Q1 2022 Masonry All Cap Select Commentary **May 2022**

"….in a shift of secular or long-term significance, the markets will be adapting to a new set of rules, while most market participants will still be playing by the old rules."

Bob Farrell, Merrill Lynch

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 may have after reading this letter.

Q1 2022 Overview of Performance and Positioning

We were pleased with the performance in Q1 2022 of the Masonry All Cap Select (MACS) strategy. For clients who have the MACS as their primary investment objective, returns net of fixed fees were, on average, up almost 18% YTD through March 31, 2022. As performance differs from account to account due to a variety of factors, please contact us for a report that is specific to your account(s). This performance compared very favorably to that of the S&P 500 which returned (4.6%) in the 1st quarter. *

As of March 31, 2022, the MACS strategy had approximately 96% in equity or equity-like securities and approximately 4% in cash and fixed income-like securities. The portfolio's largest positions at the end of the quarter were EQT Corp. (ticker: EQT), Warner Bros. Discovery (ticker: WBD) and Range Resources (ticker: RRC).

For the quarter, the largest contributors included RRC, EQT and ConocoPhillips (ticker: COP). The largest detractors were the investments in Builders FirstSource (ticker: BLDR), Gaia, Inc. (ticker: GAIA) and Carrier Global Corp. (ticker: CARR).

To put it simply, for the quarter we were long the sector that went up the most (energy stocks and other energy-related securities) which benefited from a rise in the underlying commodity prices and avoided the stocks (profitless tech and other long duration stocks) that went down the most in the face of rising inflation and increasing interest rates. That combination provided some of the best absolute and relative quarterly performance we have ever experienced. Unfortunately, it will be hard, if not impossible, to stage a repeat of it in future quarters - sorry to disappoint.

*Please see Disclaimers on p. 11 regarding performance and benchmarks.

If you have not had the opportunity to read the presentation we distributed in November of 2020 we encourage you to do so at 100 Reasons Why. Much of what has happened in the financial markets since Election Day, and particularly in Q1 2022, may begin to make more sense if viewed through the lens of the charts, graphs and commentaries presented.

Market Thoughts and Observations

The following is an excerpt from Ray Dalio's LinkedIn post which was re-posted on the ZeroHedge website on January 4, 2022:

> *"The world order is changing in important ways that have happened many times before in history, though not in our lifetimes. How the world order is changing has created the paradigm that we are in. By "paradigm," I mean the environment that we are in. Paradigms typically last about 10 years, with occasional big corrections within them. They are driven by a persistent set of conditions that takes those conditions in a swing from one extreme to an opposite extreme. Because of this, each paradigm is more likely to be opposite than similar to the one before it. For example, the Roaring '20s were followed by the depressionary 1930s, and the inflationary 1970s were followed by the disinflationary 1980s. The assets and liabilities that you would most like to have, and those that you would most like to avoid, change with the paradigm that exists at the time. For example, in the Roaring '20s you'd want to own stocks and avoid bonds, while in the depressionary 1930s it would be the opposite; in the inflationary 1970s you'd want to own hard assets like gold and avoid bonds, while in the disinflationary 1980s you'd want to own financial assets and avoid hard assets."*

We have written in the past about how decades represent distinct points of change. Think about how we categorize things like music or fashion. For example, SiriusXM has channels dedicated to music that is defined by each decade. Yet, we continue to read the musings of other investment managers who state they are using current weakness to add to existing positions in the winners of the disinflationary and declining interest rate environment of the 2010's. While they correctly observe the landscape has changed via higher inflation and rising rates, they seemingly fail to contemplate that perhaps those stocks that did so well in one type of environment might not do as well in another that is literally the polar opposite. That construct seems strange to us and hasn't been proven particularly successful since inflation began to trend upwards in late 2020 and early 2021. We strongly suggest reading Ray Dalio's full post in ZeroHedge which can be found here Ray Dalio on the Changing World Order | ZeroHedge to get some additional perspective on the topic.

