March 7, 2022

Dear Fellow Investors,

Adestella lost about 6% in the final quarter of the year. Almost all the drawdown was due to our international long positions; domestic stocks were roughly breakeven while our short book posted a modest gain. The major detractors to our portfolio were our GARP stocks and emerging market holdings, partially offset by US value names. Net exposure levels were lower than usual – below 80% by the year's end.

Markets continued to be buoyed by optimism surrounding earnings and an elongation of accommodative monetary policy, with US indices registering their seventh straight quarterly gain. Net flows set a new record, and by the end of 2021, more money had been added to global equities than in the last two decades combined. The main US benchmarks gained 25%+ for the year, led by energy, real estate, and large-cap technology, all of which we were underexposed to. In the end, despite a strong start to the year, we finished with a relatively disappointing 9% gain.

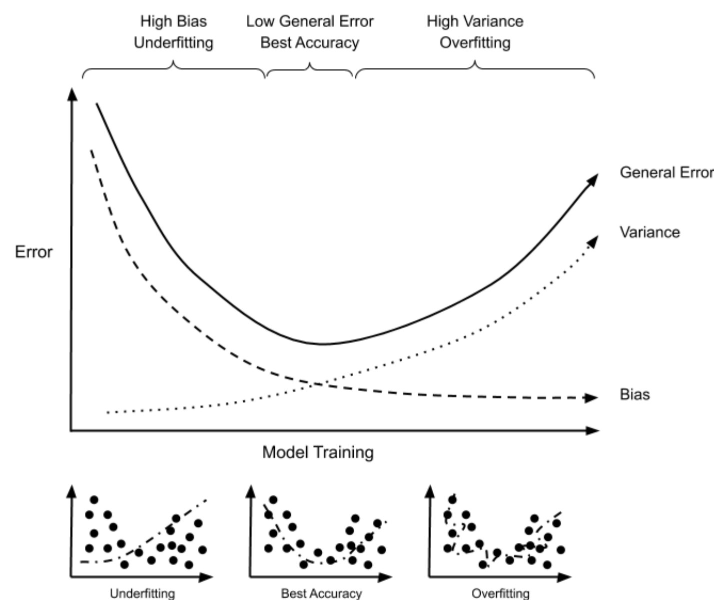
As usual, an updated performance summary is included at the end of this letter.

Five-Year Survey: Lessons Learned

This letter marks the completion of five years since I started writing these updates to shareholders. It would be fair to say I've learned more than a few lessons along the way, and I thought that reflecting on a couple of them would be a fitting way to close out the year. While the basic concepts of value investing have not changed, my thoughts on the best way to apply them in the context of a portfolio and a business model continue to evolve. What follows is a description of a few aspects of fund management for which I've developed greater appreciation over the last five years, and a discussion of how I plan to approach them going forward.

Finding the fit. While certain principles of running a portfolio remain constant (knowing what you own, careful consideration of risk vs. reward, buying at discount to intrinsic value, etc.), approaches to the investing field of play vary widely in terms of geographies, situation setups, and research priorities. Among those ideas that pass their criteria, some investors are comfortable having the majority of their portfolio in just a few names, while others spread their bets across a few dozen stocks. And once the thesis has played out, there are countless strategies for the timing and cadence of the exit, if any. I believe now more than ever there is no one "correct" way to succeed as a value investor – it is a function of personality, process, and skill set. Though the goal is the same, we are all playing slightly different games based on the tools at our disposal, and one should not feel compelled to change their approach just on the basis of what worked for someone else.

"Fit" can also mean the way in which we approach (and hopefully improve) portfolio management strategy and allocation decisions over time. While our fund is based on fundamental analysis rather than quantitative, both approaches are data-driven and rely upon accurate pattern recognition. To illustrate, in machine learning there are two competing forces, variance and bias, that affect performance. With bias, there is not sufficient adjustment made for new data points, and the signal from potentially valuable information is lost. On the other hand, with variance, excess adjustment is made, generalization ability decreases, and performance suffers if the past does not look exactly like the future – as is nearly always the case. Similarly, we want to walk the line between adjusting our portfolio to changing circumstances, while not overreacting based on only the most recent data points.



In the past I believe we've been on both ends of the "general error" curve above. There were times I may have discarded important details in a thesis because I did not sufficiently appreciate true changes in pattern. Other times, I should have placed less weight on recent data points and focused on historical base rates. Just as more data allows model data fit improvements, more time allows us to move closer to the center of the curve. In a game as complex as investing, error will never be eliminated, but continuing to make incremental reductions is a worthy goal.

