Dear Partners –

Betting against the consensus worked well in 2023. The stock market performed better than most people expected at the beginning of the year. Much of that return came from 7 stocks and in the last two months of the year. Deal activity was anemic due to a rise in interest rates. All eyes were on the Fed and the draining of liquidity. The Fed finally "paused" in December, giving investors a "green light" to return to the stock market. With an election on the way in 2024, things could get dramatic and the Fed has certainly positioned itself to help by forecasting three rate cuts. The debate in markets in 2024 seems to be forming around how many times the Fed will cut interest rates and when those rate cuts will start.

Stock Market Performance

In last year's letter, I mentioned the possibility for a bounce in the stock market in 2023 and there certainly was one. The S&P 500 increased 26.3% in 2023, including dividends, after falling 18.1% in 2022. The S&P 500 effectively earned back its entire loss in 2022 and sits close to where it did at the end of 2021.

.. but there is further segmentation required. A substantial part of the market performance came from the "MAG 7" (which are: Alphabet, Apple, Amazon, Facebook, Microsoft, Nvidia and Tesla), representing an average 110%+ return for the year. The S&P 500 equal weighted index (as opposed to the market capitalization weighted index), in contrast, total returned approximately 13.9% for the year. The latter index represents a more indicative reading of the performance of the average stock, which let's face it, was not all that great and certainly leaves investors down for the last two years.

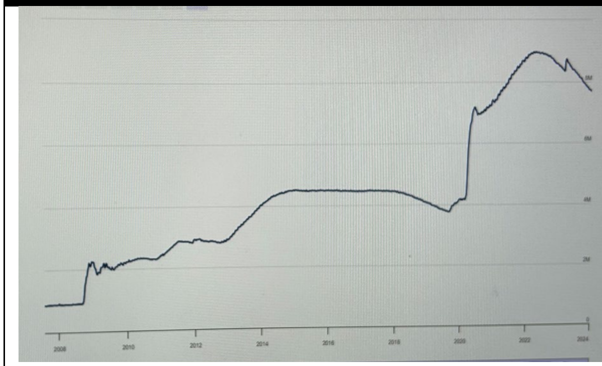
A lot of stock market return this year came in the last two months. The Fed's indications, starting in late October, of the potential for a "pause" in Fed tightening drove investors into longer duration technology investments, some producing incredible returns. I suppose that I should have seen value in these companies, in retrospect, but I was biased, having shorted them heavily in 2021 and 2022.

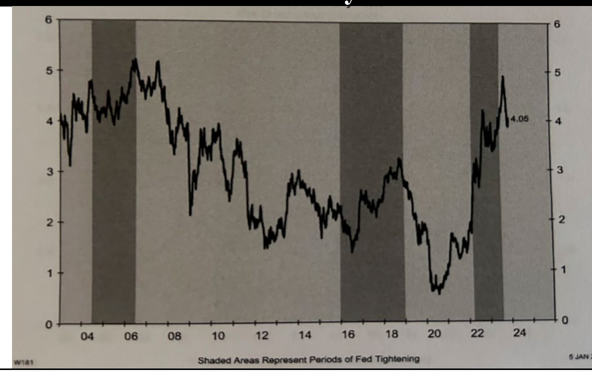
For us, the good news is that we owned Facebook this year, as it met the requirements of a "Special Situation" given how much it sold off in 2022 (more later).

The Fed

Following Covid, the Fed found itself with a bloated balance sheet and little fire power to lower interest rates. This came on the back of the Fed failing to get interest rates back to pre-Financial Crisis levels during previous Presidential administrations. It is my opinion, that the Fed's tightening, a posture that took hold after Powell met with President Biden in 2021, was as much to do with getting interest rates to pre-Financial Crisis levels as it was in fighting inflation. In fact, one could argue that increasing rates, so quickly, contributed to inflation. I have attached two charts below, which show the Fed balance sheet over time (notice the run-off over the course of the year) and the 10-year US Treasury that is now back to levels previously seen pre-Financial Crisis.

Federal Reserve Balance Sheet	US 10-Year Treasury Interest Rate





With inflation falling, the real question is whether it is down forever and where it levels out. Services inflation is still strong, but the path seems to be back to normal. My own view is we have rolling inflation for a few years.