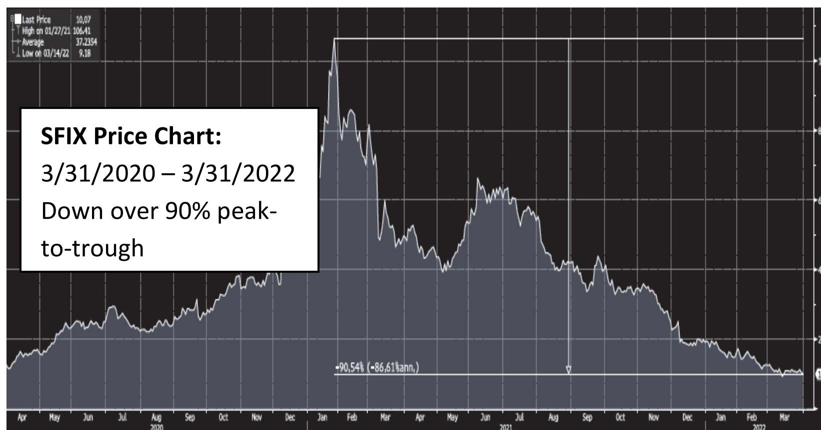
We surmised a few years ago that a bubble had been forming in U.S. stocks and, further, that this had the effect of draining demand from Value stocks, especially those that were in commodity-related businesses. Companies with hard assets as opposed to soft or intangible

assets seemed to be shunned by investors. **Chart 1** shows the relationship between the S&P GSCI, which is a benchmark for the performance of the commodity markets, and the S&P 500 index. As you can see, the relationship between the two moves in distinct cycles (as commodities do well the S&P 500 does not and vice versa). The most recent cycle low in March of 2020 pushed the relationship to extremes not seen before in a period spanning back to 1970. Only recently have commodities started to outperform. It's highly likely the recent low marks the beginning of a new cycle where commodities significantly outperform the S&P 500 for quite some time.

Chart 1

We believe Stitch Fix (ticker: SFIX) is highly representative of the high revenue growth, no profit stocks that investors piled into during the pandemic. The company grew their revenues from approximately $1.25 billion in 2018 to over $2.1 billion in 2021, but the stock price is now down over 90% from its peak **(Chart 2)** and currently trades below its trough in the March/April period in 2020.

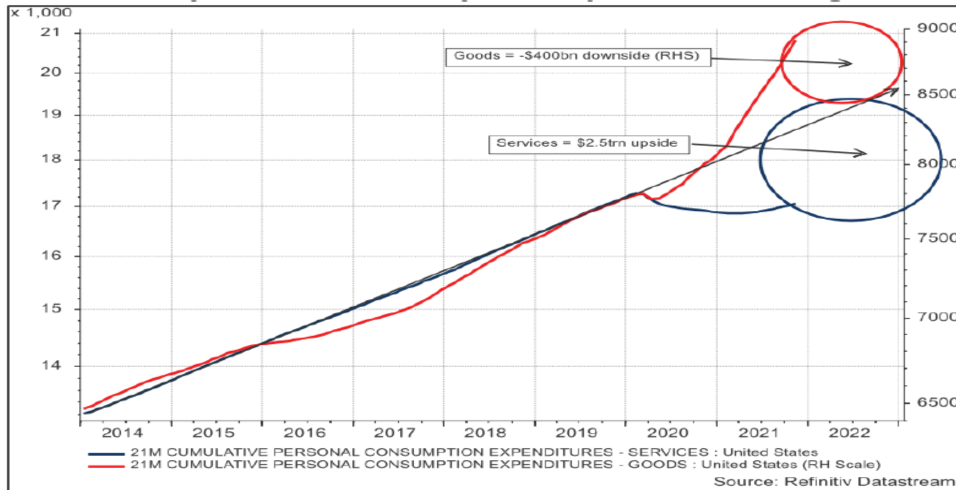
Chart 2



Demand for consumer goods, and particularly tech products and services, was pulled forward leaving an air pocket to be filled in its wake. **Charts 3 and 4** show the distortions between the

