6/30/2023

Waterfront Opportunistic Equity

Description

A differentiated value strategy that invests in approximately 50 different equities with the objective to provide strong returns over a 2 to 3 year time frame.

Product Highlights

- Disciplined bottom-up and top-down analysis.
- Multi-Cap multi-country low cash approach.

Management Fee *.65%*

Market Capitalization Range

$0-5B	40%
$5-10B	7%
$10-50B	37%
>$50B	16%

Top Holdings

Hewlett Packard Ent.	3.2%
Bayer AG	3.0%
Societe Generale	3.0%
Mitsubishi Electric	3.0%
Suzano SA	2.8%
Nokia Oyj	2.8%
Hitachi Ltd	2.8%
Xperi Inc.	2.7%
Embraer SA	2.7%
General Motors Co	2.6%

Sector Breakdown

Consumer Disc.	11%
Industrial	13%
Energy	4%
Financial	11%
Technology	27%
Communications	6%
Consumer Staples	3%
Materials	6%
Cash	9%
Healthcare	10%

Performance Net[1] 6/30/2023

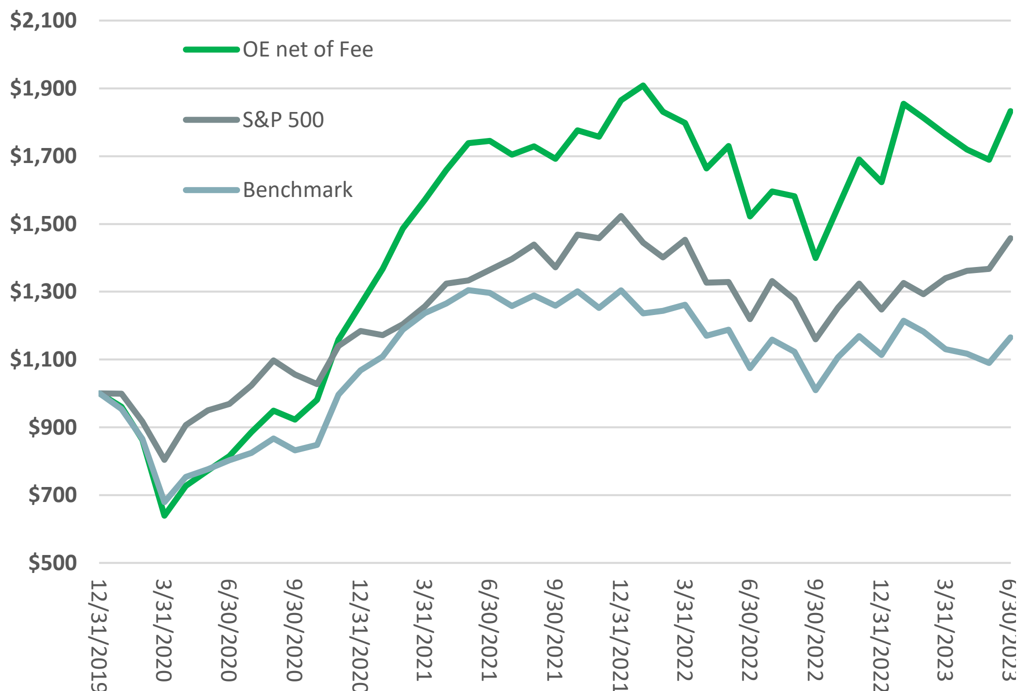
	YTD	1 Year	3 Year	5 Year	Since Inception Annualized*
OE	12.9%	20.5%	31.0%	N/A	18.9%
Benchmark	4.6%	8.4%	13.2%		4.5%
S&P 500	16.9%	19.6%	14.6%		11.4%

Annual Returns Net[1]

2023 YTD	12.9%
2022	(12.9)%
2021	47.7%
2020	26.2%

*Inception Date: 01/01/2020

Hypothetical Growth of $1,000,000[1]



[1]Past Performance does not guarantee future results. Any investment contains risk, including the risk of total loss. Returns are a time weighted average composite of the separate accounts in the strategy, net of management and trading fees. New accounts are included in the strategy the month after 60% of available funds have been invested. Returns are geometrically linked over monthly periods or shorter periods if a large cash inflow or outflow occurs within a month. Large cash inflow or outflow is >10% of composite assets. All returns are expressed in US dollars. There is no add back for any foreign withholding taxes on foreign dividends. Return calculations rely on data from TradePMR/Wells Clearing, the custodian, and Easy ROR Pro, a Hamilton Software product used for calculating the returns of a composite of separately managed accounts. Starting 1/1/20.

