BALLAST
ASSET MANAGEMENT

Real People, Real World, Real Businesses, Real Values

For the fourth quarter of 2020, the Ballast Portfolio returned 28.1% before fees and 27.8% net of fees, compared to 28.5% for the Russell 2500 Value. For the year 2020, the Ballast Portfolio returned 12.5% before fees and 11.4% net of fees, compared to 4.9% for the Russell 2500 Value.

		Periodic Returns						Annualized Returns		
		2015*	2016	2017	2018	2019	2020	1 Year	3 Year	5 Year
Ballast Portfolio[1]	Gross	-7.6%	23.8%	13.5%	-2.2%	16.1%	12.5%	12.5%	8.5%	12.4%
	Net	-8.0%	22.6%	12.4%	-3.2%	15.0%	11.4%	11.4%	7.4%	11.3%
Russell 2500 Value[2]		-5.8%	25.2%	10.3%	-12.4%	23.5%	4.9%	4.9%	4.3%	9.0%

When I started Ballast in 2015, I set out to build a specific culture, grounded in teamwork and everything that implies. A team, a real team, is one in which the whole is greater than the sum of the parts. Where each teammate not only does their respective job, but they make the teammates around them better.

I am truly humbled by every one of my teammates. The effort, drive, determination, resilience, and untiring resolve each put into making sure our clients were protected in the depths of uncertainty and positioned for upside, regardless off the shape of the eventual recovery, was simply incredible.

As the great philosopher Mike Tyson once said, “everyone has a plan until they get punched in the mouth.” Well, 2020 was one heck of a punch. The team rolled with it and countered with a flurry of crosses and hooks. BAM’s 2020 result speaks for itself, a clear demonstration of the team’s technique, training, and grit. I am in awe of each team member.

On behalf of myself and the people who trust us with their assets, thank you.

Exciting business update! In 2020, BAM launched an Active ETF that mirrors our SMid Strategy. In addition to potentially significant tax advantages for non-exempt clients and prospects, it opens new channels and offers broad access to our institutional-oriented, investment strategy. As one of the first actively managed Small/Mid cap ETFs, we are proud to lead this innovation in the marketplace. Check it out at https://www.mgmtetf.com/.

Outlook

Rather than add to your pile of desk-breaking annual projection reports, the main focus of this letter is to share what we did in 2020, what we have learned and what are doing to continuously improve our process, to position the portfolio for new realities, and to position BAM for continued success.

As a brief aside, although we are bottom-up fundamental investors, know that we actively monitor the investment environment, risk appetites, economic activity, and expectations closely. We do not bet on macro predictions per se, but understanding the present is crucial to robustly positioning for a future as complex as ever, perhaps even more so now. Here is part of our watchlist of seemingly contradictory impulses:

- vaccine versus virus
- growth versus value *(false distinction)*
- inflation versus deflation
- stimulus versus financial instability
- downside volatility versus the cost of equity diversifiers
- technology versus tangible assets
- efficient market gospel versus market structure
- sustainability versus energy costs/security
- And so on...

If you want our thoughts on high-level unknowns, feel free to give us a call. We are happy to discuss and share our views on any of the above – except politics.

Postmortem

One of our favorite times of year comes in January with our annual postmortem. We examine our investment decisions, both in aggregate and individually. It is not that we are gluttons for punishment, but rather that each time we do this, our process gets a little better, a little more systematic without being dogmatic. The feeling of improvement is euphoric, and we believe it is the biggest reason for our long-term investment success.

Our biggest lesson learned in 2020? <u>Don't be afraid to be right</u>. Said differently, we can do better by selling slower when we are right. As active managers, our research aims to uncover significant inefficiencies such as overlooked growth. Very few situations we study pass muster, so when a thesis is playing out as expected, we need to let it play out. But as fundamental investors, when a stock price goes up, it feels uncomfortable – we inherently correlate higher stock prices with greater risk. I know, weird, right? Then again, maybe not, as some of our most profitable investments have also been the most emotionally challenging – there is only a razor's edge between hubris and trusting our fact-based processes.