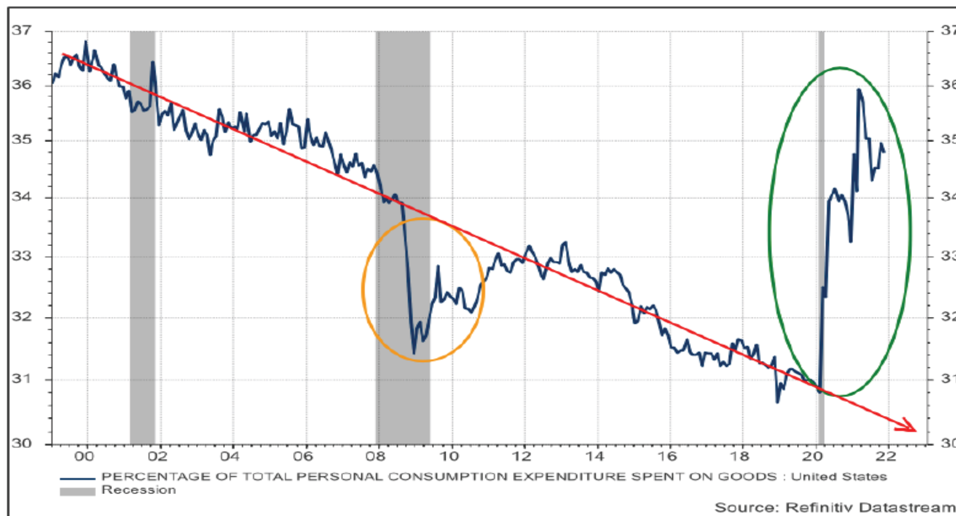
U.S. personal consumption expenditures of goods and services since the onset of COVID. We have begun the process of rebalancing back to trend and that process is already being reflected in a substantial retrenchment in price of those stocks that benefited so handsomely from this short but powerful dynamic.

Chart 3



Goods purchases exploded above trend to the tune of $400 billion while the retreat in Services spending was below trend leaving $2.5 trillion in upside to be spent.

Chart 4



Personal consumption of Goods was decimated during the Great Recession but exploded to the upside during the lockdown periods of COVID.

We remain convinced that the rotation currently under way from the securities that benefited so greatly from a decade of disinflation (bonds, consumer discretionary and technology stocks) will continue. The primary beneficiaries will be those in the real economy who will thrive in an era of elevated nominal GDP. If the past sets precedent for the future in the financial markets **Chart 5** could be said to be thesis confirming. The chart comes from a Bloomberg article written by Lu Wang and Jeremy Herron. Volatility is a hallmark of regime change in the markets. Days of 4% or more declines being erased intraday occurred during bear markets for the Nasdaq 100,

an index heavily dominated by technology. We don't believe 2022 will prove to be the exception to the experiences in 2000-2002 and 2008.

Chart 5

The table below shows the past instances where the Nasdaq 100 erased an intraday decline of bigger than 4%.

Date	Intraday Loss	Close
1/24/2022	-4.94	0.49
11/13/2008	-4.76	6.48
10/23/2008	-4.84	0.17
10/16/2008	-4.18	5.52
7/15/2002	-4.55	2.02
6/26/2002	-4.19	0.44
6/14/2002	-4.61	0.28
10/12/2001	-4.04	0.29
2/23/2001	-4.78	1.16
1/8/2001	-5.15	0.6
10/26/2000	-4.87	1.92
8/3/2000	-4.25	3.82

Interest Rates and Inflation

A headline caught our attention the other day from an article written by Eric Peters, CIO of One River Asset Management. It read: "$30 Trillion in Debt Means Ignore All The Talk: Central Banks Are Only Pretending to Lean Against Inflation." We have expressed our views at length in past letters regarding this shared belief with Mr. Peters. At our current levels of Debt-to-GDP, history shows the only way out is to default, restructure or engage in financial repression.** For all of the talk about raising rates to squash inflation, we are nowhere close to the level of real yields that would necessitate alleviating the current inflationary pressures. Higher inflation and low real yields will be with us until our Debt-to-GDP ratio allows us more maneuverability to use interest rates as an inflation regulator. We are presently residing in this world of financial repression. It is the only politically palatable answer to reduce our debt. As Ayn Rand famously said, "You can ignore reality, but you cannot ignore the consequences of ignoring reality."

