

Second Quarter 2020 Commentary

NAV increase, net	2Q2020	1Q 2020	PF 2019
WBCP	34.39%	-35.79%	18.14%
S&P 400	24.07%	-29.70%	9.11%

Inception of White Brook Capital Partners was August 16, 2019

Performance figures are provided by the administrator, PF 2019 figures are audited

Performance is net of all realized and accrued fees

Portfolio Review

For the second quarter 2020, the Fund's NAV increased by 34.29% net of all fees vs the S&P Midcap 400 index up 24.07%. At quarter end, the Fund was 91.49% invested across 11 positions.

During the second quarter, every position except for Coty, Inc (COTY) increased in value. Top contributors to the fund were Box, Inc (BOX) and IAC Holdings, Inc (IAC).

On a sector basis, our investments in the information technology and consumer discretionary sectors were the top performers, while our investment in consumer staples was the only detractor.

During the second quarter, the Fund exited Natus, Inc (NTUS) and bought no new positions. Due to a spinoff that occurred after market close on June 30th by the 1st of July we also became holders of Match Group (MTCH).

We exited Natus after taking into account Covid-19, the severe impact it would have on hospital budgets, and the likelihood that its impact would continue over the medium term. Four factors determined our action:

1. Broadly speaking, hospitals finances, already suffering in rural areas, would be in deficit in urban areas in the short term due to the delay in profitable elective surgeries.
2. Increased usage of telemedicine will result in fewer patient visits to hospital facilities in the medium and long-term, depressing revenue relative to historical performance irrespective of a post-Covid catch-up. While electoral politics and the resumption of support for the Affordable Care Act could ameliorate some of the impact, telemedicine negatively impacts hospital facilities' utilization and will continue to harm hospital finances.

3. Because of potential resurgence, even after wide scale vaccination implementation, hospitals will need to build “rainy day” funds that can be used in the event of a local Covid-19 outbreak. Building those funds will result in cuts to discretionary and non-discretionary budgets near term and over the longer term. Patient care will need to be completed with less resources than before. De facto zero based budgeting will become more standard across the industry.

Most of Natus’ products are non-discretionary, but its growth was to come from more expensive products that are more discretionary. In this environment, to grow, a hospital facing company’s products either need to service Covid patients or provide a very high return on investment in a short period of time. Natus’ products don’t sufficiently meet those goals and the position became a portfolio casualty of the Covid epidemic.

IAC Holdings completed the spin-off of Match Group (MTCH) after market close on June 30th. After IAC shares were fully assigned, the IAC position was reaccumulated to its previous weighting as a percentage of portfolio assets in the early days of the third quarter.¹

The thesis when buying IAC was that depending on how you looked at it, their holding of Match was trading at an extremely cheap price and/or their stakes in Angi Homeservices, Inc (ANGI), their other businesses including prize assets Vimeo and DotDash, and an arguably unparalleled management team were being valued at less than 0. While previously announced, at the time of our purchase, the spin of Match was somewhat in doubt given the financial tumult of the first quarter. White Brook’s view was that whether or not IAC and Match were able to split, we would be well served to own both - albeit with a preference for the spin to occur and for IAC to have the flexibility to make another major investment. As noted, they were able to separate after the closing bell on June 30th and clients have a significant position in two well run and compelling companies.

The ability to own Match with the economic and strategic moats that it had developed was a unique opportunity. While Covid-19 means that a majority of its users were unable or reluctant to use its dating services, human connection is an enduring desire that will return at least as strong when Covid-19 related lockdowns and social distancing end. In their base business, Match has multiple avenues to increase shareholder value, from attracting new users, introducing additional services, and holding on to users for longer, to lowering payments to

¹ Third quarter performance will differ based on your account’s custodian. The Fund and managed accounts held at Interactive Brokers fully accounted for the split by market open on July 1st. Schwab waited for shares to fully settle before accurately accounting for the spin.

Google and Apple to distribute Match Group' apps in their app stores. While they will seek to reduce their spin-off debt first, they generate substantial free cash flow to reduce their leverage. Ultimately, Match will expand its services to become a mainstream social network - not just a dominant aggregator of online dating sites and/or focus on what they already do well while partnering and charging a toll to other service providers who offer their own products to Match Group users. Management is smart and innovative and I expect product and business model innovation that creates significant additional value for shareholders.

