

Letter I Introduction - Launching Tenebrist

Dear Partners, Family, and Friends,

First of all, I'd like to thank you for supporting Tenebrist over the past two and a half years. It's been an exciting and eventful journey so far and I look forward to continued growth and progress in the coming years. In this first letter I'd like to provide an introduction to Tenebrist and explain motivations behind launching the Fund including perspectives on equity markets, portfolio construction, and improving as an investor.

I launched Tenebrist to apply my investment experience and knowledge garnered during my time with ShawSpring to a broader array of investment opportunities. In my previous role, I became heavily focused on long-only investing in US & Chinese Internet companies. This is a strategy that we were early to, but that many other growth-oriented investment firms gravitated to as well over time. With ambitions of exploring other areas of investing and running my own fund and firm, I decided to launch Tenebrist and take advantage of the stock prices observed during the March 2020 COVID selloff.

Embarking on this path lets me explore companies in industries, countries, and scenarios I never before had the chance to research, while rapidly improving my investment process at the same time. The ability to invest across industries and geographies is a key investor skill in today's highly correlated equity markets, but one that is often abandoned by sector, country, or style-specific funds (tech/media/telecom - "TMT" funds, China-focused, or "special situations", etc.). In this letter, I will detail why it is increasingly important to take a global generalist approach to investing so as to not become overexposed to any one geography or sector and why Tenebrist can be best-in-class via a detailed coverage expansion process.

Setting the Scene Part I - Generalism vs Specialization: Stock Market as Unkind Environment

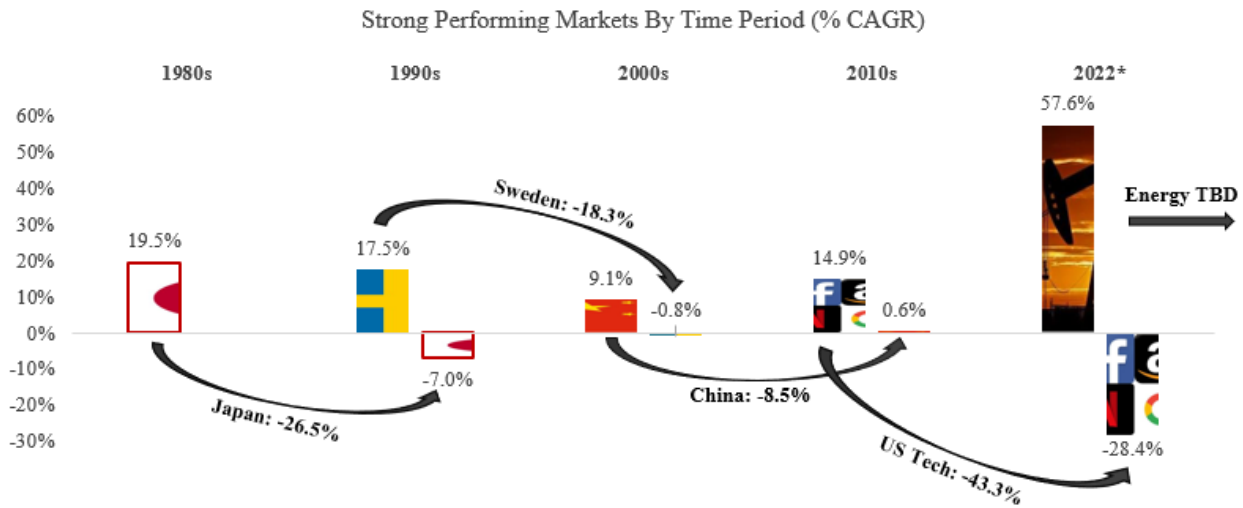
The stock market is an example of an "unkind domain" originated by Hogarth et Al and popularized by David Epstein in his book *Range*. Unkind domains are characterized by dynamicism, ambiguity, inconsistent rules, and paradigm shifts. Feedback from the system can be slow and learnings can be unreliable or misleading across regimes. On the other hand, a kind environment is where the rules of a system are known, and feedback is quick, meaning that lessons gained from experience are reliable and consistent over time. Examples of this are musical instruments and solo sports like violin or chess.



In kind environments, specialization is important because information can be aggregated and relied upon over time. Those with the most domain-specific expertise generally perform best as their experience compounds over time. Simply stated, the same skills and strategies work consistently over time because the rules don't change.

In unkind environments, specialization is less important than having and applying broader knowledge across topics and domains because the same skills and strategies *do not* work consistently over time due to sudden changes in the

context or backdrop - in this case macroeconomic and industry conditions. As shown below, the same sectors and geographies do not perform best in every time period:



Specialization in unkind domains can have adverse effects, where practitioners gain confidence in learnings which end up being random or useless over time, ultimately backfiring. Lessons learned in earlier regimes become no longer relevant, leaving investors much less effective in periods of change. For example, investors may over index to what has worked recently, like certain countries; styles, like value or growth; specific industries, like energy or technology; or scenarios; like spinoffs or compounders. Investors should pursue having a large toolbox and a diverse opportunity set, striking a balance between specialization and breadth of knowledge and skills.

