

Q4 2024 COMMENTARY

Performance Summary

As of 12/31/2024

	Since Inception	Annualized	Q4 2024	2024	2023
Arrowside Innovation	68.3%	26.0%	4.6%	13.3%	41.8%
Russell 2500 Growth	44.2%	17.7%	5.6%	13.2%	18.0%
	24.2%	8.3%	-1.0%	0.1%	23.7%
Arrowside Innovation	68.3%	26.0%	4.6%	13.3%	41.8%
S&P 500	64.0%	24.6%	2.1%	23.3%	24.2%
	4.3%	1.4%	2.5%	-10.0%	17.6%

Note: Arrowside Global Innovation inception is 10/1/22; performance is net of fees.

Market And Economic Commentary

Global markets continued their upward trajectory in Q4, with broad indices rising 2-4%. The most significant event of the quarter was the U.S. Presidential election, which resulted in Donald Trump reclaiming the White House. With both chambers of Congress under Republican control, markets interpreted the outcome as a clear policy shift toward deregulation, lower corporate taxes, and a potentially more favorable stance toward business expansion.

Corporate earnings were largely in line with or exceeded expectations, reinforcing the resilience of leading companies despite macro uncertainty. The Federal Reserve cut interest rates by 25 basis points in December, shifting toward a more accommodative stance. However, inflation remained a key concern, with sticky core levels in consumer staples and housing.

Sector performance was mixed. Consumer discretionary, communications services, and financials led the way, while healthcare and industrials lagged. Technology stocks performed in line with the broader market, with select AI-driven companies outperforming. Nvidia had another strong quarter, buoyed by AI demand, while Broadcom surged over 35% on robust earnings and AI infrastructure expansion. Cryptocurrency markets rebounded, with Bitcoin rallying sharply following President-elect Trump's vocal support. Many investors believe his administration could create a more favorable regulatory environment for digital assets, fueling speculation and renewed institutional interest.

Despite the market's continued strength, pockets of economic weakness persist. The housing sector remains sluggish due to high mortgage rates, and consumer goods companies report mixed results, reflecting a bifurcated consumer base. Companies with strong competitive positioning continue to be rewarded, while weaker firms see sharp sell-offs. Individual stock correlations are close to a 20-year low. Businesses with durable advantages and strong reinvestment opportunities.

This type of dispersion benefits active managers and reinforces the importance of investing in businesses with durable advantages and strong reinvestment opportunities.

Innovation Update

The fourth quarter continued to highlight the early innings of an AI-driven innovation cycle. Investment in AI infrastructure, semiconductors, and next-generation computing remains robust, with demand outstripping supply across multiple key areas.

Nvidia reported another strong quarter as enterprises expanded their AI commitments. Broadcom's AI related segments drove significant upside, reinforcing AI's status as a structural shift rather than a passing trend.

A new theme in Q4 was AI's impact on power consumption and infrastructure development. AI models are straining data centers and energy grids, pushing major tech firms to secure renewable energy sources. Microsoft deepened its nuclear power partnerships, while Google invested in next-gen energy storage to ensure sustainability.

Unlike past semiconductor cycles, today's AI-driven demand appears non-cyclical, as industries from financial services to healthcare rapidly integrate AI-powered tools. Semiconductor leaders like TSMC and ASML increased commitments for advanced node production well into 2026.

Beyond AI, quantum computing and advanced materials are drawing investor attention. IBM and Google reported progress in quantum error correction, while new breakthroughs in AI chip efficiency and battery technology drive material innovation.

Another innovation-driven theme was the resurgence of cryptocurrency, with Bitcoin surging over 50% in the quarter. Regulatory optimism and institutional adoption continue to integrate crypto into the broader financial system.

Investment Takeaways:

- AI infrastructure spending remains in an aggressive expansion phase, defying skepticism.
- Energy consumption challenges create investment opportunities in renewables and efficiency solutions.
- Quantum computing progress continues, though commercialization remains early.
- Crypto is back in focus, but regulatory developments remain key.