For stocks, this tight Fed meant that investors were defensive most of the year, cramming into the MAG 7 equities or going to the sidelines to earn a risk-free yield of 4.5% to 5.0%. The Fed is currently forecasting three rate cuts for the year. Investors seem to believe the Fed will have to be more aggressive by predicting six rate cuts. With the Fed likely to back-off on interest rates it is highly likely deposits in money market accounts end up back in the stock market, providing some support.

A very big concern is the yield curve's current inversion. In the entire history of the USA, there has only been one time where the yield curve inverted and there wasn't a recession (the late 1960s). With an election in the fall, it really is hard to see what will play-out.

Fiscal Policy

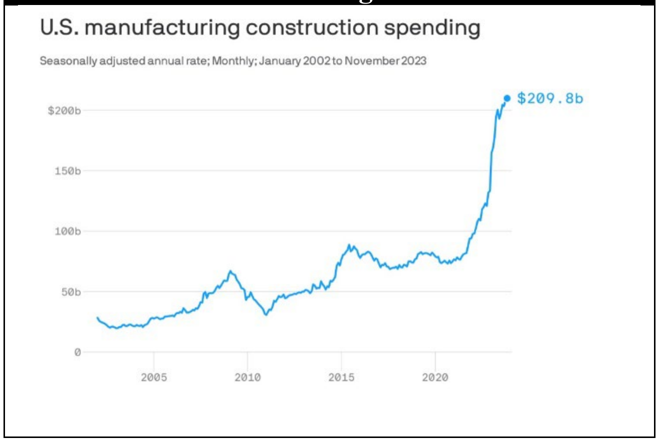
The fiscal situation in the US is untenable. With debt relative to GDP near post-WWII highs, the Treasury / Fed have only one choice - get interest rates lower, to reduce the cost to the Treasury. Currently, interest expense is equal to approximately 25% of federal spending. To some extent, inflation will increase GDP enough that debt-to-GDP will fall naturally. Clearly, the debate in 2024 will be about deficit reduction and that has the back-drop of the election.

To me, the risk is that the current Administration's fiscal plans get tapered in the coming years. I don't think the market is pricing in a reduction in the Biden fiscal stimulus bill. I would hope to see some fiscal responsibility, but the only scenario where I could see that is a second term Biden administration, and even that seems to mean higher taxes. A strong showing by the GOP could mean some spending reduction….., but that certainly didn't happen during the Trump administration.

Going forward I expect there to be a phase of asset sales in infrastructure that will allow governments to de-leverage. As I write this letter, BlackRock just purchased Global Infrastructure Partners. I think Larry Fink sees what I see: a huge pipeline of power and other infrastructure assets that will be sold by governments and creative methods to off-load capex to the private sector on infrastructure projects.

We did well with industrial stocks this year, despite those stocks not being in the Mag 7. US industrials have been benefiting from the large economic packages that the Biden administration has been putting in place. If you need any proof of re-shoring trends and spending on infrastructure, it is no better represented than by this chart:

US Re-shoring Trends



SIVB

The collapse of Silicon Valley Bank ("SIVB") was a big story in 2023. As you may know from previous letters, we have had a short position on SIVB, mostly through put options. What I saw in SIVB was an over-valued bank that traded at 3x book value. I felt that the technology sector could get softer and SIVB would struggle with its results without the gains it had been recognizing. Management, decided to invest its deposits in longer-dated bonds to help make-up for lost revenue, but this became a problem when the long-end of the yield curve started to steepen. Faced with mark-to-market losses on its bond portfolio, depositors fled the bank, causing a bank run. I wish we had a bigger short at the time.

The failure of SIVB exposed a few issues, but one that is important to me is the lack of disclosure on deposits by banks. Deposits are typically seen as safe, but when there is a heavy concentration of deposits, among a few depositors, it can make a bank easily susceptible to a bank run.

It wasn't just SIVB that failed. What seems to have happened was a rationalization of US regional banking, after an aggressive run for the sector. I felt the Treasury managed this potential crisis well.

Volatility (or absence thereof)

With the VIX sitting at 13, the market is pricing in very little volatility currently. This seems contrary to the heightened volatility that we have typically seen in the stock market around most Presidential elections. I will make sure we are protected accordingly and capitalize on any spikes in volatility this year.

