SMEAD FUNDS

# Shareholder Letter

SMEAD VALUE FUND — 2ND QUARTER 2023 (6/30/2023)

## Dear Shareholder

| A SHARE CLASS | INVESTOR SHARE CLASS | C SHARE CLASS | I1 SHARE CLASS | Y SHARE CLASS |
|---|---|---|---|---|
| SVFAX | SMVLX | SVFCX | SVFFX | SVFYX |

### There may be hills and valleys but the long-term bear market trend is intact.

We often love to quote Warren Buffett in our pieces, but it seems apropos to quote his mentor, Ben Graham, to describe our second quarter performance. “In the short run, the market is a voting machine. But in the long run, it’s a weighing machine.” We believe our relative underperformance to our benchmarks for the second quarter of 2023 can be attributed to the market voting machine and its desperate hope that the previous game of musical chairs can continue to be played ad infinitum. As we enter the second half of the year, the weighing machine is again reasserting itself.

For the second quarter 2023, the Smead Value Fund returned 3.18% versus a gain of 8.74% for the S&P 500 and a gain of 4.07% in the Russell 1000 Value. Our best-performing stocks in the quarter were D.R. Horton (DHI), Lennar (LEN), and Credit Acceptance (CACC). Our home builders were a bright spot for us in the first half of the year.

Our biggest detractors were Target (TGT), Warner Brothers (WBD), and Pfizer (PFE). Target was our worst performer in the quarter, primarily driven by customers and public reaction to in-store promotions for the month of June. We believe management has listened to its core customers, made the necessary changes, and avoided structural damage to the brand.

As our regular readers know, we run our portfolio to maximize long-term returns in a concentrated list of stocks. Nothing that happened in this year’s second quarter appears to be any interruption of what we believe our future success and risk avoidance will be.

**PERFORMANCE** — Average Annualized Total Returns as of June 30, 2023

| | One Month | QTR | YTD | One Year | Three Year | Five Year | Ten Year | Fifteen Year | Since Inception (1/2/2008) |
|---|---|---|---|---|---|---|---|---|---|
| **SVFAX** A Share Class (w/ load) | 1.79% | -2.76% | -2.78% | 8.54% | 18.25% | 10.89% | 10.98% | 11.13% | 8.98% |
| **SVFAX** A Share Class (w/o load) | 8.00% | 3.17% | 3.16% | 15.18% | 20.61% | 12.21% | 11.64% | 11.57% | 9.40% |
| **SMVLX** Investor Class | 7.99% | 3.18% | 3.16% | 15.17% | 20.61% | 12.22% | 11.64% | 11.66% | 9.50% |
| **SVFCX** C Share Class | 6.94% | 2.03% | 1.87% | 14.51% | 19.93% | 11.89% | 11.48% | 11.56% | 9.40% |
| **SVFFX** I1 Share Class | 8.02% | 3.25% | 3.30% | 15.47% | 20.93% | 12.50% | 11.94% | 11.92% | 9.74% |
| **SVFYX** Y Share Class | 8.03% | 3.30% | 3.40% | 15.59% | 21.06% | 12.64% | 12.05% | 11.93% | 9.76% |
| **RUSSELL 1000 VALUE** | 6.64% | 4.07% | 5.12% | 11.54% | 14.30% | 8.11% | 9.22% | 8.36% | 7.17% |
| **S&P 500 TR INDEX** | 6.61% | 8.74% | 16.89% | 19.59% | 14.60% | 12.31% | 12.86% | 10.88% | 9.71% |