This quote by Jim Reid, financial historian at Deutsche Bank AG sums up nicely the predicament we are currently in:

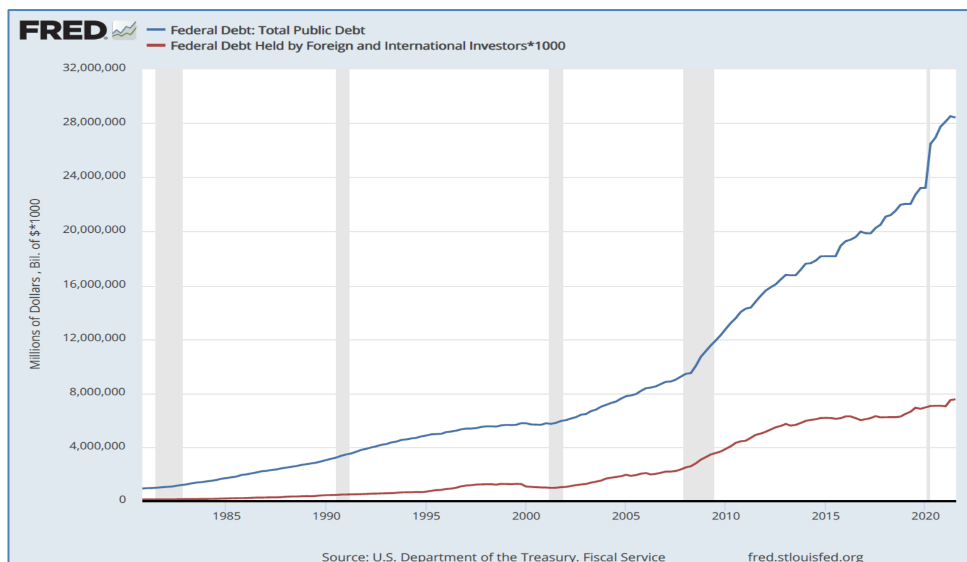
> *I'm not convinced the bond market's prediction of future inflation is particularly useful. Spot real yields should rise from here as spot inflation falls, but I'm still not convinced inflation falls anywhere near enough over the next couple of years for real yields to get*

**From Wikipedia: *Financial repression comprises "policies that result in savers earning returns below the rate of inflation" to allow banks to "provide cheap loans to companies and governments, reducing the burden of repayments." It can be particularly effective at liquidating government debt denominated in domestic currency.*

anywhere near positive. I'm also still convinced real yields on this measure stay negative for the rest of my career due to financial repression. If I'm wrong (maybe due to nominal yields rising more than I think and inflation falling faster), run for the hills given the global debt pile.

For as much as the Fed talks of Quantitative Tightening as well as raising the Fed Funds rate, one must ask who will be the marginal buyer of U.S. Treasuries if not the Fed? As you can see in **Chart 6**, the level of foreign debt held as a percent of the total outstanding U.S. debt has shrunk dramatically since around 2000 and that trend has accelerated in the past few years. With deficits running at 8% of GDP and our Debt-to-GDP level of around 120%, the U.S. is highly sensitive to increases in interest rates. We would argue this puts the Fed in a box. They can't let rates rise to a level high enough to attract buyers or it would bankrupt the system.

Chart 6



The 2 Year US Treasury (UST) and 10 Year UST inverted in the quarter. This prompted calls for an imminent recession in the U.S. The contrarian in us immediately moved to an anti-consensus call which would be no recession. After all, how many times in the past has the consensus been right with regard to such important issues (hint: not many in our experience). Our view is that the real worry should come when the 3 Month UST inverts with the 10 Year UST. That is a tried-and-true signal that Fed policy is too tight and becoming restrictive. This may yet happen, but we are of the belief (again contrarian) that there is no way the Fed can raise the Fed Funds rate to anywhere near the level predicted by the major Wall Street firms. To get to a level that would contain inflation would bankrupt our country through some combination (or maybe all of them) of a bear market in stocks, much higher long-term interest rates or a recession. All of these scenarios we simply cannot afford.

Portfolio Highlights

Despite this quarter's returns being largely driven by our investments in energy related stocks, we remain very well-diversified in the portfolio. We have a large exposure to the media and content space (don't worry we don't own Netflix) through a combination of companies with unique and differentiated positions in streaming. Only one (Warner Bros. Discovery, ticker: WBD) has ambitions of being one the largest streaming companies in the world. Niche services (AMC Networks; ticker: AMCX), deep libraries (Lions Gate; ticker: LGF/B) and exposure to offerings with advertising at lower monthly fees (Paramount Global; ticker: PARA) form the other elements of our collective position. DISH remains one of our largest holdings and we are very excited about their May 10 investor day to be held in Las Vegas. We believe it could very well mark the start of a long and financially rewarding journey for DISH and their shareholders as management plans to unveil their 5G strategy at the event.