Specifically, in June 2020, we trimmed Cerence after it jumped 63% from our original investment "way back" in February. What a mistake – it turned out to be our best stock in 2020, gaining 280% from the initial purchase. For all those behavioral finance types screaming "Outcome Bias!" we hear you, but bear with us a moment longer.

We document each investment decision with a one-page thesis, including automatic buy/sell triggers linked to observable drivers. The thesis helps us prudently resist the temptation to sell "winners" too soon and to quickly admit when we are wrong, whether the stock price is rising or falling. In the postmortem, we examine each trade – good and bad – in the context of how we made the decision with reference to the thesis. It is usually humbling to compare what we think we thought with what we thought – but it helps keep us grounded and honest with ourselves. On the evidence, it is clear we should be slower to trim positions advancing consistent with our theses that are still below our price targets.

Candidly, this is not a new lesson for us. In fact, we often tease each other "don't be afraid to be right" in our investment meetings. But like a baseball player enamored with a high fastball, sometimes we need a film review to reinforce the discipline. As a former coach liked to say – "The film doesn't lie."

Prepare for the worst, hope for the best, and settle for whatever you get.

2020 Top and Bottom Performance Contributors

Top Performing Positions			Bottom Performing Positions		
	Name	Total Return		Name	Total Return
CRNC	Cerence, Inc.	+280%	**CNXM**	CNX Midstream Partners	-39%
HZNP	Horizon Therapeutics	+102%	**SOI**	Solaris	-38%
SIVB	SVB Financial	+139%	**JCOM**	J2 Global	-55%
AVID	Avid Technology	+212%	**MLHR**	Herman Miller	-33%
PHM	Pulte Group	+120%	**NCMI**	National Cinemedia	-55%

Top Contributors in 2020

Cerence, our top contributor for the year, returned 280% since our purchase in February. The stock declined 32% in 1Q shortly after our purchase, as global auto supply chain ceased production during the pandemic. In 2Q, however, the stock rose 165% following announcement of the two largest contracts in the company's history, which validated our secular growth thesis for a rising percentage of "natively connected" vehicles and increasing penetration of connected services offered by OEMs.

Horizon Therapeutics returned 102% for the year. The company's orphan drug strategy demonstrated great success with the commercialization of Tepezza, the first and only drug approved by the FDA to treat Thyroid Eye Disease (TED). In August, the company tripled its 2020 and long-term Tepezza sales expectations from greater than $600 million to greater than $3 billion – a very meaningful contribution considering total sales were $1.3 billion in 2019.

SVB Financial, also known as Silicon Valley Bank, returned 139% since our initial purchase in March, outperforming the KBW Bank Index by over 100 percentage points over the same period. SVB's banking business and warrant portfolio in over 2,500 companies benefitted from the strong rebound in private investment and IPO activity.

Avid returned 212% since we initiated our position in May. While COVID-19 halted live broadcasts and events and slowed sales of some of Avid's products, the core software businesses, including Pro Tools and Media Composer, accelerated significantly in 2020, with subscriptions rising 78% y/y in 3Q. EBITDA rose more than 50% y/y in 3Q, driving positive free cash flow during the quarter and year to date. The stock rose from trough levels as investors have begun to appreciate the growth and value of Avid's core software business.

Pulte Group generated a 120% return since our initial purchase in April. After ominously withdrawing guidance in April, Pulte reported its strongest sales and EPS surprise in 2 years just 3 months later. First-time homebuyers, representing about a third of Pulte's customers, and extraordinarily low mortgage rates have helped drive 2021 sales expectations about 30% higher than they were at the time of our purchase.

Bottom Detractors in 2020

CNX Midstream was down 39% from the beginning of the year to the time it was acquired by its general partner, CNX Resources. Prior to the acquisition, CNX Midstream was facing unprecedented uncertainty in its downstream markets. In the early spring when NGL prices were plummeting and gas still at historical lows, shippers began to defer volumes from NGL-rich areas like the Marcellus. Investors anticipating a 2021 recovery in natural gas were likely caught off guard when CNX Midstream ultimately cut its distribution to pay down debt.