The Opportunistic Equity Strategy returned 3.9% in the second quarter of 2023, higher than its benchmark but behind the S&P 500. Domestic value stocks and international stocks, two categories that form the bulk of the strategy's allocation performed relatively poorly in 2Q. OE stocks followed a similar pattern to broader value and international stock indices. Value stocks and international stocks have been more sensitive to perceived near-term economic conditions and don't have the secular tailwinds that many technology stocks have.

As of 6/30/2023	YTD	1 Year	3 Year	Since Inception
OE	12.9%	20.5%	31.0%	18.9%
Benchmark	4.6%	8.4%	13.2%	4.5%
SPX	16.9%	19.6%	14.6%	11.4%

Inception: 1/1/2020

The performance of the Nasdaq 100 in the 1st half has been remarkable. An almost 40% return vs. closer to 5% for the Dow Jones Industrial Average and almost 17% for the S&P 500. Technology outperformance started the year with a boost from a perceived end to Fed rate hikes. Then resilient earnings power, currently and an expectation of resilience in the future, drove technology stocks higher. Finally, the excitement for AI became rampant and drove technology stock returns in a big way.

Many people ask is this excitement over AI leading to a tech bubble? I do not believe so but the stocks are overvalued nonetheless and should provide very lackluster returns going forward. Two important beliefs drive that opinion. One, while automation and AI will proliferate through the economy, it will do so at a more modest pace than believed. The ROI will be very solid in certain sectors of the economy but more broadly, the ROI will be much more modest. Two, the tech leaders in AI today are going to face some real competition going forward.

Nvidia is the most widely known AI tech leader. Nvidia caught lightning in a bottle this year with the proliferation of generative AI models. Its H100 chip and supporting software tools are perfectly designed for generative AI, the type that has taken off in 2023. Many companies large and small feel they need to at a minimum dabble in generative AI and so demand for training data sets is surging. This "catch up" investment phase that will play out in 2023 and drive exceptional growth will settle down in upcoming years and growth will be more modest.

A further impediment to strong stock returns for current AI leaders is that competing offerings are right around the corner. More compelling software tools and particularly open software tools are being rolled out. There are companies that will be releasing competitive chips and with improved software tools, Nvidia will need to cut pricing or cede market share and likely both will occur. For example, Intel's Gaudi 2 on a price/performance basis is not far behind the H100 and will close the gap even more with FP8 software support in 3Q2023. And Gaudi 3, which has already taped out and should have a clear price/performance advantage over the H100, should be in the market in early 2024. AMD Instinct MI, future Intel Xeon, in-house chips from big tech, specialized processors from smaller players are other examples of chips that can take modest market share.

After one thinks of how chip market share for AI will play out in upcoming years, one needs to think about software winners and also how much processing will be done in the public cloud vs. hybrid cloud setups. My

opinion is that AI provides an opportunity for increased competition among software providers as many software companies believe infusing AI could be what allows them to successfully compete with more established providers. While there is an element of a rising tide for all, it seems many investors are not thinking competition will still be abound in the era of software being infused with AI.

There is a notion that all AI is going to be in a public cloud and since every company needs to infuse AI, cloud data centers have a huge tailwind. It is potentially a very powerful tailwind. However, more tailored models with closed off specialized data sets should grow strongly and the public cloud will not dominate this portion of the AI market. AI should help business for many players in tech but right now the market overwhelming believes big tech is going to disproportionately benefit and that benefit is coming fast and furious. I am skeptical of the speed at which business will benefit from 2024 on. Data points in 2023 are going to provide a misleading picture of the sustainable growth of the market.

Despite some modest skepticism of the speed at which AI will proliferate this decade, the OE owns plenty of names that will benefit from AI. Baidu, one could argue is as big an AI company as any out there. The slowing Chinese economy and geopolitics prevent it from getting a US tech like multiple but make no mistake, this is a talented AI company. Hewlett Packard Enterprise has a division that has focused on building supercomputer and AI server clusters. It should benefit due to this expertise. It already has a hybrid cloud generative AI offering. Intel has a strong lineup of chips for AI coming in 2024 and beyond. While IBM has missed the public cloud generative AI business model, generative AI is not the only game in town and IBM has more prowess than believed in AI. There are several other smaller tech holdings that can do very well if AI does lead to surging tech demand.

