Q3 2024 Masonry All Cap Select Commentary **October 2024**

To Our Client Partners:

The Masonry All Cap Select (MACS) composite year-to-date return was 2.3% through September 30, 2024, and for clients who have the MACS as their primary investment objective their returns should approximate this performance. By comparison the S&P 500 return during the same period was 22.1%.

Overview of Performance and Positioning

While we are surely disappointed that our returns this year are trailing the S&P 500, unfortunately it is not unexpected. When the valuations of the market leaders get stretched as they are, it has been the hallmark of our strategy to remain disciplined and not 'chase' performance in the short-term. The better news is that while adhering to our core investing tenets we have outperformed the S&P 500 over what we consider a full market cycle with the MACS returning 19.0% net annualized over the last trailing 4 years versus the S&P 500 annualized return of 16.2%.

As of September 30, 2024, the MACS strategy had approximately 89.5% in equity or equity-like securities and approximately 10.5% in cash and fixed income-like securities. The portfolio's largest positions at the end of the quarter were the Kayne Anderson MLP / Midstream closed-end fund (ticker: KYN), The St. Joe Company (ticker: JOE) and Philip Morris International (ticker: PM).

The top contributors for the quarter were PM, EchoStar (ticker: SATS), and KYN. The largest detractors were Tidewater (ticker: TDW) and Weatherford International (ticker: WFRD).

Market Thoughts and Observations

The Federal Reserve announced a 50 basis point cut in the Fed Funds rate in September. The size of the cut and reasoning (that inflation has cooled to their satisfaction) has struck some as odd as the joblessness rate is still low and economic growth is firmly in positive territory. We were not surprised. We have written many times that the Fed would be forced to cut rates due to the interest expense on the U.S. debt becoming increasingly onerous and rapidly becoming the largest line item of the U.S. budget. The fastest way to lower the interest rate expenditure is to lower interest rates. As long as the U.S. is issuing substantial amounts of short-term debt (which they are), lower rates will do the trick.

The market may soon realize the "Fed Put" is dead and the "Fiscal Put" is now in the driver's seat. We have explained the ramifications of this at length in previous letters, so we won't repeat it again, other than to say the U.S. Treasury is now the dominant force due to our excessive fiscal spending and the Federal Reserve is merely an accomplice doing the bidding of the U.S. Treasury.

The Fed's recent action is likely the start of the second wave of inflation that we have been anticipating.

____

For some investors (more likely speculators), buying shares of a company's stock represents nothing more than trading a piece of paper. They buy based on what's 'working' in the market and they hope to sell at a higher price than they bought before the market happens to decide the no-brainer buy, as now proclaimed by the pundits (Jim Cramer comes to mind), to be a no-brainer sell. At Masonry, we believe a stock represents an economic interest in the underlying business. The concept is simple but profound. To hold this belief fundamentally changes the way one views the happenings of the stock market.

Using this framework, there is a simple way to think about how a price-to-earnings (P/E) multiple translates into the price paid for an ownership stake in the underlying business. Dividing 100 by the P/E gives the answer, which is commonly referred to as the earnings yield. If you buy a business at a 20x P/E your earnings yield will be 5%. If you pay a 50x P/E ratio your earnings yield will be 2%.

Consider Costco (ticker: COST), the adult version of Disney World. It's a wonderful and well-managed company but the stock, in our view, is a poor investment at its current price. The stock currently trades at P/E of 55x. Given the earnings yield example, at a 55x P/E, the earnings yield is 1.8% per year. Money markets are paying 4.5% and you get that yield without underwriting any business risk. To make money above and beyond the 1.8% current earnings yield one must assume nothing goes wrong in the business over time and that quite a lot goes right. At Masonry, we own a plethora of stocks at mid-single digit P/E ratios. If you own a stock with a P/E ratio of 5, the earnings yield is 20% per year (100 / 5x P/E = 20% earnings yield). At that valuation, in 5 years you would have earned back your original investment whereas with Costco, it would take 55 years to earn back your original investment assuming no further earnings growth. Costco is only one example of the many, many extreme valuations we are seeing in the stock market. To us, these excessive valuations defy economic common sense.

