January 1, 2021

Figures are rounded to save time.

Last year we won 90% and this year we made 170%. This was very lucky. These returns vastly exceed our long term expectation. That said, I'm glad to be launching the fund with a sample size large enough to imply an edge[1].

Timing the market is not my goal. I made my first macro bet this year *only* because I saw a clear catalyst with asymmetry. My default target remains 100% net long, which will vary a bit depending on individual opportunities that I find.

Part 1: Fourth Quarter

1. Results for September 28th - December 31, 2020

SP500: +14%

Fund: +42.5%

Currently we're 200% long and 120% short. Gross leverage is high because we have many covered calls, which free up margin and reduce risk.

Long:

We made 80%.

There wasn't a substantial losing long position.

[1] I've run my first and only stock portfolio since April 2018. Here are my *monthly* results since Q3, 2018 and by long/short. There were bets on 750 tickers in this sample; 59% won, winners were bigger than losers.

The biggest winner was Maxeon Solar (MAXN). We took a 6% position on Biden's victory. Our bet on Maxeon played out fast and we won 4%. I've already quit.

The main reason I went long is the growing ESG bubble combined with Maxeon lagging other solar stocks. George Soros said, "When I see a bubble forming, I rush to buy." I won't regularly bet on bubbles, or bet so big when I do, but this setup was amazing.

Maxeon spun off from Sunpower (SPWR) on August 27th and there was heavy forced selling that day. This half of the company has the residential solar patents and overseas manufacturing. Their panels are beautiful and offer the most power per square foot for residential solar. Maxeon is building up production capacity and if the latest tech is popular, shares might be worth $50+. Financials are ugly but past losses include 10 year polysilicon purchase agreements far above market price, which mostly expire this year.

Short:

We lost 20%. Shorting was *hard* this quarter.

Many companies hit hard by covid now trade for double last year's price. For example, the in-flight internet company Gogo (GOGO). In other cases, companies that temporarily benefitted from covid now trade for several times their old price. For example, Zoom Video (ZM). These irrational clusters in the market are setting up incredible short opportunities. I've got a big list of companies to pounce on as momentum wanes.

The biggest loser was Veritone (VERI). They have large losses and continuously dilute shareholders. I've been following this company for 2.5 years. Since then, they've claimed to be a cloud company, an AI company and now an operating system company. Even one would be a large undertaking yet Veritone only has a $20 million research budget. This story doesn't add up. I asked a friend to check out their website a year ago for a sanity check and his reaction was something like, "their website is a word salad." Unfortunately, Wall Street believed their latest story and shares rallied *2,000%* from March lows. This bet cost us 1.5% and we're no longer short for now.

The biggest winner was Express (EXPR), which I wrote an article about. Express was hit by covid the worst of any clothing retailer I've seen. Shares shot up late November with many other junky companies, creating a nice set up. December earnings were likely to be a trainwreck - I couldn't think of any reason they'd improve much over the previous quarter - so I increased the position size to 3% late November. This played out well and we won 1%. I remain short and think they're going bankrupt within a year.

2. Notable Positions

This section briefly updates the big bets I talked about in previous letters. If you've read them, a quick skim here is fine. I'm being cagey with new ideas since many investors join the fund soon and I want to get them the best possible entry.

Our largest long is 10% in Ternium (TX), the Latin American steel company mentioned in the Q3 letter. Ternium is still 20% undervalued. The position is up 110% so we'll hold at least until April for tax reasons.

Our next largest long is 9% in Fraport (FRA.DE), a German airport company. The thesis is the same as Grupo Aeroportuario del Centro Norte (OMAB), the Mexican airports I've mentioned in past letters. Fraport sold off when European countries locked down in October and I bought a 6% position. Fraport is still quite cheap. I'll hold long term since airports are predictable monopolies and air travel has clear long term tailwinds.

Our largest short is American Airlines (AAL) at 7%. This is an unusually large short position which I'm comfortable with because I don't expect more than 100% upside besides rare outliers. This is a good example for why I don't follow hard sizing rules - in my opinion this bet is far less risky than, say, a near term bankruptcy at a 3% position. On top of that, we're long many travel stocks and it's likely we're protected even if American Airlines goes up 150%.

