September 29, 2019

Figures are rounded to save time.

In poker, I did everything I could to maximize my hourly rate. This got great results but also contributed to burning me out. In some spots, I took on too much stress for too little extra gain. I won't make the same mistake with investing. Even if I want to endure more pain, this is less appealing to most of my investors. Including friends. For the wellbeing of everyone involved, max starting position size will be 10% for longs and 5% for shorts. Most often I'll go with half or less of that. That said, I will never commit to hard rules. If a situation warrants I'm still leaving myself the option to bet bigger.

1. Results for July 1 - September 27, 2019

SP500: +1%. Max drawdown 6%. Sharpe .37
Fund: +6%. Max Drawdown 20%. Sharpe .93.

Currently we're 150% long and 100% short. So net 50% long. This differs from the net 100% long target. In the intro letter I wrote, "Based on .. opportunities available, the ratio of longs to shorts will shift around." A special, rare event happened. I cover this in section 3. This created many opportunities on the short side so I freed up margin to exploit them. Just to be clear: I'm *not* attempting to time the market.

Long:

We're about even on the long side, in line with the market.

The biggest loser was my highest confidence pick last quarter, AAWW. The air freight company. They had a horrific quarter and the CEO is stepping down. Management's explanation was very weak. We lost 8%. I'm still mulling this one over. Was this bad luck or a bad investment? Probably a combination. Nobody could really know they'd have the worst quarter in the company's history. This part was probably some bad luck. On the other hand, because the company's assets were selling so cheaply, I overlooked numerous red flags: Slim management ownership, SJW politics in SEC filings, stated one dimensional goal of growth and lots of debt. Overlooking too many red flags was probably a mistake. I quit the position. In the future I'll have a tighter threshold on red flags versus cheapness.

SJW politics in the SEC filings will be a massive red flag. BUR.ln had them too, for example. I dodged that bullet thanks to my dad and Casey's opinion on the accounting.

Sometimes AAWW will bounce back. If so, it'll be easy to be results oriented and think I was dumb for quitting. I don't think that's right, though. Without getting into much detail, the likely upside on the bet was really only $60 in most outcomes - so I made a mistake from the outset. With new information from the latest quarter, the downside is certainly $0. That's just a coin flip. That's a lot different than my perceived $80 upside and low probability of bankruptcy. As my perceptions change, so will my decisions.

The biggest winner was FPAYW. They're a lease-to-own company for stuff like Iphones and tires. The business model is to charge obscene interest on products over about a year. Defaults are high but so are profits when customers finish payments. These warrants cost just $.25 and peaked at $.90 during the quarter, before retreating back to $.50. I sold off some as they went up but still have a position. I'm a small buyer again sub $.50. We won 6% on this bet - or 9% including last quarter.

Short:

We're up 6% on the short side. My sample of outperformance is getting quite big given the massive win rate. If this keeps up my edge will be pretty clear in another couple of quarters.

The biggest loser was VGR, mostly a tobacco company. The company was added to the sp600 which caused the price to spike. The SP indexes add stocks on a discretionary basis so this was unpredictable. This is just a form of bad luck. This was a pretty big short and we lost 2.5%. After that, they had a solid quarter. I quit the position since the share price didn't react. The short still has merit but my timing was too early. The thesis is simple. The dividend will likely be cut in the future. With the latest good quarter this probably won't happen until the middle of next year, though. In theory a dividend cut shouldn't have an impact on share price. In practice this always causes a large drop, though. This idea will be revisited next year.

The biggest winner was BE, a money losing fuel cell company with a ton of debt. Their tech is not economical. It's more expensive than grid power or backup diesel generators. On top of that, the tech uses natural gas which is increasingly stigmatized by the green community - yet BE marketed themselves as green friendly. This company is obviously worthless yet was trading at over a billion dollars. The first large drop was due to bad guidance. Then a top rated short seller released a report which caused another 20% drop. I'm shorting more as it goes down. We won 3% on this bet.

2. Notable Long and Short Positions

Our largest long position is MTG at 11%. They're a mortgage insurer that survived the financial crisis which is impressive to me. There's very heavy inside ownership and the company trades at less than 8 times earnings. A fund with a strong track record, Oaktree Capital, holds a position. I believe the market is fearful of another real estate crash because of what happened in 2008. While possible, nobody is pointing to obvious red flags like back then. This company is particularly attractive because 1. Return on equity is high at 18% and 2. The company requires little reinvestment for growth. A catastrophe might cause this investment to be wiped out completely - but due to my volatile shorts, the overall fund should be protected.

