MASSIFCAPITAL

Thursday, July 9, 2020

Dear Friends and Investors,

The core portfolio for Massif Capital was up 18.3% during the second quarter of 2020. Year-to-date, as of the end of second quarter, the portfolio has returned 21.9%. A detailed report on individual account performance will be provided to investors in the coming days.

Attribution[1]

Our long book drove 100% of the results this quarter. This is a hard pivot from our first-quarter results, which were driven by our short book and tail risk strategy. Mining firms led the performance with Equinox Gold, Lucara Diamonds, Turquoise Hill, Barrick Gold, Lithium Americas, and Ivanhoe Mining, each contributing more than 2.5% to the portfolio's return. On the short side, our trio of new energy/alternative fuel companies, at least two of which are little better than companies formed to take advantage of the public's appetite for stocks with green credentials, dragged down results by a combined 6.7%.

From a sectoral perspective, our Basic Materials allocations contributed 24.9% to the portfolio while Energy and Industrials were both a drag on the portfolio. The tail risk hedge contributed -0.5%, which is to be expected, given the market's swift move to the upside since the end of March.

In total, the equity short book was down 8.9% this quarter, and the equity long book was up 29.5% with minor contributions from options and currencies.

We adjusted some of our portfolio management practices in early 2019 following a challenging 2018 fourth quarter. We elaborated on some of the changes we implemented in previous letters. One area of focus was position sizing. For many managers, sizing decisions are driven by judgment and intuition, making it a tricky area of an investment practice to improve upon. However imperfect, we have attempted to develop an empirical framework to understand the impact of our sizing decisions better.

Results suggest that our sizing criteria following the fourth quarter of 2018 are having a positive impact. Pre-2018 winning positions produced an average absolute return of 53.6%. The losers lost, on average 35.9%. Weighting the absolute returns by their relative share of the portfolio, the winners contributed, on average, 5.2% to the portfolio, and the losers contributed an average loss of 3.1%. The impact of a winning position on the portfolio, pre-2018, was 1.7x the impact of a money-losing position on the portfolio.

[1] Attribution of the core portfolio, gross of fees. Results in individual managed accounts will vary.

When we duplicate this analysis for positions sized according to our post fourth-quarter 2018 framework our winners now have a 2.48x greater impact on the portfolio vs. our money-losing positions. We are beginning to see directional evidence that adjustments to our process are leading to improved portfolio performance.

Separating process from outcome is critical for us to improve. Knowing which processes need improvement, however, requires disaggregation of outcomes to determine which one needs attention. A more nuanced understanding of how we generate returns will allow us to improve those returns. It will also present you with a more insightful and multifaceted view of what we are doing as we grow the capital you have entrusted us with.

We Have No Idea

We suspect many managers will be tempted this quarter to write lengthy exposes on the state of the market and the economy. We were tempted to do the same, but when we sat down to do so, we found the results underwhelming. Not only is the volume of conflicting information quite high and our ability to separate signal from noise at the macro level poor, but it was also very unclear to us how we, or you, were going to make money with the commentary.

We then thought it might be useful to layout competing arguments about the likely path forward for the economy. We found this exercise amusing, but it to did not produce a result any more meaningful than our effort to pick a reference narrative for the economic path forward. In reviewing the work, it became apparent that at best, we were bringing our opinions to the discussion rather than our distinctive knowledge. In some regards, this makes sense; we study companies, not economies, and dissect industries, not macro-economic models.

We cannot overlook the fact, however, that we are also trying to create a well-calibrated market-neutral portfolio, the balance of which helps defuse market volatility. In an ideal world, the aggregate dollar value of the short investments we hold would be roughly equal to that of the long investments.

A market-neutral strategy hopefully allows us to maximize our exposure to the idiosyncratic nature of the businesses we invest in. This approach also has the benefit of reducing the downside associated with a macro environment that is at the best of times opaque and, at the worst of times, for instance, now, radically uncertain.[2] We aim to allocate capital in a manner that is robust and resilient to a range of plausible macro-economic outcomes, which we believe is the best anyone can do if they are honest with themselves.

Portfolio Review

During the 2nd quarter, we closed out three short positions and four long positions and added two long positions.

Hess: We took a short position in Hess during the first quarter due to what we believed to be a weakness in their assertion that the Bakken would serve as a cash engine, along with their Gulf of Mexico assets, to pay for the development of their offshore Guyana fields. Our analysis suggested that not only was their

[2] Mervyn King, the former governor of the Bank of England, has recently published a book with fellow economist John Kay titled Radical Uncertainty: Decision Making Beyond the Numbers, it is a must read for all market participants and likely one of the best books of the year.

fracking in the Bakken unprofitable but that it was unlikely ever to be so. The market very quickly told us that although we might be right in our analysis of the fundamentals, it did not care. We suspect that much of this has to do with the fact that Hess had hedged nearly 100% of their production in 2020 during the relatively high priced 2019 period, but we cannot be certain. Since we closed out the position, the stock has rallied a further 45%. We take this as directional evidence (perhaps) of a good decision. Hess contributed -0.19% to the portfolio during the quarter.

