PhestosCapital

February 27, 2025

Dear Partners,

I hope this update finds you well. Our fund has had a volatile but strong start in the year. I am sharing below some thoughts on the current state of the markets as well as some updates on our portfolio.

Fund Updates

We recently redesigned the investors-only area of our website. You can now find a table with our largest holdings, news and short commentary related to our positions, as well as an archive of past communications and investor updates. We will be emailing the password to access the investor-only area separately over the next few days.

Market Commentary

We're now a bit more than a month into the second Trump Presidency. After a post-election rally that lasted until early December and a good start in 2025 major market indices are in the midst of a pullback and have turned slightly negative for the year.

Major U.S. Indices Returns YTD, between Election (11/5/24) and Inauguration (1/20/25), and since Inauguration

Index	YTD	Nov. 5th - Jan. 20th	Since Jan. 20th
S&P 500	-0.1%	5.0%	-3.1%
Nasdaq Composite	-3.8%	8.0%	-6.1%
Russell 2000	-4.1%	2.6%	-7.7%

It is too early to talk about the economic impact of the second Trump administration, and the market is still in a "wait and see" mode and in anticipation of more specifics. The Trump administration has an unequivocally pro-business and pro-market rhetoric. Nevertheless, this hasn't translated to specific policies so far. Regarding the policies being discussed, the projected impact is mixed. Lower taxes are certainly pro-market; as is the administration's stated objective of lower interest rates.[1] Tariffs are not. As for reducing the size of the federal

[1] Treasury Secretary Scott Bessent has mentioned lowering the 10-year Treasury rate specifically as a benchmark of success.

government (through layoffs and agency shutdowns), the long-term economic effect of that is debatable[2] – but it will almost certainly have a contractionary impact in the short run.

The market assessment seems to be that Trump will not do everything he has said he will with regard to the economy, and that the most "aggressive" parts of his rhetoric are primarily a negotiating technique and not an actual policy objective. Along these lines, statements made by the President or key economic advisors seem to have a diminishing effect; while some statements (mainly related to tariffs) caused volatility in equity markets during the first ten days of the Presidency, more recent statements (which under different circumstances might have caused a strong market reaction) have been met with a muted response.

As some of you know, the new Treasury Secretary (Scott Bessent) used to be a hedge fund manager. In a letter to his investors almost exactly a year ago he discussed how he expected a second Trump presidency to play out, with an emphasis on the expected economic policy. That entire letter makes for a very interesting read (especially given Mr. Bessent's new role), but I would highlight the following excerpts:[3]

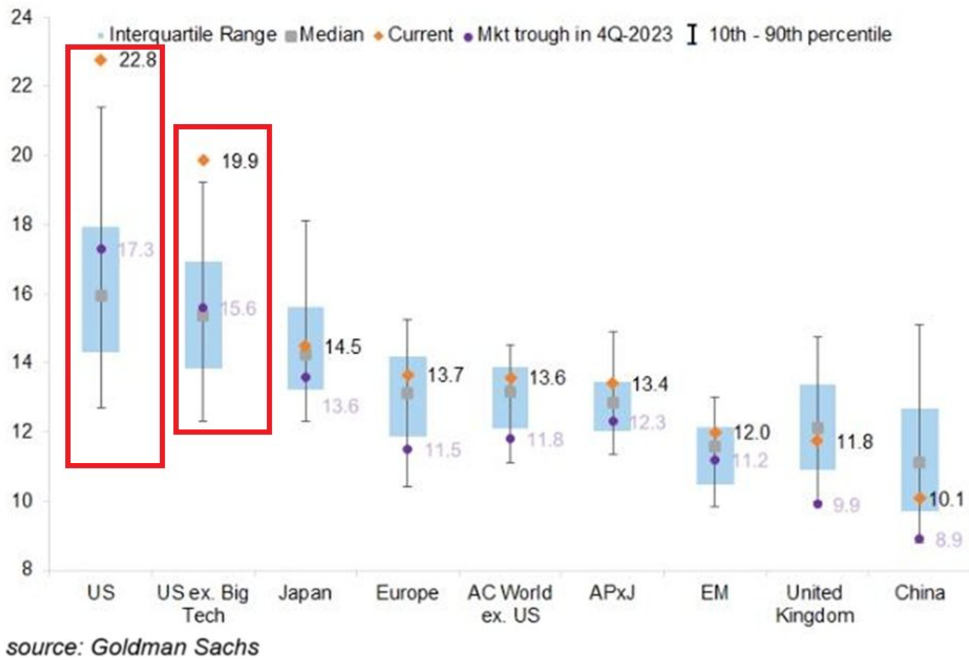
- About tariffs: "Another differentiated view that we have is that ***Trump will pursue a weak dollar policy rather than implementing tariffs***. ***Tariffs are inflationary and would strengthen the dollar--hardly a good starting point for a US industrial renaissance***. Weakening the dollar early in his second administration would make U.S manufacturing competitive. A weak dollar and plentiful, cheap energy could power a boom. The current Wall Street ***consensus is for a strong dollar based on the tariffs. We strongly disagree***. A strong dollar should emerge by the end of his term if the US reshoring effort is successful."
- About the election rally: "… we believe that as long as Trump remains ahead in the polls or the race is close, the Trump Rally can run right up to the election […] ***in the event of a Trump win, the markets could be at very high levels on Election Day. At that point, our Rejuvenation and Roaring Twenties thesis would have to be made clear or there could be a substantial setback***."