American Airlines is losing $3 billion per quarter right now and they will have -$8 billion equity after this quarter's results. The government did two airline bailouts which saved them 4 months of losses. I expect American will have negative $5-10 billion equity within a couple quarters, including these bailouts. At that point, if air travel demand has strongly recovered, American is still overvalued today. And if not, American is going to zero. Remember a key difference between airlines and airports: airports breakeven at 30% of normal traffic while American Airlines breaks even at 75% - which goes up fast as their balance sheet gets worse. A bad outcome is a third government bailout plus demand returns quickly, but even then I don't think American is worth $20.

3. Private Prison Election Bets

I thought the election was a coin flip while pollsters thought Biden had a 90% chance to win[2]. This created anomalies in the market and I found the private prison company CoreCivic (CXW)[3]. The market thinks the Democrats will close private prisons so the stock was beaten down.

CoreCivic options were mispriced. I bought $10 strike December call options for $.15 late October.

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[2] Social "scientists" have an extreme left wing political bias and most pollsters are no exception. House results, where all 27 tossup districts went red, are concrete proof that something went off the rails in this profession. A take I liked, "538 is astrology for liberals."

[3] I also bet on GEO, another private prison co, but I'll just talk about CXW to keep it simple.

Given what happened after Trump's last surprise victory, these could realistically pay 10:1, and possibly 20+:1. By election day these call options traded up to $.45 as the market caught on. Since the odds were less stacked, I closed the position before the election played out.

I watched Florida's early vote counts, which update in real time unlike many states. It seemed clear before noon that Trump was going to win. Not only is Florida a key state for the election outcome, this also implied that pollsters were wildly wrong like in 2016. I bought a direct stock position in CoreCivic.

I studied numbers from key states all day and night, getting just 3 hours of sleep. Late night US time, mail-in ballots were counted overwhelmingly in Biden's favor in Pennsylvania. Yet when the premarket opened my prison bet had spiked. I took profits since the bet once again seemed like a coin flip. An hour went by and Trump's odds were slipping fast based on rust belt mail-in ballot counts. I reasoned Trump only had a 25% chance to win, while Predictit still had him at 60%. I shorted prisons before they dropped.

I think Democrat politicians are no enemy of prisons. For one example, Kamala Harris was perfectly willing to keep innocent people locked up to advance her career as district attorney. For another, Democrats had control under Obama but did not close Guantanamo. They'll only follow through if it's politically expedient. Frankly, I doubt it. Meanwhile CoreCivic trades for under 3 times cash flow which means there's good value even if you lose everything half the time. I got long prisons again after the drop.

Combined these bets won 1.5% - I bet small since I'm not normally a day trader.

4. Q4 Broker Report

Our portfolio has many covid recovery plays and its beta - which is supposed to measure risk - more than doubled right after the great vaccine news came out. This doesn't make sense to me. Multiple working vaccines substantially lower pandemic risk. On top of that, I trimmed net long exposure on the spike, which further reduced risk. This is a clear example where modern portfolio theory is wrong.

Many funds are incentivized, directly or indirectly, to minimize beta. They quit investments when beta spikes. Now the market isn't being totally crazy: *way* more often than not, higher volatility indeed comes from greater risk. But a solid amount of the time this is wrong, or even gets it backward. So while beta does a decent job measuring risk for many investments, such as growth stories, it does a horrible job when price spikes on good news. This creates trading opportunities.

Dave & Busters (PLAY) is a specific example, but there were many like this. We'd been long since October. I sold some on the vaccine news spike, anticipating that many funds would sell to lower their beta, and rebought after the subsequent drop. Thanks, modern portfolio theory!

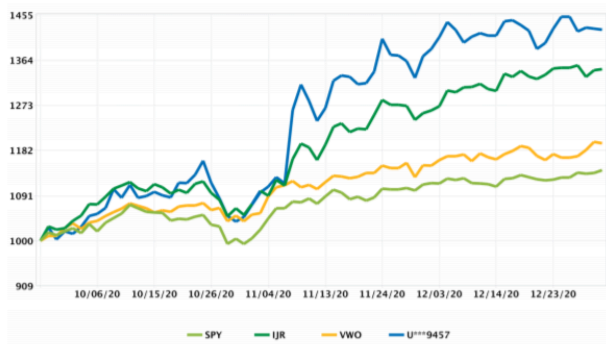
At least that's my interpretation of what happened here but I'm interested in alternative theories.

