November 30, 2024

Dear Partners,

I hope this update finds you well. Our fund had a good Q3, up 10.4% net.[1] Our performance in Q4 so far has been strong, and I am optimistic that we will end the year on a high note. I share below some thoughts about what comes next, as well as our portfolio updates.

Fund Updates

I am pleased to announce that Dr. Theofanis (Fanis) Papamichalis has joined the Phestos team as an academic advisor. Dr. Papamichalis is an Assistant Professor at the University of Cambridge and the Greta Burkill Fellow in Economics at Murray Edwards College of the University of Cambridge. His research centers around macro-finance and theoretical and empirical asset pricing. Beginning in Q4 he will be advising on issues related to portfolio optimization and volatility targeting, as well as conducting research in collaboration with the fund. Dr. Papamichalis holds degrees from Oxford (DPhil in Financial Economics), MIT (MFIN in Finance), Cambridge (Masters of Advanced Study in Mathematics) and Imperial (MEng in Electrical and Electronic Engineering). He has won multiple awards in international math competitions, including a Bronze Medal in the International Math Olympiad. At a personal level, I have known and admired Fanis for more than 20 years, and I am very excited to collaborate with him professionally.

Market Commentary

The most important macroeconomic event since our previous update was obviously the U.S. elections. Donald J. Trump was the big winner and will serve a second term as President. Trump's victory was not a surprise to the markets. Throughout the entire campaign cycle prediction markets were assigning a higher chance to a Trump victory compared to models based on polling averages and, in this case, it turned out that prediction markets were correct.[2] The market has so far reacted well to Trump's victory, and his nominee for Treasury Secretary, Scott

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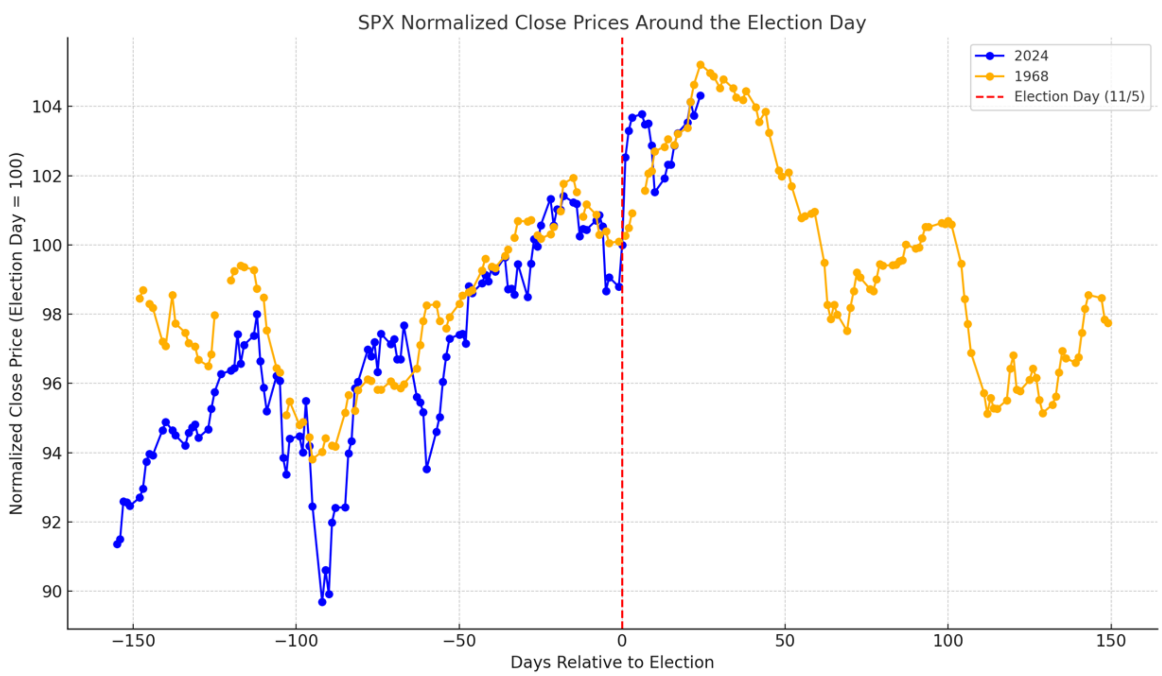
[1] Performance for a hypothetical Class A holder who subscribed at inception. Individual returns will vary depending on the Class and the time of subscription.