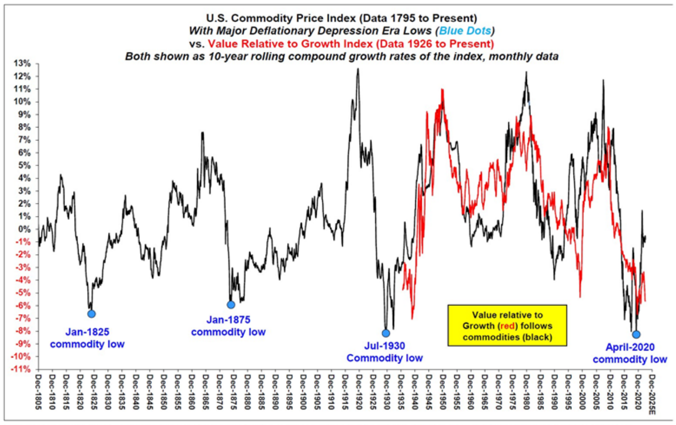
*A Shares Gross Expense Ratio 1.25%   C Shares Gross Expense Ratio 1.84%   I1 Shares Gross Expense Ratio 0.98%   Y Shares Gross Expense Ratio 0.83% Investor Gross Expense Ratio 1.25%*

*Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling **877-807-4122**. Performance for SVFAX (w/load) reflects maximum sales charge of 5.75%. Performance for SVFAX (w/o load) does not reflect maximum sales charge of 5.75%. If reflected, the load would reduce the performance amount quoted. SVFAX imposes a 1.00% deferred sales charge on purchases of $1,000,000 or more that are redeemed within 18 months of purchases. Performance data does not reflect the deferred sales charge. If it had, returns would be reduced.*

*Investor Class shares of the Fund commenced operations on January 2, 2008. I1 Class shares of the Fund commenced operations on December 18, 2009. Performance shown for I1 Class shares prior to its inception reflects the performance of Investor Class shares. Class A shares of the Fund commenced operations on January 24, 2014. Performance shown for Class A shares prior to its inception reflects the performance of Investor Class shares, adjusted to reflect Class A expenses.*

*Smead Capital Management, Inc., The Advisor, has agreed to waive its fees and/or absorb expenses of the Fund to ensure that Total Annual Operating Expenses do not exceed 1.26% for Class A shares, 1.26% for Investor Class shares, 1.84% for Class C shares, 0.99% for Class I1 shares and 0.84% for Class Y shares respectively, through March 31, 2024. This operating expense limitation agreement can be terminated only by, or with the consent of, the Board of Trustees. See the prospectus for additional details.*

# Stock Market Symmetry




Source: U.S. Census Bureau - Historical Statistics of the United States (1795 to 1904), U.S. Federal Reserve Economic Data - Industrial Commodity Prices (1904 to 1956), Bloomberg commodity price data (1956 to 1994) and (1994+). Value vs. Growth is the Ken French (Data) from 1926-77 and Bloomberg Growth and Value Total Return Indices (Russell 1000 large capitalization) 1978-present, Stifel estimates.

## Stock Market Symmetry

In Warren Buffett's 1999 Allen and Co. talk in Sun Valley, Idaho, he argued that the stock market has historically had what he called a "Biblical kind of symmetry!" As we come to the end of the stock market's second quarter of 2023, we will ask the following question: Is the U.S. stock market bumping up against natural and historical limits? Here is how he saw things back then:

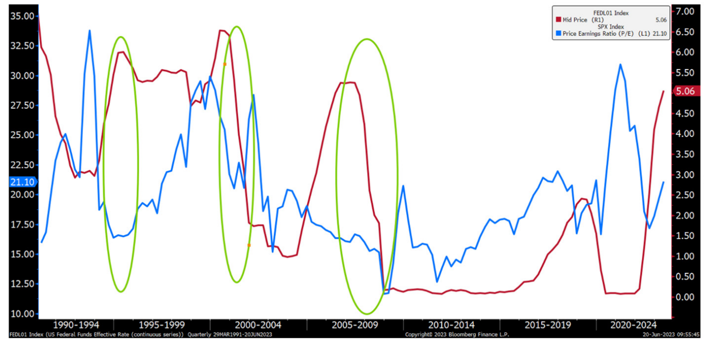
> *"Now, to get some historical perspective, let's look back at the 34 years before this one--and here we are going to see an almost Biblical kind of symmetry, in the sense of lean years and fat years--to observe what happened in the stock market." November 22, 1999 (FORTUNE)*

Buffett argued that the two factors that were the most important in the poor performance of stocks from 1964-1981 were the rise in interest rates to 14% and the decline in corporate profits as a percentage of GDP to 3.5% (the low end of the historical range). He then argued that the success of stocks from 1981 to 1998 was closely tied to the decline in interest rates from around 14.0% to 5.4% and the corporate profit margin rising to approximately 6.0% (Buffett considered this to be at the high end of the range).