Political commentary aside, and speaking purely in market terms, it is a fact that valuations are stretched. That's not new: valuations have been stretched for a while, but they have recently hit new extremes. U.S. equities are at

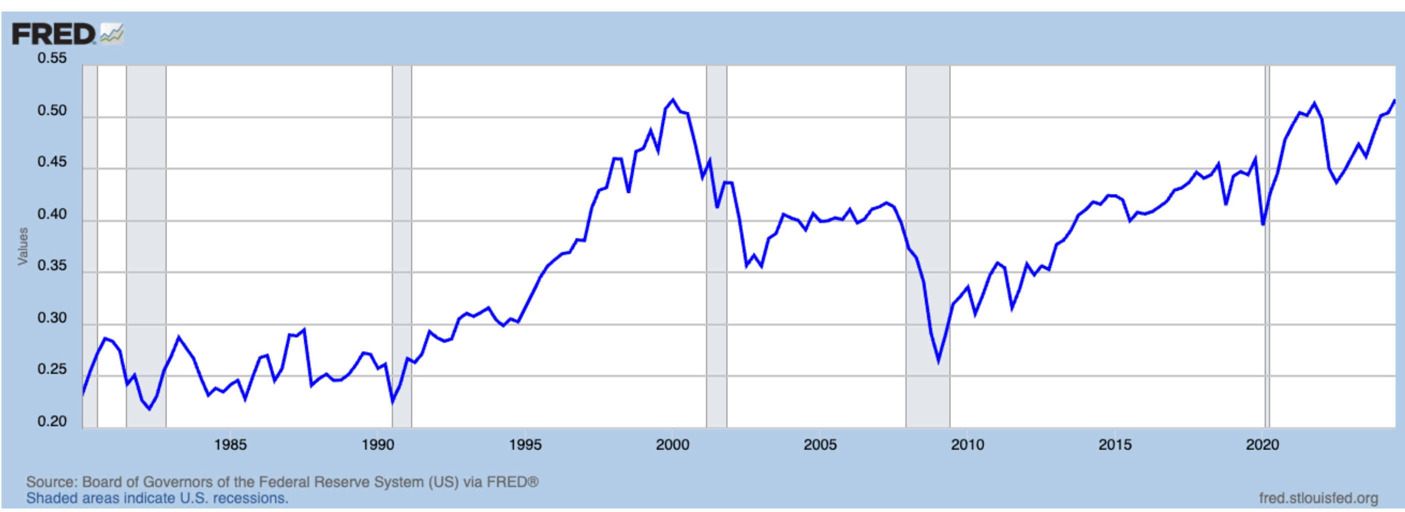
[2] My opinion is that well-functioning regulatory agencies with clearly defined mandates are necessary for the well-being of the markets. But I admit that there are arguments for both sides. Tariffs, on the other hand, are pretty unanimously considered bad by economists when it comes to their overall effect on productivity and economic output.

[3] A copy of the letter can be found here: https://assets.realclear.com/files/2024/02/2353_keysquare.pdf .

historically high valuation levels, even excluding the Big Tech companies. The U.S. is an outlier among major global equity markets, as valuations in the rest of the world are closer to their historical averages.