We're still long PLAY via covered calls. January '22 $40 calls have a 20% annualized return while still leaving 30% upside on the common. The business earns about 10%/year and they're still growing. A subtle bull argument: PLAY might have esports or microbrew option value. Combined, IRR is likely 30% including bad outcomes.

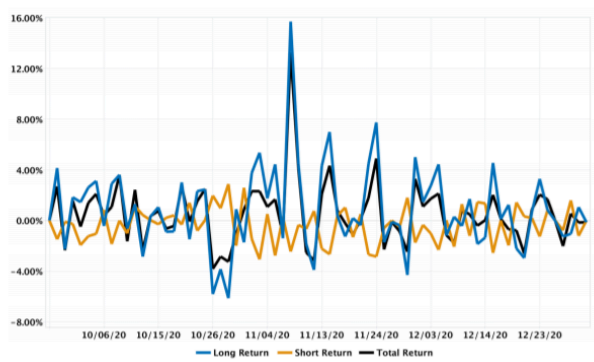
Risk Analysis

	SPY	IJR	VWO	U***9457
Ending VAMI	1,142.21	1,345.74	1,196.14	1,425.51
Max Drawdown	7.35%	6.31%	3.42%	10.54%
Peak-To-Valley	10/12/20 - 10/30/20	10/23/20 - 10/28/20	10/23/20 - 10/28/20	10/23/20 - 10/29/20
Recovery	6 Days	6 Days	5 Days	7 Days
Sharpe Ratio	3.21	4.80	4.33	3.55
Sortino Ratio	5.04	9.35	7.18	7.45
Standard Deviation	0.99%	1.48%	0.98%	2.47%
Downside Deviation	0.63%	0.76%	0.59%	1.18%
Correlation	0.50	0.76	0.40	-
β:	1.25	1.27	1.00	-
α:	0.77	-0.04	0.73	-
Mean Return	0.20%	0.44%	0.26%	0.54%
Positive Periods	38 (55.07%)	42 (60.87%)	44 (63.77%)	39 (56.52%)
Negative Periods	31 (44.93%)	27 (39.13%)	25 (36.23%)	30 (43.48%)

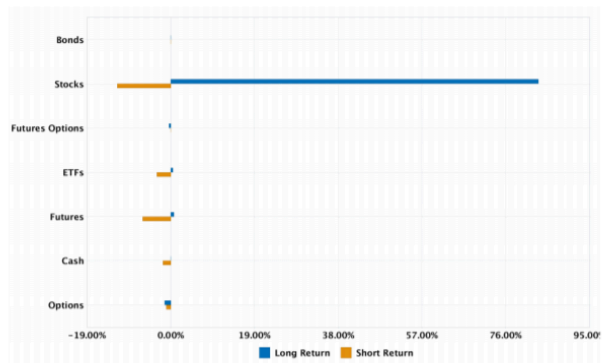
Value Added Monthly Index (VAMI)



L & S Performance Comparison



L & S Performance By Financial Instrument Comparison



Part 2: Full Year

1. 2020 Results

SP500: +18%
Fund: +171%. Long +65%, Short +64%

This year I made 450 bets spread over 300 companies.

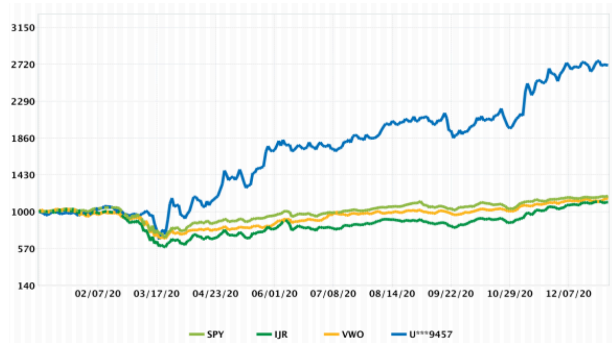
One advantage of a diversified strategy is that you have more room to play tax games. For example, you can quit losing long positions early to offset short term capital gains from winning shorts, and then buy something similar and hold that for a year instead. About 70% of the year's profit will be long term capital gains, though in a less volatile market that'd have been lower.

If the fund had $10 million under management, instead of $1 million, we'd have won 10% less this year.