The biggest short is Intelsat at 7%. They're a foreign satellite operator with lots of debt. They will go bankrupt unless they receive a $5 billion+ windfall from the US government. Lawmakers on both sides of the aisle are reading my arguments back to me, "Why should we give away billions to foreign owned satellite operators?" I guess we'll see but I don't buy it. Nobody could produce an example of the FCC giving away that much money before. Yet people did show examples of lawmakers preventing smaller windfalls in the past. I've been staying short for 16 months. In that time the company lost another billion dollars, losses are accelerating and new low earth orbit satellites are a serious competitive threat. Somehow the market doesn't seem to care about any of that and the share price remains elevated. There's even a way to hedge the bet with another satellite operator so the risk here shouldn't be that great.

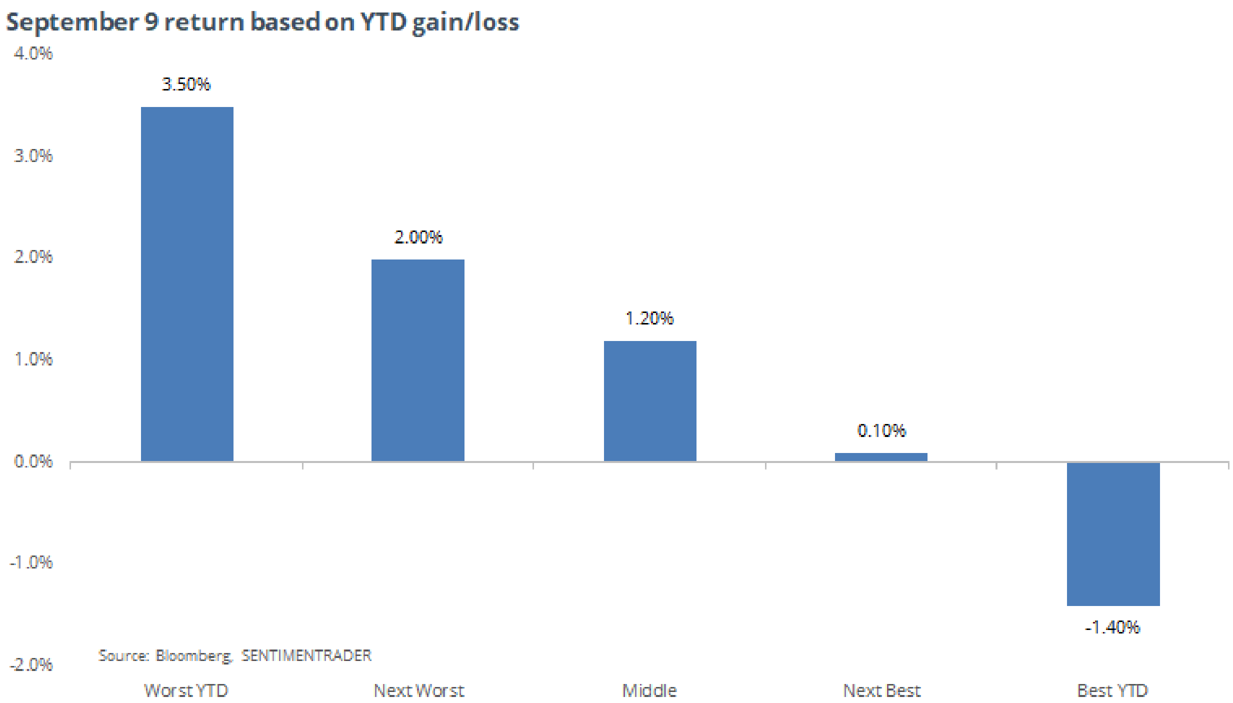
3. The Quant Quake

Bots trade on complex strategies in the market. I'll invent a plausible but overly simplified strategy to show how this works. Say that shorting companies when 25% of the shares are sold short is a profitable strategy. Then someone realizes what I'm doing and front runs me, shorting the shares at 24% instead. Someone exploits him, etc. Won't these strategies overstep sometimes? Eventually someone will realize that something is totally off and pull the plug on their bot. Or maybe someone else creates a bot to exploit the situation, forcing the change. I don't know the details. However, such an unwind occurred.

I present the quant quake:

Momo means companies that have been going up.
Value means companies that appear cheap on basic metrics.