Setting the Scene Part 1 - Generalism vs Specialization: Stock Market as Increasingly Correlated

Diversification is a topic often discussed in investing circles with an antiquated lens. Primarily, diversification is discussed from the angle of total number of investments - “how many stocks are in your portfolio?” This was an extremely relevant question at the advent of modern portfolio theory in the early 1950’s, however, the equity markets have changed dramatically since then. Let’s begin by addressing why this is an important topic at all. Number of stocks (“w” or weightings of a particular asset) in an equity portfolio is a core component of the equation for portfolio volatility as shown below:

$$\sigma_p = \sqrt{w_1^2 \sigma_1^2 + w_2^2 \sigma_2^2 + 2 w_1 w_2 \rho_{1,2} \sigma_1 \sigma_2}$$

Portfolio "Volatility" (Standard Deviation of the Portfolio)

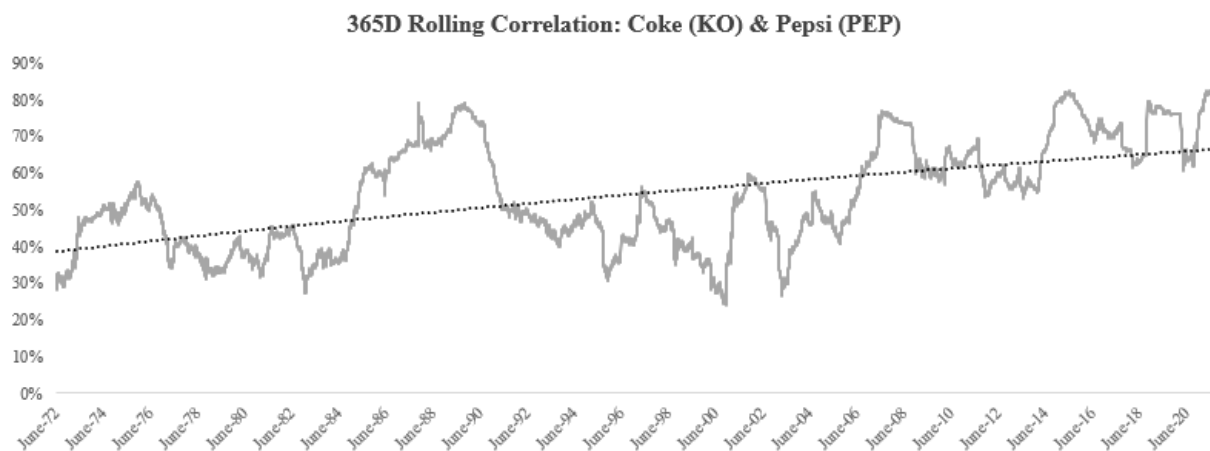
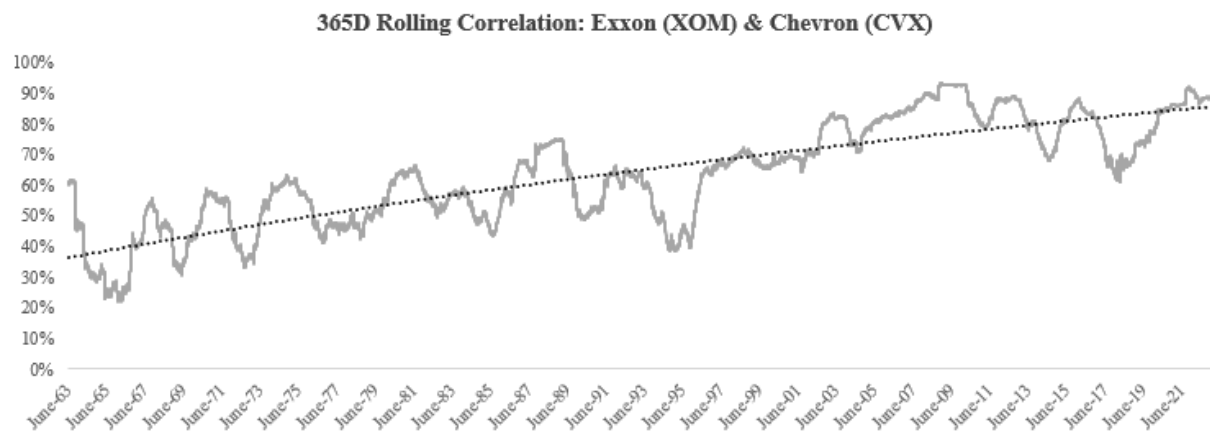
Asset Weights, Asset Standard Deviations, Correlation Between Assets 1 & 2

Asset 1 Characteristics, Asset 2 Characteristics, Correlation Term

This term goes to 0 if correlation is 0 and is highest if correlation is 1

In addition to the number of stocks/weighting of each stock variable, is the volatility of each individual stock, and the correlation of each stock in relation to one another. The way the math works out, unsurprisingly, as the correlation of the assets in the portfolio approaches one (identical assets essentially) the benefit of having the additional equity investments diminishes to zero.