We will make the case that a wide variety of parameters make Buffett's 1999 argument even better in the middle of 2023.

**Interest Rates**

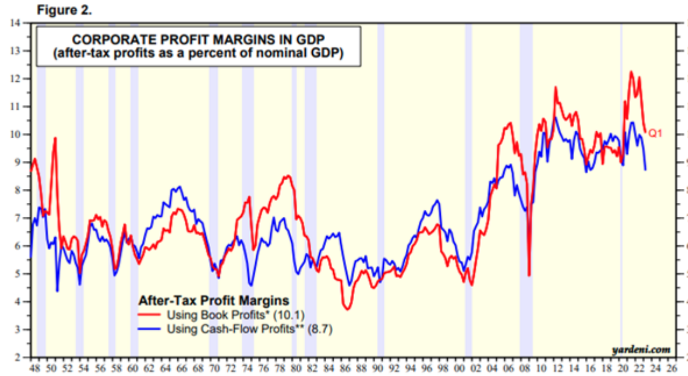
Interest rates on Fed funds have moved from near-zero in late 2021 to 5.25% faster than at any time in U.S. history and the Fed Chairman is indicating additional rate increases. The chart below shows the price-to-earnings (P/E) ratio of the S&P 500 Index at prior rates of near-5% in the green ovals ranging between 12 to 17 times earnings. Today's market trades at 21 times earnings.




Source: Bloomberg. Data for the time period 3/20/1991-6/20/2023.

**Corporate Profits as a Percentage of GDP**

Figure 2.



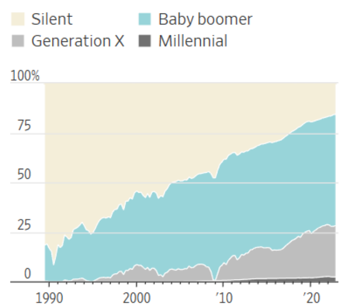

* Tax-accounting basis as reported to IRS.
** Book profits including Inventory Valuation Adjustment (IVA) and Capital Consumption Adjustment (CCAdj), which restate the historical cost basis used in profits tax accounting for inventory withdrawals and depreciation to the current cost measures used in GDP.
Note: Shaded areas are recessions according to the National Bureau of Economic Research.
Source: Bureau of Economic Analysis.

Source: Yardeni.com. Data for the time period 1/1/1948 – 3/31/2023.

As interest rates moved lower and labor lost its bargaining power, corporate profits benefitted immensely.

**Ownership**

Corporate equities and mutual-fund shares, by generation




Note: Generations are defined by birth year as follows: silent and earlier (before 1946), baby boomer (1946–1964), generation X (1965–1980) and millennial (1981 or later).
Source: Federal Reserve

Source: Federal Reserve. Data for the time period 1/1/1990 – 3/31/2023.

# Stock Market Symmetry

In a recent *The Wall Street Journal* article titled, "Boomers Got Hooked on Stocks. Now They Can't Let Go," the writers pointed out that nearly two-thirds of U.S. adults aged 65 and older have money in stocks. In other words, at the time of life when Americans normally seek income and safety, they are keeping the pedal on the metal and are relying on capital gains to give them money to live on. This has kept equity ownership at Dotcom Bubble Era levels!