Leverage, Financing and Private Equity

A big issue that resulted from the increase in interest rates was the impact on the private equity ("PE") sector. PE deal makers had to be more creative because debt markets were not available for the quantity and cost of money that could make these deals work. In addition, the weakness in the equity market prevented many "exits" from happening. This has all led to a liquidity problem among LPs. Growth in the secondary market for LP stakes and lending to PE funds were the outcomes. I see this as an opportunity if we can get capital to help solve some of the liquidity problems at the company level. I am working on it….

At the same time, levered REITs are also struggling. Having 4% or 6% cap rate assets that refinance at 9% just doesn't work. I think there will and is a lot of difficulty in commercial real estate that will need to be fixed. Again, I am working on it……

Special Situations Fund

	BCI Special Situations Fund I	S&P 500 with Dividends	Russell 2000 with Dividends
2019	43.1%	31.5%	25.4%
2020	34.3%	16.4%	20.0%
2021	12.2%	28.7%	14.8%
2022	(13.9%)	(18.1%)	(20.4%)
2023	20.1%	26.3%	15.1%
Cumulative	123.0%	107.3%	58.3%

For 2022, the fund returned 19.2%. In comparison, the S&P 500 returned 26.3% and the Russell 2000 returned 15.1%, both including dividends. I'm reasonably happy with 19%, but I lament that we left some money on the table this year.

We did well with spin-offs in 2023. The break-up of GE into four sperate companies was a profitable trade. We did well with GE Healthcare ("GEHC"), which became a standalone company in January 2023. I think that GEHC has the potential for higher profit margins and it produces good cash flow, setting things up for returns of capital to shareholders. GEHC is a leading business in healthcare equipment, a sector that has a good fundamental backdrop. Another spin-off situation that occurred in 2023 was Johnson & Johnson. I thought the structure behind the J&J spin-off was too complicated and we were smart to wait before we participated. I didn't get Kenvue (J&J's consumer business) at the bottom, but we purchased it at a good level. I feel both the parent and the subsidiary could perform well this year. Kellogg also spun-off its North American cereals business, but we just haven't had room in the "book" to be involved.

Another winning investment for us this year, that I am particularly proud of, was Onex Corporation. A Toronto-based private equity firm, Onex has been known and admired by me for quite some time. Investor sentiment on Onex was very poor in 2023, as private equity firms struggled.   Onex's fund-raising efforts also fizzled. I felt Onex operated differently from KKR and Blackstone. Rather then being funds focused, most of Onex's capital is on its balance sheet. At one point, the stock was trading at C$62 per share and Net Asset Value of the firm was C$140 per share. Onex is known for conservative valuations of its portfolio companies as well. When we saw that founder Gerry Schwartz was willing to step down and collapse his dual class share structure, we purchased the stock. In the past, Onex has traded at a premium to NAV and if the current management's plan does not work, it is likely that that Onex could get sold, MBO'd or liquidated. That all said, we have sold about 75% of our initial stake, in order to risk manage. I may add to the position again.

We added Facebook to the portfolio at the beginning of the year, in size, and that recovered well in 2023. I don't have a lot of magic analysis to share, but I felt the stock was over-sold, insiders have shown resilience in the past and that things would recover. All of this became true!

Closer to the end of the year, we purchased Estee Lauder. The company has struggled from weakness in China. We think the sustainability of the brand will prevail and that the company will turn around. The stock had been quite penalized.