We continue to maintain or build positions in companies exposed to homebuilding and residential development such as the St. Joe Company (ticker: JOE) and building supply distributor, Builders FirstSource (ticker: BLDR). Housing remains woefully undersupplied in this country as a result of the overhang from the Great Recession. There will be peaks and valleys in the journey due to inflationary factors, rising interest rates and rising home prices, but ultimately there will be more demand for homes than there is supply due to favorable demographics.

Last, we should mention our higher than usual exposure to the commodity complex exposes us to higher than usual volatility. It is, in our view, well worth the sometimes-stomach-churning price movements to be able to profit from the extraordinary favorable setup we see. There is a wide swath of securities whose current price is a fraction of what we believe to be their intrinsic value in this area of the market.

Select Portfolio Details

We are long natural gas producers in EQT, RRC and ConocoPhillips (ticker: COP) among others. These stocks not only traded at ridiculously low valuations post-COVID, providing a short-term opportunity, but there were, and still are, long-term structural dynamics that make them attractive. Strangely, and in quite short order, natural gas producers are now viewed as an acceptable 'bridge' between the fossil fuel era and the new era of clean energy. EQT's website proudly proclaims, "Unleashing U.S. LNG" along with "Replacing international coal with American natural gas is the largest green initiative on the planet and the world's best weapon to address climate change." In addition, U.S. produced LNG is now being consumed by Europe in an effort to replace Russian gas which is having a substantial effect on the supply and demand function here at home.

Oil producers have shown an enormous amount of discipline thus far in not moving to overproduce. This is great news for shareholders, but it translates to higher oil prices for everyone else. The International Energy Agency recently warned that markets could lose up to

3 million barrels per day of Russian crude oil and refined product from the month of April. When viewed in the context of the level of U.S. Crude and Product Inventories and the U.S. Strategic Reserves **(Charts 7 and 8)** it should be alarming to everyone with the exception of the oil companies.

Chart 7

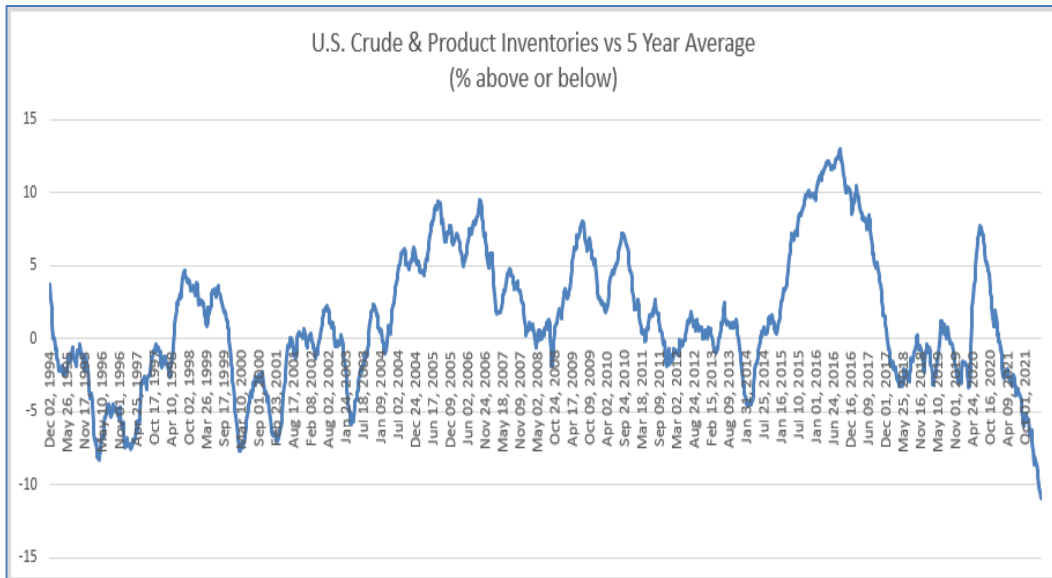
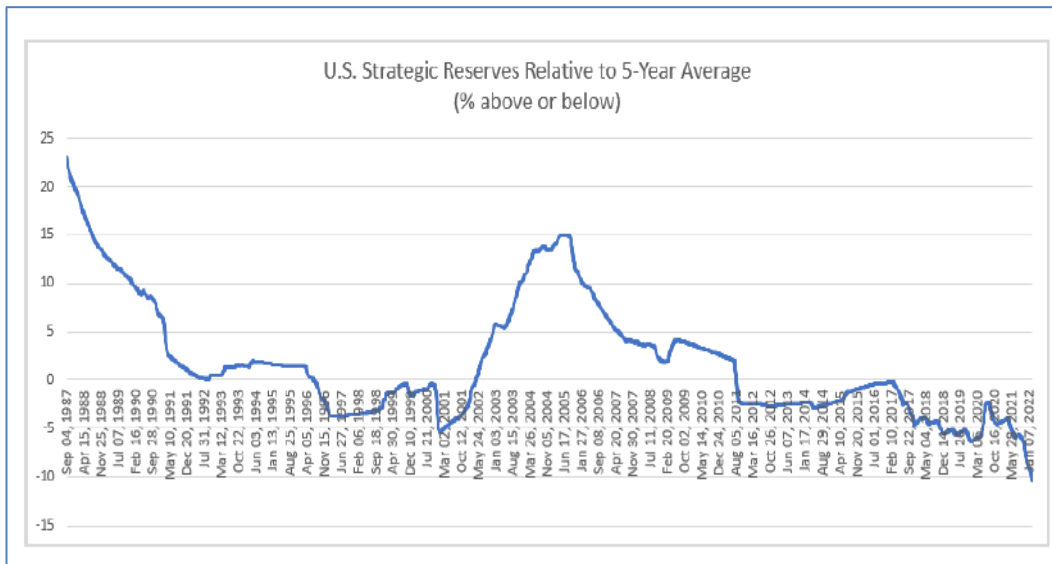


