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July 15th, 2023

2023 Return	April	May	June	Q2	Annual Return	Return Since Inception
Mountainworks	-9.7%	-8.4%	17.0%	-3.2%	-8.5%	21.9%
S&P 500				7.0%	11.6%	162.9%

Dear Member,

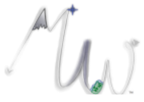
In the second quarter of 2023, Mountainworks lost 3.2% of its value, versus a 7% gain for the S&P 500 dividends reinvested (according to DQYDJ). Since inception (February 2016), the Fund has returned 21.9% against a 162.9% clip for the S&P 500. It is yet another disappointing underperformance against the market, which continues to be resilient in amazing fashion. While my goal is always to outperform the S&P 500, it especially stings when we are down and the S&P rises. The bite brings with it many questions, which usually start with, “am I doing something wrong?”

General Market Performance. To say that I have made mistakes would be an understatement, and it is clear that since inception of the Fund, I have failed at my goal, and have made errors requiring introspection. Anyone wishing to delve into my own thoughts and failures can read previous letters. This time, I’m going to ask an obvious question: am I benchmarked to the right index? In other words, should I be comparing the performance of Mountainworks to the S&P 500, or some other measure?

Well, the answer is just as obvious: I want to benchmark my performance to the best funds out there. If I want to be the best, then I have to beat the best. While that might be considered an exercise in pride, with strong desire bordering on envy, it helps to have humility, gratitude, and self-control to defeat such vices. That said, my approach is evolving in a way that should improve my performance. Moreover, life has taught me that emotional problems (pride, envy, and desire) inevitably have tangible solutions.

But most investors don’t want to be bothered with promises for the future. In fact, it might be more apropos to say that people want results – and money – now! The most recent example of the investing mob looking to strike gold has been the Artificial Intelligence craze. Anyone out there who has managed to be a part of it and made some profits: I tip my cap to you.

It’s really quite amazing to see the resilience of the S&P considering the macroeconomic backdrop, and because I focus on single companies or specific situations, there are times when I’m just missing out. The second quarter was one of those times.



Yet I take it in stride. With the market cap to GDP ratio sitting at 172% (well above last quarter's 157), and the market P/E Ratio standing at 31.4, stocks remain overvalued, and as a general commentary, that drives me more toward specific situations, single stocks, and alternatives to equities (i.e., bonds). In "macro" speak, it is clear that the 2-10 yield inversion makes for an easy arbitrage, especially in a rising interest rate environment. Certainly a 5% risk-free yield seems more plausible than buying momentum in tech stocks, right? Why not just build a bond ladder in short term T-Bills, or find some interesting tax free municipals?[1] One would think that with higher interest rates, and more opportunities in bonds, investors would flock to safety and drain liquidity out of the stock market. But it hasn't happened. The traditional 60/40 portfolio got crushed in 2022; meanwhile investors are happy to bid up "low volatility" tech like they are the new blue chips.

I have learned that people – in the most general of terms – behave quite irrationally. Can it be true that tech names like Microsoft, Apple, Google, Meta, et al are the safe place to be?

From the outside looking in, that seems to be a bit counter-intuitive. To further my point, consider portfolio manager William Nygren's elaboration on risk, and how that idea changes depending on your perspective:

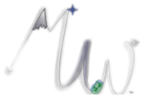
> "Business owners say risk is the chance their business is worth less in the future than it is today. Academics […] measure daily stock price changes and use risk metrics like beta, standard deviation and correlation. Many portfolio managers think of their risk of getting fired, so to them, tracking error (how much their portfolio return differs from their benchmark index) becomes the most relevant risk measure."
> -William Nygren, Oakmark Funds[2]

The problem with risk multiplicity is that as of now, so much of the S&P 500 index is weighted toward tech, investors who are diversifying by purchasing an S&P ETF are in fact becoming more concentrated, bringing not just market risk - but also concentration risk – into their portfolio.

Specifically related to the NASDAQ 100, its five largest positions represent 47% of the index. There may very well come a time (in the short future) in which "diversified" portfolio managers will have to actually sell off their holdings to stay within the legal definition of diversified. The tech blue chips have become such a safe-haven that the unintended consequence of concentration is creeping

[1] A minimal-effort search for municipal bonds coming to term in 12 months or less was indeed fruitful. For example, if you decide to invest in the Pflugerville, TX independent school district, you could earn 4.5% APY tax free through mid-August.

[2] Source: Oakmark Funds 2023 Q2 Commentary. Notably, Mr. Nygren points out that the Investment Advisers Act of 1940 demands that a "diversified" fund should have no more than one-quarter of its assets in positions that each represent over 5% of the portfolio. In other words, a diversified fund can't put 5%+ in each of Apple, Microsoft, Google, Meta, or Netflix. Diversification & modern portfolio theory are ingrained into the financial industry by law!



up to the fore. I would consider such behavior irrational; though, the vexing effects of this risk have yet to be seen.

