap. But they have good balance sheets, which means they have time to fix problems that made them cheap.

1-Year Daily Chart of General Motors Company

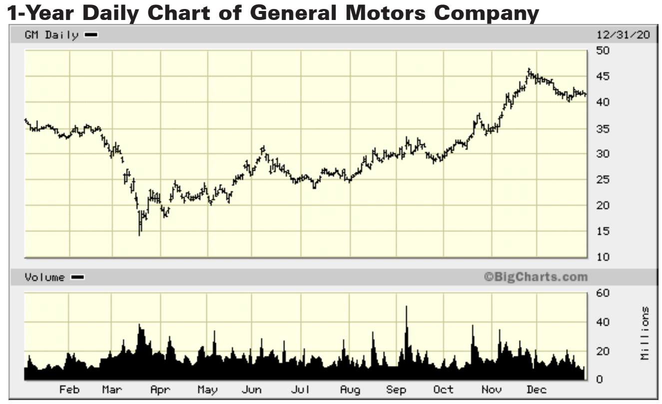

Chart provided by www.BigCharts.com

So we're value investors. But throughout the 26 years, we also have these big macroeconomic themes that we want to use to benefit our clients. And these themes are things that we observe in the world. Then, we want to position our portfolio because over the next five or 10 years, we think these themes are going to be powerful. And the electric vehicle theme is something that's echoed in our portfolio through **GM**, which, as my dad mentioned, has wonderful, not only electric vehicle technology, but also battery technology that is slowly coming to the forefront.

This is a company that was trading, I believe, six times earnings earlier in the year. And many people were thinking that the electric vehicle component of their business might be worth anywhere between $20 billion and $100 billion. Well, this was back when the stock had a market cap of $40 billion. You can imagine how undervalued it was back then. But you will also see that that theme of electric vehicles played out in our portfolio through positions like **BorgWarner** (NYSE:BWA), as well as the contributions in **Corning** (NYSE:GLW), just to name a few.

1-Year Daily Chart of BorgWarner Inc.

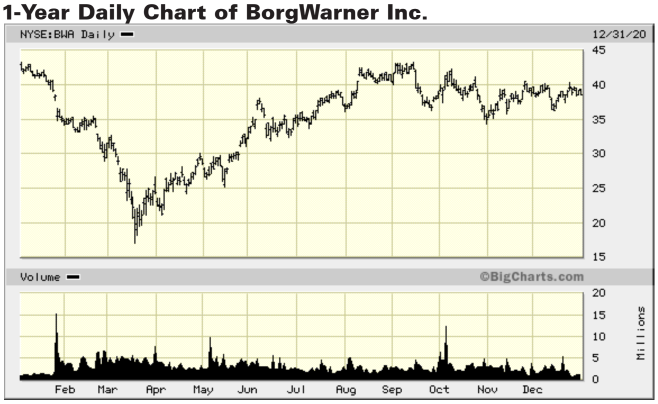

Chart provided by www.BigCharts.com

create this misperception that investing is about being in the market, being out of the market. And long-term successful investing couldn't be further from the truth.

It's important to navigate this market given COVID and the opportunities and challenges that it's presenting. But investors should be navigating this market, not trying to time this market. It was just earlier this year — March and April — that gave you every negative news headline that would give you an excuse to run for the hills. You would have missed one of the greatest rallies in the last generation. So being invested is important. It's just a matter of what you're invested in along the way that is also important.

Mr. Britton: Just to follow up on those two points. Patience, we view as an essential component to being a successful investor. It's one of the key characteristics that distinguish investors from speculators in our opinion. Going back to, as Harrison was talking about, in the beginning of the year, we went from a bull market to a bear market in 20 days. That is the fastest correction in history. People who are trying to time this market likely were not able to reinvest their capital in an efficient way in time to be great beneficiaries of the recovery that we've seen so far.

And this is something we've seen throughout history. Because we're actually working on our newsletter right now, and we're doing some research on this subject. If you had stayed invested and gotten market-like returns as measured by the S&P 500 over 20 years from January 3 of 2000 through the end of last year, you would have had about a 6.1% return. Missing just the 10 best days in the market over that time period and you would have had less than 2.5% return. So the notion of people trying to time the market and seeking cash for comfort is not necessarily consistent with being a successful investor.

