



Bumbershoot Holdings LP
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Dear Partners,

We had our best year yet—registering a gain of nearly 29% and outperforming the major indexes.

In many ways, though, 2021 was a *fantasy*. While it “worked” for a number of different investment styles and strategies—including *ours*—it only served to push back a vision of *reality* that I’ve been talking about for the past two years.

I’ve been highlighting since the 2019 letter to partners that “*you have to get it right on price too.*” I’m not sure if that means we were early or wrong—with a gap in the middle for the pandemic—but it is starting to play out *today* and is driving a rotation in markets which we’ve been positioning towards for a few years.

What does that mean? Well, it’s complicated. I will try my best to tie up all the loose ends in the *Investment Outlook* section, but in general it involves going back pre-pandemic to mid-2019 when repo-rates first blew out and the Fed “pivoted” on interest rates & balance sheet expansion through QE4/Not-QE4.⁵

The net result is a similar message to last year though. That the economic world is shuffling through a period of historically accommodative monetary policy. While many stocks are extended, others are at such low levels of cash earnings that it defies logic... *if* an expansion is set to continue. We’ve started off 2022 slightly positive through early Feb and looking forward, I’m as excited as at any point since starting the fund. I believe we have substantial gains mounting in our largest positions.

By Month:	Bumber	S&P ¹	Russell ²	FTSE ³	Barclay ⁴
Jan-2021	6.99%	-1.11%	5.00%	-0.82%	1.05%
Feb-2021	7.30%	2.61%	6.14%	1.19%	2.56%
Mar-2021	5.40%	4.24%	0.88%	3.55%	1.11%
Apr-2021	0.61%	5.24%	2.07%	3.82%	2.04%
May-2021	-0.54%	0.55%	0.11%	0.76%	1.02%
Jun-2021	1.15%	2.22%	1.83%	0.21%	0.77%
Jul-2021	-3.28%	2.27%	-3.65%	-0.07%	-0.18%
Aug-2021	1.21%	2.90%	2.13%	1.24%	1.05%
Sep-2021	-1.15%	-4.76%	-3.05%	-0.47%	-0.95%
Oct-2021	10.88%	6.91%	4.21%	2.13%	1.57%
Nov-2021	-4.45%	-0.83%	-4.28%	-2.46%	-1.36%
Dec-2021	2.54%	4.36%	2.11%	4.60%	1.20%

Bumbershoot Holdings L.P.

2021 Performance

		S&P ¹	Russell ²	FTSE ³	Barclay ⁴
FY-2021	28.75%	26.89%	13.70%	14.30%	10.26%
Inception	100.4%	165.7%	116.6%	27.8%	53.3%



“More peculiar is all the “high-flyer” tech stocks, which seem to be resembling store of value assets. Trading like “trophy assets” makes little sense though, since storage costs for a business do not resemble anything like that of a hard asset. In general, I believe that the valuations here have run their course [...] businesses have absorbed all the liquidity it can handle. A select few will [grow into & well beyond] current valuation levels, but for vast majority... it is nearly impossible to underwrite a positive return, even with a minimal discount rate long into the future. [...] most of the money in this area will need to find a “permanent home” lest risk giving it back. This is driving a huge rotation, which is already underway; and which I see as the largest risk to the overall market. [...]”

Before I get to that though... I want to take a minute to reflect back on the past year. The long-term goal for every investor should always be the same—compound capital at above average rates for a very long period of time. The only problem with measuring and tracking to that goal... it necessitates *time*. Just like anchoring to the present moment in meditation—you cannot get back a past breath, nor can a future breath be made to come any sooner.⁶ I can’t rush the results of our long-term track record, even if I wished to... but that doesn’t mean we shouldn’t celebrate small victories along the way. Counter to last year, when the heaviness of tough year was agonizing, it feels good to have accomplished something positive in this one... even if just an interim stop along the way. The journey continues...

Performance

Bumbershoot Holdings L.P. generated a positive gross return of +28.75% for the full-year 2021.

The partnership has a *cumulative* total gross return of +100.4% since inception in Oct-2015.

Looking more closely at performance, monthly returns tended to directionally correlate with small-cap “value” stocks, albeit with the magnitude of our returns driven by company-specific performance.