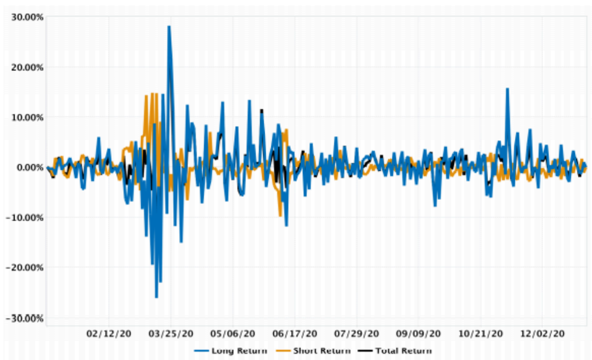
Risk Analysis

	SPY	IJR	VWO	U***9457
Ending VAMI	1,183.73	1,112.77	1,151.92	2,707.14
Max Drawdown	33.70%	42.57%	33.53%	36.51%
Peak-To-Valley	02/19/20 - 03/23/20	01/16/20 - 03/23/20	01/17/20 - 03/23/20	02/12/20 - 03/18/20
Recovery	100 Days	171 Days	145 Days	5 Days
Sharpe Ratio	0.67	0.46	0.60	1.92
Sortino Ratio	0.91	0.63	0.78	3.37
Standard Deviation	2.07%	2.65%	2.01%	3.79%
Downside Deviation	1.51%	1.95%	1.54%	2.16%
Correlation	0.55	0.69	0.54	-
β:	1.00	0.99	1.01	-
α:	0.95	0.98	0.98	-
Tracking Error	3.17%	2.74%	3.20%	-
Information Ratio	48.05	58.09	48.64	-
Turnover	-	-	-	661.11%
Mean Return	0.09%	0.08%	0.07%	0.45%
Positive Periods	154 (59.00%)	145 (55.56%)	147 (56.32%)	153 (58.62%)
Negative Periods	107 (41.00%)	116 (44.44%)	114 (43.68%)	108 (41.38%)

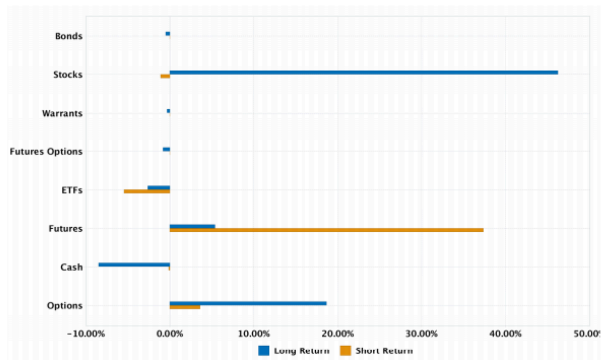
Value Added Monthly Index (VAMI)



L & S Performance Comparison



L & S Performance By Financial Instrument Comparison



2. Covid Wrap Up

There's lots of covid spam out there so I'll keep it brief.

Last quarter I made a few guesses. I was too optimistic on a couple - cold weather increases R0 more than I thought and more EU countries locked down than expected. I wasn't optimistic enough about the vaccine, though. Two working vaccines with 95% effectiveness, so soon, was a home run. This is the key variable and the virus will mostly be dead in Q2. It's remarkable that humans created them in less than a year - we're capable animals when we give it our best.

There are still great covid recovery long bets out there but choices are far more limited than in October. A juicier hunting ground is to sell one year, out of the money covered calls. These often offer 10-20% IRR if the underlying goes sideways, while still leaving 10-30% upside on the common. Find undervalued common stock and that's a wonderful bet. Six Flags (SIX) is an example similar to Dave & Busters. If you find one please share the idea with me! These opportunities will fade as the market normalizes and VIX drops back to 13.

3. Brief Fund Update

There's another slight delay setting up the bank account. I didn't realize I needed two EINs, and the IRS system for creating them is comically down for 10 days. Sorry that this keeps getting pushed back - I'm bad at administrative work. Luckily this will be automated soon and I can just focus entirely on investing. Unless there's yet another delay, the first wave of contributions can now be accepted until January 11th and then at the end of each month.

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I feel fantastic about making my friends $700k last year. That's a lot of money for a group that mostly works regular jobs or runs small businesses. Helping my friends in this way is far more meaningful to me than poker ever was. Hopefully things continue going well and I'll make a nice buck, too.

Once again, thanks for investing with me.

David Orr