[2] My (untested) theory is that, when it comes to elections, prediction markets have a right-leaning bias. So, they tend to do well when the more conservative candidate actually wins, and worse when the more liberal one does. Note that these are *prediction markets* we are talking about here, not polls.

Bessent, is well regarded among market participants. Trump is perceived as pro-business and pro-market, and in his previous term he demonstrated an unusually strong interest in seeing the equity markets do well. Having said that, his economic plan is not crystal clear, and some of his policy proposals (notably, tariffs) may cause market headwinds.

Interestingly[3], the analogy with 1968 I wrote about in the August update continues to hold. Not only was the result the same (the Republican candidate who had previously lost an election defeated the Vice President of an incumbent President who could, but did not, run for re-election), but the race also played out in a very similar way.[4] The stock market movements (using the S&P 500 as a proxy) around the election in both years are also eerily similar. In 1968 the market had a sharp decline starting in mid-July and ending on August 2, followed by a recovery leading up to the election, and a post-election rally that peaked on the last trading day of November (11/29, coincidentally a Friday, just like this year).



[3] Hopefully it is interesting to others as well, and not just me.

[4] In 1968 Nixon was the heavy favorite until about mid-August, when his opponent started closing the gap, moving to ostensibly 50-50 odds right before Election Day, and finally a comfortable Nixon win with 301 electoral votes vs Humphrey's 191; it tracks closely to how the odds for the presidential race evolved this year, with Trump eventually winning with 312 electoral votes vs Harris' 226.

The S&P 500 has followed a very similar pattern this year, with a local top in mid-July, a sharp selloff with a low on August 5, and then a recovery and a post-election rally through the end of November. Right now, the S&P 500 is 6.4% higher than its mid-July local peak; on 11/29/68 it was 5.9% higher than that year's mid-July local top.[5]

After peaking in the end of November 1968, the S&P 500 stayed at roughly the same level for a couple of weeks, before beginning a months-long decline ending in May 1970; the November 1968 peak would not be reached again until almost three and a half years later, in March 1972. This sounds a bit ominous, but it is of course just an analogy – there are many reasons to believe that 2025 will play out differently. One important way in which the political analogy between 1968 and today does not hold is that back then Nixon won the Presidency, but Democrats retained control of both the Senate and the House. This year, Republicans achieved the "trifecta," winning the Presidency *and* the majority in both the Senate and the House. Historically, a divided government with a Republican President (as was the case in 1968) has been the worst possible outcome for the stock market.[6] Whereas, a unified government under a Republican President (as will be the case starting Jan. 20th, 2025) has historically been the best.[7] [8]

Moving beyond historical analogies, there are three important reasons to be cautious in the short- to mid-term:

1. Valuations are stretched: by any conventional valuation metric, the market appears overvalued, and in some cases extremely overvalued (i.e., in the 99th percentile of historical valuations). Valuations multiples *are* mean reverting, so they likely won't stay this high for much longer. The optimistic argument here would be that corporate earnings and cash flows continue to outgrow expectations over the coming years, as they did in 2023 and 2024, thus keeping stock prices high even as multiples decrease.

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[5] We didn't include all election years since 1968 in the chart for clarity purposes, but if we did, it would be clear that the movements in 1968 and 2024 leading up to Election Day are extraordinarily similar. There is no other discernible pattern among the remaining years (meaning, the stock market trajectories leading up to the elections are practically random). There *is* however a discernible pattern post-election: post-election rallies (defined as more than 4% increase in the SPX during the four weeks following the Election Day) are the norm – presumably on the idea that the removal of uncertainty is good for the markets.

