MountainWorks, LLC
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April 15th, 2020

2020 Return	January	February	March	Q1	Annual Return	Return Since Inception
MountainWorks	8.8%	2.0%	-10.9%	-1.2%	-1.2%	-0.5%
S&P 500				-24.9%	-24.9%	34.4%

Dear Member,

In the first quarter of 2020, MountainWorks lost 1.2% of its value, versus a 24.9% loss for the S&P 500, dividends reinvested (according to DQYDJ). Since inception (February 2016), the Fund has lost 0.5% against a 34.4% return from the S&P 500. The general stock market picture has changed drastically since the beginning of March, and we now face a new challenge that brings with it a new set of realities. Even though I have operated at a loss for just over four years now, I will offer an opinion on a market sentiment that includes fears, faults, and failures.

Our failure through the first quarter of 2020, however, has been extraordinarily muted. While the S&P 500 fell 24.9%, over the same time frame the fair value of our collective assets have declined a mere 1.2% through March 30th. Furthermore, the unprecedented and rapid movements by the Federal Government & the Federal Reserve in response to Coronavirus have resulted in volatile swings in the general stock market; so much so that at present (April 15th, 2020), we stand at about a 10% increase year-to-date versus a 15% decline for the S&P (note that these figures are approximate). I understand the personal struggles that we are all going through…and yet, I am in good spirits. I am happy to present a message of encouragement: Our out-performance against the market should pay wonderful dividends for us down the road - figuratively and literally. Viewing the Fund as a whole, with a long-term horizon, I consider a time period in which (a) the market declines and we decline by a small amount to be vastly superior to a similar time period in which (b) the market gains and we gain just a bit more than the market.

> *"I would consider a year in which we declined 15% and the Average 30% to be much superior to a year when both we and the Average advanced 20%. Over a period of time there are going to be good and bad years; there is nothing to be gained by getting enthused or depressed about the sequence in which they occur. The important thing is beating par; a four on a par three hole is not as good as a five on a par five hole and it is unrealistic to assume we are not going to have our share of both par three's and par five's." - Warren Buffett, 1961.*

Please know that my thoughts today include hope & encouragement at a time when uncertainty reigns supreme. I could not be where I am today without the support from Members, as well as the savvy business managers with whom our faith (and assets) lie. And so, we begin with some general market performance, followed by thoughts on our philosophy regarding the Fund.

General Stock Market Performance. As the S&P 500 is down about 15% year to date, the markets have erased about 2 years worth of gains. In my last letter, we focused on two historical metrics used to value the stock market: the Shiller P/E Ratio cyclically adjusted over ten years, and total market capitalization of the stock market relative to Gross Domestic Product (Market Cap/GDP).

Currently, the Price/Earnings ratio for the market stands at about 26 (three months ago it was 31.5), representing a 17.5% decrease, about on pace with how far the market has fallen. Don't let the big swings fool you…keep in mind what exactly has changed! P/E is a simple ratio, Price divided by Earnings. If the market has fallen ~15% in line with the Shiller P/E Ratio, then only one variable is different: the "Price". In other words, the world has fallen prey to a novel coronavirus that we don't know that much about…and yet, the "Earnings" in the P/E hasn't moved an inch. Does that seem strange to you?

Next, let's visit the Market Cap/GDP ratio. Three months ago it was at about 150%. Today, it's 127%. Similar to the Shiller P/E, the ~23% drop is still fairly in line with stock market performance year to date. It appears that even though we feel the impact of Coronavirus so greatly in our daily lives, not much has changed in terms of stock market valuation, which is a scary thought.

My point is that if you're looking at a 25 P/E ratio in the current environment, and the only thing that's changed in three months has been the Price, then we could be in for one hell of a roller coaster when companies begin reporting the "E". It's a delayed variable, because companies haven't reported financials post-Coronavirus. Furthermore, in the course of one month I've seen businesses (1) withdraw their 2020 guidance, (2) apply for Federal Bailouts, (3) furlough employees, (4) suspend dividends & buybacks, (5) explore bankruptcy talks, and/or (6) some combination of all of the above. If you put some math behind it, a 25 P/E against a price for SPY of $276.61 yields earnings of about $11.06 per share. On a conservative basis, removing 1 month of earnings from the S&P 500 (worth about $0.92/share for the SPY ETF), yields an 8.4% drop for the S&P and a price of $253.46 for SPY. Put simply, we don't know what effect earnings will have on the general stock market.

The same argument could be made for GDP. While the overall stock market capitalization has dropped ~23%, GDP numbers for the United States are delayed, and we won't know how bad the fall is until about a month or so after the fact. We are treading carefully. My thought is that earnings adjustments could rattle investor sentiment post-Coronavirus. That might not be on the minds of institutional investors at the current time. Indeed, the situation is concerning.

