**Q3 2021 Masonry All Cap Select Commentary** **October 2021**

"We are going to discover that, as time progresses, bond yields are entirely decoupled from inflation."

*Russell Napier; Interview from July 2021 with Mark Dittli*

To Our Client Partners:

The aim of our quarterly updates is to provide insight into the current portfolio and our thoughts on what may lie ahead. Please reach out with any questions or comments you have after reading our letter to you.

## Q3 2021 Overview of Performance and Positioning

As of September 30, 2021, we were approximately 96.75% in equities and equity-like securities and 3.25% in cash. The portfolio's largest positions at the end of the quarter were DISH Network (ticker: DISH), Kayne Anderson Energy Infrastructure Fund (ticker: KYN) and Star Bulk Carriers (ticker: SBLK).

For the quarter, the portfolio's largest contributors included Range Resources (ticker: RRC), Builders FirstSource (ticker: BLDR) and ConocoPhillips (ticker: COP). The largest detractors were Discovery, Inc. (ticker: DISCK), AMC Networks (ticker: AMCX), and Scorpio Tankers (ticker: STNG).

## Market Thoughts and Observations

Strangely, it seems that almost every day we enter into new and uncharted territory in some fashion or another. Segments of the stock market trade at historically high valuations that persist well beyond what any historical context might suggest possible. Interest rates stay stubbornly low while inflation remains stubbornly high. Our government officials tell us inflation is transitory yet the companies we follow – the boots on the ground, so to speak – are telling us elevated prices are here to stay.

The 3rd quarter of 2021 reflected Delta variant concerns and the potential for reinstating lockdowns, economic growth concerns coming out of China and supply chain disruptions around the globe. We think these most likely will amount to temporary blips in a longer term structural economic growth story. That said, we are watching closely to determine what effect a slowing Chinese economy might have on the rest of the world particularly with regard to demand for certain commodities. Our thesis at present is that the push for Green Energy and infrastructure spending may take the reins from China as the driving force global GDP growth in the decade ahead.  There seems to be ample evidence this may be the case as supply/demand imbalances (**Chart 1**) could lead to a structural upturn in commodity prices for many years (**Chart 2**) and result in a change in leadership in the stock market (**Chart 3**).

**Chart 1**

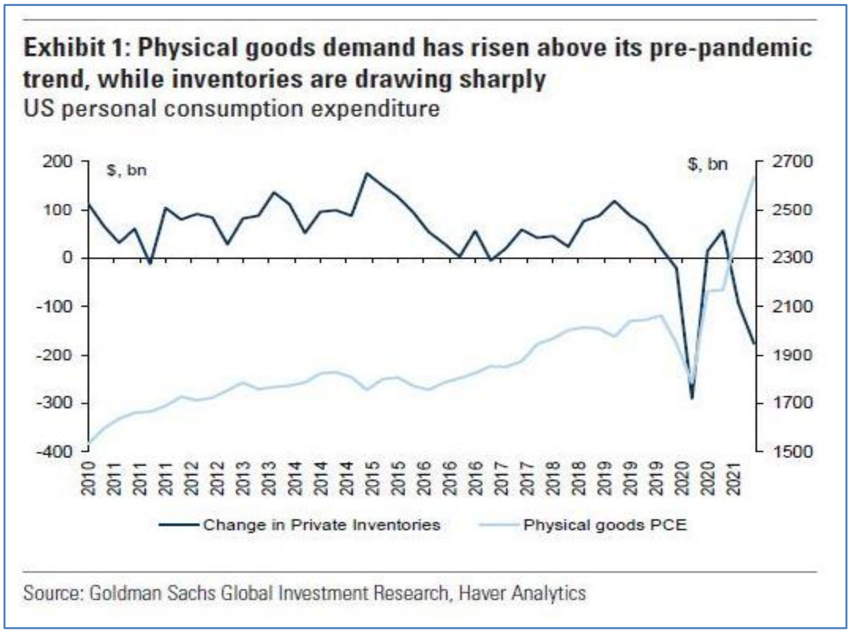
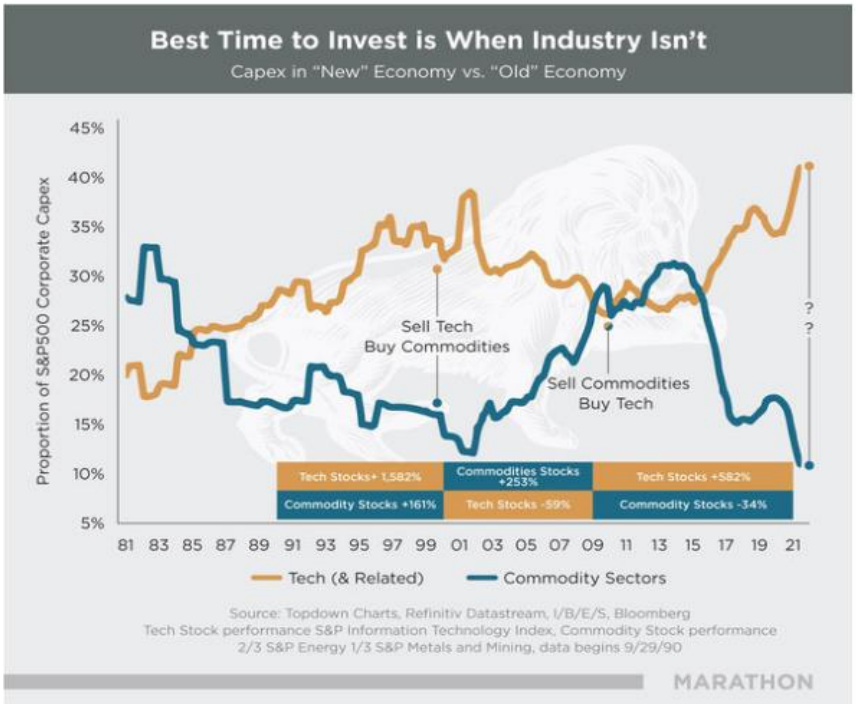