We are unapologetically stock pickers. We look for individual businesses that are deeply misunderstood. And we believe that we only

"We have a saying amongst ourselves: Weakness is your friend. So the future looks extremely promising. The year probably will have some exceptional growth economically, but there's going to be corrections as there are most every year. And we see about a 10% correction yearly."

TWST: If we look into the past year, obviously, we've had the COVID pandemic, we have a new president coming in January, and there are still struggles with the COVID issue. Did you want to offer advice for investors as to what they should do given these major trends in the country?

Mr. Phil Grodnick: We have a saying amongst ourselves: Weakness is your friend. So the future looks extremely promising. The year probably will have some exceptional growth economically, but there's going to be corrections as there are most every year. And we see about a 10% correction yearly. And into that weakness, we would recommend buying stocks that are attractively priced.

Mr. Harrison Grodnick: If I could just add to that, in the 1960s, the average holding period for U.S. investors was about six years per position. The average holding period for investors today is about six months. And that type of knee-jerk, reactionary trading does

invest when we see a real advantage that we think we have; where we think we see tremendous value in a good or a great business that is really misunderstood. And then we need to be patient. And that patience, I believe, has rewarded our clients very well.

Mr. Phil Grodnick: I'll add something a little, maybe, controversial. When the commission structure was attacked and reduced in 1975, over the years since then, the commission business has gotten less and less if you're specializing in equities. It's gotten to the point where it's almost impossible to make a living if you want to specialize your business just in equities unless you sell products. So as a result, there's been very few craftsmen committed to the marketplace. And if the investor can find someone who is still committed day and night to understand the language of the markets, understand the valuations of companies, he would be well served — much better than one who just tries to sell products and hasn't spent his life trying to understand the equity market.

TWST: Do you get the sense too that Millennials might start to invest more in the market?

Mr. Phil Grodnick: Evidently, a lot of the Millennials are already in, I guess. The firm **Robinhood** has attracted an enormous number of them. And I think it's good that they're more and more paying attention and investing in the marketplace. This is how they'll get their education. In this industry and in this stock business, pain is one of the great educators. And I think the Millennials will get their dose of pain. And with a great education that will make them great investors in the long run.

Mr. Harrison Grodnick: It appears to us that the younger investors who are jumping into the market these days are — we're all — products of our own experiences. But the last 10 years where you've had this rising tide lifting all boats in a very obvious market. By that we mean, invest in what's popular, invest in what's working, invest in what everyone else is investing in. The more popular and obvious, the better. So, **Facebooks** (NASDAQ:FB), **Amazons** (NASDAQ:AMZN), **Netflixes** (NASDAQ:NFLX), **Googles** (NASDAQ:GOOG), **Teslas**. The last decade has rewarded being part of the herd. And the result, if you're a young investor, the past 10 years has pushed you towards that philosophy of investing, where going against the crowd isn't worth it. And so, as Phil mentioned, it's been a positive feedback cycle for the younger investors.

If you're a product of your own experiences in 2010, the last thing you would have wanted was market-like performance. You would have had less money after the end of that decade than the beginning of the decade. So the recent experience of the market has contributed towards younger investors really being pushed towards index, popularity, growth. And that will turn out to be costly.

Mr. Britton: The market is the best friend that most individuals will ever have. It is capable of creating tremendous wealth to the tune, I believe, of about over 7% a year for over the past 200 years, according to Professor Jeremy Siegel in his book *Stocks for the Long Run*. With interest rates as low as they are, young people aren't going to be able to save money and put it in a bank account and see any real material change to their wealth. And as they get older, they're going to realize that earning an income from a job is likely not enough, and that they're going to need to supplement their income with strong investments. And we believe that the stock market has always been — and certainly relative to where interest rates are — continues to be a tremendous opportunity for them to create wealth.

"With interest rates as low as they are, young people aren't going to be able to save money and put it in a bank account and see any real material change to their wealth. And as they get older, they're going to realize that earning an income from a job is likely not enough, and that they're going to need to supplement their income with strong investments."

