ARROWSIDE

Arrowside Capital Q1 2023 Commentary

Performance Summary (as of 3/31/23)

	Q2 '23	YTD '23	Since Inception
Arrowside Innovation	11.9%	28.0%	32.1%
MSCI World	5.8%	14.0%	23.3%
Relative Performance	6.1%	14.0%	8.8%
Arrowside Small Cap Growth	6.7%	18.0%	18.0%
Russell 2000 Growth	6.8%	13.1%	13.1%
Relative Performance	-0.1%	4.9%	4.9%

Market and Economic Commentary

The first quarter of 2023 showed strong returns in the global equity markets, despite some turbulence in the banking sector. Investors paid close attention to corporate earnings, Federal Reserve policies, interest rates, and the impact on the banking industry.

During the first quarter, the Federal Reserve raised interest rates twice by 25 basis points each, bringing the targeted rate to 4.75-5.00%. This is quite a significant change compared to a year ago when the rate had increased to a target of 0.25-0.50%. This shift in interest rates occurred within a short span of one year.

Investors closely monitored inflation as an indicator of Federal Reserve policies. In February, the consumer price index (CPI) rose by 6.0%, a slight decrease from January's 6.4%. There are indications that inflation may have reached its peak, providing some relief to equity markets.

The major highlight of the quarter was the challenges faced by the banking sector. Certain regional banks, such as Silicon Valley Bank and Signature Bank, suffered significant mark-to-market losses in their bond portfolios due to the rise in interest rates. Silicon Valley Bank faced a deposit run and had to sell some bonds at a loss, eventually leading to insolvency. This situation, reminiscent of the Global Financial Crisis, eroded trust in the financial system. However, these issues have been limited to a few regional banks so far. The Federal Reserve intervened by providing ample liquidity and guaranteeing the uninsured deposits of the insolvent banks. These measures helped restore market confidence and may have allowed most indices to record positive returns in the quarter. The banking sector's troubles may impact overall lending, particularly in the corporate sector. While it is still early to assess the full extent, it is likely that equity markets will favor companies with self-funding capabilities until there is more certainty about the banks' risk tolerance.

Layoffs continued in the technology sector during the quarter, affecting both private and public companies. Notable public companies like Microsoft, Amazon, and Salesforce implemented workforce reductions. The impact of economic uncertainty even extended to renowned consulting firms like McKinsey and Bain, which postponed their hiring plans.

There was increased activity in the private equity sector, with buyouts of software companies such as portfolio company Duck Creek by Vista Equity Partners. Private companies also sought financing or liquidity, including Stripe, which secured a $6.5 billion Series 1 round at a valuation of $50 billion. While private equity activity slightly increased compared to late last year, it remains below the levels seen in 2021. Many companies are hesitant to conduct down rounds, which involve raising funds at a lower valuation.

Earnings reports were closely watched for indications of a potential recession. Many companies reported decent results for the December quarter but lowered their expectations for the first half of 2023. Our portfolio companies generally delivered strong results, with some being cautious in their guidance for 2023, while others reported robust results and provided positive forward guidance. The portfolio is most exposed to muted forward guidance in companies tied to the housing market. Companies like RH have expressed expectations of a slowdown in residential housing activity and reduced spending on furnishings and household goods. Despite this, we maintain confidence in the long-term prospects of companies like RH, as we believe there is still a shortage of homes in the US, and spending will normalize in 2023 after an excessive period of ordering during the pandemic.

We believe that equity markets are undergoing a bottoming process that began in the fall of 2022. This process takes time and involves periods of volatility. It also results in greater variation among individual stocks. This increased dispersion presents opportunities for active investors to identify winners and leaders that will lead us out of the downturn.

We believe that the process of reaching the market bottom presents opportunities in high-quality growth companies that generate cash flow and have solid balance sheets. After downturns, well-managed and strategically positioned companies tend to emerge even stronger. Weaker companies, on the other hand, may struggle due to adjustments made to survive during the downturn. By focusing on the best-in-class companies, we are uniquely positioned to invest in the new leaders that will emerge in the next bull market.

Outlook

As we near the end of this cycle of interest rate tightening, we are becoming increasingly positive about equity markets. Uncertainty is generally disliked by equity markets, but with inflation peaking or showing signs of sustainable decline, investors can now see a light at the end of the tunnel. This shift in focus puts more emphasis on the individual fundamentals of companies, creating an ideal environment for bottom-up investors.

We are reasonably confident that we have reached the bottom for this cycle and anticipate a gradual upward trend, although there may be some continued volatility. Historically, the small and mid-cap sectors have led and outperformed during market recoveries. We expect a similar pattern this time around and have positioned ourselves accordingly to capitalize on it.

The pace of rapid innovation remains unabated, with companies introducing exciting new products and services. Our long-term outlook is highly optimistic when it comes to investing in transformative change. As we reach the bottom and enter a new bull market, we anticipate excellent investment opportunities to arise. We expect this rebound to commence sometime in 2023. For these reasons, we refrain from timing the market and instead stay invested in the best-in-class companies that drive change, allowing us to look past short-term fluctuations and maximize long-term returns.

We appreciate the trust you have in our philosophy and process. Please do not hesitate to reach out with questions or feedback.

Sincerely,

Tucker Walsh
Managing Partner / CIO

About

Arrowside Capital is a Boston, Massachusetts based investment company focused on investing in innovative companies that have demonstrated financial discipline. The firm was founded in 2022 by Tucker Walsh, who has more than 30 years of experience in investing in small and midsized innovative companies. Arrowside Capital believes that investing in innovative companies creating change builds the most value over time. The firm's rigorous investment process searches for companies that are both innovative and profitable. Companies in the firm's concentrated portfolios have durable competitive advantages, superior margins and returns on capital, and ample reinvestment opportunities. The combination of great conditions, plus great management behaviors produce the most intrinsic value growth over the long-term. Arrowside Capital favors small and mid-cap companies to take advantage of the market inefficiencies resident in these types of companies.

Disclosures

Act") or any state securities laws or the laws of any foreign jurisdiction, and the Fund will not be registered as an "investment company" under the Investment Company Act of 1940 (the "1940 Act"). The interests may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the U.S. Securities Act. Accordingly, each purchaser of the interests will be required to (a) represent that such purchaser is an "accredited investor" as defined by Regulation D under the U.S. Securities Act and (b) make such additional representations as may be required by the Fund to allow it to comply with one or more exemptions from registration under the 1940 Act. "