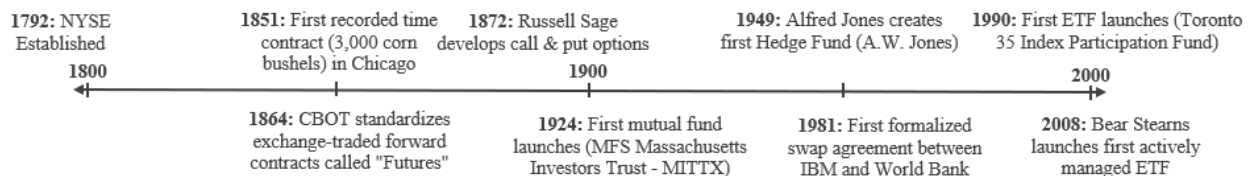
When modern portfolio theory was devised by Harry Markowitz in 1952, correlations across equity markets were lower, and the emphasis on total number of stocks, and not correlation of each stock, was justified. Today, that is no longer the case. The chart below highlights the increasing correlation between companies like Exxon/Chevron, Coca-Cola/Pepsi, and Amazon/Google:





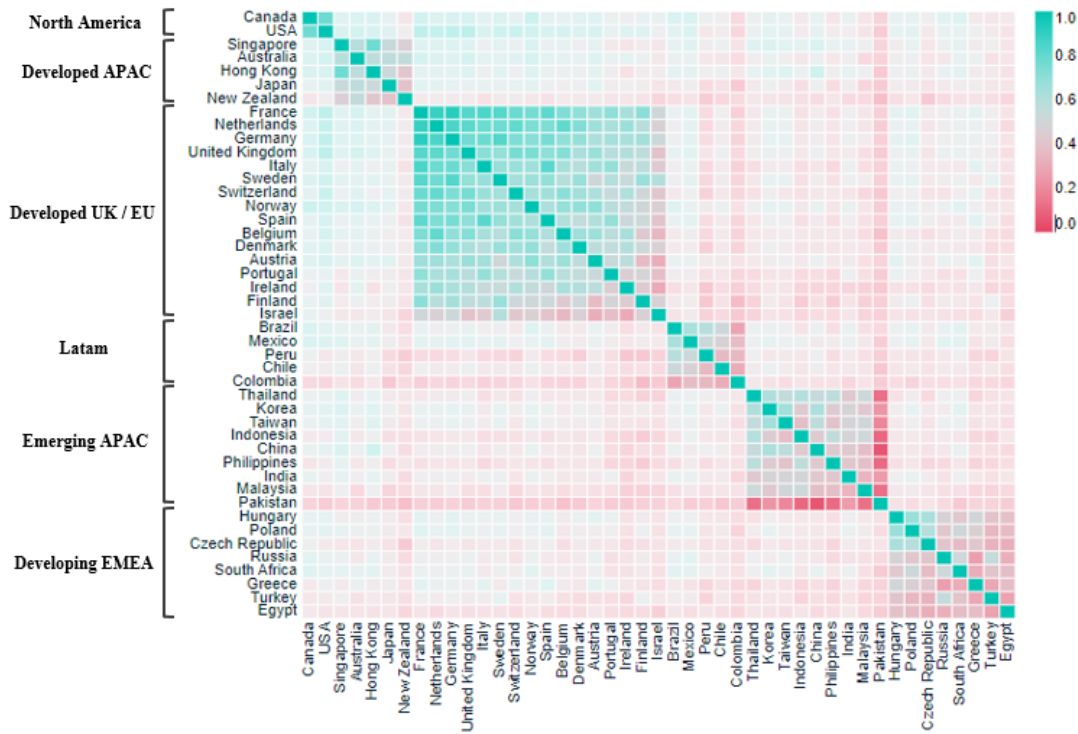
For most of the 20th century, an investor could invest in these companies and feel diversified due to lower correlations. However, as correlations increased, these increasingly became identical bets on oil/energy or on soft drinks/beverages - not on whether Exxon would outperform Chevron or Coke vs. Pepsi.

Increased correlations across equity markets could be driven by increased productization of individual securities and globalization of trade. From a trade perspective, equities *should* be more correlated because the underlying fundamentals and business dynamics of global corporations are more intertwined. From a productization standpoint, financial institutions have created more ways to access underlying securities over time.



As equities become more commonly accessed, bought, and sold via equity products (funds, derivatives, etc.) and not the underlying securities themselves, this increases the correlations across the underlying assets. I.e. investors are trading all of the S&P 500 or an Energy ETF at once, not Exxon or Chevron individually, meaning both get bought and sold at the same time, for the same amount. Returning to the portfolio volatility equation, as the correlations of equities continue to approach one, the importance of the total number of stocks in a portfolio approaches zero.

