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2023 Return	July	August	September	Q3	Annual Return	Return Since Inception
Mountainworks	27.3%	-11.3%	-11.1%	1.1%	-7.5%	23.3%
S&P 500				2.7%	13.5%	167.3%

Dear Member,

In the third quarter of 2023, Mountainworks returned 1.1% of its value, versus a 2.7% gain for the S&P 500, dividends reinvested (according to DQYDJ). Since inception, the Fund has returned 23.3%, against a 167.3% clip for the S&P 500. The gyrations over July, August, and September make it clear that as a concentrated Fund, we can run into multiple ups and downs. On the upside, Microsoft's acquisition of Activision has been a textbook case study of market inefficiency related to legal proceedings. At the same time, my ill-timed exposure to retail with Sportsman's Warehouse caused downward reverberations that will take time to recover from. I have come to think of modern day investing as an almost "quirky" exercise in normal accidents. When there is no immediate liquidity threat, money freely moves to momentum. This year has been a story of mega cap technology…the froth at the top continues. For us, not much has changed since our second quarter letter. But there are some opportunities to explore. That said, we can reiterate investment points, and discuss the future of the fund.

General Market Performance. The current market cap to GDP ratio sitting at 162%, and the market P/E Ratio standing at 29.9. Both figures are relatively unchanged versus last quarter, and remain elevated against historical measure. The general market appears to be overvalued; that would create a tendency toward bonds and other instruments with higher market savings rates. To a certain extent that is true. As of the most recent quarter, there is almost $6 trillion dollars sitting in money market funds.[1] These types of funds invest in short duration securities, like T-bills or overnight reserves.[2] It is a similar strategy to a bond ladder (which I have employed). I would think that with more money headed toward fixed income, less would be available for the stock market. But others are taking the opposite bet. Just in the past few days some favorable inflation marks have resulted in

[1] Source: St. Louis Federal Reserve, Money Market Funds, Total Financial Assets
[2] As an example, Fidelity's Government Money Market Fund (SPAXX) is composed of approximately 28% Treasury Bills and 44% U.S. Government Repurchase Agreements, which are yielding over 5% each

vicious moves to the upside. It should be interesting to see what happens when the money market millionaires come off the sidelines. Let the house money effect begin…

It'll make for good news headlines; here and now, I tell you that you'd be better off reading the tarot cards than following my predictions. While I believe that large macroeconomic trends are easy to spot, I make no guarantee of return. Even still, we are operating in a high interest rate market that broadly speaking works to suppress growth. People are behaving accordingly, as evidenced by the shift to money market accounts. But the consequences of a Federal Reserve policy pivot - or their behavior in the event of recession - remains anyone's guess.

Unusual Behavior. To find opportunities, one would have to believe that people behave irrationally. Perhaps I am no exception. In general, a high interest rate environment raises the cost of borrowing. Despite this cost, never in my life have I used so much margin in the portfolio in order to manufacture a return. At one point over the past two months, the amount of margin represented approximately 117% of the fund. I imagine that to most investors this is sheer absurdity, and could even make prospective clients shy away. After all, it puts the entirety of the fund at risk. We've all heard stories in which excessive margin caused a bitter collapse, with reverberations that nearly drowned the entire market.[3] Given the history of bettors who lever up, I knew the fund was in a risky position. I also knew that there was a high probability of success.

I'm referring to our position in Activision, which as of writing has been officially cleared from the portfolio. There was an extraordinary opportunity: the deal had a high probability of closing, but legal ramifications were holding back the stock. With a fair amount of due diligence, it became mildly easier to see that with ATVI trading around $92 in mid-September, with one month to close, the internal rate of return was higher than the current borrowing costs.

In the end, it was old school interest rate arbitrage, and while I don't expect situations like this to come around very often, it was good to find success. It was a quirky accident on a very large scale. A financial fruit fly[4] that demonstrates the type of opportunity I am looking for.

Sportsman's Warehouse. On the other hand, after gains with ATVI, Sportsman's Warehouse took a turn for the worse, as the business has operated at a loss over the past few months. It is discouraging to think that three years ago Cabela's was willing to pay $18/share for the company, and

[3] One example would be the downfall of Long-Term Capital Management. For the whole story, I suggest you read *When Genius Failed*, by Roger Lowenstein. The firm was a group of intellectuals with PhDs, who used margin to create swap trades on bonds. When Russia defaulted on its debt circa 1998, LTCM lost hundreds of millions of dollars, and had over $1 trillion in margin risk on the table. The words of Thomas Sowell ring true: "For creating a truly monumental disaster, you need people with high IQs" (though, at the time he was referring to the Obama administration).