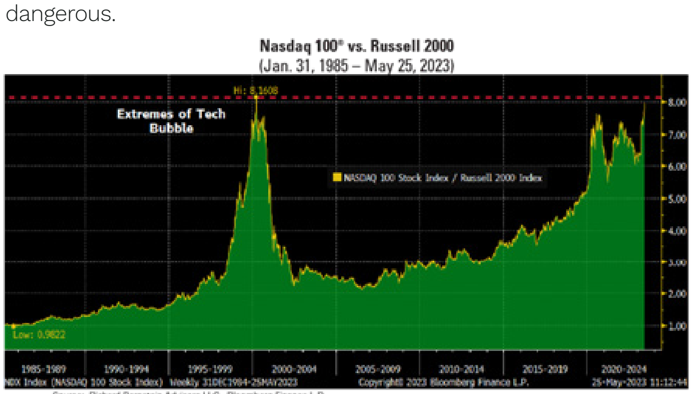

Source: Federal Reserve, Bloomberg. Data for the time period 1/1/1952 – 6/30/2022.

The WSJ writers continued:

> *"Many baby boomers began investing during a period of stock-market success in the 1980s. They have witnessed market crashes—from Black Monday in 1987, to the bursting of the dot-com bubble, to the 2008 financial crisis, to the onset of the Covid pandemic—and have seen stocks recover and climb higher again and again.*
>
> *Individuals who have experienced high stock-market returns over the course of their life report higher financial-risk tolerance and are more likely to invest in the stock market and allocate a greater share of their portfolio to equities, according to research by finance professors Ulrike Maeander and Stefan Nagel."*

### Speculation

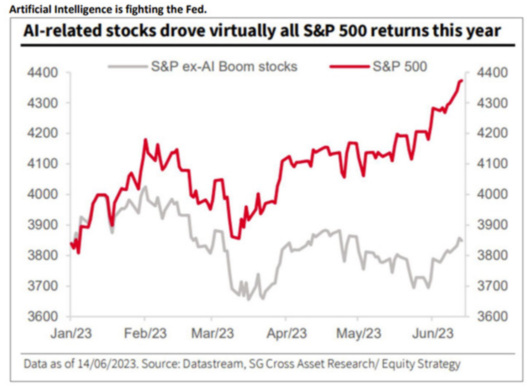
Numerous charts prove that speculation is historically high and dangerous.



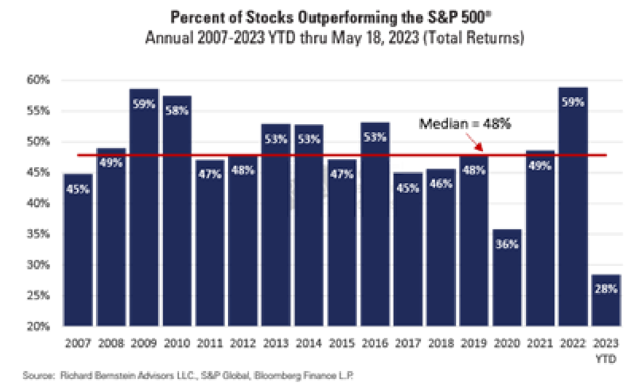

Source: Richard Bernstein Advisors, Bloomberg. Data for the time period 1/1/1985 – 5/25/2023.

Charlie Munger said in late 2021 that this is the biggest financial euphoria episode of his career (75 years) "because of the totality of it." Look how long we have maintained the dot-com bubble level of euphoria in the last five years!

This has resulted in the narrowest stock market of our 43 years in the investment business.

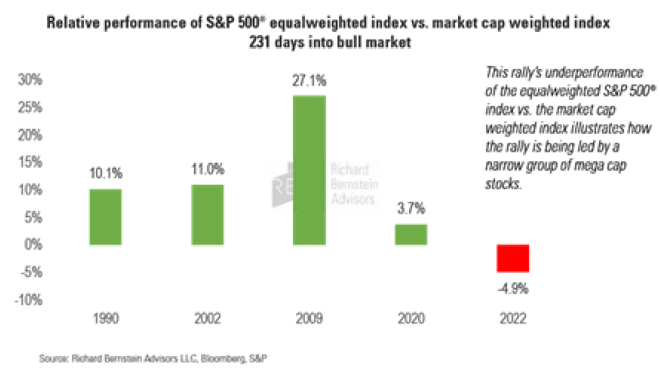



Source: Datastream, SG Cross. Data as of 6/14/2023.