This is not a new concept in investing nor are we suggesting it is particularly profound, but we do believe it is being ignored or forgotten in today's market environment. We seem to be at that stage in a bull market where valuations do not seem to matter to the vast majority of investors. What does matter is the view (mistaken in our opinion) that there is easy money to be made riding the wave and they want to participate due to the fear of missing out.

Taken from another angle, we provide a comparison of two companies and their respective multiples in **Chart 1**. These are two businesses with strikingly similar margins but in two very different industries. One of the businesses has suffered from a lack of investor enthusiasm over the years and the other seems to be a current beneficiary of a very positive market narrative (Artificial Intelligence) that has been propelling the stock market throughout 2024.

Chart 1

	Year Ending 2023	
	Company A	**Company B**
Gross Margins	44.13	63.35
Operating Margins	29.82	32.85
Net Profit Margins	25.31	22.21
Cumulative Net Revenue Growth - 3 Years	5.3%	12.0%
P/E on 2025 Bloomberg Consensus Earnings	31.4	17.0
(using stock price as of 9/30/24)		

These two unlikely bedfellows are Apple (ticker: AAPL) which is Company A and Phillip Morris International (ticker: PM) which is Company B.

Berkshire Hathaway (Warren Buffett) has been making headlines this year due to their sale of a massive amount of AAPL stock. We may never know the true reason behind the sale, but we view it as unlikely that Buffett is selling because he still believes Apple stock is a good investment at its current valuation.

The S&P 500 Shiller CAPE Ratio is now well above a 30 price-to-earnings multiple for only the 6th time in the last 150 years. In all five previous instances, the major market indices proceeded to lose at least 20% of their value. When valuations of the overall market get to these levels two things happen 1) the risk of severe loss is heightened in the expensive stocks that led the market and, 2) a tremendous opportunity is presented in the stocks who were left behind and missed all the fun (the stocks we own and are buying).

Portfolio Highlights

The general characteristics of our holdings have not changed in any significant way over this year. The portfolio is populated with securities trading at extremely low multiples using any variety of measures (P/E, price-to-free cash flow, etc.), large discounts to the replacement value of their assets and clearly identifiable pathways to realize the value we see inherent in our holdings. Therefore, it is highly probable we will be rewarded for our discipline and patience in time…we just can't be sure of when.

We have been active in buying shares in companies that share some distinct similarities which are:

1) They entered the recent period of higher interest rates with substantial debt on their balance sheets due to expansion, acquisitions or both that, in some cases, occurred just before the Fed embarked on the fastest interest rate increases in U.S. history.
2) The combination of higher indebtedness, higher inflation and a slowing consumer proved a heavy blow, and valuations cratered to some of the lowest absolute valuations we can ever recall.

The companies on our radar adjusted. They didn't just sit still. They started actively paying down their debt. They adjusted their cost structure, and they became more efficient. If interest rates continue to come down as we believe they will, the headwinds these companies have faced for over 3 years should abate and may even become a tailwind in the period ahead.

Select Portfolio Details

There were some significant positive developments in the portfolio last quarter. The first was that Sirius XM Holdings (ticker: SIRI) completed a transformational corporate action, finalizing the split-off from Liberty Media. On September 9, 2024, Liberty Media Corporation redeemed its shares in Liberty SiriusXM Holdings (LSXMA), resulting in SIRI becoming an independent company with a simplified corporate structure. This move allows SIRI to operate with more strategic and financial flexibility, focusing on its core business of satellite radio and audio entertainment. SIRI shares had fallen almost 50% YTD prior to the transaction. Post the transaction they continued to fall another almost 17%. The good news is this price action allowed us to buy more shares (and Berkshire Hathaway, which now owns over 32% of the total stock outstanding) to establish a full position at a valuation of around 7x our estimate of next year's earnings.

EchoStar is another holding that saw a significant rise since mid-August due to several major developments. First, the company announced transformative financial moves, including a $5.1 billion capital injection to enhance its balance sheet and further support the rollout of its nationwide 5G Open Radio Access Network (RAN). Additionally, EchoStar entered into an agreement with DIRECTV to sell its video distribution businesses, including DISH and Sling TV, improving its strategic focus on wireless services. The result is a vast improvement in EchoStar's financial profile that should allow the time to capitalize on the sizeable wireless investments the company has made. We own the company at a share price that is a fraction of our estimated value of their spectrum assets. The wireless growth opportunity is just icing on the cake.