[6] Since 1947, average value weighted excess returns of the CRSP U.S. Total Market Index under a divided government with a Republican President are 1.22% per annum, which is 8.80% lower than the average of all other combinations – a statistically significant difference.

[7] Since 1947, average value weighted excess returns of the CRSP U.S. Total Market Index under a unified government with a Republican President are 10.77% per annum.

[8] Dr. Papamichalis has conducted extensive research on this topic. An Institutional Investor article discussing one of his working papers can be found here.

2. Notwithstanding the general belief that "Trump is good for the market," there are many things that could go wrong in the beginning of the new Trump presidency. It is an oft-repeated fact that "markets don't like uncertainty." Given the personalities of several people involved in the incoming Trump administration, and the relative lack of clarity and specifics about economic policy, I think we are more likely than not to see heightened uncertainty and perhaps some market turbulence during the weeks leading up to the inauguration and the months after it.[9]
3. The rates market seems to be coming to the realization that the Fed cutting cycle may not be as aggressive as originally expected: growth remains strong and inflation has stopped receding, so it wouldn't be a surprise if the Fed cut another 25bps in the December meeting and then paused for an unspecified amount of time. That would keep the Fed funds rate above 4% for most of 2025 – which would be a headwind for equities. The 10-yr and 30-yr yields started rising sharply right before the Fed started cutting rates and the 10-yr currently stands 56bps *higher* than it did right before the Fed had its first rate cut on Sept. 18.

The Other Election Winner

One last comment related to the elections: in addition to Musk and a number of prominent Silicon Valley billionaires supporting Trump, another major winner of the recent elections was the crypto industry. Trump openly voiced his support for Bitcoin and crypto in general during his campaign (albeit without making any concrete policy commitments), unlike Kamala Harris who refrained from making any meaningfully supportive comments. The industry, organized behind the Fairshake super PAC and other groups, spent about $135 million in the recent elections. 20 "pro-crypto" candidates were elected in the U.S. Senate vs 12 "anti-crypto," and 278 pro-crypto candidates were elected in the House, vs 122 anti-crypto.[10] Notable amongst the results was the defeat of incumbent Ohio Senator Sherrod Brown, the chairman of the Senate Banking Committee and a crypto sceptic, to pro-crypto candidate Bernie Moreno. It is impressive how quickly the crypto industry has emerged as a powerful lobbying force.

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[9] One clear and specific measure that has been discussed so far are of course the proposed tariffs, and these are likely to have a negative impact on both the economy and the stock market.

[10] Numbers and pro-/anti- designation according to Stand With Crypto; industry tracker here: https://www.standwithcrypto.org/races .

Portfolio Updates

Intuitive Machines (LUNR)

It's been a great run for Intuitive Machines since we introduced this position in the August update. The stock price is up almost 5x (!) since then and as of writing it trades at $16.35/sh. (compared to $3.40 in early August). In August and in September LUNR was awarded two new contracts from NASA.[11] The new contracts signal LUNR's increasing importance within NASA's Artemis program, and also decrease the probability that LUNR will need to raise new equity (and dilute existing shareholders) over the next year. As I was writing in August, dilution is one of the main risks with LUNR, and following the two new contracts this risk has largely been mitigated: even in the (still likely) event that LUNR issues new equity, it will not be as dilutive.

LUNR was also one of the stocks that rose sharply following the election results, almost doubling in value in the two weeks following Trump's win – arguably on the grounds that Elon Musk's heavy involvement in the Trump administration will ensure continued support for the space program.

The company is a bidder for an additional NASA contract, the awarding of which is expected before the end of the year.[12] Winning an additional contract will obviously be very positive, our thesis however does not depend on Intuitive Machines winning any single bid, but rather on the space economy growing and Intuitive establishing itself as a key infrastructure and services provider. In addition to the possibility of a new contract award before the end year, there is a catalyst coming up in Q1 2025 with the launch of the IM-2 mission.