Source: Richard Bernstein Advisors, Bloomberg. Data for the time period 1/1/2007 – 5/18/2023.

Which evidenced itself in the wildest outperformance by mega-cap stocks relative to equally weighted indexes in 16 years:

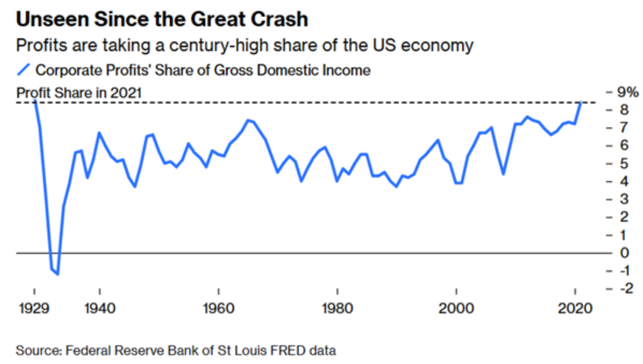



Source: Richard Bernstein Advisors, Bloomberg. Data for the time period 1/1/1990 – 12/31/2022.

### Labor and Real Assets

The combination of advances in technology, declining interest rates, reduced labor bargaining power and a bear market in commodity prices has caused corporate profits share of gross domestic income to hit record levels:

# Stock Market Symmetry



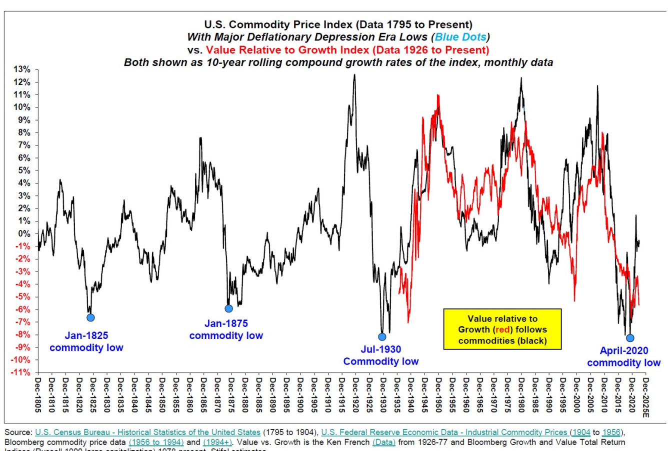

Source: Federal Reserve Bank of St. Louis FRED data. Data for the time period 1/1/1929 – 12/31/2021.

Let's pull this all together. How do you make money in the stock market if the positive forces from 1981 to today disappear? First, interest rates on six-month T bills remain at a higher level than in the past 20 years.

Source: Bloomberg. Data for the time period 203 – 6/22/2023.

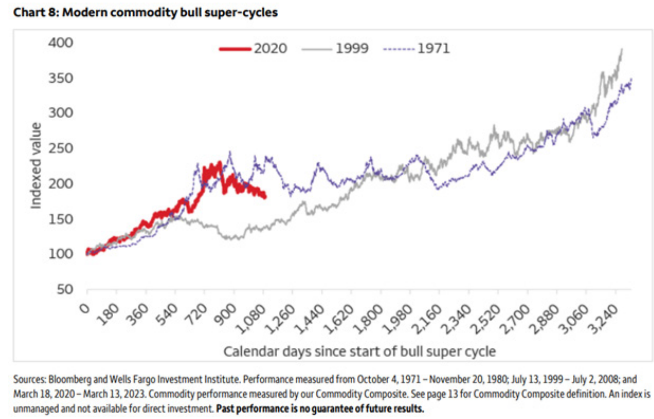
This fact automatically reduces corporate profits and lowers the bar for P/E ratios.