Solaris Oilfield was down 38% for the year. We've held our position in Solaris since the end 2018 and chosen to hold fast despite the tremendous volatility in 2020. The stock reached a low of $4.55 on March 23 and ended the year at $8.14. Solaris brings new technology to fracking industry that lowers the environmental impact, improves well-site efficiency, and reduces total costs to E&Ps.

J2 Global was down 55% from the beginning of the year to the time we exited our position in June. Since the time we first got involved in J2 Global in January 2012, it had compounded at more than 18% annually and generated a total return of almost 300% through the end of 2019. The acquisition-fueled growth story had largely matured in our view, resulting in lower returns on invested capital. Hindenburg's short report highlighting self-dealing concerned us, and we decided to exit our position. Hindsight is 20/20, and we now know that selling the position in J2 Global was the wrong call. The stock was up 55% after we sold, beating the Russell 2500 Value by 21 percentage points. We did, however, use cash proceeds to fund the purchase of Lydall (LDL), which returned 77% through year end.

Herman Miller fell 33% from the beginning of the year to our date of sale in April. We made the decision to cut our exposure to office furniture, seeing the economic benefits of adopting working from home structures, and we used the proceeds to fund a new position in Lamar Advertising (LAMR). While the stock recovered on strongly near-term demand for home office furniture, we expect the next few years to be challenged as companies adjust their office footprint and a glut of used furniture overhangs the secondary market.

National Cinemedia Few industries were more impacted by COVID-19 than the movie exhibition industry, and our exposure to this industry through National Cinemedia was no exception. National Cinemedia was down 55% through the date of our exit in June. As movie theaters across the world shut their doors, studios postponed their scheduled release dates, and in some cases, bypassed the exhibition altogether by taking films direct to streaming services. Since National Cinemedia derives almost all revenue from its domestic theater advertising network, sales have fallen approximately 95% during the pandemic. Our decision to exit was based on the opportunity cost and expected duration of the disruption to the exhibition industry. Our postmortem analysis confirmed that exiting National Cinemedia was the right call, as it under-performed the benchmark and our total portfolio from the date of the sale through the end of the year.

As always, our team is available to discuss performance in greater detail, as well as the changes we have made in response to 2020. We appreciate your continued investment and confidence in our team and strategy. Wishing you and your families continued good health during this unprecedented time.

Regards,

Ballast Asset Management

Important Notes and Disclosures

The investment decisions we make for clients' accounts are subject to various market, economic, and other risks, and there is no guarantee that those investment decisions will always be profitable. Clients are reminded that investing in any security entails risk of loss, which they should be willing to bear. The past performance of the firm or its principal is no guarantee of future results.

Some information contained in this communication was obtained from third-party sources. While these sources are believed to be accurate, that information has not been independently verified.

[1] The Ballast Portfolio represents the performance of a composite of accounts invested in the firm's model strategy that was launched on August 11, 2015. Gross Performance represents the returns of the composite after all expenses, but before deduction of management fees. An individual client's account would be subject to the deduction of management fees in accordance with the Ballast fee schedule. Net Performance represents returns net of all expenses and the highest management fee rate (1%) in the firm's fee schedule. The returns achieved by an individual client's account may vary from those reported for various reasons, including management fee rate, timing of cash flows, frequency of rebalancing of individual accounts, and an individual client's restrictions. In April 2019, Ballast transitioned from calculating performance based on a proprietary account to composite. The composite performance should be the sole source of information used when evaluating past performance. Past performance does not guarantee future results.

[2] The Russell 2500 Value Index measures the performance of those Russell 2500 companies with lower price-to-book ratios and lower forecasted growth values. Returns shown include the reinvestment of dividends and are based on data obtained from FTSE Russell.