In as much as a diversification could be reaching a boiling point, and the fact that owning 50-60 positions in a portfolio is considered "above-average risk" (as compared to say, 100 positions), Mountainworks is *extremely* concentrated in single stocks and special situations. That's our hunting ground. What follows is a small taste of both.

Activision. It was only recently that ATVI became a hefty part of the portfolio, and that was largely due to the evidentiary hearing in the Northern District of California federal court. Of course, I will not bore you with too much legal jargon, suffice to say that I have been privy to some great information regarding (1) the FTC's request for a preliminary injunction that was summarily denied by Judge Corley, (2) the CMA's attempt to block the merger and corresponding appeal by Microsoft to the CAT (the UK's "Competition Appeals Tribunal"), and (3) the FTC's appeal to the 9th Circuit, which was recently denied.

What the merger comes down to is a concession in cloud gaming on the part of Microsoft to appease UK regulators, which will likely come at the 11th hour. Given the amount of information I've been able to glean regarding the proceedings, I feel relatively confident in either (A) Microsoft closing the merger or (b) extending the deadline into August (these points might even be moot by the time this letter is published). Either situation is advantageous to us.

I always like to ask myself, "why does the opportunity exist?" Who are my counterparties? That is, if I'm buying up ATVI, the who is selling, and why? It's possible that the average institutional investor (1) doesn't care about the merger because ATVI is 0.001% of the portfolio (re: diversified funds mentioned above), (2) sees too much risk in the foreign nature of the transaction (that is, too much uncertainty in the UK), (3) is properly hedging exposure to ATVI by shorting out the position, or (4) are happy to own ATVI regardless of the merger, because of its success with CoD, Diablo, and other gaming titles.

At the moment, we are in relatively good position, and if the timeline is right, my particular foray into ATVI will end in short order. It's sort of curious and a bit funny (my favorite type of arbitrage): the merger is huge and dominates the news, yet half the analysis I read is from investors/arbitrageurs, and the other half is from concerned video gamers![3]

[3] It's almost as if my "trend to the outdoors" thesis with SPWH & CWH might be in trouble, because so many people are *willingly* stuck inside playing video games. What kind of a future are we building for our children!? But I digress…

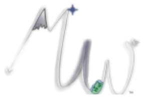
Sportsman's Warehouse. As expected, but not necessarily welcome, SPWH shares dropped to below $7 per share when they reported, due in part to a high inventory build. In fact, it traded in the $4's for a short time. That was a big part of my underperformance in the second quarter; nevertheless, I've been using the opportunity to pick up shares on the cheap. Once again, it represents a highly concentrated position in the portfolio, and is a microcosm of my existence somewhere between want and self-control.

On the one hand, I have a great desire to beat the market, and that might lead me to trimming a position that has taken a steep fall over the past year. On the other hand, we're about two years in on a multi-year investment. Therefore, intertemporal choice dictates that I should demonstrate some level of self-control and trust my investment process. From a mental accounting point of view, anytime I am sitting on a losing position, there could be some sort of improvement. However, that does not mean that the investment thesis is entirely broken. Over the course of a decade, I have found that being "right" in the market is largely a function of time. It's quite possible to be wrong in 2023, but overwhelmingly correct in 2024.

Just like with Activision, I feel confident in the amount of information I've been able to sift through in order to understand how Sportsman's Warehouse should perform over the next few years. Again, if this is to be true, who are my counterparties? Why does the opportunity exist? Sportsman's Warehouse is a niche retail business that (a) is a small cap company that large institutional investors won't touch, (b) is a small enough company to fall under the radar of a portfolio manager with >50-60 positions, and (c) relatively overlooked by analysts who concern themselves with short to medium term growth projections.

It's a very cliché thing to say, but: time will tell. That is the advantage of self-control over impulse. If I am wrong, then I will admit to the mistake with humility, and move on. If nothing else, the key is to simply wait, and take any new information as it comes.

Conclusion. I'm well aware that readers may not see tangible benefits from a discussion of vice & virtue within investments. There are definitely those who would prefer some concrete statistics and valuation. However, my edge has come to be one of behavior just as much as it is mathematical. Finding knowledge and an in-depth understanding of special situations helps minimize prideful mistakes. Knowing the limits of portfolio allocation helps deter envious over-leveraged betting. Intertemporal value choices enhance will power and prevent ingratiating oneself with the proclivity for quick-buck trading.

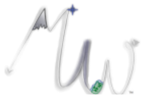


Our endeavors in Activision and Sportsman's Warehouse are good examples, with the former involving key knowledge and the latter utilizing the time-value of money. In the next few letters, I hope to highlight the advantages of virtuous investing with humility, gratitude, and will power.

I appreciate your interest in Mountainworks. If you would like to discuss anything, please don't hesitate to reach out: Justin@mountainworksllc.com.

Yours,

Justin Polce
Managing Member



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