Second, commodities outperform most other asset classes:



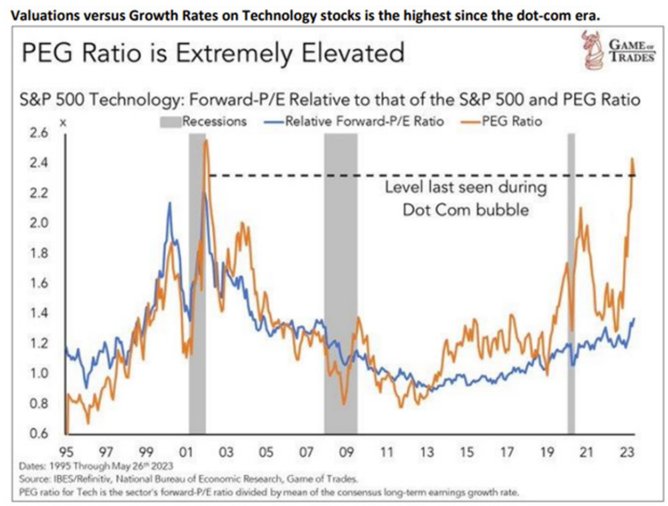

Source: Stifel. Data for the time period 1/1/1805 – 6/30/2023.

We are coming off the cheapest commodity indexes have been relative to stock prices in 220 years of data. The first move was very positive and matched the last two commodity super-cycles:




Source: Bloomberg and Wells Fargo Institute. Data for the time period 10/4/1971 – 3/13/3023.

Thirdly, P/E ratios contract to more normalized levels and go at times well below average.

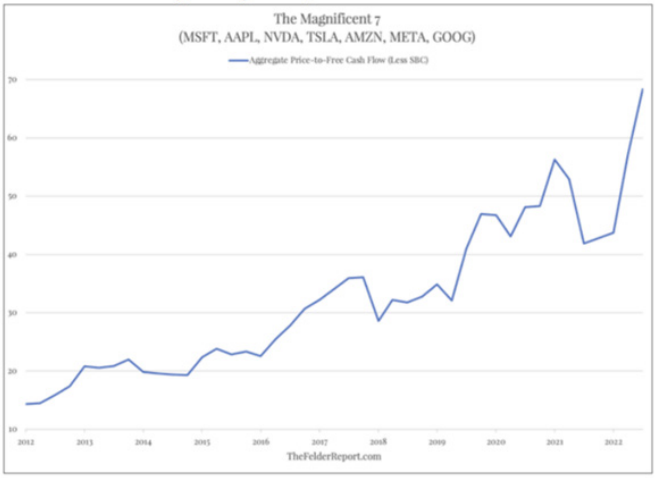



Source: IBES/Refinitiv, National Bureau of Economic Research, Game of Trades. Data for the time period 1/1/1995 – 5/26/2023.

# Stock Market Symmetry

As you can see, we have spent very little time at elevated PEG ratios in tech stocks, and you must ask yourself if you want to fight the biblical symmetry. Check this latest look at the maniacal pricing of today's tech darlings:

**Valuations on 2023's Darlings, the Magnificent 7, are at nosebleed levels.**




Source: TheFelderReport.com. Data for the time period 1/1/2012 – 12/31/2022.

Do you want to keep asking this stock market to do what it has never been able to do before? The answer for us is we will go where we believe your money will be treated the best. We want to be in the oil and gas business, the real estate business via class A/outlet malls. We want to build homes to give millennials access to being their own landlord and invest in other businesses that can prosper in a solid economy and a sub-par stock market. And, as always, we will fear stock market failure.

**Bill Smead**
Lead Portfolio Manager

**Cole Smead, CFA**
Co-Portfolio Manager

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# Invest With Us Today!

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