Staying in the game. In recent years, I have been more willing to trade an elimination of the best-case scenario for also eliminating the worst. In practice, it is usually both easier and more costly to underestimate a stock's downside than its upside. On a portfolio level, the unintended consequences that can come when seemingly unrelated assets suddenly become correlated can have pernicious effects, even if those correlations only persist for a short time.

In my last letter, I wrote about how investing is an infinite game, where the only objective is to keep playing. In a dynamic landscape, unfortunate confluences of events occur without warning and with far more frequency than I, or anyone else, would like. Being caught in a vulnerable position when such a confluence occurs is perhaps the most likely way in which an investor could be prematurely removed from the field. For example, anyone who took out margin loans to juice their returns in early 2020 likely was forced to exit those leveraged positions at great loss at the worst possible time. Meanwhile, we had no forced sales, and we were actually able to deploy cash in late March of that year, which eventually paid off handsomely. A similar situation has occurred in recent weeks, as individuals who became forced sellers due to Russian sanctions are likely to experience permanent capital impairment that could very well force them to the market sidelines.

One consequence of these learned experiences has been an increased emphasis on robustness in all investment climates. Our gross exposure levels have trended slightly downward over the years, along with our exposure to stocks and asset classes where the potential IRR is highly sensitive to the timeframe. Conversely, our speed and willingness to admit to being incorrect in our initial assessment of an investment has increased. After all, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

While we will always underperform an investor who commits 100% of his capital to a high-flying industry during a bull run, we will also outperform anyone who puts all their chips on a theme that either didn't pan out or eventually ran out of valuation or sentiment support. In an infinite game, there will always be new opportunities to profit, and capitalizing less on a certain idea than someone else did is not a shame. The only irreversible error is when you allow a few (or even one) probability miscalibrations to prevent you from making future ones.

Short Memories. I have also come to appreciate the pervasiveness of investor emotions, how they shape investment flows, and how these forces combine to impact stock prices. Given the ubiquity of books, blogs, and gurus that all generally preach the importance of time horizon and temperament, it seemed reasonable to believe that a decent portion of market participants would have internalized those concepts, or that perhaps the impact would be limited to certain subsets of stocks. But it seems as though most investors simply cannot help themselves, even if they know better. Fear and greed permeate through rationality almost continually as human nature overrides logic. The knock-on effect this can have on funds that have these types of people as their clients is also meaningful, as it can force managers into transactions that they otherwise would not have made. This has happened to us more than once, which is why I have put an emphasis on finding like-minded investors less susceptible to such urges.

Often, it seems as though many market participants have traded memory depth for length. They have acute emotions that cannot be controlled in times of stress, yet once the period ends, their memories of it – and the degree to which it affects their comportment going forward – fades quickly. Thus, the same types of headlines that create panicked buying or selling when I started Adestella seem to cause the same reactions even today. Every month, there are in-depth

conversations and news articles about things such as purchaser prices and jobs reports and how to best react to them, but within a few weeks, those same people neither remember or care what those numbers were.

This observation is neither positive or negative, but just simply a description of how the investment world works. Rather than try to fight it, it's best to use it to our advantage. Just like a good poker player should be glad that weaker players sit at their table even if they occasionally cause him a loss due to suboptimal play, we should view the situations caused by such noise solely as opportunities to buy or sell at more favorable prices than warranted, even if such movements occasionally go against us in the short term. Focus on figuring out the few things that will actually impact a business's intrinsic value going forward and leave the other data points to the talk shows.

Discussion on Selected Positions

There was low portfolio turnover in the final months of 2021. I have been relatively cautious in terms of our exposure levels, and many of our existing positions experienced drawdowns to the extent that adding to them was the most attractive use of capital. We did, however, take some new positions in companies in cyclical industries where favorable operating conditions have created very cheap stocks on a run-rate basis. Our basket comprises a variety of commodity industries, ranging from old favorites such as BXC to new additions such as US Steel (both of which are currently available at less than 3x earnings). The fear is, of course, that current performance represents the cycle peak and is not sustainable going forward. My response to these concerns is twofold:

