CORBYN INVESTMENT MANAGEMENT, INC.

January 2021

Dear Clients and Advisors,

We are pleased to report that Corbyn accounts ended 2020 with strong fourth quarter gains. Both equity-oriented and fixed income accounts benefitted from increased optimism toward a "re-opening" of the United States economy, driven by fiscal stimulus and the approval of two vaccines to fight against the coronavirus. In previous letters, we discussed our belief that equity market performance would broaden out beyond the highly-concentrated leadership that existed since the market's trough, once the markets began to factor in a recovery of the global economy. We witnessed this increasing market breadth during the fourth quarter of 2020 as an improving economic outlook gave investors greater confidence to invest in a more diverse range of companies where valuations remained attractive, driving solid performance in many market sectors.

While there remains a stubbornly high rate of coronavirus infections, hospitalizations and deaths, the news of effective vaccines has encouraged investors to look past the virus and focus on the outlook for future economic activity. A more optimistic attitude was fueled by the ongoing economic recovery in the United States supported by improving employment, manufacturing, and construction markets. Global shipping lanes have become highly congested due to increasing demand from both end users and inventory restocking. This acceleration in economic activity spurred generally stronger than expected earnings reports late last year, with many corporate executives articulating increasing levels of optimism.

Fixed Income

Our fixed income accounts continued to produce steady positive returns. As we write this letter, money market returns are close to zero and the 10-year Treasury yield is just over one percent. In such a low interest rate environment, the annual total return earned on most fixed income investments is heavily influenced by bond price changes, which are typically driven by movements in interest rates. As rates moved lower over the last several years, the annual returns from longer-dated bonds benefitted from gains associated with higher bond prices. At Corbyn, we prefer to be less dependent on changes in interest rates in order to achieve our return, especially when rates have so little room to move lower. We have written many times about the benefits of having short-duration bonds in your fixed income portfolio, and we believe this is especially true today, given the current economic environment and our expectation that the recent increase in the 10-year interest rate may be a harbinger of rising rates during 2021.

The economic dislocations caused by the pandemic during early 2020 were met with an unprecedented and aggressive response by the Federal Reserve (the "Fed"). To address the economic slowdown and prevent dysfunction within the financial markets, the Fed reduced short-term rates to near-zero and flooded the markets with liquidity by purchasing Treasury securities, mortgages, corporate bonds and other securities. These actions caused the Fed's balance sheet to expand by $3.1 trillion dollars, to $7.3 trillion, adding 74% more to a balance sheet that had already been expanding for more than a decade. Earlier this month, the Fed reiterated that it would maintain its low short-term interest rate policy and purchases of securities until it meets its targets of full employment and an inflation rate of 2% or higher. The Fed's actions, coupled with Congressional approval of fiscal stimulus bills, injected a substantial amount of additional dollars into the economy. This increased liquidity may result in higher inflation, once this money finds its way in to the economic system.

One of the metrics worth watching to gain insight into the outlook for inflation is the difference or "spread" between the yields of the 2-year and 10-year Treasury notes. This yield spread can often act as an indication of investors' expectations for future economic activity and/or inflation, with a higher spread indicating the possibility of an improving economy and/or heightened inflation. During the fourth quarter of 2020 and the early days of 2021, this spread widened significantly, helping fuel speculation that inflation may in fact be a part of our not-too-distant investing future. If inflation does accelerate as the Fed desires, the short duration of our fixed income securities should result in far less price volatility compared to a longer-duration fixed income portfolio and allow us to reinvest proceeds from bond redemptions and maturities at higher and higher rates.

<u>Equities</u>

Our equity accounts performed extremely well throughout the fourth quarter of 2020. The accounts benefited from the significant rotation and expansion in market leadership, driven by the additional optimism brought by the vaccine launches. The environment that COVID created back in March 2020 led investors to concentrate on those companies that benefitted from lockdowns and social distancing, including companies in the technology, home improvement and outdoor recreation industries, to name a few. This concentration initially created a "lag" in the stock price performance of many companies that were more dependent on a more traditional base of economic activity. During the last several months of 2020, however, investors increasingly looked to identify companies that had performed relatively well operationally despite pandemic headwinds and had outlooks poised to improve further as the economy recovers. In many cases, these companies are on track to generate full year earnings similar to, or above, pre-pandemic expectations yet their stock prices, in some cases, remained below pre-pandemic levels. We expect investors to continue to view these companies as attractively valued as they continue to grow more comfortable investing in broader areas of the market.

The pandemic presented significant and unprecedented challenges to many companies, forcing many unplanned decisions to address issues that may not have existed during the normal operating environment prior to March of 2020. We have used this time of crisis to observe how the management teams of companies we own, or may want to own in the future, have navigated through this difficult period. We believe that challenging circumstances often highlight the strengths and weaknesses of a business and the people that run them. We firmly believe in owning companies with strong management teams and feel that managements who perform best in difficult times are more likely to succeed during the good times as well.

Looking back, 2020 was a year with no shortage of events that fueled the flames of concern and uncertainty. Despite this, the stock market staged a strong rally following the steep decline early in the year. While current news headlines may feel consistently negative, it is important to remember that financial markets focus far more on future expectations than current events. We live in a world where local, national, and global events are delivered to our physical or digital "front doors" on a real-time basis. It is easy to focus on the current, new, sensational event that is "trending" on social media and forget to maintain a longer-term view of the real catalysts that are affecting the trajectory of economic activity. As an investor, one must constantly differentiate between the various media narratives and identify the events that may fundamentally change the outlook for the future. Daily headlines, good or bad, should never indiscriminately control your longer-term investment decisions or strategies, and we remain on guard against this temptation.

We thank you for being a Corbyn client and are pleased that we had such a strong finish to 2020. We look forward to the New Year with excitement and optimism and are eager to tackle the issues that lie ahead.

With many thanks and appreciation,

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