From an investment perspective, returns had a strong start to the year as the significant recovery in “value” that was staged in the latter part of Nov-Dec continued to accelerate into the first couple months of 2021. This stalled out as time stretched into the summer months with investor confusion/complacency starting to set in as indexes remained elevated, but the “winners” of the pandemic struggled to regain momentum. The “great rotation” then continued and possibly even accelerated into the end of the year as inflation readouts picked up and the Fed initiated talk of a taper/tightening.

Overall, it was a positive year, although in retrospect it felt more like the opener for 2022, than the headliner. For many of our investments, the rise in share price did not keep pace with growth in earnings or improvement in fundamentals.

Investment activity is categorized into five segments—*Core, Micro, Value, Special Situation & Discretionary*—although as previously noted, the distinction between certain categories is difficult to distinguish, making it a challenge to attribute the specific contribution from each strategy. Estimated P/L performance for 2021 by category is as follows:

<i>By Category:</i>		<i>By Market Cap:</i>	
Core	19.9%	Large	0.8%
<i>Core - Long</i>	25.7%	Mid	2.9%
<i>Core - Short</i>	-5.8%	Small	19.7%
Micro	5.6%	Micro	5.5%
Value	1.2%	Fx	-0.3%
Special Situation	0.5%	<u>Misc</u>	<u>0.1%</u>
Discretionary	1.7%	FY-2021	28.8%
Fx.	-0.3%		
<u>Misc.</u>	<u>0.1%</u>		
FY-2021	28.8%		

Core gains were led by **Intrepid Potash** (*IPI:NYSE*), **Berkshire Hathaway** (*BRK-B:NYSE*), **Alphabet** (*GOOGL:NYSE*), **Cimarex** (formerly *XEC:NYSE*) and **Micron** (*MU:NYSE*) among others. Contribution was broad with nearly every major position being a positive contributor to some degree.

While **Viking Therapeutics** (*VKTX:NCM*) was down for the year—we were able to take advantage of a spike in price during February to moderately reduce/hedge our exposure and transfer some of the position over to **Ligand Pharmaceuticals** (*LGND:NGM*)—Viking’s former parent company. Ligand still owns nearly 10% of Viking’s shares, to go along with its own compelling growth story. The combined **Viking/Ligand** position was a positive contributor to performance.

Detracting from performance was our investments in **Barrick Gold** (*GOLD:NYSE*) and **KVH Industries** (*KVHI:NGS*), as well as any short exposure in general, which continued to hold back consolidated results.

Micro strategy had another outstanding year led by **Charles & Colvard** (*CTHR:NCM*)—subject of one of the case studies from 2020. **Photonics** (*PLAB:NGS*) and **Select Energy Services** (*WTTR:NYSE*) helped round out the contribution. **PFB** (formerly *PFB:TSX*), the featured investment of the 2019 letter to partners, was sadly acquired towards the end of year. While this was accretive to near-term results, it hampers returns in the long-run, as the company still appeared to have tremendous upside.

Value category registered a gain primarily attributable to investments in **Adams Resources** (*AE:NYSE*) and **Patriot Transportation** (*PATI:NYSE*). Several other non-disclosed positions also contributed positively.

The *Special Situation* portfolio had a mixed year as we picked a few winners, but also gave some back on a few mistakes. This is par for the course dealing in distress, merger-arb, and other event-driven opportunities.

In terms of exposure levels, *Bumbershoot* ended 2021 with over 20+ “positions of significance” representing more than 100bps. This has generally remained steady in the 20-25 range, with a few always bouncing around above/below that threshold. *Core* category ended year at its target exposure level; while *Non-Core* categories were mixed vs. target weightings of ~5% AUM each.

Investment Outlook

The investment outlook for 2022 presents something different.

The structural configuration of the economy has shifted rapidly—from one in which the Fed must do anything and everything to protect against a deflationary spiral, to one in which it is now closely monitoring the threat of runaway inflation expectations. The Fed is still very much in charge, but it has given up *control*.

Or saying it another way, we're *off-leash*.

Because inflation is not a problem—at least not from a monetary perspective. The Fed *knows* how to deal with inflation...

