Performance	QTD	YTD
DJ Industrial Average	18.4%	8..4%
S&P 500	6.3%	6.3%
Russell 2000	12.7%	12.7%
allcapbros	**30.1%**	**30.1%**

Our portfolio was up 30.1% in Q1 2021 driven by our core positions, namely DFIN, FC, and AOUT that were up over 30% in Q1. The market rotation from growth to value that took flight in Q4 2020 was accelerated this quarter by the Ten-year almost doubling from the beginning of the year to 1.74%. We have reduced our leverage down to zero given that "coming off of zero" so to speak is slightly more pernicious to certain pockets of the equity market (all else equal) than a general rise in rates from a more normalized starting level. We write about the theoretical argument for this here.

Value outperformed growth by roughly 13% over the period. Our portfolio tends to have a strong value bias, so during short periods of time we expect most of the volatility to be explained by this bias however over long periods of time security alpha will dominate and our returns will look significantly different from the index. This behavior is shown in the 1986 Brinson study that states asset allocation explains 94% of quarterly portfolio volatility however explains only a small fraction of ten-year returns. Why does asset allocation policy explain only a small fraction of the ten-year returns but a large fraction of the variation of short-term returns? The answer is simple: compounding returns. Persistent small increments to periodic returns compound over time that will lead to larger and larger differences in cumulative performance the more you increase the window of time. This may seem simple and straightforward but it is alarming how often this study is misapplied and market practitioners come to the glaringly false conclusion that asset allocation is of overwhelming importance because it explains 90%+ of returns and security selection is far less significant. All this is to say given our willingness to hold outsized positions combined with the fact that we will generally never have a portfolio of more that 10-15 names, we expect the difference in cumulative intermediate to long term returns between our portfolio and any given index to be drastically different.

Although the overall market (S&P 500) is trading at 21.9 fwd P/E which is roughly 1.6 standard deviations away from the 25-year average of 16.4, the market cap of the index is dominated by the top 10 names (27% collective weighting) and the dispersion in valuation between stocks in the 20th percentile vs the 80th percentile remains extraordinarily high. Thus, we continue to find new opportunities and our challenge with portfolio allocation tends to revolve around what to sell or trim to make room for new ideas.

Position Updates

Donnelley Financial (DFIN)

DFIN continues to leverage their market share to take advantage of the current capital market climate. Capital Market Software Solutions and Investment Company Software Solutions had sequential quarterly revenue growth of 6% & 7% respectively. These are the key segments of focus and they continue to outpace expectations and remain ahead of their goal of trying to achieve close to 50% revenue from SAAS offerings in 2024. Our revaluation of the company at current cash flow levels suggest a conservative estimate that gives DFIN 40%

more upside from current levels. We expect the company to continue to beat both topline and bottom-line estimates for the coming quarters given sustained elevation in capital markets activity assisted by the beneficial operating leverage from an optimized cost structure. The shareholder friendly company continues to pay down debt and buy back shares.

New Positions

American Outdoor Brands (AOUT)

American Outdoor Brands spun off from Smith and Wesson in July of 2020. AOUT is composed of both outdoor and gun accessory brands with gross profit margins around 40%. These brands represent piecemeal acquisitions SWBI did for several years. The aggregate purchase price of these brands was about 360 mm which is roughly where AOUT currently trades with a significantly more beneficial environment for AOUT's target markets along with a more aligned management team. AOUT currently trades at about 10x '21 earnings. Under SWBI, AOUT's brands languished and remained stagnant with little to no revenue growth even though these were best in breed brands growing at double digit CAGRs before being acquired. We expect that being spun off and more entrepreneurially run will harness the latency of these brands.

Due to COVID and the subsequently accelerated affinity for outdoor activities and guns, about half of AOUT's brands have experienced triple-digit growth yoy. Now that it has separated from SWBI, AOUT's strategy is to leverage the potential of their brands, named "dock and unlock". When AOUT comes up with a new product -they shoot for about three hundred per year- they will "dock" it underneath one of their four brand categories. These categories were recently created to segment their brands to reduce overlap and confusion. The idea is to have each brand category entrepreneurially run with its own marketing, customer service reps, and incentives. This allows AOUT to quickly "unlock" the potential and take new products from "niche to known". AOUT is also transitioning from producing products to enabling lifestyles which considerably expands their TAM. This shift in framework is subtle but important as it breathes life into a brand and achieves better customer engagement and loyalty- critical to grow DTC and e-commerce presence. An example of this at play is AOUT's Bubba brand. SWBI purchased Bubba Blade for 12mm in 2017 and at the time it was solely a fly-fishing knife. AOUT was able to leverage the strong brand to expand Bubba's brand presence to cover more of the "water to plate" lifestyle and it now spans dozens of tools needed for fishing with several of them topping Amazon's best-seller lists. AOUT is now using this playbook for their other brands such as UST and BOG whose websites have recently gotten much needed facelifts. We believe AOUT's strong brands and growing success in e-commerce and DTC put them in a terrific position to expand their brands and margins. See our valuation here.

Iteris (ITI)

Iteris is a provider of hardware, software, and consulting services to the signalized intersection industry. ITI has their hardware in nearly thirty percent of the signalized intersections in the USA and process petabytes of traffic data per day. ITI is leveraging its hardware footprint and long-term adviser relationships with thousands of state agencies to upsell its innovative SAAS offerings. ITI has recently positioned itself as a pure-play transportation company and is well poised to ride USA's needed infrastructure upgrade and the coming of smart cities.

The transportation industry has seen a lot of consolidation and there is a good chance ITI will get acquired. The acquisition spree has involved Cubic being acquired for 2.8B and Flir being acquired for 8B. With the massive infrastructure bill in the works, it could prompt even more consolidation. An offer has already been made by Rekor valuing ITI at almost $8/share (about a 20% premium) , however, this was summarily dismissed due to the terms. We would not be surprised if there are more offers to come. As Laughing Water Capital said in his 2016 ITI write up:

> “What are the chances that a $200 million micro-cap company that is developing the architecture that will shape the future of autonomous vehicles will not be purchased by a larger consulting / technology vehicle player?”

There are many ways to win with Iteris. Its footprint and the value of its data make it a juicy acquisition target. Even without being acquired, its growing SAAS segment will make it considerably cheap on a FCF basis. Multiple trends along with a possible infrastructure bill will continue to provide a long runway for ITI’s business. Run by a capable CEO whose domain expertise is up ITIs alley, who is also shareholder aligned, we see limited downside and significant upside to ITI. See our valuation here.