As this occurs, investors cannot simply add more stocks to their portfolio to achieve sufficient diversification anymore. They must search for equities that are less productized and less global. However, even looking internationally for diversification can be fruitless since correlations across countries, especially within the same region, can be quite high as well:



To deconstruct the above results, we will use ETFs as a proxy for productization, and US trade exposure as a proxy for globalization. We observe that the least correlated equity markets such as Pakistan and Egypt are also the least productized, with only 2% of ETFs holding equities from either country. Moreover, these countries receive less than 3% of their GDP from trade with the US, the World's largest economy.

Country	Total ETFs	US ETF Exposure	GDP	US Trade Exposure	Total Overlap
United States	1163	54%	\$23,200	104%	79%
Mexico	313	15%	\$1,273	52%	33%
Canada	497	23%	\$1,988	34%	28%
United Kingdom	948	44%	\$3,131	4%	24%
Netherlands	492	23%	\$1,013	9%	16%
Germany	501	23%	\$4,260	5%	14%
China	518	24%	\$17,730	4%	14%
France	399	19%	\$2,958	3%	11%
Japan	361	17%	\$4,941	4%	11%
Russia	148	7%	\$1,779	2%	4%
Poland	99	5%	\$675	2%	3%
Pakistan	44	2%	\$348	2%	2%
Egypt	53	2%	\$404	0%	1%

While there are many factors influencing productization and globalization, such as the overall economy's size, it's clear that to find uncorrelated equities, investors need to look to more isolated markets. Countries researched or

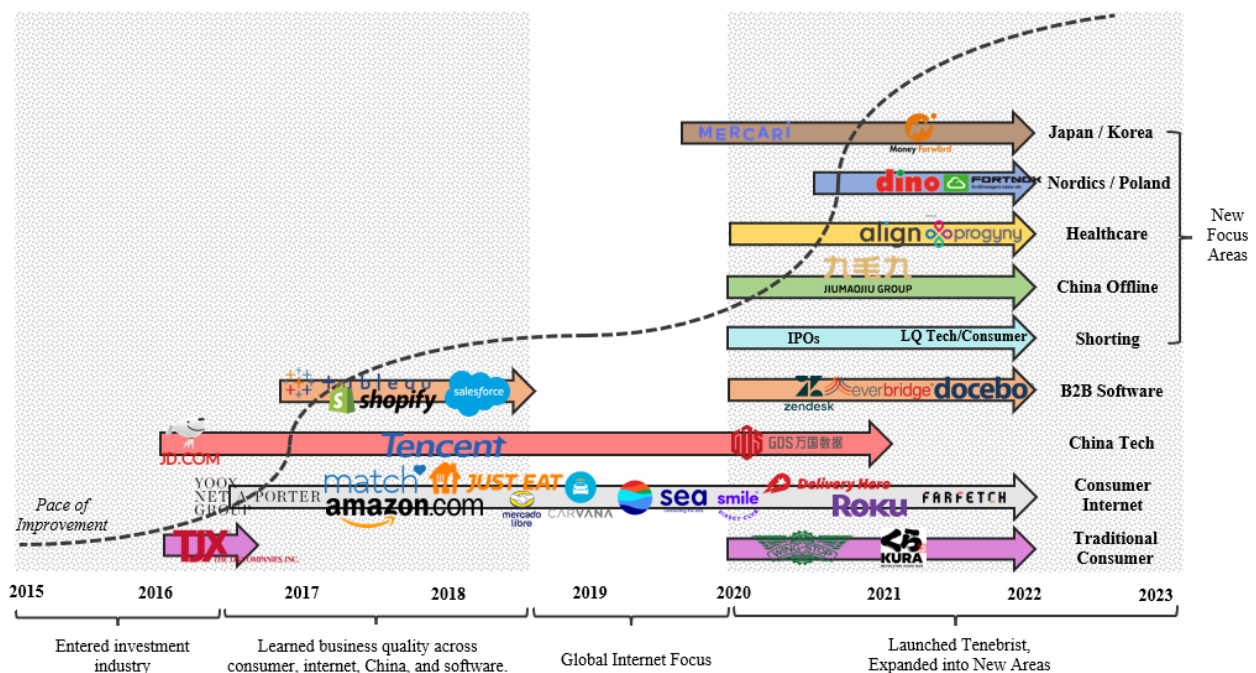
¹ MSCI

² VettaFi ETFDB

invested in that fit this criteria are Poland, China, Kazakhstan, Japan, South Korea, and Greece for example. The rest of this letter will discuss building up familiarity with new countries and industries for this purpose.