Chart 8



We are long other commodity producers as well. Freeport-McMoRan Inc. (ticker: FCX) is a miner predominately of copper and gold. After a recent conference, Richard Adkerson, CEO, responded to a Goldman Sachs analyst comment that copper prices need to go higher to stimulate a supply response. Adkerson said the market tightness "is far beyond a price issue."

Copper miners, for a variety of reasons, are simply not able to meet the supply needs of a world moving through an energy transition. In a commodity business (or really any business) rising demand combined with supply scarcity is rare to see and typically leads to large profits. A first-year college student studying economics learns this simple lesson.

From a fundamental company view, FCX is trading at 5x EBITDA on 2024 company estimates and is currently generating substantial amounts of free cash flow. Their operating cash flow in 2022 is estimated to be approximately $8 billion at $4.50/lb. copper with each $0.10 change in copper equating to a $365 million impact on those cash flows. Their capex is slated to be $3.3 billion this year. They have a conservative balance sheet with a net debt to adjusted EBITDA ratio of around 0.1x in Q4 2021 down from 1.5x in Q4 of 2020 with no significant debt maturities until after 2026. Debt reduction has been a focus of the management since the middle of the last decade, and they recently achieved their net debt reduction target of $19 billion which was a goal set at year-end 2015. They established a base quarterly dividend of $0.30 per share and the company has moved to a performance-based payout policy where they are now designating up to 50% of their free cash flow for shareholder returns split between share buybacks and dividend payments above the base dividend. Interestingly, we are seeing these types of formulaic earnings or free cash flow-based shareholder return policies across the entire complex of our holdings in the commodity space. Maybe they know or see something most don't. Our cost in FCX is just under $37.50 per share and the stock closed at $49.74 at the end of the quarter.

Funny Anecdote: *from Mark's perspective*

I came across the headline in Bloomberg and it sums up the lunacy typically seen during peak bubble periods. This gem was from March of this year.

03/16/2022 11:17:47 [BN] Bloomberg News

Fraud Prevention CEO Rogas Pleads Guilty to Defrauding Investors

By Chris Dolmetsch

(Bloomberg) -- The co-founder and former chief executive of cyberfraud-prevention company NS8 Inc. admitted to defrauding investors by using fake financial statements to raise more than $100 million in financing.

You just can't make this stuff up. Investment discretion and discernment, valuation discipline, etc. all just fly out the window when the investing public thinks there is easy money to be made. The reality is that there is an endless supply of fraudsters anxious to help naïve investors permanently part with their money.

Firm Update

The firm continues to grow in a measured but significant way since our founding. Total active assets under management were approximately $70 million at the end of Q1 2022. Total assets

(discretionary and non-discretionary) now total well over $500 million. We continue to pursue like-minded investors to join us as clients and would value your help in identifying individuals and institutions that might be a good fit.