**Chart 2**

**Chart 3**




Source: https://twitter.com/MRAfunds/status/1442673913540923394?s=20

**Inflation and Interest Rates**

Our base case remains that the Fed is 'behind the curve' – and is doing so on purpose. The U.S. simply cannot afford to pay higher interest rates on its massive debt load. The Fed needs to continue to buy U.S. Treasuries to keep interest rates low while idly standing by as inflation runs hot. We are engaging in financial repression on a scale not seen since immediately after the end of World War II. This has profound implications for the stock and bond markets as we have outlined in our previous commentary.

We have wondered what the pin might be that bursts the speculative bubble we have witnessed over the past decade. The usual culprit is higher interest rates and tighter credit and more specifically, rapidly rising rates, which can have the effect of resetting stock price multiples in a sudden fashion. We have spent a healthy amount of time cutting through the popular narratives around market corrections and crashes and have noticed a common thread underlying each. The culprit always seems to be rising interest rates but they never seem to get the credit they deserve for ruining bull markets in stocks. Read the following commonly held beliefs around different periods of stock market distress as described by Wikipedia and then consider our take:

**Market Crash of 1973 – 1974**

Wikipedia:
*"The 1973–1974 stock market crash caused a bear market between January 1973 and December 1974. ... It was compounded by the outbreak of the 1973 oil crisis in October of that year. It was a major event of the 1970s recession."*

Masonry's Take:
In response to rising inflation, caused in large part by the oil crisis, short term rates spiked from under 4% in mid-1972 to almost 10% by the fall of 1974. In June of 1973 the yield curve inverted with short-term U.S. Treasuries higher than the 10 Year U.S. Treasury. Historically this has been a very reliable indicator of a coming recession.

**Severe Recession in 1979 and early 1980**

Wikipedia:
*"It is widely considered to have been the most severe recession since World War II. A key event leading to the recession was the 1979 energy crisis, mostly caused by the Iranian Revolution which caused a disruption to the global oil supply, which saw oil prices rising sharply in 1979 and early 1980."*

Masonry's Take:
Both short-term U.S. Treasuries and the 10 Year U.S. Treasury spiked starting in the fall of 1979 and lasting until the spring of 1980. The 10 Year U.S. Treasury moved from around 9.5% all the way up to 16% and the short-term UST from 9% almost to 14%. These are huge moves in a short amount of time. Again, we believe that contrary to popular notion, it wasn't the energy crisis per se that caused a recession and crashed the market but the interest policy response to an inflationary crisis.