Firm Update

We have been very pleased with the growth of the firm. Total assets actively managed were approximately $63 million at the end of Q3 2024. Total assets (discretionary and non-discretionary) were approximately $380 million.

Thank you for your continued confidence and trust and please feel free to contact us with any comments or questions.

Best Regards,

Masonry Capital Management, LLC

Mark A. Meulenberg, CFA, Managing Partner
Chief Investment Officer
Email: mark.meulenberg@masonrycap.com
Cell: 434.987.0943

Clay J. Sefter, Managing Director
Chief Operations Officer | Chief Compliance Officer
Email: clay.sefter@masonrycap.com
Cell: 434.422.1656

Shan Meulenberg
Office Manager
Email: shan.meulenberg@masonrycap.com
Cell: 704.608.2649

DISCLOSURES:

THIS INVESTMENT REVIEW IS FURNISHED FOR GENERAL INFORMATION PURPOSES IN ORDER TO PROVIDE SOME INSIGHT INTO THE INVESTMENT MANAGEMENT PROCESS AND TECHNIQUES THAT MASONRY CAPITAL MANAGEMENT USES TO MAKE INVESTMENT DECISIONS. IT IS PROVIDED FOR ILLUSTRATIVE PURPOSES ONLY. OPINIONS AND INFORMATION PROVIDED ARE AS OF THE DATE INDICATED. THIS MATERIAL IS NOT INTENDED TO BE A FORMAL RESEARCH REPORT, AND AS SUCH, IT SHOULD NOT BE CONSTRUED AS AN OFFER OR RECOMMENDATION TO BUY OR SELL ANY SECURITY, NOR SHOULD INFORMATION CONTAINED HEREIN BE RELIED UPON AS INVESTMENT ADVICE. OPINIONS AND INFORMATION PROVIDED ARE AS OF THE DATES INDICATED. MASONRY CAPITAL MANAGEMENT DOES NOT UNDERTAKE TO ADVISE YOU OF ANY CHANGE IN ITS OPINIONS OR THE INFORMATION CONTAINED IN THIS REPORT. THE STATISTICS IN THE ARTICLE WERE OBTAINED FROM SOURCES BELIEVED TO BE RELIABLE, BUT THE ACCURACY OF THIS INFORMATION CANNOT BE GUARANTEED.

ANY SPECIFIC STOCKS DISCUSSED IN THIS PRESENTATION ARE INCLUDED TO HELP DEMONSTRATE THE INVESTMENT PROCESS OR, AS A REVIEW OF THE COMPOSITE'S QUARTERLY RESULTS; AND ARE NOT INTENDED AS RECOMMENDATIONS OF SAID SECURITIES AND CARRY NO IMPLICATIONS ABOUT PAST OR FUTURE PERFORMANCE. ALL OR SOME OF THE SPECIFIC STOCKS MENTIONED MAY HAVE BEEN PURCHASED OR SOLD BY ACCOUNTS WITHIN THE COMPOSITE DURING THE PERIOD, OR SINCE THE PERIOD, AND MAY BE PURCHASED OR SOLD IN THE FUTURE. THE MASONRY ALL CAP SELECT COMPOSITE INCLUDES ONLY ACCOUNTS WHICH HAVE THE MASONRY ALL CAP SELECT STRATEGY AS ITS PRIMARY INVESTMENT OBJECTIVE.

INVESTMENT PERFORMANCE:

THE PERFORMANCE REPRESENTATIONS CONTAINED HEREIN ARE NOT REPRESENTATIONS THAT SUCH PERFORMANCE WILL CONTINUE IN THE FUTURE OR THAT ANY INVESTMENT SCENARIO OR PERFORMANCE WILL EVEN BE SIMILAR TO SUCH DESCRIPTION. ANY INVESTMENT DESCRIBED HEREIN IS AN EXAMPLE ONLY AND IS NOT A REPRESENTATION THAT THE SAME OR EVEN SIMILAR INVESTMENT SCENARIOS WILL ARISE IN THE FUTURE OR THAT INVESTMENTS MADE WILL BE PROFITABLE. NO REPRESENTATION IS BEING MADE THAT ANY INVESTMENT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN PRIOR PERFORMANCE RESULTS AND ACTUAL RESULTS ACHIEVED BY A PARTICULAR TRADING PROGRAM.