We have an update regarding employees of Masonry. February 28th was Tyler Van Selow's last day with us. We were saddened to see him leave to pursue endeavors outside of the financial industry but are grateful for his hard work and dedication in getting Masonry 'off the ground' these last few years.

We are thrilled to announce that Clay Sefter has joined us as a Managing Director after over 5 years at Chase Investment Counsel here in Charlottesville. We are confident Clay's background in accounting, investment research and portfolio management will allow him to make a substantial contribution to our investment management process and also to Masonry's business endeavors.

As part of our regulatory requirement, we are making available our Form ADV Part 2 to all of the existing clients of Masonry Capital Management and the limited partners of the Masonry Partners Fund. Please contact us via email at mark.meulenberg@masonrycap.com or office phone at 434.817.4237 if you would like to receive an updated copy. Additionally, the updated form is posted to our website, masonrycap.com.

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

Best Regards,

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ANY PERFORMANCE DEPICTED HEREIN IS UNAUDITED. PERFORMANCE SHOWN IS ALSO NET OF ALL FEES AND EXPENSES AND REFLECTS THE REINVESTMENT OF DIVIDENDS AND OTHER EARNINGS. THE FEE STRUCTURE APPLIED TO THE PERFORMANCE WAS THAT OF A TYPICAL INVESTOR: PERFORMANCE SHOWN IS FOR ELIGIBLE INVESTORS PAYING THE STANDARD FEES (AS APPLICABLE). YTD PERFORMANCE ASSUMES AN INVESTMENT HAS BEEN HELD SINCE JANUARY 1, OF THE RELEVANT YEAR. BECAUSE SOME INVESTORS MAY HAVE DIFFERENT FEE ARRANGEMENTS AND DEPENDING UPON THE TIMING OF A SPECIFIC INVESTMENT, NET PERFORMANCE FOR AN INDIVIDUAL INVESTOR MAY VARY FROM THE NET PERFORMANCE STATED HEREIN. ACTUAL RETURNS WILL VARY AMONG INVESTORS. INVESTMENT RETURNS AND THE PRINCIPAL VALUE OF AN INVESTMENT WILL FLUCTUATE AND MAY BE QUITE VOLATILE. IN ADDITION TO EXPOSURE TO ADVERSE MARKET CONDITIONS, INVESTMENTS MAY ALSO BE EXPOSED TO CHANGES IN REGULATIONS, CHANGE IN PROVIDERS OF CAPITAL AND OTHER SERVICE PROVIDERS. INVESTORS RISK THE LOSS OF THEIR ENTIRE INVESTMENT.

MASONRY ALL CAP SELECT (MACS) PERFORMANCE: NO REPRESENTATION IS MADE THAT THE UNAUDITED PERFORMANCE SHOWN IS INDICATIVE OF FUTURE PERFORMANCE. AN ACCOUNT COULD INCUR LOSSES AS WELL AS GENERATE GAINS. PERFORMANCE FIGURES FOR EACH ACCOUNT INCLUDE INCOME ACCRUALS, REALIZED AND UNREALIZED GAINS AND LOSSES AND REFLECT THE DAILY WEIGHTING OF CASH FLOWS. ACCOUNTS THAT HAVE THEIR PRIMARY INVESTMENT OBJECTIVE AS THE MACS SRATEGY ARE INCLUDED IN THE PERFORMANCE PRESENTED AND ARE NET OF FIXED MANAGEMENT FEES, NET OF TRANSACTION COSTS AND INCLUDES THE REINVESTMENT OF ALL INCOME. NET OF FEE PERFORMANCE WAS CALCULATED USING THE ACTUAL ANNUAL FIXED MANAGEMENT FEES OF THE CLIENTS IN THE STRATEGY APPLIED MONTHLY.

PERFORMANCE RESULTS ARE NOT GIPS COMPLIANT.

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INDICES REPRESENT SECURITIES WIDELY HELD BY INVESTORS. YOU CANNOT INVEST IN AN INDEX.

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THE MSCI EMERGING MARKETS INDEX CAPTURES LARGE AND MIDCAP REPRESENTATION ACROSS 21 EMERGING MARKETS COUNTRIES. WITH 824 CONSTITUENTS, THE INDEX COVERS APPROXIMATELY 85% OF THE FREE FLOAT-ADJUSTED MARKET CAPITALIZATION IN EACH COUNTRY.