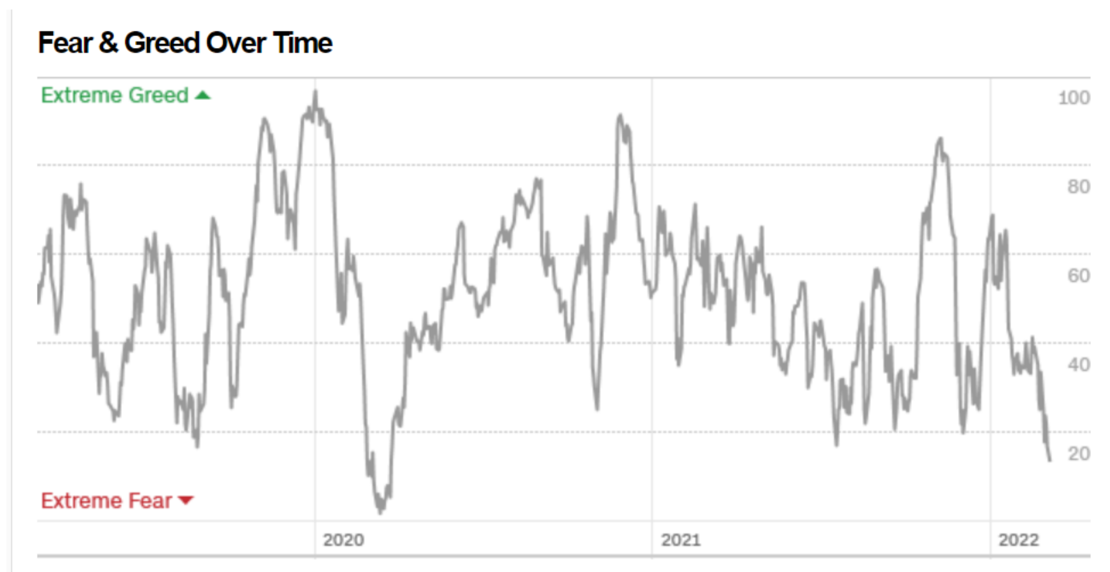
1) The industries and underlying commodities to which we have exposure are ones we believe to be either closer to midcycle or where fundamentals support a peak performance plateau, rather than a quick reversal. In the case of BXC, for example, the housing market remains very strong, with tight supply and pent-up demand.

2) At low-to-mid single digit multiples of earnings and cash flows, the cycles don't have to last long for such names to do well – even if they last for less than we expect, there is a significant margin of safety offered by the current valuations. US Steel may very well generate its entire current market capitalization in cash over the next two years and has already reduced its net debt to below 1x its trailing five-year EBITDA average. Pro forma for the company's near-term projects, the current valuation would remain materially below the long-term, though-cycle median even assuming a regression to mid-cycle profitability levels.

So long as management uses the windfalls intelligently, either by deleveraging or returning capital to shareholders, these stocks will act as coiled springs. Furthermore, attempts to reduce inflation

do not seem to be coming to fruition quickly as of now, which has historically boded well for materials stocks and furthers our attempt at weather-proofing the portfolio.

While we were relatively inactive in Q4, our activity levels in the ongoing quarter have already been significantly higher than last. We are now seeing extreme fear levels (see chart below), the highest since the onset of the pandemic, which has historically been a good time to buy. Large swathes of stocks have been beaten down by recent developments yet have little, if any, exposure to current geopolitical tensions and thus offer a compelling risk-reward proposition on a three-year view. Our strong returns in 2020 came from being willing to buy when it was highly uncomfortable, and I hope we can repeat the trick this year.



Outlook & Conclusion

Following our modest step-up in marketing efforts last year, we are in the initial stages of launching a comingled investment vehicle, rather than only offering separately managed accounts. This will hopefully allow us to expand our investor base, and it also offers the key advantage of allowing IRAs to access our core long-short strategy. I am also personally looking forward to the workflow efficiency that will come with not having to separately transact for each new account or check that all account allocations are in line with each other. It will likely be a few months until the lawyers have the documents ready to go, but the process is underway. Current investors will be contacted in the near future to discuss options but will not be forced into the commingled vehicle if they prefer the existing structure.

Looking back on my first letters, much has changed in the interim. But such is the nature of the investment business, and the ability to analyze something new every day is one of the great benefits of this line of work. There has yet to be a boring day at the office, as the ever-shifting

investment landscape presents a constant barrage of new developments and opportunities. I expect the next five years to see plenty of changes as well, and I look forward to sharing regular updates along the way.

"Eighty percent of success is showing up. "

- Woody Allen

Per Ardua Ad Stella,

Andrew Jakubowski

Performance Summary:

	4Q 2021	2021	Since Inception
S&P 500	11.1%	28.8%	180.2%
Vanguard Total World Stock ETF	6.3%	18.3%	104.4%
Russell 2000	0.3%	12.6%	104.0%
HFRI Equity-Hedge (Total) Index	0.7%	11.7%	65.7%
Adestella Investment Management	**-5.9%**	**8.7%**	**262.5%**

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