We sold more than half of our LUNR position during the recent rally, given that it had become an uncomfortably high percentage of our portfolio. We would be sellers at prices above $16/sh. and may exit completely if the rally persists; the long-term thesis hasn't changed, but the risk-reward ratio is not as attractive at those prices. The main issue with LUNR is that it will likely take a long time before it can scale, and that places a cap on how high the market cap can sustainably go. The vehicles and equipment it designs are mission-specific. Sure, experience accumulation is important, and there are similar challenges between missions, but right now there is no clear, visible path for the company to achieve the economies of scale that would push marginal costs massively down (there is the prospect for charging for communications via the satellite communications network LUNR will develop as part of the NSN contract, but this is still far into the future.) When we opened this position, the

[11] The first contract relates to payload delivery at the Moon's South Pole and the second (and larger) contract relates to the establishment of NASA' Near Space Network (NSN). See here: https://www.nasa.gov/news-release/nasa-awards-intuitive-machines-lunar-south-pole-research-delivery/ and here: https://www.nasa.gov/news-release/nasa-selects-lunar-relay-contractor-for-near-space-network-services/ .

[12] This contract is also part of the NSN services.

valuation was very low compared to the scale of the opportunity (and given the company's competitive advantage and head start), leaving a lot of margin for things that could go wrong. Now, at a multiple of our entry point, this is no longer the case. Of course LUNR can go higher (and I hope it does), but that would start pricing in a version of the future where everything goes exceptionally well for the company.

Position Exit: Centrus Energy (LEU)

We sold our entire Centrus position during the recent rally. I've written about Centrus a couple of times before. It offered an excellent risk / reward ratio when we entered the stock, at an enterprise value of ~$460 million. Earlier this quarter it reached an enterprise value of $1.9 billion, at which point we exited our position completely. We first purchased Centrus in August 2022 at $38.8/sh, and our last purchase was in April 2024 at $43.2/sh.; our weighted average cost basis was $39.6/sh. We started trimming our position in May at ~$47/sh and exited completely in October at ~$100/sh.

I've always thought that this stock would not rise in a gradual fashion, but instead suddenly spike higher. Indeed, in early September it broke out into a magnificent rally that culminated in early November in a 209% return – the stock price more than *tripled* over a period of less than two months. I have to admit that I was growing frustrated with LEU; its stock price action over the past few months offers a strong argument *against* the idea that markets are generally efficient. For one, I believe the market was fundamentally misunderstanding this company (and to some extent, still is). I read all the short-seller reports I could find over the roughly two years that we owned Centrus (there were plenty): all of them based their bearish view on the stock on what Centrus *had been doing* over the past few years (*i.e.*, reselling imported Russian low-enriched uranium); whereas the company's value in my view lies on what it can do in the future, namely enriching uranium in the U.S., and in particular High Assay Low Enriched Uranium ("HALEU.")[13] Having understood the short thesis, and disagreeing with it, gave me confidence in our position. This confidence however was tested when the positive news started rolling in, and yet the stock

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[13] *See*, for example, this commentary from the June 2023 Update: "What [Centrus] does is resell enriched uranium that it procures at very low prices, thanks to long-term contracts with the actual enrichers (primarily Tenex of Russia). Despite this being a very high-margin operation, it is not a sustainable revenue source in general (they are effectively just an intermediary) and in particular when it comes to Russian-sourced uranium (which could face a U.S. ban). The real value proposition for Centrus lies in the High-Assay Low-Enriched Uranium ("HALEU") market potential and the company's plan to become the first U.S. HALEU producer." (Phestos Investor Update, June 6, 2023, pp. 6-7.)

price wouldn't move. There was always some explanation proffered as to why, but these explanations were unconvincing.[14]

The frustration, and the argument against market efficiency, comes from the fact that all the "news" that in theory should have validated the thesis and pushed this stock much higher, had already happened and yet the stock price had little to no reaction. And then, it finally exploded higher on news that… were not really new, nor did they really change the company's cash flow expectations, and kept surging on no news at all, as was the case during most of the recent rally. Well, better late than never as they say; sometimes the Market works in mysterious ways.