Best case—it will be able to engineer this “soft landing” we’ve been hearing about for years. “*When you gonna drop Magnum on us already?*” That it can raise rates and control inflation without damaging the job market and sending the expansion into recession.

Worst case—it cannot... and it will need to hit the hard reset button. *Flip the boardgame*. Hike interest rates to *crush* demand-pull inflation; and give back all the gains from the expansion along with it.

Either way it is a situation it can manage based on its unique ability to control interest rates—the Fed’s chief *superpower* from last year’s *Hero’s* analogy. So, it can tolerate to standby as the economy runs off for a bit.

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Make no mistake though, inflation is a problem.

Economist Milton Friedman famously said, “Inflation is always & everywhere a *monetary* phenomenon.” The suffering from it, though, seems to be decidedly *fiscal*. A real-life “*Squid Game*” of sorts.

Last year, I talked about three “important *distinctions*” in the case to buy stocks.

1. Risk of a “normal” economic slowdown...
2. Underestimating the lengths to which the Fed would go to sustain the expansion...
3. “Spillover” effect into the real economy...

These are still in focus because the forces of #2 to stave off the obvious risks from #1 due to the effects of the pandemic, eventually led to leaks in #3, which allowed this policy of permissive inflation to seep further into the consciousness of people’s long run expectations... which is now pressuring the Fed to act... imperiling #1 all over again. *Pheew*.

One of Jerome Powell’s most memorable quotes from this entire period was a remark about the labor market that was heating up and the idea of not tapping out on the expansion too early. He said, “to call something ‘hot,’ you need to see some heat.”

Well, we’re cooking with gas now.

The Fed is feeling the pressure; and it’s being *forced* to act in order to re-anchor people’s expectations.

The *momentum trade* is officially *over*.

Whether that also results in ending the *reflation trade* and killing the overall expansion, though, is yet to be determined. I don’t think it will.

Go back to distinction #2—don’t underestimate! The Fed has been talking about benefits of the late-stages of expansion for years. About building back *monetary space* off the lower bound. There is no way it wants to cede back those gains.

And because *DEFLATION* is still the real enemy...

Although before you start calling me Cathie Wood—let me discuss that part again from last year, because the *outcome* of it looks very different to me.

“This dynamic was always positioned as a balance. The Central Bank Superheroes trying to defend against the evils of Deflationary Forces in the economy—namely demographics, globalization and technology/efficiency. And just like in the comics, in the end the superheroes always win... because even when it looks most grim... they still win (2% at a time...) through inflation—growing our way out over cycles. This was traditionally the risk. Timing of the cycles. The ebbs and flows of liquidity to the reflation trade—the equivalent of potentially being forced to bed early without having a chance to flip to the next page to find out how the story ends.”

Inflation is just a *filler arc*.

We are back in the “traditional” part of the risk cycle. Ebb and flow of liquidity. Movement of funds between various sectors. Timing of cycles.

If the fiscal side of the house would pick up the baton, inflation might even be a “win” for the Fed in its *Quest for Monetary Space*.

Deflation is the real supervillain. The one that pushes the limits of the Fed’s powers to the test.

So, the Fed will do what it needs to do to cut down the excess from the momentum trade/asset bubble of the past few years and re-anchor expectations.

It will tap the brakes, but it won’t stop the car.

The Fed doesn’t want to go backwards. Whether right or wrong, it is still going to great lengths to sustain the expansion...

It will avoid the hard reset, unless absolutely necessary to the sanctimony of the U.S. dollar, bond market and financial system.

“You shall not crucify mankind on a cross of T-Bills.”⁷

As I discussed last year, I didn’t choose this structure! We are *failing people* and I still continue to believe it will lead to even greater inequality.

But those are the rules of the game for right now... all we can do is keep playing it to the best of our ability.

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So, what does this mean for return producing assets?

IF the expansion is set to continue... then I believe we are going to enter a period of sustained stagflation. Low growth. Tight employment. Margin compression. This will drive the *Great Rotation* in equities that I’ve been alluding to and building up to for some time.

Because while this will make it exceedingly difficult to generate sizable returns in specific sectors—for other businesses in the “old guard” sectors of the economy, this could lead to a massive cyclical boom.

It’s a combination of the cartoonish increase in money supply & liquidity, mixed with a shortfall of “quality” assets with durable cash profits to support valuation.

