Galloway Capital Partners

Monthly Investor Newsletter

Dear Investors:

In August and September 2022, the Portfolio generated returns of -7.54% and -14.52%, YTD -37.26% and +210.97% since January 2018.

This year the markets have been very challenging, particularly with a "double-edged sword" hitting us; FED tightening and interest rates rising 300 basis points in a short period of time. We could not avoid this Tsunami! We believe the FED has taken a very aggressive stance with a disregard for the stock and bond markets and the general economy to the right a wrong from 2021 when inflation was called transitional, and the FED did nothing.

Unfortunately, during a severe secular stock market downtrend, we cannot avoid the downdraft in our Portfolio. We have tried to be very defensive by investing in preferred and dividend-yielding stocks and in the oil and gas sectors. These positions have been challenged in the past two months as the "tsunami" has overwhelmed them.

The situation was the same for many of our small-cap and special-situation stocks, as there was a dearth of buyers, which created very illiquid markets for many of our positions. We believe this is temporary because the market is overwhelmingly negative right now despite fundamentals holding up strongly, especially in our stocks. Some of our stocks are "Recession Proof" and have government components to their revenues.

As you know, we focus mostly on smaller-cap and special-situation stocks that are under the radar screen of large institutional investors. Usually, when there are short-term moves up and down in the stock market, the fundamentals hold their own and are not affected by the market. As we have been stating for years, the stock market is dominated by algorithmic and derivative program trading, and unfortunately, with the downdraft, this type of trading has exacerbated the selling and shorting, and many of our companies have been targeted despite strong fundamentals.

We believe the economy and earnings will hold up in general, creating a reversal and a short squeeze. Because this market is one of the worst, we have ever seen. We believe this is the most opportune time to deploy fresh capital. Small and micro caps are the cheapest they have been in years. We believe that, overall, the U.S. economy is too strong to crumble and that there are multi-trillion-dollar transformative trends presently in place for the future. These trends will have stimulative effects and should immunize the economy from a recession.

First, an on-shoring is happening that is helping to reverse 50 years of exporting jobs, factories, and production overseas, specifically in China. Second, a trillion-dollar migration to the cloud combined with the rollout of 5G and 6G Networks and cyber security.

Third, Artificial Intelligence is a growing trillion-dollar industry. These transformative trends should keep the economy growing despite the rising interest rates. In summary, all our companies are profitable means that they can bounce back very nicely, unlike other money-losing companies.

We have been particularly hard hit in certain sectors of the economy. Our two home-building position companies are trading at 1x and 1.5x earnings, respectively. They both have huge backlogs, and they are subsidizing buyers with lower mortgage interest rates. This could hurt margins slightly from the record levels seen earlier in 2022. The worst case could be that their earnings will be cut in half, and they'll be trading at 2x and 3x earnings shortly. In the last 14 years, due to low production in the Home Building sector, there were only about 7mm homes constructed. This has created a shortfall that needs to be replenished which makes both of our companies huge opportunities.

Some of our investments are in technology which has been the hardest hit sector due to the increasing interest rates. Technology companies are down 70-80%, even north of 90%. Our Artificial Intelligence position was down 75%, and as one of its largest customers to Twitter, we cut back due to the uncertainty of the acquisition with Elon Musk.

We have a transportation and logistics company generating $5.5 billion in revenue, trading at 1.3x earnings and down 75% this year. These are crazy valuations that we've never seen before, which creates the opportunity of a generation. For this reason, we are raising fresh capital to both invest in these companies and to take an activist role to possibly buy some of them to take them private. This is a trend that's going to accelerate as the public markets are significantly cheaper than the private markets, and the private equity firms will jump in and take advantage. In the past 12 months, four of our positions have been acquired by private equity.

We continue to have a well-balanced and diversified portfolio with approximately 47 positions across many industries and market capitalizations which should significantly outperform the major indices. We believe that we are well-positioned to take advantage of any upside in the market when we get through this period of uncertainty and volatility. We believe our value/catalyst approach is the optimal way to generate significant investment returns along with a balanced portfolio of natural resources and preferred and dividend stocks which should reduce the downside volatility.

In a potential downturn, buyers disappear as technical factors overwhelm them. This should be temporary until the technicals break.

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