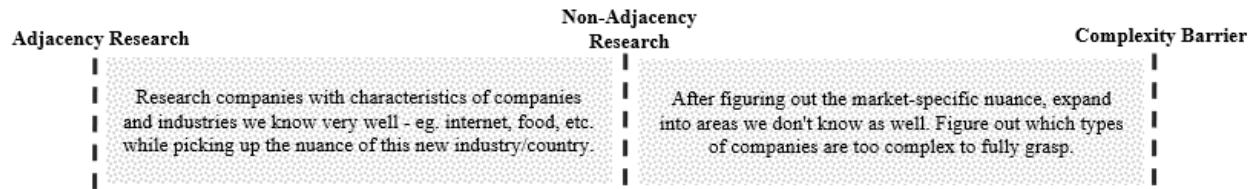
Pursuit of Generalism: Expansion of Coverage

As an investor, expanding one’s circle of competence is a critical task in a dynamic and increasingly correlated global equity environment. At Tenebrist, I’ve aggressively expanded geographical and industry coverage since launch into areas like the unique countries mentioned above, and industries like healthcare - chosen for the large, current investable universe. Sometimes, I’ll make a bet that there will be a large market opportunity with robust public enterprises in the future like in cannabis, Southeast Asia, and Africa. Below is a quick rundown of coverage expansion over the years:



Being a best in class global generalist requires a bulletproof game plan to expand coverage while avoiding errors. For us, this takes the form of expanding by adjacencies, and by continuously identifying areas of potential complexity and risk.

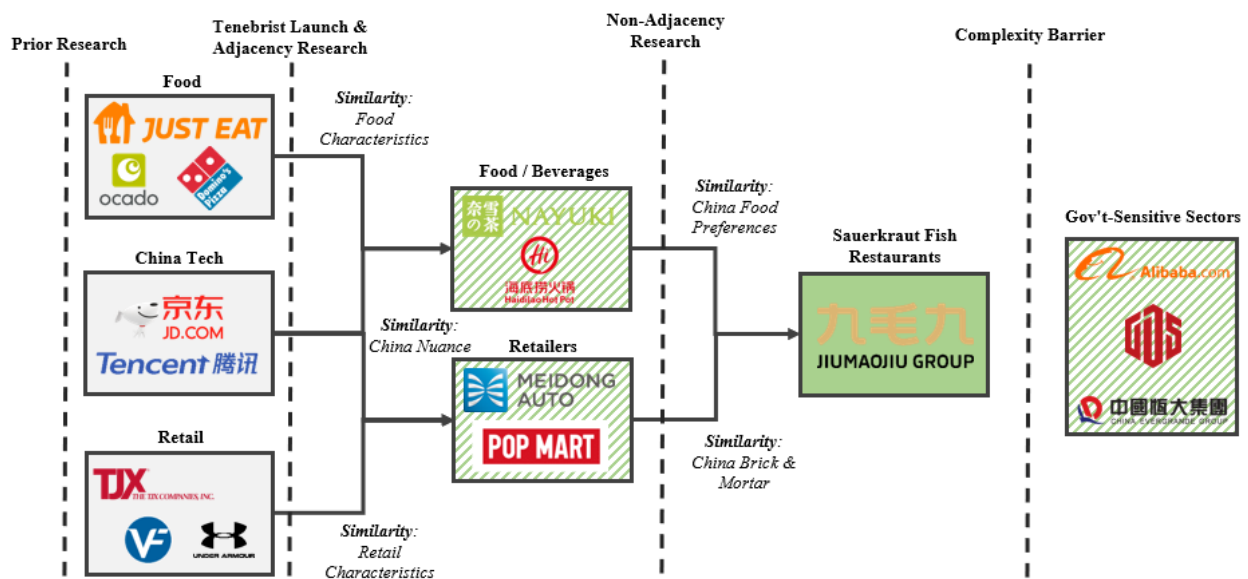
One of the fortuitous aspects of my investment history is that new companies I researched happened to be adjacent to each other. Retailers like TJX and JD provided a base to then understand Amazon. JD and Amazon’s marketplace businesses provided a base to understand other marketplaces like Just Eat and Sea Ltd. Amazon Web Services provided a base to understand other software companies like Shopify and Salesforce. When I realized how beneficial this approach was, I began actively integrating this “expansion by adjacency” approach directly into my and my Team’s research gameplan. When expanding coverage, we also seek out complexity and unpredictability in the companies, industries, and countries we’re researching so we can segment markets into areas of adjacency, non-adjacency, and complexity.



At the beginning of researching adjacent markets/companies, we're essentially getting a feel for the new market. We take introductory meetings with adjacent companies and seek out market-specific content like long-form primers and conferences to attend. Importantly, we build a framework around market complexity: answering the question "What is unique to this market that a generalist cannot easily master?" (These are typically areas requiring significant domain expertise due to unpredictable variability in potential business, industry, or country outcomes.) To determine if these are barriers which can be overcome or prevent investment at this time. Below are a few examples of expansion into new areas and how we ended up at our current investments:

New Country: China Offline & Jiumaojiu (Hong Kong - 9922)

Having already entered China via the China Tech adjacency in my prior research, at Tenebrist it made sense to focus on offline-consumer businesses like restaurants and retailers. We quickly found Jiumaojiu and took a liking to it.