Market Review

The second quarter reversed a significant amount of the losses of the first quarter across major asset classes. Within US equities, mega cap technology stocks led the move higher and were joined by other US technology stocks while the median S&P 500 stock continued to be down >11% for the year with small and midcap indices down more than 13%. In crisis, investors migrate to where they feel capital will be the safest and after almost 4 years of back to back and layered crisis, stocks that seem easy to understand and who have already performed have been deemed the least risky. To those buying, those stocks' past performance is an indicator of future performance and should be relied upon to make future investment decisions.

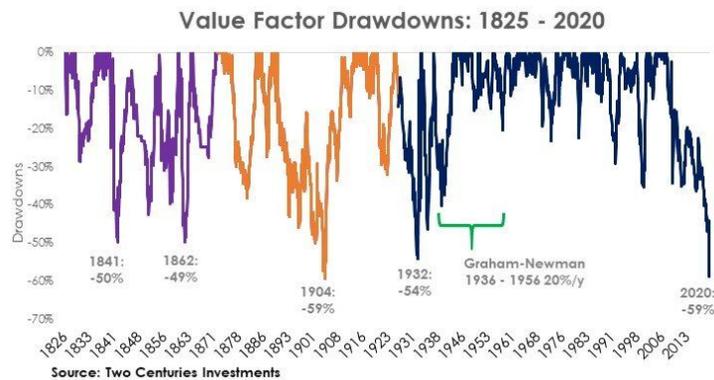
Company Size	Market Cap	P/E	P/S	P/FCF	P/B	YTD Returns
Top 10	\$848.6 billion	31.4	6.3	33.2	6.3	9.6%
Top 50	\$198.7 billion	28.7	4.6	23.3	5.5	2.4%
51-100	\$77.6 billion	26.0	3.8	25.0	5.3	-5.7%
101-150	\$49.5 billion	22.9	3.9	23.6	4.1	-1.9%
151-200	\$30.5 billion	26.4	3.0	23.5	4.1	-6.7%
201-250	\$24.6 billion	24.4	2.6	20.0	3.2	-9.3%
251-300	\$20.2 billion	23.2	2.6	21.8	3.3	-5.5%
301-350	\$14.9 billion	23.9	2.8	22.8	2.5	-8.5%
351-400	\$11.8 billion	22.1	1.8	18.4	3.0	-17.6%
401-450	\$8.9 billion	13.3	1.4	12.8	1.9	-22.6%
451-505	\$5.1 billion	13.9	0.8	10.0	1.2	-38.5%
S&P 500	\$21.8 billion	22.8	2.4	20.4	3.0	-11.0%

Source: Ycharts

Even as stocks of all market caps and valuations appreciated during the second quarter, expensiveness beget more relative expensiveness and cheapness beget more cheapness - resulting in so called growth stocks handily outperforming value stocks.



This level of drawdown was not unique, but it certainly is uncommon.



To White Brook, large cap US tech and growth in general has crossed from reasonably to unreasonably valued as the largest growth companies now exceed ~\$1.5 trillion in market cap. Those market capitalizations imply unlikely end market dominance and market growth to generate the free cash flow necessary to justify those prices. That said, it's impossible to know how long irrationality can last and how irrational any market can become. If I were to guess, antitrust action and/or a more stable world are most likely to reduce their market capitalizations.

1. Antitrust: A suit or two or three brought by US or European entities seems likely. A simple breakup of the companies is probably the most shareholder friendly outcome with a more likely outcome to be restrictions on how the companies compete. This would be a serious obstacle to continued dominance limiting growth while simultaneously requiring them to spend more to obtain and retain prized talent.
2. A more stable world. In a more stable world, that doesn't lurch from one manufactured crisis to another with such rapidity, the safety of mega cap tech

stocks and other growth investments is less sought and safety of investment is weighed against the price of investment - not in isolation as it seems to be today.

3. A recognition that a real economic toll has been exacted by Covid-19. The overall financial well being of their customers has been worsened by the epidemic. Growth, while accelerated during the crises as customers increase their online spending, is unlikely to extract the same overall dollar amount in the medium term as their total addressable market shrinks - given weaker customer finances.

Covid-19

The portfolio has performed fairly well through Covid 19, but it's still early to judge as the market has vigorously ignored the pandemic and the likely length of the recovery. Government action has extended the period of questionable survivability and news of Covid related bankruptcies is only now starting. Much of what I wrote last quarter - my view on the path of Covid-19, the reactions, the tactical theses for each of our investments, areas to avoid, and my views of the impact of putting swaths of the US economy through bankruptcy proceedings is similar today as it was a quarter ago.