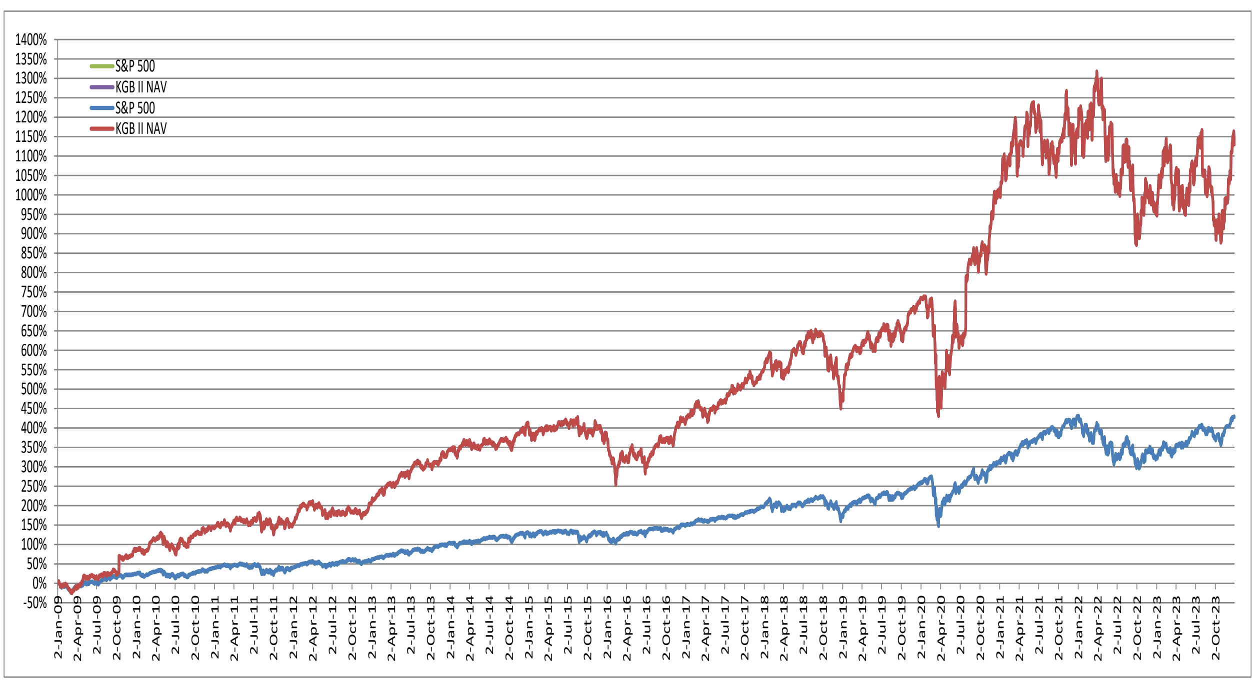
Another strong performance came from holding one of the Japanese trading houses, Mitsubishi Corporation. As Japan is now incurring inflation it has been great for value stocks there. Most stocks that were trading at a discount to book value are now trading at book value or higher. Mitsubishi re-rated in the stock market in 2023.

Nexgen continues to be a good performer for us. The energy transition story is very real. I have come to the conclusion that nuclear is a major part of the solution for the energy transition. Uranium is in short supp and Nexgen is a major deposit that can sustain this growth.

In the poor performer category, Hertz just hasn't worked out well for us. Re-emerging from bankruptcy and the auto production supply chain backed-up, Hertz made an innovative decision to purchase electric vehicles for their fleet. As prices have fallen for EVs, Hertz has had to incur lower residuals on the sale of its EVs, at the end of their useful lives. Higher maintenance costs for EVs have also been an issue. We may reduce this position in 2024. Spirit Aerosystems has also suffered in ramping up 737 production (see later section of the letter for more details).

We continue to look at capital alternatives to make the Special Situations Fund a more substantial business. I had a break-through this year when a high profile mentor approached me about managing some capital. I am in a process to get "Registered" in Ontario to facilitate money management there.

Performance of the Special Situations Fund Since Jan 1, 2009.



Relationship Investing / Private Investment

	Barratt Capital Holdings, Inc. NAV	S&P 500 with Dividends	Russell 2000 with Dividends
2019	34.9%	31.5%	25.4%
2020	31.5%	18.4%	20.0%
2021	51.9%	28.7%	14.8%
2022	(27.5%)	(18.1%)	(20.4%)
2023	14.3%	26.3%	15.1%
Cumulative	123.3%	107.3%	58.3%

As I have discussed in previous letters, Barratt Capital Holdings ("BCH") Inc. is a concentrated equity investment corporation that uses leverage. The Net Asset Value ("NAV") of the firm's investment portfolio increased by 14.3%, in 2023. In comparison, the S&P 500 returned 26.3% and the Russell 2000 returned 15.1%, both including dividends. About half of the BCH portfolio is in loans that yield about 8% a year. In the last five years, we have out-performed the small cap and major US stock market indices.