“You have to get it right on price too.”

As Warren Buffett aptly detailed in his 2000 letter to shareholders, for every bubble “*a pin lies in wait*.” For fantasy stocks of the past few years... it’s over.

For most higher-quality stocks though, the pain trade will just be sideways. Many of these companies have been expensive, but reasonable... for quite some time. These were the “*places to hide*” from last year’s letter. While these pulled forward years of growth in terms of valuation, they may now need to digest that growth as rates slowly normalize and yields increase.

There are certain pockets of the market, though, where cyclical earnings growth has been enormous; and yet these stocks are valued at historically low multiples of cash flow and earnings.

Cheap, but high quality.
Defensive, but showing growth.
Value, but tremendous upside.

No one believes the cycle can continue, but the risk is *worth it*.

We are leaning into that as I think this year will prove that doubt to be mistaken. And if it does... next year’s letter is going to be a lot of fun.

Administrative

There are no changes to report from an administrative perspective.

Similarly, there is not much to update on the business development front. The fund continues to grow, albeit mainly through performance on our existing assets.

Any support to intro the fund to new capital partners is greatly appreciated.

Taxes

Form *Schedule K-1* that reports each partner's share of income/losses for the 2021 tax year is being prepared. Copies will be sent to each LP.

As a reminder, we successfully implemented a "master feeder" structure over the course of 2019 to be able to more efficiently pass back long-term gains in our *Core* holdings. While this had minimal effect in 2020 given that our tax burden was already minimized by returns, it had a significant positive/deferred effect in 2021.

I'll wait on the final tally from our administrator, but I expect to recognize relatively minimal taxable income for the 2021 tax year, despite a sizable mark-to-market gain in our investment account. While those increases will become taxable upon ultimately being *realized* at some point in the future, the tax effect is long-term in nature; and I still expect an efficient/advantageous tax strategy moving forward.

Summary

I added a note to the summary of last year's letter that the significance of the message may have perhaps been overlooked... and would therefore, bear repeating:

"The risk of *permanent capital impairment* is only **the** risk if you have permanent capital; otherwise, the risk is *volatility*."

Please read that sentence again. Stocks go up... stocks can go down... but the true risk to investors still always rests in permanent capital impairment (ie. bankruptcy, restructuring, dilution, etc.). As long as one maintains the resolve to sit through volatility—then it isn't a risk to the ability to compound over the long-term. In the money management business though... that is the risk.

Drawdown hard/fast enough or underperform for long enough and you will likely become forced to act. Risk therefore shifts from evaluating a company on its long-term merit to trying to avoid any near-term unrealized losses/volatility and needing to chase momentum.

The point of which is to say that I am grateful to have an incredible investor base that by and large has acted like *permanent capital* ever since I started the fund.

The focus of *Bumbershoot Holdings* is on maximizing long-term returns. That objective is centered on our '*quality over quantity*' philosophy to investing, which relies on deep fundamental analysis. Our patience & discipline remain the foundation for success.

I take the responsibility of managing a portion of your money extremely seriously and continue to have the vast majority of my personal net worth co-invested in the partnership. I am proud of everything that we have accomplished and look forward to great things ahead!

Sincerely,



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¹ S&P 500 Index --

<https://performance.morningstar.com/Performance/index-c/performance-return.action?t=SPX...>

² Russell 2000 Index -- <http://www.ftserussell.com/index-series/index-tools/russell-index-performance-calculator>

³ FTSE 100 Index --

<http://performance.morningstar.com/Performance/index-c/performance-return.action?t=UKX...>

⁴ BarclayHedge Hedge Fund Index --

http://www.barclayhedge.com/research/indices/ghs/Hedge_Fund_Index.html

⁵ Federal Reserve – What Happened in September 2019? --

<https://www.federalreserve.gov/econres/notes/feds-notes/what-happened-in-money-markets-in-september...>

⁶ Mindfulness Meditation --<https://www.youtube.com/...>

⁷ “Cross of Gold” -- <http://historymatters.gmu.edu/d/5354/>

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Long IPI, BRK-B, CTRA, MU, VKTX, LGND, GOLD, KVHI, CTHR, PLAB, WTTR, AE, PATI