The challenge a lot of people have — my two colleagues have already referenced — is that they can lack the experience in navigating bear markets and downturns, and they may not know how to properly use the stock market as a powerful tool. And that just isn't for Millennials; I think that's for many individuals. Investing in publicly listed equities remains, we believe, a tremendous wealth creator and opportunity for individuals to participate in the great innovation that's taking place in the world and the great capitalist system that this country is known for.

TWST: Looking forward, there's going to be a transfer of wealth from those who pass away and then estates are being given to their heirs. Do you think those heirs are ready to take on that wealth? And what do you think they're going to be doing with it?

Mr. Harrison Grodnick: To the part of your question: is the next generation ready for that massive wealth transfer that will take place? And I would respectfully suggest that they're as prepared as any generation before them. There will be a learning curve. Investing is not meant to be easy. As Rob correctly pointed out, the equity market is a wonderful asset to harness and can create meaningful differences in people's life. But it can also be a place that can punish those who blindly follow the herd. And so, I think that this generation is capable. And my guess is that, as Phil alluded to, there will be pain for those who blindly follow the herd and invest in the same six stocks, index fund investing, who don't pay attention to value, there will be pain. But I would suspect that this generation will probably learn faster than previous generations from that lesson.

TWST: For many people who are investing on their own, they're bombarded with business news channels on TV which produce information 24 hours a day. Has that been a detriment to some investors because they're constantly trying to respond to the latest news and they're going to adjust their portfolio based on what they might hear one day on a business news channel rather than going with the long term?

Mr. Phil Grodnick: I would concur.

Mr. Harrison Grodnick: Yes, we've said for a long time that the media's incredible abundance of information and media news channels, and the various programming, has not led to more successful investing. To the contrary, if you look at the statistics, the amount of information has become more and more abundant and investors are able to look on their phones or any device, not only to get information but to trade immediately. It has not led to better long-term results, but just more knee-jerk reactions. So, if you listen to a lot of these programs on TV, you might own the entire stock market one day, and you may sell the entire market the next day.

And the disservice of all of these media outlets that are really interested in getting more eyeballs than creating wealth and giving good advice is that it forces these younger investors, especially, to lose track of what is the most important part of the equation, which Rob mentioned earlier, which is patience.

Many great investments have had periods along the way where they have underperformed for a quarter or a year or maybe two years. I mean, imagine, if everyone who owned wonderful businesses like **Disney Corporation** (NYSE:DIS), with every time the stock underperformed for a given year, they just got out over the past 20 and 30 years. How much would they have missed?

These financial news networks look at bad quarters or bad years and they're quick to call it the end of days for that business where sometimes patience is the most important component to long-term wealth creation. And it does get taken away from the younger investors specifically. But I think the more you watch these financial news networks, the more you lose it as well.

Mr. Phil Grodnick: I think the last 10 years, from my viewpoint, fundamental analysis has been somewhat put in the back, not in the forefront, of most people's thinking, and been replaced by momentum. And if you listen to the talking heads on the stations, it's always momentum, momentum. Very rarely do they ever discuss the valuation of a company; what you're paying for it versus its balance sheet, etc. So, to answer your question, I do think there's been something amiss. And I think in time, you will see the correction take place where momentum isn't the proper vehicle to focus on, but the balance sheet and what the company is earning.

Mr. Harrison Grodnick: I agree. The point of emphasis, at least from my perspective, is that the business news networks focus on the market a lot, almost exclusively, and that's important. But we focus on companies. We are a research-driven firm, and we love researching individual companies and understanding their valuations and where they are mispriced. And the business news networks tend to focus on broad markets and far, far less on individual companies.

TWST: Anything we haven't talked about you care to bring up?

Mr. Harrison Grodnick: Well, there is this perceived and long overdue rotation that people are starting to observe between the popular stock — the growth stocks — and the value stocks over the past three or four months now. Our portfolio has been a beneficiary of individual stock picking, as well as this rotation taking place under the surface. And if that's the case — after probably the longest period in post-war history where growth has outperformed value — if the rotation is beginning to take place, we don't believe that it will be a short or subtle rotation. Rather, we believe that it will be powerful given the tide that came before it. And the blind and incredible acceptance of these few businesses at any price could be very painful for those investors on the way out. And as investors, but business owners, we firmly believe in avoiding those popularities and avoiding the risk associated with that. And we do so for the benefit of our clients.

TWST: Thank you. (ES)

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