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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CERTAIN INFORMATION CONTAINED IN THIS MATERIAL CONSTITUTES FORWARD-LOOKING STATEMENTS, WHICH CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS “MAY,” “WILL,” “SHOULD,” “EXPECT,” “ANTICIPATE,” “TARGET,” “PROJECT,” “ESTIMATE,” “INTEND,” “CONTINUE,” OR “BELIEVE,” OR THE NEGATIVES THEREOF OR OTHER VARIATIONS THEREON OR COMPARABLE TERMINOLOGY. SUCH STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE OR ACTIVITIES. DUE TO VARIOUS RISKS AND UNCERTAINTIES, ACTUAL EVENTS OR RESULTS OR THE ACTUAL PERFORMANCE OF AN ACCOUNT MAY DIFFER MATERIALLY FROM THOSE REFLECTED OR CONTEMPLATED IN SUCH FORWARD-LOOKING STATEMENTS.

SPECULATIVE RISK:

AN INVESTMENT WITH MASONRY CAPITAL MANAGEMENT IS SPECULATIVE AND INVOLVES A HIGH DEGREE OF RISK. CERTAIN TECHNIQUES MAY BE EMPLOYED, SUCH AS SHORT SELLING AND THE USE OF LEVERAGE THAT MAY INCREASE THE RISK OF INVESTMENT LOSS. IN ADDITION, THE FEES AND EXPENSES, SUCH AS COMMISSIONS, OFFSET TRADING PROFITS. ALL OF THE RISKS, AS WELL AS OTHER IMPORTANT RISKS AND INFORMATION (INCLUDING, WITHOUT LIMITATION, INFORMATION REGARDING TRADING OBJECTIVES AND PROGRAMS, FEES, AND EXPENSES, TAX CONSIDERATIONS AND SUITABILITY REQUIREMENTS) ARE DESCRIBED IN DETAIL IN THE FIRM’S ACCOUNT AGREEMENT. PROSPECTIVE INVESTORS ARE STRONGLY URGED TO REVIEW THE ACCOUNT AGREEMENT CAREFULLY AND CONSULT WITH THEIR OWN FINANCIAL, LEGAL AND TAX ADVISORS BEFORE INVESTING WITH MASONRY CAPITAL MANAGEMENT. OUR INVESTMENT PROGRAM INVOLVES SUBSTANTIAL RISK, INCLUDING THE LOSS OF PRINCIPAL, AND NO ASSURANCE CAN BE GIVEN THAT OUR INVESTMENT OBJECTIVES WILL BE ACHIEVED. AMONG OTHER THINGS, THE PRACTICES OF SHORT SELLING AND OTHER INVESTMENT TECHNIQUES AS DESCRIBED HEREIN CAN, IN CERTAIN CIRCUMSTANCES, MAXIMIZE THE ADVERSE IMPACT TO WHICH INVESTMENTS MAY BE SUBJECT. TRADING GUIDELINES AND OBJECTIVES MAY VARY DEPENDING ON MARKET CONDITIONS. WE MAY ALSO USE VARYING DEGREES OF LEVERAGE AND THE USE OF LEVERAGE CAN LEAD TO LARGE LOSSES AS WELL AS LARGE GAINS.

ILLUSTRATIVE PURPOSES ONLY:

EXAMPLES OF OUR PROCESSES AND ANY OTHER IDEAS PRESENTED HEREIN ARE FOR ILLUSTRATIVE PURPOSES ONLY. THERE IS NO GUARANTEE THAT THE FIRM WILL ACQUIRE A POSITION IN AN ISSUER OR INDUSTRY REFERENCED IN SUCH EXAMPLES OR IDEAS OR THAT ANY SUCH POSITION WOULD BE PROFITABLE.

INVESTMENTS AND ACCOUNTS AT MASONRY CAPITAL MANAGEMENT:

- ARE NOT INSURED OR GUARANTEED BY THE FDIC OR ANY OTHER FEDERAL GOVERNMENT AGENCY
- ARE NOT DEPOSITS OF, OR GUARANTEED BY, A BANK OR ANY BANK AFFILIATE
- MAY LOSE VALUE