Dear Investor,

In this letter we will review our performance in Q1 2022 including our biggest impact performers as well as our investment focus for the remainder of the year.

Rod Capital Q1 2022 Results

In the first quarter of 2022, Rod Capital was down -11.9%. Russell 2000 Growth stocks were down -13.5% while the S&P 500 was down only -4.6%. Russell 2000 Growth stocks are the types of stocks that make up the majority of our net portfolio. However, we compare our results to the S&P 500 (to our own disadvantage) because we take a long-term view. The S&P 500 is the best gauge of the stock market on a long-term basis because it represents the majority of the total value of all stocks.

We attribute S&P 500 outperformance to two factors: 1) the large number of stock buyback programs that seem to be supporting prices of relatively overvalued companies, and 2) retail shareholders who continue to purchase ETFs and buy stocks regardless of valuation.

Being value hunters, these two factors are ones in which we tend to ignore. Stock buybacks and retail buying is not supposed to have such an outsized influence on the market. Yet, it seems that overall liquidity has spread thin, especially since Russia invaded Ukraine, causing the divergence of weak smaller cap names while buybacks and retail continue to support the S&P 500. This has caused major underperformance for us.

Our top performers were mostly short positions in Q1. Carvana Co. (CVNA), Rivian Automotive Inc. (RIVN), and NIO Inc. (NIO) led our best performing short positions and contributed 2.82% combined. Our best contributing long position was Pebblebrook Hotel Trust (PEB) which added 0.90%. We also held smaller energy and opportunistic value stocks that performed well.

Our worst performers were our top position (currently #2 position) Callaway Golf Company (ELY) which took us down -2.24% and RH (RH) which brought us down -1.98%. Consumer discretionary stocks were hit by the possibility of recession despite continuing to post strong results. Our top megacap stock Meta Platforms Inc. (FB) was hit with a high profile earnings miss (-1.96%). And our air leasing stocks led by Aercap Holdings (AER) were impacted by the loss of planes as a result of the Russian war on Ukraine (-1.30%).

Q1 2022 Review

A year ago our record of outperformance led to an influx of new investors. Today, many of those same investors who had that unfortunate timing have run for the hills. We can relate. Chasing great performance when things are hot and panic selling when things are rough has been tempting and we have made these types of decisions many times. Frankly, it’s just always a tough business, even with a ton of experience. Fear and greed are consuming and sometimes dangerous emotions that lead to market inefficiencies and opportunities.

Before I managed a hedge fund, I didn't pay much attention to monthly returns or worry about short term investor sentiment. My greatest concern was always, "Do I have enough information and understanding of my investments and of the overall economic environment?" And the answer was always the same, "No." But the more information I could grasp, the more risks I could take, knowing that probabilities are on my side. The less understanding, the less risk I could accept. I have sometimes found myself floating away from these basic concerns operating as a hedge fund and am working to be better focused on what matters.

2022 Investment Focus

Today, we are using the unique opportunities in the market to take more aggressive positions in certain small cap names that the market has abandoned. We are currently targeting a net exposure of around 90% and gross of 180%. The reason for the higher net exposure is that we believe we are going into a period of increased buyout activity. Over half of the net exposure is to cash rich companies that have an elevated chance of acquisition.

Our top name is an innovative South Korean semiconductor company which was the first company to make certain patented chips for OLED screens back in 2003. They were set to be acquired by a Chinese company but were blocked by the United States last year due to the strategic importance of their technology. The stock has fallen to nearly half of that buyout price despite over a third of the market cap being cash and reports that they have once again begun to shop themselves to potential buyers. We believe the stock is extremely attractive even without an acquisition, but, of course, are rooting for a big payday from a buyout.

On the short side, we are taking a closer look at the influence of buybacks and stock compensation. Our long-term short book has been the weakest part of our strategy for over a year now and we are looking to improve it by factoring in the effect of buybacks along with retail excitement. The most frustrating aspect in reviewing our shorts in the last year has been that we picked many of the right stocks to short, but suffered from major position sizing mistakes. For example, in the last year we held prescient short positions in Shopify (SHOP), Carvana (CVNA), and Peloton (PTON) – which were down approximately 50, 60, and 80 percent – but made the mistake of sizing larger short positions in Apple (AAPL) and Tesla (TSLA) – which were up about 30 and 50 percent. We ignored Apple buybacks and retail investment devotion to both Apple and Tesla and instead focused on valuation and the safety of shorting larger companies. We also didn't put a great enough weight on hidden stock-based compensation expense which are more extreme in the smaller names like Peloton. Had we flipped the sizing on these short positions, we would have had significantly improved results.

Improving the effectiveness and correlation of our hedging on the short side is a primary focus. For example, our second largest short today is Opendoor Technologies Inc. (OPEN), a cash losing company at risk in any real estate slowdown. It offsets some of our positions in real estate and takes advantage of the tremendous downsize risk in a company with outsized stock-based compensation and a questionable business model that Zillow Group (ZG) rightly chose to abandon.

Inflation is running very hot and employment is very strong - an unusual and disruptive combination. This is lighting a fire under all of us and might be exactly what the economy and world needs right now - one that gets back to work and becomes more serious and less speculative. People are gradually becoming less interested in gambling and more interested in investing in the market. We believe this is healthy and expect corporate buyout activity to rise significantly and are looking for the best candidates in the small and mid cap space. We are also optimistic that valuations will gradually normalize, opening up a prosperous period for more calculated long-term risk takers.

Perry Rod, RCM Chief Investment Officer