[4] A nod to Richard Thaler, who points out a few financial fruit flies that don't exist for very long in his book, *Misbehaving*.

here we are with SPWH trading around $5. The easiest explanation for my investment was that of a broker merger-arb. It was post-pandemic, the outdoor trend was vibrant, and the broken deal created forced selling on the part of merger-arbs. But my problem came when inflation & interest rates started to rise…people in lower income brackets are a significant portion of the Sportsman's Warehouse customer base. When inflation hit, it meant those customers had less disposable income in their pocket. Then the Fed raised rates, and made it even harder for people to borrow money. The theoretical result has been a two-pronged hit to average citizens trying to make ends meet; the unintended consequence being less room for sports & leisure purchases.

It appears that I'm approximately two years too early on my SPWH retail investment. How, then, can I adjust the process to avoid untimely pitfalls? It's not that the thesis is completely broken, it's more that the time frame has to be adjusted. In the coming two years, I see a great opportunity in SPWH. But the allocation process has to be better. In this particular case, I was wrong to think that a broken merger-arb like Sportsman's Warehouse would pop back inside of one year. Similarly, my allocation was too strong, too fast, resulting in unnecessary pressure on the fund. If you permit me, I will tell you this is a case of envy and desire, requiring more gratitude and self-control on the part of the investor. Alas, some fruit flies are just there to nag you.

Ultimately, the issue isn't one of a broken thesis, but rather misallocation. Too many times throughout the past 8 years I have discovered that being right in the market is a function of both price and time, with the latter being quite difficult to ascertain. One can be wrong on an investment for a year, then right on the investment soon afterwards.[5]

At present, Sportsman's has a ballooning inventory account. Part of this is due to expansion of new stores, and part of it is bad luck in the face of high inflation. Regardless of the cause, it is a hurdle that management must work through in order to right the ship. When it comes to retail, inventory is an asset that can depreciate quickly, forcing discounting & sales, and in turn lowering margins. That is the most pressing job facing the business. If the American consumer powers through, we could see significant upside.

The Next Steps. With the S&P up 14% this year, I am not at all pleased with the results of the fund to date. But rather than looking for new strategies, much of what I have embarked upon has been self-reflection. I've been reading my own writing, in an attempt to parse through my thoughts and find some missing detail. I am playing moneyball, and looking where everyone else isn't.[6] I am on the hunt,

[5] I am once again referring to my own experience. Back in 2018, I entered into a hefty Camping World position around $22/share. By the end of 2019, CWH shares traded well under $10.00. Less than 12 months later it had a $30 handle.

[6] Candidly speaking, one place to look where no one else does is inside the head of the beholder.

and I feel that I am very close to a breakthrough; I just need one more piece to fit the puzzle. It is, to be honest, a maddening practice.

We're setting out on a course to analyze companies with relative efficiency (relative being the key word). Given we live in the advent of "AI"[7], this is no easy task, and the competition is substantial. It will require patience and humility, along with diligence. Yet if this goes in the direction I think it will, I should have one more key to fit in the lock, and perhaps a singular advantage over the opposition.

I will be deliberately reticent about details, but I can say that it is a pure attempt to maximize efficiency. In fact, now that I think about it, much of my daily life involves focus on getting things better, regardless of the task. In as much as we are a small operation with limited resources, I am certain there are good opportunities out there, and confident that we can find success in a fairly competitive space.

My focus is to *do what others cannot do*, and that is the future of this fund. We will sift through as much information as possible in order to make better decisions, build stronger theses, and allocate properly.

Conclusion. It may be true that what I have written is not a very exciting expose on investing. Nor have I gone in depth into specific theses regarding investments. But we are still on the hunt for special situations – they may come few and far between, and finding them requires a behavioral edge that leans on humility, self-control, and gratitude. I've said it before, and I'll say it again: a humble knowledge helps minimize prideful mistakes. Understanding the limits of portfolio allocation helps deter envious over-leveraged betting. Will power prevents a proclivity for quick-buck trading. With these virtues in mind, we can achieve success.

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

[7] I don't subscribe to the "AI" craze…it's a catchy phrase for saying computers can perform tasks for you. This has already been happening for decades, going back to the invention of a calculator.

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