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Dear Investor,

In this letter we will review our performance in Q4 & FY 2023 including our biggest impact performers as well as our investment focus for 2024.

Rod Capital 2023 Results

For the full year, Rod capital was up 15.11% while the S&P 500 was up 26.25% and the Russell 2000 was up 16.89%. In addition, Russell 2000 growth companies were up about 18%, while investment grade corporate bonds and 20-year treasuries were up about 9% and 3%.

In the fourth quarter of 2023, Rod Capital was up 4.44%. The S&P 500 was up 11.68% and the Russell 2000 was up 14.02%.

Our top performer for the year was Lionsgate (LGF) contributing 8.08%. We spoke about this position a year ago and have since sold out of this position after it reached our target price.

Our worst performer for the year was shorting Coinbase (COIN) which hit us for -3.43%. We continue to short Coinbase after its enormous 391% run up for the year.

In the fourth quarter some of our short positions weighed on our positive results. For example, cryptocurrency stocks Coinbase (COIN), Microstrategy (MSTR), and Riot Blockchain (RIOT) collectively dropped -5.00%. We feel even more strongly that these securities are grossly overvalued and present great hedging opportunities today.

Q4 & YTD 2023 Review

Q4 felt like the circus had returned to the stock market. Inflation was declared defeated and it was again time to close your eyes and buy everything. Despite a long list of positive results for us on the long side, it was once again an unusually rough time to be simultaneously short stocks like Tesla (TSLA), which hit us for -3.21%, Opendoor (OPEN) -2.31%, and other high-flyers that rose – even with negative news about the fundamentals of their businesses. We attribute some of that activity to end of year tax gain and loss harvesting decisions and the growing complacency in the market due to overall gains with the megacap stocks.

I’ve been asked, “Do you want to be right or do you want to make money?”

In the long run, being right is still the way to make money. Stick with good management, good ideas, fundamentals, and reality. You may sometimes suffer in the short-term, but you will ultimately succeed in the long-term.

Yet, there were also times I was just not right. For example, how did I manage to lose -1.34% shorting AMC in 2023 despite the fact that I was right that the stock would fall apart? It fell 85% in 2023! How could I have possibly lost money shorting that?

In reviewing mistakes in recent years, I have found that less than half of them had to do with being generally wrong about specific investments. Instead, they have more to do with position sizing, the speed of removing or adding positions, and making macro side investments.

In general, as a single individual portfolio manager, I have come to realize that balancing too many investment layer risks at once and reaching beyond my core competency – which is valuing companies and special situation equity positions – stretches my lonely self too thin. One example that cost us in the last few years has been partially hedging a mostly small cap portfolio with some large cap indexes. I added another layer of risk with the side belief that small caps would finally outperform large caps. The opposite has persisted. It was an unnecessary layer of investment risk that has cost us a few points every year. We have removed this unnecessary investment risk and are now tracking and eliminating other distracting layers of risk.

2024 Investment Focus

After the government poured an astronomical amount of stimulus into the economy, the idiocy that gripped the markets is still rippling today. That’s in addition to the insane politics that has endured. And so, rather than trying to understand all of that, I have to just put my head down and focus and invest on what I know. This is how I kept my head together during the Covid crisis.

For example, this month I have put on an arbitrage strategy to continue to short Microstrategy (MSTR) and hedge it with new Bitcoin exchange-traded products (ETPs) like IBIT, FBTC and GBTC. Microstrategy trades at an overvalued 40% premium to its Bitcoin holding plus legacy business, minus their debt and dilution. The company and CEO are selling their shares to buy Bitcoin (they already own more than 1% of the Bitcoin float), so they are single-handedly Bitcoin’s most important buyer. Incidentally, as long as that premium exists, Bitcoin will have a consistent buyer. But when that premium inevitably grinds down and turns into a discount, Bitcoin will face a reckoning and those same ETPs will be good short candidates. As for today’s Microstrategy, there is no longer a reason to pay a premium for an indebted, diluting company with a small old software business, whose market cap is entirely based on Bitcoin holdings, when simple exchange-traded products now exist.

This kind of hedged strategy still has its risks but is ideal because predicting what the overall market will do – even with silly cryptocurrency - is always speculative. We may indeed be in a soft-landing goldilocks style economy now where price and wage increases have slowed down and interest rates can come down. But does that suggest the coming of disinflation and a market downturn? Tesla (TSLA), for example, trades at the same price it did over a year ago when the expectation then was for double this year's earnings. Double! Is that sustainable and are there big risks in the megacaps? You better believe it. It's best to stay vigilant.

In 2020, we outperformed in a year when there was a major black swan event. That was because we didn't ease up on our short positions and were primarily long already beaten up stocks with more limited downside. We've remained positioned in this way in case a future unforeseen crisis unfolds, which shaves down our performance, but we are confident this insurance is necessary for when things go surprisingly bad.

Today, we are about 145% long and 55% short after adjusting out unusual cases of large cash pile companies (which increases our exposure by around 30%). A third of our long exposure involves short-term special situations such as mergers & acquisitions and special positioning for near-term events. This reflects our overall conservativism with our 'regular' long-short portfolio netting out to around 50%. In addition, we are also closer to net neutral in our long-short portfolio of higher risk higher valuation positions. Higher risk, higher valuation positions outperformed in Q4 and in recent years but we expect that trend has run its course.

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As for that AMC loss last year I mentioned, I took on an appropriately sized short position early on and capitulated when the going got tough. I thought I was doing risk management in reducing the position. And then, when the event I was waiting for finally came and the math said that the company's dilution would almost certainly and dramatically force the price to drop and offset the cost to borrow shares, did I reup the position quickly and appropriately? Or did I get distracted with other layers of the portfolio?

This is why I have reduced the number of positions I take on by half and am sticking with what I know best – which is not much, but enough to beat the market in the long run.

Don't try this stuff at home. 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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