**Market Crash of 1987**

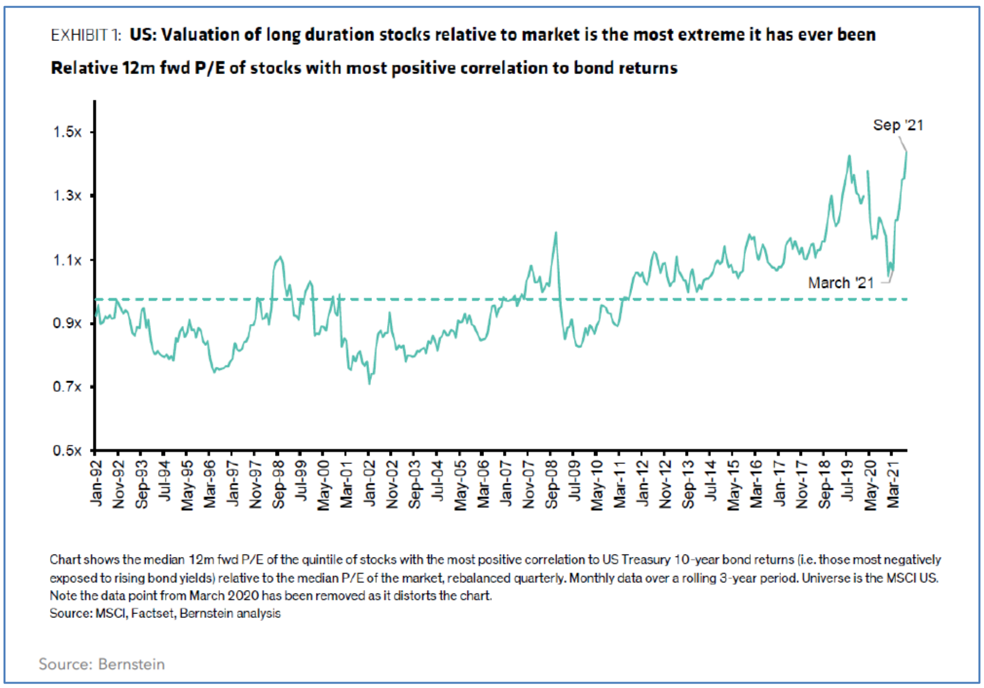
Wikipedia:
*"The "Black Monday" stock market crash of Oct. 19, 1987, saw U.S. markets fall more than 20% in a single day. It is thought that the cause of the crash was precipitated by computer program-driven trading models that followed a portfolio insurance strategy as well as investor panic."*

Masonry's Take:
The 10 Year U.S. Treasury moved from around 7% in early 1987 to over 10% by October. Short-term U.S. Treasuries also jumped from around 5.5% to over 7% during that time. Both peaked within days of Black Monday when the S&P 500 crashed over 20%.

Our point is simply that rapidly rising rates almost always seem to be at the center of some nasty market corrections despite credit being given largely to other events. If we are correct in our belief that the U.S. can't afford to let rates rise, the usual mechanism that serves to reset excessive valuations and pop bubbles is thereby absent. However, the release valve for keeping interest rates artificially low is that inflationary pressures will continue to build and grow.

When interest rates finally do rise, which we believe can only happen after the ratio of U.S. debt to GDP is lowered, there are large segments of the market constituting long duration stocks that are susceptible to significant valuation compression (**Chart 4**).