We have mostly avoided shorting oil companies in the last few years. The opportunity is appealing but extremely tricky to evaluate. Hess remains an interesting short. We have little confidence in the long-term viability of operations in the Bakken, and Hess remains a large player. Yet as the firm moves further along in their development and monetization of assets in Guyana, the weight of the Bakkens failure to play a meaningful role in producing positive free cash flow becomes increasingly difficult to determine by looking at the financials and perhaps less significant to the market. One thing that seems increasingly true of the environment we are investing in is that bad capital allocation by management teams can be easily forgiven if there is plenty of liquidity, even if access to liquid capital imperils long-term solvency.

SunRun and Plug Power: We laid out our thesis on Sunrun in our first-quarter letter to investors and concluded that while the company had dropped 50% in March, we still felt comfortable holding the short position, this was an error. We re-evaluated that posture in May, following a rapid rise in the stock price, and decided to exit the position as the title wave of liquidity entering the markets seemed more than enough to continue to support a firm dependent on capital markets for cash. Given the level of support we see in credit markets right now, our misgivings about their business model do not add up to sufficient catalysts to allow us to hold the position. We encourage readers to revisit our thesis on the company. We would highlight that our decision to re-enter at any point in the future will likely be a function of regulatory rulings on utility net metering practices or compelling evidence to suggest a decline in tax equity investing.

We also closed our short position in Plug Power this quarter as the market was subsumed with enthusiasm over their recent acquisitions, resulting in an almost 80% rally in the stock over ten trading days. Our decision to exit was painful at the time as we were forced to reconcile with a collective exuberance that was (and is, in our opinion) not grounded reality. In hindsight, it was the correct decision as we avoided most of its recent vertical trajectory. Like SunRun, we have several signposts in front of us for Plug Power that would prompt a re-enter.

The alternative energy landscape is a tricky environment right now. We are enthusiastic about many of the technology and market-driven solutions that are moving society closer to carbon neutrality. A component of our core strategy is deeply rooted in the belief that assets are increasingly mispriced in a rapidly changing energy landscape. We are believers in some young technology companies, wary of stranded asset risks, and understand that many currently out of favor industries will require *investment* in decarbonization efforts, not *divestment*.[3] Yet, the nascent stage of the energy transition we find ourselves in also invites the creation of businesses that will ultimately prove unsuccessful. Positive sentiment in the collective is necessary to drive complex and challenging societal issues like decarbonization. Still, it can be dangerous at the individual (company) level if it results in the misallocation of resources - purposefully or otherwise.

[3] See our recent blogs posts on stranded asset risk: Silent Stranded Assets & ArcelorMittal's Path to Carbon Neutrality

We are likely to remain patient right now with many of these firms. The attractive trade in alternative energy right now certainly appears to be on the long side. We will continue building into many of our wind investments and are intrigued by developments in the European utility space, and international power developers.

Barrick Gold: We entered Barrick Gold at an average price of roughly $10 a share in late 2018, and on the Friday before the firm announced its transformational merger with Randgold. Over the approximately two years that we held the position, not only did the price of gold rally dramatically, but the business itself produced excellent returns under a superior (dare we say the best?) management team in the gold industry. The position returned roughly 125% or 6.6% to the portfolio. Although this is a good return, the position was not without its challenges. The first challenge was sizing. We started the position small, with a roughly 3% portfolio weighting. We intended to add to the position, but we proved behaviorally incapable of adding to a position that had appreciated significantly.

This is a behavioral shortcoming that should not be dismissed simply because we made money and is without question a mark against us as investors. We are aware of it, though, and awareness will hopefully help us avoid making similar mistakes in the future.

The second challenge came at the time of closing out the position. Although we remain highly constructive on gold in general, we believed we needed to exit the position as our valuation for the company was between $20 and $25 per share at gold prices of around $1,500 to $1,600 an ounce. At our exit, the company was trading between 125% and 150% of the low end of our intrinsic value estimate. So although constructive on gold, and thus open to the possibility that a continued run in gold might take the stock higher on sentiment and momentum, we were concerned that the additional price appreciation was exposing us to the risk of needing to find a greater fool to sell the position to, if and when we wanted to exit.

This was one of the more difficult decisions we made this quarter, but hopefully represents a situation we will find ourselves frequently. Our valuation of Barrick was based on a fundamental mine by mine model supported and informed by a qualitative assessment of the companies' possible paths forward. The model, by its nature, was static and did not consider sentiment or market action, but we, as portfolio managers, must. Barrick had reached its fundamental intrinsic value by our measure and was trading on some combination of momentum and positive sentiment around the price of gold. The positive momentum is undoubtedly something we aim to capture and will always be present in commodity-related businesses, especially when the commodity starts to move. The judgment calls around capturing that momentum are not easy, and the call is more about a qualitative feel for the market being made in the stock then they are about facts and figures.

When confronted with challenges such as this, we often try to create a process that allows us to think through the strengths and weaknesses of any given decision systematically, so we can keep clear what we know, what we don't, and most importantly, why we are making a decision. Unfortunately, despite some valiant efforts by quantitatively driven investors, the decision about when to sell a winner that has positive momentum remains elusive.

