

**Tidefall Capital LP**  
**Q3 2023**  
**October 25, 2023**

|                          | Q3 2023 | Year to Date | Since Inception<br>(Jan 21, 2020) | Since Inception<br>CAGR |
|--------------------------|---------|--------------|-----------------------------------|-------------------------|
| <b>TIDEFALL LP (Net)</b> | 5.4%    | 2.8%         | 194.1%                            | 33.9%                   |
| <b>S&amp;P (TR)</b>      | -3.3%   | 13.1%        | 36.7%                             | 8.8%                    |
| <b>TSX (TR)</b>          | -2.2%   | 3.4%         | 24.8%                             | 6.2%                    |

When studying the most successful investors in history, the vast majority of their outperformance was through long term security selection rather than forecasting macroeconomic conditions. That is why, absent a few sentences during our initial pandemic letters warning that stimulus spending would likely cause inflation, I've focused on writing about the key variant perceptions in our stock portfolio. However, after fourteen letters and in light of the fastest increase in interest rates since the 1970s, I would like to give more detail on my view of equities in this new environment.

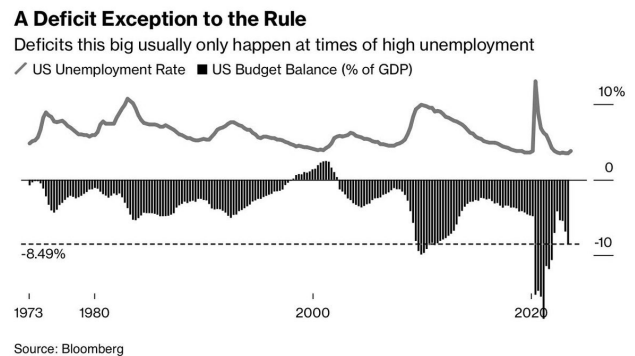
The equity risk premium as defined by the S&P 500's earnings yield minus the 10 year treasury yield, has declined to levels not seen in the past two decades. The S&P is down 11% from its all time high and has held up far better than the median stock due to the performance of the so called 'magnificent seven' which are the largest US tech stocks and are up on average 91% this year.

The magnificent seven have wide moats, excellent management and incredibly strong balance sheets. Consequently, they are viewed by the market as economically insensitive, safe havens. In addition to these positive attributes, the magnificent seven are also incredibly appealing to Portfolio Managers from a career perspective given their large 30% weighting in the S&P which reduces their risk of relative underperformance. These are unquestionably excellent companies and we even owned Meta and Amazon at the start of this year, however as a group, forward returns are unlikely to match anywhere close to historical levels due to today's elevated valuations. The average trailing twelve month price to earnings (PE) ratio on the magnificent seven has now increased to a lofty 58x, or to inverse this metric, just a 1.7% earnings yield.



Unless the Fed returns to a zero interest rate policy, an outcome we view as unlikely and is discussed below, we believe the magnificent seven are likely to underperform going forward. The resource and bank dominated TSX is far cheaper and in my view is likely to outperform over the next decade. I recently wrote [an article for the Globe and Mail](#) that goes into further detail.

The US economy has held up incredibly well over the past year with strong GDP and job growth, confounding most economists (and surprising myself). We believe a major factor of this strength is due to excessive government stimulus. Despite today's favourable economy, the US has a budget deficit that outside of covid and major wars, has only ever been seen briefly during the depths of the global financial crisis. Heavily stimulating the economy during economic booms is the exact opposite of sound economic policy and is pushing up inflation expectations and long term borrowing costs. This is occurring at a time when US debt to GDP is eclipsing World War II levels and with ageing demographics forcing continued government spending. Despite what you might hear from elected officials, there's no free lunch in economics. Central banks may need to keep rates higher than what the market expects to maintain their credibility in the eyes of bond holders.



Aside from a relatively small merger arbitrage position, we have not added meaningful to any new investments recently. That is not to say the stock market is grossly overvalued; there are certainly optically cheap stocks but many are either highly cyclical or highly levered. For most of my career cash and government bonds provided a negative return when adjusted for inflation. Thankfully, the Fed's zero interest rate policy that entailed nearly all of the past 13 years is now over and we are able to receive 5% on any uninvested cash. Although 5% is certainly not an appealing long term return (especially to myself as PM given our use of the Buffett partnership fee structure), it is a riskless, positive real return that provides optionality should future opportunities emerge. Despite a recent increase in our cash holdings, the majority of our capital remains invested in high free cash flow, well capitalized companies that we believe offer excellent long term returns through any economic cycle.

Trevor Scott

This document is intended for informational purposes and should not be construed as an offering or the solicitation of an offer to purchase an interest in Tidefall Capital Management LP (the "Fund"). Past performance should not be mistaken for and should not be construed as an indicator of future performance and there is no assurance that the investment objectives of the Fund will be achieved. An investment in the Fund involves a high degree of risk. The information contained in this document is not, and should not be construed as, legal, accounting, investment or tax advice. The contents of this document are based upon sources of information believed to be reliable but no warranty or representation, expressed or implied, is given as to their accuracy or completeness. All opinions and estimates contained in this report constitute the Manager's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. The Manager asserts that the reader is solely liable for their interpretation and use of any information contained in this document.