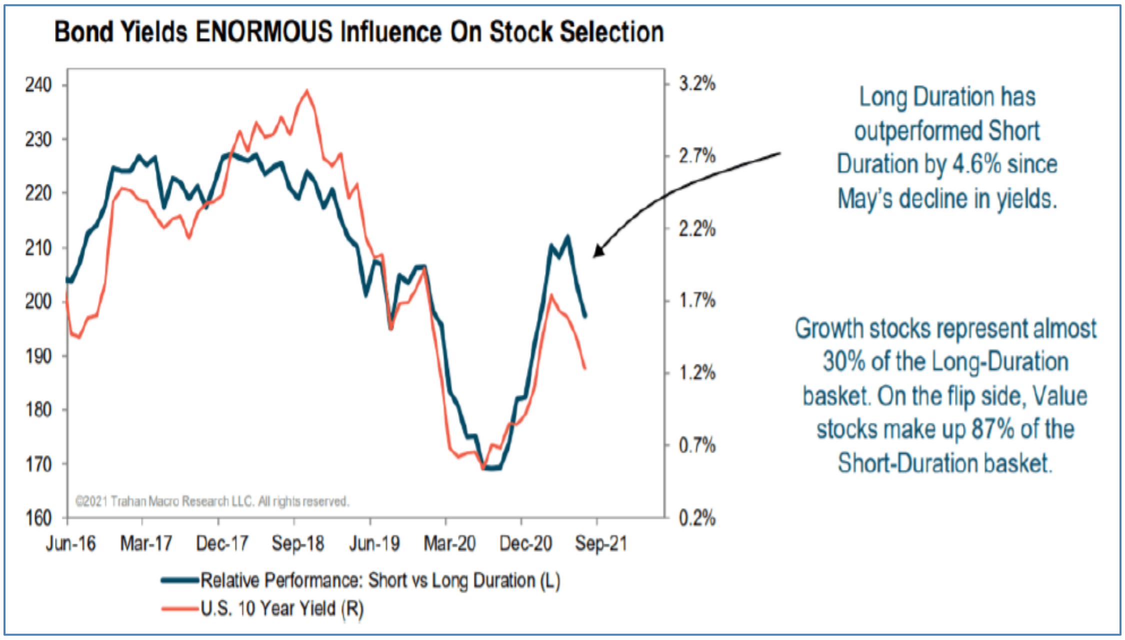
**Chart 4**




## Portfolio Highlights

**Chart 5**, in a nutshell, describes our performance in Q3 2021. Despite the economic prospects of the companies in the portfolio growing increasingly bright, the prices were essentially 'stuck in the mud' until September rolled around. The headwinds of a declining 10 Year U.S. Treasury rate, concerns over the Delta variant and the supply chain conundrum all served to mute our returns in the quarter. Only when the worries over the Delta variant started to recede and the 10 Year U.S. Treasury yield started to climb, did we start to generate meaningful outperformance. All of which occurred in the month of September. Our view remains that what occurred in Q3 2021 was a temporary headwind both to the U.S. economy and our portfolio.

**Chart 5**




Source: SeekingAlpha (SA), Kim Khan, SA News Editor, August 28, 2021

## Select Portfolio Details

Most of the portfolio activity in Q3 2021 was 'around the edges' with some minor adjustments occurring. As part of these changes, we did incrementally increase our exposure to the U.S. construction cycle (infrastructure – roads and bridges, commercial and residential) by adding or establishing positions in a steel producer as well two building products companies. In depth discussion of these additions will be included in the future as we are still refining our positions.

## Funny Anecdote: *from Tyler's perspective*

The macro-zeitgeist of the current investment mania is that the "system" is broken. The Federal Reserve, it is argued, has created a zombie economy dependent on central bank liquidity, and our federal budget deficit—financed by quantitative easing—now amounts to 15% of GDP. None of this is considered "good" or "sustainable" on a long-term basis.

Financial and political pundits opine that our debt levels will stimmy growth, exploding deficits will cause runaway inflation and crowd out private investment, and the moral hazard of not keeping our financial house in order is causing a liquidity trap that will end in complete collapse. Game over.

But while much has been said about negative aspects of our financial system, little is ever said about the genius of that scheme, viz., its ability to keep the game going. To understand how this works, we point you to a simple explanation embedded in the actual rules of play for the board game Monopoly:

> "The Bank never 'goes broke.' If the Bank runs out of money, the Banker may issue as much more as needed by writing on any ordinary paper."

The important point as it pertains to investing is to always remember that the "game" never ends. The players will change, and the rules will evolve, but the game goes on. As such, a large part of our job is to determine what is (and what is not) changing and how best to protect capital and profit from these developments—a process which we have laid out in this and past letters and will continue to do in the future.

## Firm Update

Masonry continues to grow in a measured but significant way since our founding. Total active assets under management were approximately $56.7 million at the end of 2019, $65.2 million at the end 2020 and $96.3 million at the end of Q3 2021. Total assets (discretionary and non-discretionary) now total approximately $500 million. We continue to pursue like-minded investors to join the firm and would value your help in identifying prospective clients.

Please feel free to contact members of our team with any comments, questions or potential investment ideas.

Best Regards,

Masonry Capital Management, LLC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THE DOW JONES – UBS COMMODITY INDEX IS DESIGNED TO BE A HIGHLY LIQUID AND DIVERSIFIED BENCHMARK FOR COMMODITIES AS AN ASSET CLASS. THE INDEX IS COMPOSED OF FUTURES CONTRACTS ON 19 PHYSICAL COMMODITIES. NO RELATED GROUP OF COMMODITIES (E.G., ENERGY, PRECIOUS METALS, LIVESTOCK, AND GRAINS) MAY CONSTITUTE MORE THAN 33% OF THE INDEX AS OF THE ANNUAL RE-WEIGHTINGS OF THE COMPONENTS. NO SINGLE COMMODITY MAY CONSTITUTE LESS THAN 2% OF THE INDEX.

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