Dear Investor,

In this letter we will review our performance in Q1 2023 including our biggest impact performers as well as our investment focus for the remainder of the year.

Rod Capital Q1 2023 Results

In the first quarter of 2023, Rod Capital was up 15.43%. The S&P 500 was up 7.48% and the Russell 2000 was up 2.74%.

Our top performer in the quarter was Lionsgate Entertainment Corp. (LGF A), which made a dramatic comeback and nearly doubled, after being our worst performer in the previous quarter. This was our top position at one point but we have reduced it as a result of this valuation correction. Meta Platforms Inc. (META) was our second strongest contributor to results, up 76% during the quarter. It is our largest mega-cap position, even though we are under-weight the mega-caps due to current valuations.

Our worst performers in Q1 were our short positions in Tesla Inc. (TSLA) and Riot Platforms (RIOT), which were up 68% and 195%. Short positions made up the majority of our losses in the strong quarter.

Q1 2023 Review

There were two parts to the successful first quarter. The first part was before the regional banking crisis, and the second part was after the regional banking crisis. Before all hell broke loose in early March, valuation corrections toward normalcy were happening. 2022 tax loss selling was reversed, and all was well in the land. But two months was enough serenity and the market went into panic again when a run on a bank associated with start-ups (SVB Financial Group) brought regional bank stocks crashing down around 25%. Two other cryptocurrency associated banks crashed and burned as well. Investors rotated out of small caps and into large technology mega-caps looking for a hiding place and fearing that commercial real estate exposure is next.

There is a persistent hope in the market that any harsh shocks to the economy will bring interest rates back down and we can all go back to the big party, funding all of our hopes and dreams of crypto money printing and self-driving cars. However, our parents at the Fed just don’t understand (cue Will Smith music). The view is that the rate hikes of the Fed are killing growth. Well, the Fed is going to stand up to the speculation and maintain their professionalism (even if the low interest rate lovers like Elon Musk and Cathie Wood want to slap the Fed around). Interest rate rises and Fed balance sheet contraction are tools to help slow down inflation. But inflation won’t give up that easily just because the credit markets vanish for some start-ups and some cryptocurrency businesses that don’t even provide any real value. What needs to vanish are jobs and consumer spending for the Fed to blink, but those metrics are relatively stable at this point.

We continue to take on investment positions that are undervalued and/or may provide significant short-term opportunities. Lionsgate was a good example of both, providing results in the first quarter. Shares were trading well below our estimated net asset value and the company is planning to spin off and find new partners, which could provide a short-term catalyst. Fortunately, a valuation correction alone with good quarterly performance provided a nice bump for us to de-risk the position and still await and benefit from news of a spin-off.

2023 Investment Focus

When interest rates are not near 0%, when everybody still has a job, and when there are worries about a recession despite continued growth, we view these as positive signals that things are "OK". Capital intensive growth businesses and speculation should have a harder time, but it is becoming a more comfortable environment for value investing – which is what we primarily do. Our top worry is what happens if/when a market general like Apple, Tesla or NVIDIA (we are shorting two of three) falls hard. Does it drag down the whole market and push us toward recession?

With that question in mind, our rough portfolio composition is like this: 150% long equities after we adjust out large cash piles in certain companies we invest in, and 60% short equities. Of the long positions, a third of those have high buyout prospects within a year and we consider these special situations. Backing these out creates a net +40% long-short exposure, which we have positioned conservatively in regards to growth and speculation due to our aggressive short positions. This leaves us exposed to a basket of mostly small cap value and takeover opportunities and underexposed to large cap high flying stocks.

In fact, our largest short continues to be Tesla (TSLA) for the same reasons we have spoken of in the past. Tesla is a car company with industry leading software. It is not a technology company that happens to make cars. The company has benefited from the luxury status of its original models, along with public subsidies, positive media attention, and weak regulation. Today, the company's luxury status is in rapid decline, there is growing competition for those subsidies, the media has turned on Mr. Musk, and regulators and the public are beginning to catch on to the lies regarding full self-driving and other empty promises. Most importantly, margins are getting squeezed with price cuts as demand for Teslas have somewhat moderated. This margin pressure will lead to much lower cash flow and earnings.

Our largest position is Magnachip (MX), a small South Korean semiconductor company which we have discussed in the past as well. We have increased and averaged down our price for this underwater position due to its extremely low enterprise value and high prospects in the growing OLED space. The company is using its relatively large cash position to slowly acquire its shares throughout the year, which will increase our stake in the business as customers return. The company was hit with China lockdowns, which resulted in their customers' inventory build ups. We believe a return to growth will result in an acquisition at double the current price, most likely by a South Korean competitor who has publicly expressed interest, which is partially why we've taken this aggressive position.

With increased interest rates, we expect a market that is becoming more challenging for both retail investors and passive index investors who are exposed to overvalued companies. This provides us the opportunity to outperform by being a thoughtful and positive contribution to market price discovery. We believe more financial allocations to quality active managers are desperately needed in the markets to prevent major disruptive price dislocations.

Please let us know if you have any questions. We hope you and your families are well and I look forward to writing you once again in a few months.

Best Regards,

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