There were some solid stock performers in the second quarter. In local currency, Mitsubishi Electric returned 28.4%, the highest of any stock in local currency, however the Japanese yen depreciation hurt USD returns by about 10 points. Japanese stocks have rallied this year on a strong economy but more importantly changing management attitudes toward ROIC in Japan, partly due to rules changes from the stock exchange. Mitsubishi Electric has the added benefit of being involved in some industries that have long-term secular growth. It's industrial automation business is strong. It's HVAC business is strong. It is a provider of power semiconductors and is ramping silicon carbide capacity.

Advancers/Detractors	2023 2Q Return
Covestro AG	25.7%
Societe Generale SA	24.1%
Terex Corporation	24.1%
Dropbox Inc.	23.4%
Unum Group	21.6%
Xperi Inc.	20.1%
Impinj Inc.	<33.8%>
Canaccord Genuity Group (in USD)	<22.3%>
Amarin Corporation	<20.7%>
Daqo New Energy Corp	<15.3%>

Covestro had a strong return despite continued weakness in the chemical markets. It received a takeover bid that caused a stock rise. Societe Generale had a strong quarter as the European bank fallout from Credit Suisse and US regional banks begins to fade and investors are focusing more on earnings power than macroeconomic factors. Terex had a strong quarter as macro concerns begin to fade and investors focus more on earnings power and some secular growth drivers for its particular lines of materials equipment. Dropbox rose on broad strength in technology. Unum's stock rose on a Fed higher for longer notion that has crept into

markets. Xperi has a unique technology offering that has been underappreciated by investors but might now be starting to get recognized for it.

Some of the worst performing stocks included Impinj, Canaccord Genuity, Amarin and Daqo New Energy. Investors are starting to think Impinj's massive growth opportunity is going to have hiccups. Near-term weakness in retail will offset the benefit of new industries adopting RAIN. The OE trimmed Impinj at a much higher valuation than it currently trades at and in hindsight should have sold it all but the move down has been far less painful with a smaller position. Canaccord Genuity's management led buyout has fallen through for now and worse there are concerns of some shenanigans coming from management surrounding this buyout. This is a tricky one to analyze because faith in management is gone but the possibility of a buyout at a meaningful premium to trading price is still there. Amarin has a new management team that is providing more frank realistic color on Vascepa expansion in Europe. I think the more honest picture being presented is refreshing and the risk-reward from where this stock trades is really good despite investor disappointment over timelines in Europe. This is a company that has had a wild history.

Daqo New Energy sold off on collapsing polysilicon prices. A polysilicon glut was clearly coming, and that was widely anticipated. However, Daqo trades at a negative Economic Value and it is probably the lowest cost high quality producer of polysilicon in the world. Even with very low prices that force others to shut capacity Daqo is able to still have positive operating income and of course once capacity shuts and leaves the market, prices will rebound. Polysilicon prices won't rebound anywhere close to where they were but modeling polysilicon prices bouncing between the high single digits and low double digits leads to strong earnings power. In 2024 Daqo should be able to close its arbitrage gap between its valuation in China and the US in a much more meaningful way than it can in 2023, although it is able to close the gap by a decent amount in 2023.

Looking forward to the later part of 2023, it seems the recession in the US will finally arrive. Consumer spending has started stagnating and pricing power is leaving the market. Unfortunately, it seems the Fed might raise once or twice more and so the risk of a hard landing in late 2023 keeps increasing. A resilient economy, which the US economy has been provides no value in predicting the future state of the economy. A sharper than expected fall in prices, if one does materialize, is not something that necessarily should be cheered by the markets because it will indicate corporations are losing pricing power. The upcoming earnings season will provide important data points about where margins might be heading for companies. The Chinese economy continues to suffer from a lack of consumer confidence and property market overcapacity. Economic data has weakened in Europe. Even if the US economy remains resilient, large corporations derive earnings from economic conditions globally. The large shock of higher interest rates has not yet begun to widely impact US economic conditions but it will. Technology companies are not immune to weakening economic conditions. Some of the frothy valuations in technology should unwind in the later part of 2023.

Chris Harrington
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