StarBulk: Starbulk is our only real COVID19 victim. The position was entered at the start of the year based on the firm's industry-leading position in the dry bulk shipping industry, the quality of its fleet, managements investment in upgrading its fleet to deal with new fuel-related regulations and its optionality to a potential strengthening dry bulk market in the form of significant spot market exposure.

Unfortunately, the global economy and global trade came to a halt, and with it, the stocks of all the dry bulk shippers. The companies kept shipping, but the shares took a negative turn.

As Starbulk bottomed (which at the time we did not know was the localized bottom), we re-examined our thesis. We determined that there was no obvious catalyst to turn the market's opinion of the company. We also thought, given its leverage to a growing economy heavily dependent on trade, the firm's outlook may have changed in ways difficult to understand or foresee. Reshoring of supply lines, slowing globalization, increasing trade tensions, all seemed risks before COVID19 but seemed even more, pressing now in the wake of the pandemic. All these concerns are still valid, but as soon as we sold the stock, it rallied roughly 25%. In our postmortem of the trade, we struggle to see how we could have made any decision other than the one we made.

Timing remains a curious and confounding issue. We exited six positions this quarter, and five of them have gone the direction we expected them to go when we exited. As such, one might consider them good sales in that we either preserved capital already made or avoided further losses. How did we achieve that? Was it luck? Was it skill? Was it a combination of the two, and why couldn't we go six for six? How can we go six for six next quarter? These are all questions we continue to search for answers to, and so pointing them out may seem somewhat anticlimactic. Still, we think highlighting some of the less understood and appreciated day to day challenges of portfolio management (as opposed to valuation) is instructive.

Current Positions

Looking ahead, we maintain a positive outlook for our uranium and gold positions. We expect further appreciation in both this year. We will not seek to add to our uranium exposure (comprised of a 6% position in Kazatomprom and a 3% position in Yellow Cake Uranium). We continue to look for opportunities in the gold sector. The present challenge with gold mining equities is that all the easy buys of the last two years have disappeared. Our previous successes in Barrick, Continental, and our yet to be realized success in Equinox (currently up ~100% for us) were all the result of purchasing stock at rock bottom prices when the world had no interest in gold. The situation has changed. Nevertheless, we believe there remain companies with significant asymmetric return potential in the junior mining space; we just need to find the right management teams and the right assets.

Our energy exposure continues to diversify, specifically via growing exposure to wind production. At this point, we have only one pure-play oil position. We will not go so far as to suggest we will not add more oil exposure to the book, but we find it unlikely we will find anything at this time (and at the current oil prices) that excites us much.

Regarding energy more broadly, we increasingly think the place to look for opportunities is Europe. Europe is further along in imposing climate change-related regulations on industry participants. Thus, there is a clearer picture of what the future energy landscape might look like, particularly in electricity markets. Additionally, one can add a potential tailwind in the form of a vastly more thoughtful COVID19 related stimulus than investors will find in the US, a significant percentage of which is directed at the energy industry and productive investment. We have at least one utility and several independent power producers that warrant careful following and may find a place in the portfolio.

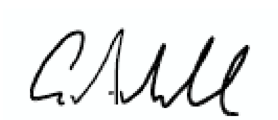
U.S. electricity markets are still too dominated by utilities operating in an uncertain regulatory environment, and energy markets are also plagued by fracking firms in which we have little interest or enthusiasm. Shorting oil producers in the US remains intriguing (their business models remain shockingly fragile). Yet, we are concerned that most investment thesis's hinge on an unwavering conviction in the direction of oil prices. To the degree we can increase our conviction on the directionality of the price of oil or find a company whose future hinges on more than just oil prices, we may add to our short book. In the absence of a resolution of either of those two issues, we will likely withhold.

The basic materials component of our portfolio, which is all mining firms save for this quarter's recent addition of Bakkafrost, continues to be a strength. We admit to being surprised by this quarter's rally in copper stocks, specifically the two we own, Ivanhoe Mining and Turquoise Hill, and are concerned that the rally is overdone. Given copper's high sensitivity to the economic cycle, a turn in the current positive sentiment around a rapid recovery may result in a sell-off. Turquoise Hill has doubled since we purchased it, and Ivanhoe is up 60% from where we bought it. We may bleed off some unrealized gains in a sell-off but would be happy to add to both positions at lower prices. At the current time, 54% of the portfolio's net asset value is invested in mining stocks. We are comfortable taking that exposure to 66%, via the addition of two further 6% long positions but see little room for more mining investments beyond that.

We have no exposure to the industrial sector in the long book; all our exposure is on the short side. We expect that trend to continue, especially given that two-thirds of our current hopper of short opportunities are in the industrial space.

As always, we appreciate the trust and confidence you have shown in Massif Capital by investing with us. We hope that you and your families stay healthy over the coming months. Should you have any questions or concerns, please don't hesitate to reach out.

Best Regards,



Will Thomson Chip Russell