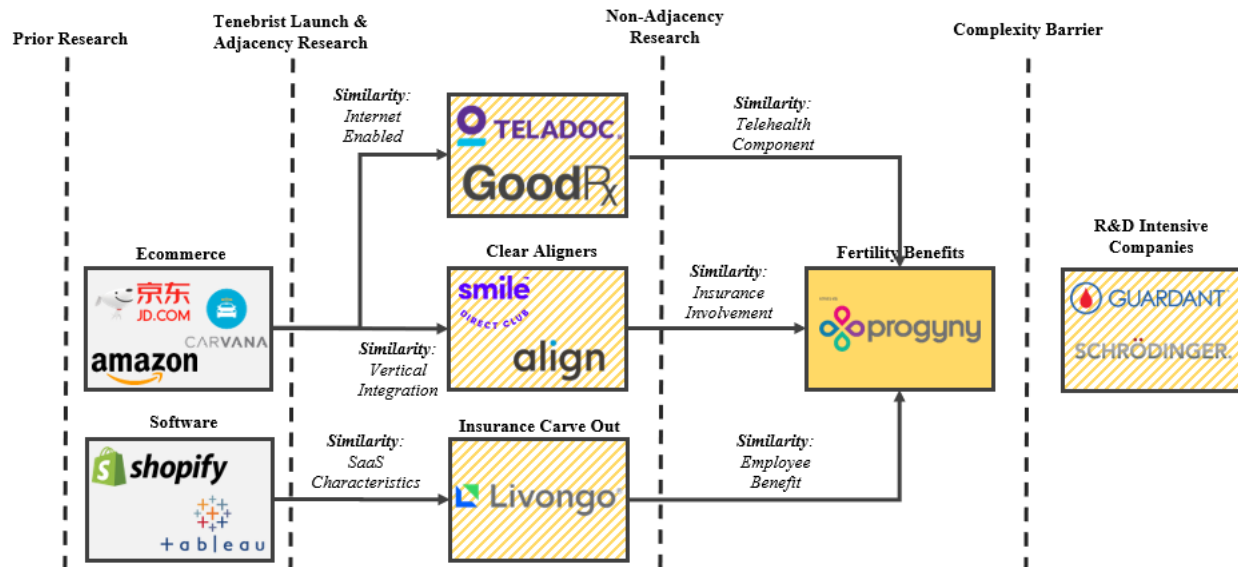


As we continued to research and invest in China, we came to dislike areas the government is overly focused on such as data, financial services, education, media, health, and infrastructure, since policy around these industries is difficult to predict and usually only surprises to the downside.

New Industry: Healthcare & Progyny (PGNY)

Healthcare is always a space I've wanted to participate in because of the growth opportunity and historically high returns on capital. My first healthcare exposure was researching SmileDirectClub (SDC), an online clear-aligner business. This was a great inroad to healthcare due to commonalities with vertically integrated ecommerce companies I invested in prior. Because of this foundation, I was able to focus on the nuances of the clear aligner

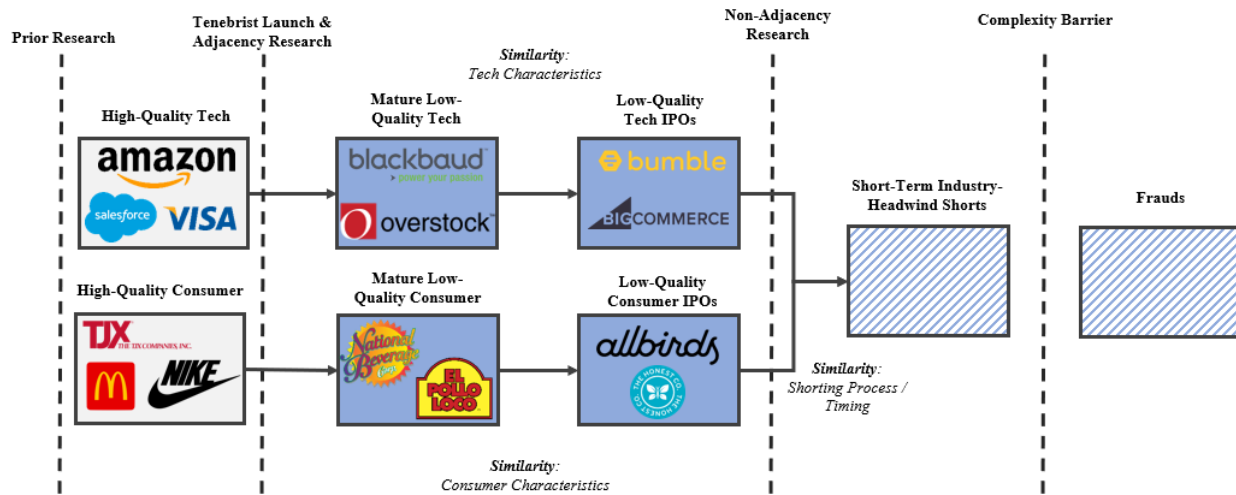
market (design/manufacturing, competition with Align Tech/orthodontists and other D2C players, insurance, etc.) rather than focusing on the distribution model (Internet / Ecommerce). We then used my understanding of clear aligners to explore other healthtech companies like Teladoc (TDOC), GoodRx (GDRX), and Livongo (LVGO). As an employee benefit and insurance carve-out, Livongo was a perfect foray into learning about Progyny (PGNY), another employee benefit/insurance carve-out which we ultimately ended up investing in.