> *"All of the above is not intended to imply that market analysis is foremost in my mind. Primary attention is given at all times to the detection of substantially undervalued securities."*
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> *-Warren Buffett, 1958*

Our Current Philosophy. That is not to say there are no profitable opportunities in the stock market - there are, and we have found some of them. However, a line-by-line play-by-play investment breakdown doesn't necessarily explain our philosophy. Rather, a bit of engineering jargon from a previous letter might (oddly) do the trick:

> *"Without getting too long-winded or losing the interest of readers, I'll simply state that we are trying to create a complex system of investments that is loosely coupled, as opposed to an ordered system that's tightly coupled. In both situations, accidents will happen. But in the first, the failure of one branch (say, event driven investments) does not impede the success of another (say, equity options). Meanwhile, the latter ordered system can succumb to "normal accidents" that compound each other." - January 2020*

I don't claim to be a prognosticator, but it appears that a "normal accident" has hit us. The action from Coronavirus - stay home and lock down the economy - has perhaps changed our outlook forever. It has also compounded other issues like employment, healthcare, travel, and retail, to name a few. Additionally, the resulting reaction - the CARES act by the Federal Government and $2.3 trillion in liquidity from the Federal Reserve - has caused binary outcomes in the stock market. On March 16th, the Dow Jones fell 12.93% - the second largest single day percentage drop ever (worse than the Great Depression but not as bad as 1987's Black Monday). Eight days later the Dow had its fourth best percentage gain in history at 11.37% (bested by October 30th, 1929, October 6th, 1931, and March 15th, 1933). It's mind-blowing.

There's something definitely unusual about these figures - but it's not just the large percentage moves, it's the timing. Historically, 12 out of the top 20 percentage moves in the stock market occurred prior to 1933. Three out of those 20 occurred in the past month alone. So there's this underlying notion that stock market moves are supposed to be less frequent - Efficient Market Hypothesis would have that effect - but somehow it's getting more concentrated and more vicious, like a snake coiled up and ready to strike.

I don't have much proof in the way of numbers, but nevertheless a "slow hunch" nudges me toward ETFs, index investing, and volatility trading as guilty parties. We are experiencing a normal accident that is amplified by the system. The massive moves in the market have blown up to where some $2.5 trillion dollars can just evaporate in a single day. It's hard to fathom.

Under the usual circumstances, the stock market is considered an "ordered system" that's "loosely coupled". Think of a toll booth - millions of cars travel through it every day, with no problem at all. Well in theory the stock market has a similar utility. Trillions of dollars flow through it, and it has safeguards like ETFs, VIX trading, and other tools that help institutional investors "hedge" their assets. They protect the system from unusual disturbances.

Yet in my view, it's more like a "complex system" that's "tightly coupled". Complexity - from an engineering standpoint - is a measure of the interactions of different elements in the same system. The more interactions between elements, the more complex the system. Imagine for a moment that a hedge fund takes a loan from its seed bank. That bank in turn borrows money from the Federal Reserve to clear the transaction (a "Repo" loan). The hedge fund is able to invest that money into the stock market (via ETFs, for example), and also buy VIX contracts against it for insurance. Under normal circumstances, the process works perfectly. Keep in mind, however, the number of elements involved in the process grows quickly. In this daily-to-weekly event, there are five interactions: (1) The bank, (2) the hedge fund, (3) The Federal Reserve, (4) the VIX market, and (5) the stock market. The question is, how easy is it for this system to break? I think Coronavirus gave us the answer.

My job, as it stands today, is to develop a system that doesn't fail under the circumstances of a normal accident. By normal accident, I mean a "system accident", and while a worldwide pandemic is an exogenous shock, we have seen how it affects the "system" that is the stock market. More often than not, I've found myself thinking about a complex system that is *loosely coupled*. That is the abstract solution to a distinct problem (How do I make successful investments?). Don't get me wrong, we are still in the business of finding great companies with great people around them, but along with that, my challenge is to prevent failures when the market goes haywire.

This leads me to another so-called slow hunch, that we can mitigate the effects of normal accidents through different branches of investing. Since MountainWorks is a multi-strategy fund, it makes sense that we can use different tools of the trade. At present, I can further classify our philosophy into seven different branches:

Chapter 11 Bankruptcies
Corporate Reorganizations, Liquidations, & Tenders
Kelly Investments
Merger Arbitrage
Pre-Arbitrage
Short Investments
Speculative Investments

Each strategy can have some overlap with another, but this is a natural occurrence that should not greatly affect all of them. Warren Buffett had a similar philosophy, but segregated his partnership into three sections: (1) Generals, (2) Work-Outs, and (3) Controls. The first represented generally undervalued securities with no timetable and no corporate interaction, the second included securities whose financial results depended on corporate action rather than supply and demand, and the third consisted of taking very large positions and attempting to influence corporate policy.

Our smaller size makes us preferably nimble, but we can only expect minimal impact when it comes to corporate governance (nevertheless, our actions in the past have included suggestions to management). But our philosophy is very similar to Mr. Buffett's circa 1960, with a few more twists. And up to this point in 2020, the loosely coupled complex system that is MountainWorks LLC has stood up to a worldwide pandemic.

> *"As stated above, a declining Dow gives us our chance to shine and pile up the percentage advantages which, coupled with only an average performance during advancing markets, will give us quite satisfactory long-term results." - Warren Buffett, July 1962*

A Thank You. I want to again thank the Members for their steadfast faith in the fledgling business that is MountainWorks, LLC. They are extraordinarily supportive and I could not ask for better partners. The discussions make us all better in the long run, and I hope that their return on knowledge is as good as mine. To those who are interested in MountainWorks but are not yet members: We are still on the hunt for investors willing to become Members. As the Fund grows, you are important additions that can help us achieve success. Finally, I ask that if there are any questions, please do not hesitate to contact me. I sincerely hope you and your families are all doing well. My thoughts are with you as we plod our way through the Coronavirus pandemic.

Yours,

Justin Polce
Managing Member

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