BCH holds an extremely concentrated portfolio and employs financial leverage. The purpose of the company is to generate above benchmark returns, in spite of volatility, through high conviction investments. The core investment strategy is to hold large public equity investments or private investments (which can be control or minority investments) where we have active involvement.

Spirit Aerosystems – Spirit has been weighing down the performance of the company for two years now. Spirit remains our largest position. I originally bought this industrial company near the depths of Covid. Spirit manufacturers fuselages for Boeing and Airbus and is heavily weighted to the 737 Max. Despite significant capital markets coaching, the company has just failed to execute operationally. Who knew that making a 737 airplane could be so complex? The nadir for the company was the replacement of the CEO and a refinancing of the balance sheet in 2023. The company appears to be turning the corner, but I have been wrong before with them. I felt their balance sheet financing was poorly timed and lacked forward vision. They are certainly earning the moniker "the plane maker who can't shoot straight". I believe that the stock can be a $75 stock again, but not the $120 that I originally was hoping for. I am hopeful, given the better tone of talks with China on the acceptance of 737 Max deliveries, that 2024 could be a solid year for Spirit in the equity market. If the company fails to execute again, this could be the last year of our Spirit investment. Capital has alternatives and an opportunity cost. Sometimes you have to cut your losses. Hopefully, Spirit can turn the corner in 2024.

Lufthansa Technik – For the first time in a few letters, I can finally share what I have been working on in Europe. In 2021, together with a strong team I assembled, I approached Lufthansa AG about an investment in their subsidiary, Lufthansa Technik ("LT"). LT, the global leader in maintenance, repair and overhaul of commercial aircraft, worth about €5B to €6B, was still doing well. I felt we could invest in the business and supply valuable capital to Lufthansa to deal with losses at the airline. I partnered with some of my former Morgan Stanley colleagues. We added a high profile ex-German politician and a former colleague from Ontario Teachers to the group, later on. We arranged capital for €2B of equity investment from some global sovereign funds. Mason Capital, an important relationship of mine in NYC, helped fund some of the deal expenses. The ultimate investment structure was an LT convertible preferred, with governance and other minority rights, with an intention to IPO the business in a few years. Competitively, we did well. After a period of discussion with the company, the Board of Directors created a J.P. Morgan-led process that invited 60 groups. We made it to the group of 20, submitting a formal proposal at that time, and then travelled to Frankfurt to present with the top 5 later on. Ultimately, Bain Capital was chosen as the lead investor, but that process ended in November 2023. We think Lufthansa was doing so well that they no longer needed to monetize LT. The deal just took too long to come together.

Looking back at the process, I pursued the investment opportunity because it was a minority investment and I didn't see as much private equity competition for that. As the market for PE deals dried up though, there was less for these firms to do and they all showed up. I was proud of how the team came together. I was proud of how we did in the process (a shout-out to my friend Dirk Nothesis, the ex-Head of Morgan Stanely in Germany) who got us to the right people. We beat-out some solid groups, Brookfield for example, and established some solid relationships during the process. Personally, I enjoyed getting involved in the global investment community again. A silver lining is that some of the investment banks are showing us opportunities as a result of our connection on LT.

Barratt Developments PLC – I have a long-term position in this publicly-listed, leading UK home builder. The company's share price bounced back to previous normal levels and paid a strong dividend yield in 2023. I am optimistic on the performance of this company in 2024. 2024 is an election year in the UK and the Conservatives will be keen to improve the economy. With an expectation that interest rates will fall, I believe home demand could return in this under-supplied housing market.

In an effort to raise capital and scale, we continue to pursue one-off "Side Car" deals. Our primary pursuits at the moment are UK power generation assets and a hotel take-private situation. Highlights of our activities this year, including bidding on the liquidation of a Toronto-based defunct hedge fund portfolio, re-financing some broken REIT situations and a distressed purchase of an office complex in Florida.

On a personal note, 2023 also saw the death of my mother, who was almost 88 years old (I have older siblings). It's definitely not easy to see your parents getting older, but I feel at peace that she lived a long life, in mostly good health. Her death certainly gives one a sense of perspective and a sense of what is important. It also reminds me that life is not infinite. In a way, her death has lit a fire under me and I am more focused / motivated than ever. I hope you have a healthy and prosperous 2024.

Best,

Geoff Barratt