We decided to sell when LEU's enterprise value approached $2 billion. This investment's primary appeal was its limited downside (for reasons articulated in earlier updates – in summary, its inventory and the fact that it is the only U.S. company with a proven ability to enrich uranium right now), and *secondarily* its upside, which was sizable but capped. Why capped? Because Centrus' technology is old and at risk of becoming obsolete over the next 10-15 years, and also because increasing HALEU production requires a large investment. Funding the investment will not be an issue (the government will likely subsidize it one way or another), but the large Capex needs limit the upside. Our analysis indicated an enterprise value in the $1-$1.5 billion range based on conservative estimates about future cash flows, which made our entry point (at an enterprise value of ~$500 million, with capped downside) very attractive. At prices above $100/sh. we were above our enterprise value estimate range. It is certainly possible that the stock keeps heading higher, but the "easy" money has been made. At a stock price above $100/sh. the position is slightly more speculative than I would like, so we have decided to exit.

Position Exit: BABA

Similarly to LEU, BABA was a trade going mostly sideways for a while… and then suddenly exploding higher. I was writing in the previous update that the moment China became somewhat "investable" again, the BABA price would move sharply higher. That moment came when the Chinese government announced a stimulus package and stated its intention to support the country's capital markets. Our exposure to BABA was via out of the money options, for reasons I outlined in the previous update. We had purchased call options with a strike price of $120, expiring in June 2025. At the time the BABA stock was trading at around $75/share – it would require a 60% increase in the share price for our options to be in the money. BABA stock price increased ~55% between late July and early October, and as a result our option prices increased from less than $3 to more than $15 per contract. We sold most

[14] Most of these concerns had to do with Centrus' relationship with its supplier, Tenex (a Russian company).

of our position at BABA share prices between $110-$115. As of writing we have sold more than 90% of our position. We still hold some BABA options making up less than 1% of our portfolio.

Other Positions

We continue to hold most of our uranium positions as well as our positions in Mama's Creations (MAMA) and Expand Energy (EXE)[15] and we have started building positions in two small caps that I will write more about as soon as we finish purchasing.

A note on ASPI

We exited our entire ASPI position a while ago – we started selling in February and exited completely in early June, with most sales at prices above $4/sh. (after making our first purchase at $0.35/sh. about a year earlier). The stock took a dive shortly thereafter, falling all the way to $2.03/sh., before staging a roaring comeback to $8.77/sh. Last week, a short seller report caused the price to tumble by 23.5% in just one day, and it has continued falling since. I had a cursory look at the report. Most of the critique centers around ASPI's prospects as a uranium enricher and the report's main argument seems to be that ASPI's technology is not applicable or efficient when it comes to uranium enrichment. (There are of course also the usual in short seller reports sensational allegations about fraud, etc.) The only comment I'd like to make here, without expressing an opinion on the report's allegations, is that when we invested in ASPI, we invested in a prospective medical isotopes producer; the possibility for enriching uranium was gravy on top. The recent rally was driven almost entirely by an "ASPI as a uranium enricher" narrative: a very speculative proposition. Our main concern when we started exiting our position was that scaling the business (as a medical isotopes producer) would require more money and time than what the market seemed to anticipate.[16] Doing the same as a uranium enricher will obviously be even more challenging.

As always, I am available if anyone wants to discuss any of the above in more detail.

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[15] This is the company formerly known as Chesapeake Energy.

[16] Here is the language in the 2/27/24 update: "To continue going higher [ASPI] will need to add a lot of revenue, quickly. ASPI can scale up production in its current facility quickly, however, continuing revenue growth will require adding more facilities (management has plans to acquire or build new facilities in locations with low energy costs), and due to the nature of the operations and the regulatory approvals required, adding new facilities would take time." (Phestos Investor Update, February 27, 2024, p. 10)

With warm regards,

For Phestos Fund, LP

Nikos Angelopoulos

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