In healthcare, the complexity for us is generally any company in the development stage where there is uncertainty around the future of a specific drug or solution. Forecasting these products takes more scientific background than we have at the Firm so we have avoided it thus far.

New Style: Shorting

I view shorting primarily as an additional tool to generate profits and look for stocks with significant immediate downside (generally 30%+). When we started shorting at Tenebrist, we leveraged my experience in technology and consumer to find low-quality stocks like Overstock.com (OSTK) and El Pollo Loco (LOCO). We then started broadly shorting low-quality technology and consumer IPOs and De-SPACs.



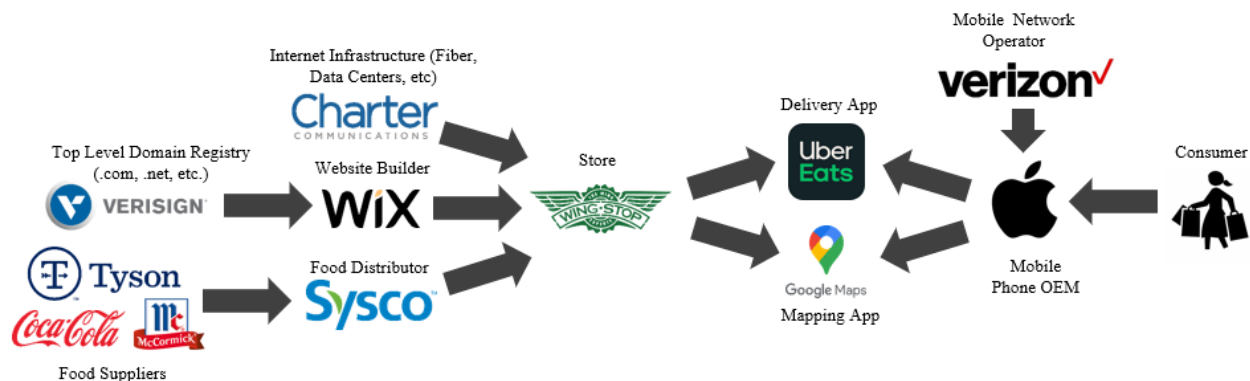
Next, we’re going to work on shorting companies facing short-term industry or economic headwinds. From a complexity standpoint, it’s unlikely that we’ll be the first to uncover any frauds as the return on time spent is questionable for what would ultimately be a small short position. However, we’re happy to short companies if the fraud has already been uncovered but it still has reasonable availability and borrow cost.

Synergies of Being a Generalist

There are many synergies with researching and investing long and short, across multiple countries and industries. One of the major benefits of not specializing is the ability to recognize and identify patterns across seemingly dissimilar companies since business models and competitive advantages can often rhyme across industries and countries.

Synergies Researching One Company

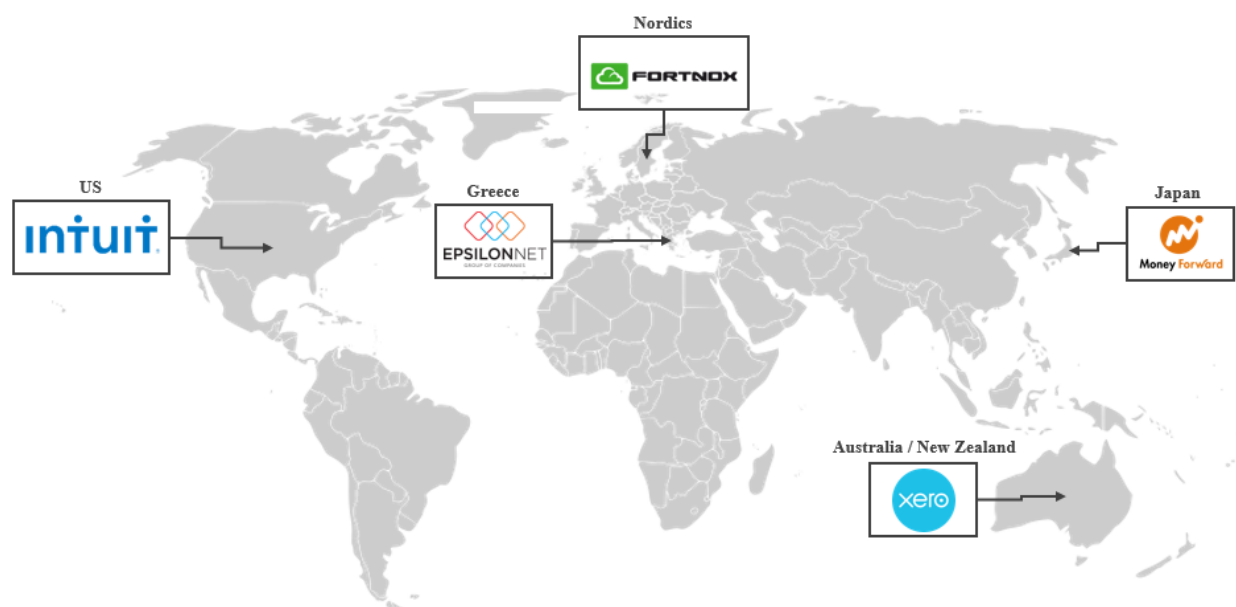
Almost every company value chain is composed of companies spanning multiple industries. By researching all of them we can better understand the businesses we invest in and the ecosystems which they exist in. For example, the value chain for a restaurant like Wingstop (WING) may look something like this:



In this ecosystem, it's likely that these companies are covered by seven separate analysts/teams across restaurants, food suppliers, beverages, Internet, software, technology hardware, and telecom. What this means is few analysts or investors have a complete grasp of the entire ecosystem. By expanding coverage across industries, we can better understand what's going on for each investment we make.

Synergy Across Countries

Consumer and business needs are mostly homogenous across geographies. This leads to there being similar businesses in each market. For example, in many countries there are large, high quality, publicly traded, accounting software firms like Intuit (US - INTU), Fortnox (Sweden - FNOX), Epsilon Net (Greece - EPSIL), Xero (Australia - XRO), and Money Forward (Japan - 3994).



When we find an accounting software business in a new country, we look for similarities in the business model, having confidence and a solid foundation for beginning our research. For example, we had already taken a look at Money Forward and Intuit before we found Fortnox, which allowed us to focus on key success factors like partnerships with accounting firms securing distribution to end-customers.

Synergy Across Industries

I've found that business models are generally the same across industries. For example, the razor and blade business model is one that frequently arises with slight variation. Seeing industry examples enables us to reduce a business model to its building blocks and have diverse data points on where and when the model works or doesn't work. At first, I viewed the razor and blade model as a hardware play: companies sold sticky hardware with accompanying recurring consumable purchases thereafter. Then I started to see software versions, as when Roku licensed its smart TV operating system to TV OEMs to sell into consumers and then monetizing via ongoing advertisements and payments. The concept is simple: a company sells one lower-margin yet very sticky product to lock the customer in, then sells recurring higher margin products, or services, on top of it.



The underlying building blocks are illuminated over time with more unique examples to improve the framework. One instance reminds of another, and another, and so on, without even needing to be called the razor and blade. If we recognize such business models as generally being indicative of quality, this gets us closer to an answer on the company's potential competitive advantage and whether it will meet the investment hurdle.

Synergies Across Long and Short

The skill that is most transferable to long investing from shorting is the identification of low-quality businesses. Identifying low-quality businesses, while core to short selling, is also important for long investing when trying to avoid mistakes. Shorting helps improve an investors ability to identify low-quality businesses because it forces investors to approach research projects from a neutral angle and then deep-dive companies with red flags rather than moving on. Long-only investors don't get this kind of practice because they're naturally biased to the long side and discard projects at the first sign of trouble. Short sellers on the other hand can monetize the additional effort spent on a lower-quality company, learning as much as possible, identifying additional red flags, and continuing to follow the company over time. For example, a long only investor would likely see a company make a controversial acquisition in a market unrelated to core business operations and immediately pass. A short seller would see this and dig further to understand why management would make such a decision. After skimming through company filings the short seller observes that management is incentivized to grow revenue as part of their annual KPIs and compensation, not earnings. This is a potential red flag that would be good for long-only investors to be aware of while researching long ideas. Moreover, short sellers get the opportunity to see these red flags pop up in various companies, giving them more confidence in their conclusion.

Conclusion

At Tenebrist, our goal is continuous improvement of the global-generalist investment strategy and process highlighted in this letter. For us, this means becoming better versed in every worthwhile country or industry while being vigilant of potential pitfalls. We also want to continue to refine the exact characteristics of companies we look to invest in both long and short, and become more efficient reaching conclusions about said companies. This is not something that will happen overnight, but a mission that will unfold in the coming decades. Having a broad universe of options will make it easier to consistently find unique and compelling investments in an equity market plagued by high correlations and regime shifts. Pursuing a diversity of investments with exposures across countries and industries will allow us to isolate stock-picking skill versus riding the sentiment of markets or styles-du-jour. I believe this will keep Tenebrist ahead of other growth-oriented investment firms that are overexposed to the same

types of stocks - generally US-traded technology. While I can't promise that every investment made will be a homerun, I do promise to relentlessly pursue improvement of the Tenebrist process and portfolio each day.

Thank you a million times over for your time, support, and capital,



James Reynolds, CFA

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