I have been surprised at the size and efficacy of the government's financial intervention and unsurprised at the populace's response to the virus and lockdowns. My underlying investment thesis as it relates to Covid was that people's discipline would waver. It's easy to stay inside in February, but given an excuse to go outside in July, people will. The boundary of what people will do once they get there expands over time and what parents will threaten to do to their kids if they are unsafe, or what they'll refrain from doing themselves weakens over time. My view moving forward is that Covid spread will decelerate as the weather worsens into the autumn and winter. I don't think vaccination will occur widely enough and frequently enough to limit Covid and achieve herd immunity and a world of algae-like blooms of infection is the most likely future. My advice for friends is to get busy living and put personal procedures in place to protect yourself because this is going to be with us for a long time.

There are many takeaways for companies. Risk mitigation suggests that on-site manufacturing and service work should be broken up into pods with those people interacting exclusively with one another. While this limits the spread to only the pod should a member of the pod become infected, should only a member become infected, the whole pod is wiped out without further redundancy. Daycares and summer camps seem to have taken this into account surprisingly well and early in the second quarter earnings season, manufacturing companies

that have enacted these policies are reporting minor delays in shipping individual products to customers as employee absences prohibit the shipping of individual skus. It does seem to be the way forward.

In the days that come, I expect company spending that first focused on enabling remote work, to pivot towards the new needs of companies' new workflow and mission critical work and staffing. Companies have a decision to make, they can try to get through the next several years without changing much, or they can enable a new workflow to make the Covid way of working, their core way. It's not an easy question and the appropriateness of the answer may be different for two companies in the same industry. My sense is that most will wait and see until there's a competitive impact by the leaders of their industry and then spend to catch up or exploit the tumult.

Politics

My current expectation is that a change in administration will significantly change the investability of swaths of the market. As previously mentioned, by not lurching from one manufactured crisis to another, long-term investing based on reasonable valuations and delivered value should become relatively well rewarded again. But changes could also create upheaval in different industries.

1. **A change in capital gains tax regimes.** Paying for Covid relief measures necessitates wholesale changes to the pre-Trump tax code, much less the reforms that created almost \$1 trillion deficits during a time of strong economic growth. If Congress adopts equal treatment of income and capital gains as suggested by some of Biden's primary competitors, it will incent more short-term investing. Most investors trade for less than a year, with even supposedly long-term investors on the whole holding positions on average for a little over a year. While the industry posts pre-tax returns to measure performance, what you the client should care about is after-tax returns which can differ considerably based on holding times. Holding stocks through a bad quarter or two is hard but is rewarded by better after tax returns as the sale happens after a year. If you equate a 6 quarter holder to a 1 day holder, I think you'll see much higher turnover with those of us that hold stocks for multiple years on average really differentiating ourselves. My sense is there aren't many multi-year professional investors out

there and volatility will be much higher all other things behind equal unless the legislation is smarter than the headline.

2. **Reinvesting in the Affordable Care Act.** Renewed support for the Affordable Care Act by a new administration and Congress could see massive changes to government's role in providing healthcare and how it's paid for. In my estimation, laggards and leaders cannot be predicted today as the ACA as is, was molded by just a few personalities. Based on how Congress forms and who a potential Biden administration trusts to spearhead the effort, it could have dramatically different form.
3. **A resumption of environmental regulation.** A Biden administration with a Democratically controlled congress will focus on reclaiming pollution from the environment and investing in the manufacture and implementation of greener technologies. This is likely to be a positive for smaller businesses and companies with emerging technologies and an obvious shift from current policy.
4. **A reinterpretation of net neutrality.** Net neutrality will be reworked, again. While cable and telecom operators have been slow in claiming some of the rights given back to them by the FCC, the FCC's regulatory regime encourages vertical integration to encourage new broadband competition. That competition largely hasn't materialized and the introduction of streaming services based on those economics will look a lot worse, if net neutrality is reversed and more strategic action will occur.
5. **Financial services will be regulated again.** The Trump administration castrated the Consumer Financial Protection Bureau and has stripped out vestiges of the Dodd-Frank regulation limiting investment risk by the money center banks. A Biden presidency would likely seek to reestablish both.
6. **Education costs have reached a tipping point.** The Trump administration has cut significant state funding while pushing more responsibility previously held by the federal government to the states. In response, states cut funding to their state universities. Covid-19 further stretches states' funding base even as it requires additional funds to treat the epidemic. Something drastic will likely have to be done so more colleges don't close. The current solution of charging more for additional methods of accessing educational resources is not the answer.

On the whole, I'm medium and long-term bullish if we get a new take and can somehow marry that with a fiscally responsible approach.

As always, feel free to reach out to discuss this or any of your investments with White Brook Capital. I thank you for your support and will strive to continue to earn your trust.

Thanks,

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Portfolio Manager
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