And a different perspective:



I have no clue why momo and value are inversely related. I also have no idea why this collapse was triggered. Fortunately, I don't need to. Bots *seriously* bought a lot of "value" stocks. Value goes in quotes because bots are stupid. They don't know a terrible company based on qualitative factors. They buy stuff because the company seems cheap based on surface level numbers. Overall they're probably winning but they're making many mistakes, too. A few examples:

Low quality retail real estate that is worthless because of Amazon's growth,

Company that buys film rights to try to resell, which is a terrible business. They also took on toxic financing,

Pharmaceutical company that will go bankrupt from legal liabilities. They got countless Americans hooked on opioids - the bonds already trade for a fraction on the dollar.

Christian radio - two headwinds in one!

There are many other examples. I've been working constantly to track down the best leads. Hopefully this lasts. I'm printing money right now. Feels very similar to the rare times that games are great in poker - like around certain holidays or major sporting events.

4. Detailed Broker Reports

Q: Why was max drawdown so big compared to the market?

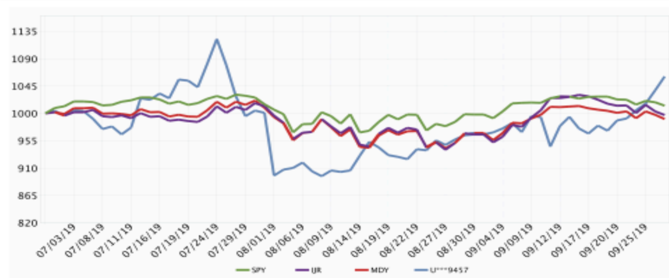
A: 5% is explained by FPAYW going up massively and subsequently retreating. I took some profits at the top, too. This variance is fine - the bet made money, afterall. 8% is explained by AAWW, which I discussed earlier.

Risk Measures **Benchmark Comparison**

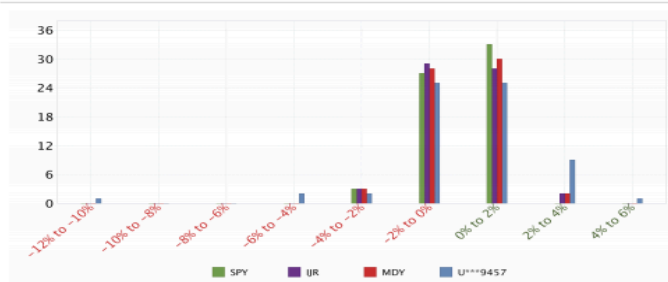
Risk Analysis

	SPY	IJR	MDY	U***9457
Ending VAMI:	1,012.87	997.37	990.66	1,060.74
Max Drawdown:	6.02%	7.51%	7.70%	20.11%
Peak-To-Valley:	07/26/19 - 08/05/19	07/30/19 - 08/27/19	07/30/19 - 08/27/19	07/24/19 - 08/08/19
Recovery:	Ongoing	11 Days	Ongoing	Ongoing
Sharpe Ratio:	0.37	-0.05	-0.25	0.93
Sortino Ratio:	0.08	-0.41	-0.68	1.03
Standard Deviation:	0.93%	1.15%	1.08%	2.26%
Downside Deviation:	0.72%	0.84%	0.82%	1.77%
Correlation:	0.05	0.09	0.13	-
β:	0.11	0.18	0.27	-
α:	0.39	0.40	0.41	-
Mean Return:	0.02%	0.00%	-0.01%	0.12%
Positive Periods:	35 (53.85%)	33 (50.77%)	34 (52.31%)	35 (53.85%)
Negative Periods:	30 (46.15%)	32 (49.23%)	31 (47.69%)	30 (46.15%)

Value Added Monthly Index (VAMI)

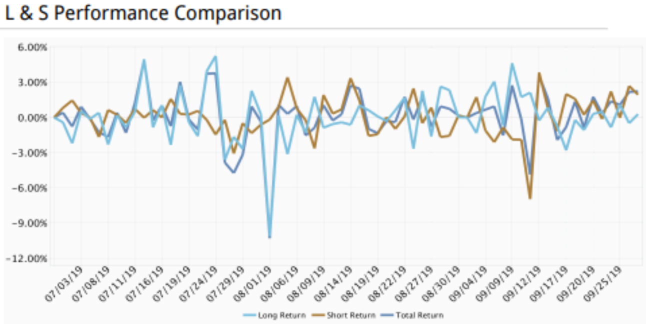


Distribution of Returns



Performance by **Long & Short**

L & S Performance Comparison



L & S Performance By Financial Instrument Comparison