ANY PERFORMANCE DEPICTED HEREIN IS AUDITED ANNUALLY. PARTIAL YEAR PERFORMANCE 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 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 STRATEGY ARE INCLUDED IN THE PERFORMANCE PRESENTED AND ARE NET OF ACTUAL INVESTMENT 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 USING THE TIME WEIGHTED RATE OF RETURN METHODOLOGY. TRADE

DATE ACCOUNTING IS USED FOR CALCULATION AND VALUATION PURPOSES. SECURITIES ARE VALUED DAILY USING CLOSING MARKET VALUES. PERFORMANCE IS PRESENTED IN US DOLLARS.

PERFORMANCE RESULTS ARE NOT GIPS COMPLIANT.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

INDICES:

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

REFERENCES TO INDICES CONTAINED HEREIN ARE NOT INTENDED TO COMPARE TO THE ACTUAL PERFORMANCE OF AN ACCOUNT, BUT SOLELY FOR THE PURPOSE OF COMPARISON TO CERTAIN INDUSTRY SEGMENTS.

REFERENCE TO THE S&P 500 AND OTHER INDICES IS FOR COMPARATIVE PURPOSES ONLY. THE S&P 500 IS AN UNMANAGED CAPITALIZATION-WEIGHTED INDEX OF 500 STOCKS, DESIGNED TO MEASURE PERFORMANCE OF THE BROAD DOMESTIC ECONOMY THROUGH CHANGES IN THE AGGREGATE MARKET VALUE OF 500 STOCKS REPRESENTING ALL MAJOR INDUSTRIES. THE INDEX TRACKS THE CAPITAL GAINS OF THE STOCKS OVER TIME, ASSUMING THAT ANY CASH DISTRIBUTIONS, SUCH AS DIVIDENDS, ARE REINVESTED BACK INTO THE INDEX AND IS NOT AVAILABLE FOR DIRECT INVESTMENT. THE S&P 500 MAY BE MORE DIVERSIFIED THAN AN ACCOUNT MANAGED BY MASONRY CAPITAL MANAGEMENT AND MAY NOT REPRESENT AN APPROPRIATE BENCHMARK. HOLDINGS MAY VARY SIGNIFICANTLY FROM THE SECURITIES THAT COMPRISE THE S&P 500. PAST PERFORMANCE OF THE INDEX SHOULD NOT BE CONSTRUED AS AN INDICATOR OF FUTURE PERFORMANCE OF THE FUND OR YOUR ACCOUNT.

HFRI INDICES ARE BROADLY CONSTRUCTED AND DESIGNED TO CAPTURE THE BREADTH OF HEDGE FUND PERFORMANCE ACROSS ALL STRATEGIES AND REGIONS. PAST PERFORMANCE OF AN INDEX SHOULD NOT BE CONSTRUED AS AN INDICATOR OF FUTURE PERFORMANCE OF AN ACCOUNT.

HEDGE FUNDS TRADE IN DIVERSE COMPLEX STRATEGIES THAT ARE AFFECTED IN DIFFERENT WAYS AND AT DIFFERENT TIMES BY CHANGING MARKET CONDITIONS. STRATEGIES MAY, AT TIMES, BE OUT OF MARKET FAVOR FOR CONSIDERABLE PERIODS WITH ADVERSE CONSEQUENCES.

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.

THE MSCI EAFE INDEX (EUROPE, AUSTRALASIA, FAR EAST) IS A FREE FLOAT-ADJUSTED MARKET CAPITALIZATION INDEX THAT IS DESIGNED TO MEASURE THE EQUITY MARKET PERFORMANCE OF DEVELOPED MARKETS, EXCLUDING THE U.S. AND CANADA. AS OF JUNE 2007, THE MSCI EAFE INDEX CONSISTED OF 21 DEVELOPED-MARKET COUNTRY INDICES.

CRUDE OIL IS THE WORLD'S MOST ACTIVELY TRADED COMMODITY, AND THE NYMEX DIVISION LIGHT, SWEET CRUDE OIL FUTURES CONTRACT IS THE WORLD'S MOST LIQUID FORUM FOR CRUDE OIL TRADING, AS WELL AS THE WORLD'S LARGEST-VOLUME FUTURES CONTRACT TRADING ON A PHYSICAL COMMODITY.

FORWARD LOOKING STATEMENTS:

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