Investment Cycle Thoughts

As 2024 concluded, the investment cycle remained characterized by persistent dispersion, high capital costs, and an emphasis on capital efficiency. Markets continued rewarding strong business models, profitability, and reinvestment capability, while speculative growth continued to be penalized.

Key structural forces—AI proliferation, intangible-driven business models, and economic concentration among fewer companies—remain unchanged. The market is increasingly distinguishing between high ROIC businesses and those that previously relied on excess liquidity. Companies executing well continue to gain valuation premiums, while those struggling face significant headwinds.

Valuations remain elevated but not extreme, with our portfolio holdings trading around 20-25% above long-term historical averages. Given sustained revenue growth and strong capital returns, selective premium valuations are justified.

A notable shift over the past two quarters has been the market's emphasis on balance sheet strength and self-funding growth. Companies that can reinvest internally at high incremental returns are outperforming, while those reliant on external capital struggle.

While technology and AI-driven firms still lead, there are early signs of broader market participation. Mid- and small-cap equities trade at valuation discounts to large-cap peers, but their outperformance hinges on lower capital costs and earnings re-acceleration.

The era of mass speculation is over, reinforcing a dispersion-driven market that favors active management and high-quality company selection.

Portfolio Thoughts

Our portfolio remains focused on repeat monetization models, high returns on capital, and strong reinvestment capabilities. AI-driven infrastructure, semiconductors, and digital transformation remain key investment themes.

During the fourth quarter, we initiated investments in publicly traded private equity firms, including Apollo, Blackstone, and Hamilton Lane. We see a fundamental shift in financial markets, where capital formation and lending are increasingly shifting toward private equity and alternative investment managers.

With traditional banks constrained by regulatory capital requirements, private equity firms have emerged as dominant forces in financing innovation and infrastructure. This is particularly relevant in the AI era, where data centers, semiconductor fabs, and cloud infrastructure require significant capital investment. The need for private capital in AI-driven infrastructure will continue to grow, positioning these firms as major beneficiaries.

Key Sector Positioning:

- Semiconductors & AI Infrastructure – Given AI's sustained demand for computing power, we remain constructive.
- Consumer & Digital Platforms – Focused on strong monetization models and digital engagement advantages.
- Enterprise Software & Cloud – Becoming more selective, emphasizing profit-driven software growth.
- Financials & Alternative Asset Managers – The shift to private capital reinforces our investment in leading private equity firms.

Our long-term, disciplined strategy focuses on compounding intrinsic value through high-quality businesses.

Outlook

Significant market volatility is expected as we enter 2025. The interplay of inflation, interest rates, and a bifurcated consumer will drive sharp asset price movements.

The Federal Reserve's December rate cut signaled an easing cycle, but the path forward is uncertain. Inflation has moderated, yet absolute price levels remain high, affecting lower-income consumers more than wealthier households and corporations. This divergence will shape investor sentiment throughout the year.

Simultaneously, AI-driven technological disruption will amplify market volatility. Tech stocks, which dominate indices, will experience larger and more frequent price swings, driven by reinvestment cycles and uncertainty around monetization. These moves will impact the broader market.

Despite short-term uncertainty, our five-year forward outlook remains highly constructive. Innovation cycles consistently create long-term value, and leading AI, technology infrastructure, and private capital firms are well-positioned to scale.



In areas with strong returns on capital and reinvestment opportunities, valuations are slightly higher than history, but not majorly extended. Unlike prior speculative periods, today's premium valuations reflect fundamental strength.

We remain focused on deep water currents, not surface waves. Market turbulence is inevitable, but the long-term investment case for quality, innovation-driven companies remains intact.

We appreciate your trust in our philosophy and process. Please reach out with any questions or feedback.

Sincerely,

Tucker Walsh
Managing Partner and 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 midsize (SMID) 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

Of those stocks listed in this commentary, Arrowside currently holds positions in Nvidia, TSMC, Apollo, Blackstone, and Hamilton Lane.

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100 Summer Street, Suite 1600, Boston, MA 02110
www.arrowside.com