Positioning is also stretched. Retail allocation to stocks is at a record high – the U.S. investment public has never been more invested in the stock market, on aggregate.

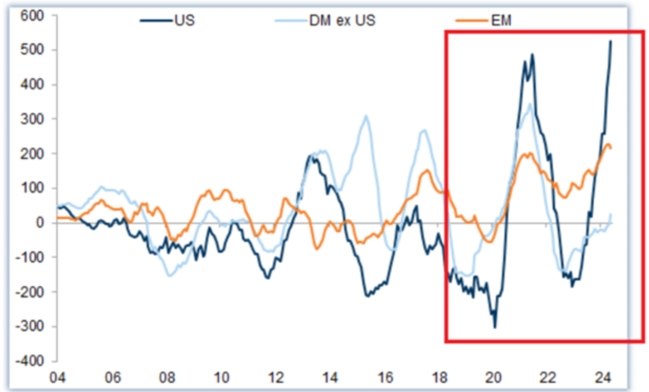


Household allocation of liquid net worth to stocks is at a record high

Global investors have also flocked back to the U.S., following the 2022 bear market. The 12-month rolling inflows now exceed even those observed right before the January 2022 market top.

Exhibit 7 : US equity flows have picked up even more into 2025

12-month rolling, monthly flows from global investors, in USD bn. MTD sum of weekly flows when monthly not yet available.



Source: EPFR, Goldman Sachs Global Investment Research

Now, as mentioned above, none of these observations is entirely new – valuations and positioning have been stretched for a while. In general, valuation is a poor timing indicator. But it *is* a reliable long-term returns predictor. Buying the S&P 500 right now does not bode well for long-term returns. This doesn't mean that a crash is imminent; it simply means that, over the next 5-10 years, broad market indices are more likely than not to underperform their long-term averages (for the S&P 500, the long-term average has been ~9.6%). The last time we were at similarly extreme levels in terms of valuation was early January 2022. In the 38 months since then, the S&P 500 has returned (assuming dividends have been reinvested) 28.1%[4] – or 8.1% annualized, slightly below its long-term average. Someone who purchased the index the last time valuations were this high (January 2022) hasn't done so bad three years later.[5]

I've written in the past about the federal deficit and how it has been a huge stimulating factor for the U.S. economy in recent years. It is a fact that the deficit will have to be reined in; if it doesn't, the U.S. will eventually face a severe debt crisis. The way this is done though obviously matters. Trump has talked about achieving a balanced budget by 2027 and Elon Musk, the de facto decision-maker for the "Department of Government Efficiency" ("DOGE") has set a goal of reducing public expenditure by $1 trillion this year. If federal budget cuts for 2025 come anywhere close to that level, it is hard to imagine how this will not cause a decline in real GDP in the short term.

Putting it all together: valuations and positioning are at extreme levels, there is uncertainty about key aspects of the new administration's economic policy, and the fiscal support the economy enjoyed over the past couple of years may be abruptly withdrawn.

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[4] As of closing on February 27, 2025.

[5] It's worth noting that January 2022 also coincided with the beginning of an aggressive tightening cycle by the Fed. Right now this is not the case: the Fed has paused and has not communicated any intent to raise rates this year; the market prices in zero probability of Fed cuts in 2025.

Portfolio Updates

Intuitive Machines (LUNR)

It's been a great run for Intuitive Machines. As discussed in the previous update, we started reducing our position at prices above $16/sh. and were sellers in January, when the price reached as high as $23/sh. We have now significantly reduced our position but still have exposure – as of writing LUNR is our fourth largest holding. In December Intuitive's management took advantage of the stock price appreciation and completed an equity offering, raising $110 million for new shares priced at $10.50.[6] In hindsight perhaps the offering could have been better priced – but raising the money was the right decision. The main risk with LUNR was dilution – that they would run out of cash and need to issue new stock with the price at low levels, excessively diluting existing shareholders. With the recent equity raise and consequent liquidity improvement this risk has now been mitigated. Overall, the developments for Intuitive since the last update have been overwhelmingly positive; in addition to the liquidity improvement, it secured new NASA contracts and successfully launched its IM-2 mission – their "Athena" lunar vehicle is expected to land on the moon on March 6th. The company also received a $10 million grant by the Texas Space Commission.[7]

Despite the very positive company-specific developments, it's hard to ignore that LUNR's price movement follows very closely the path of the "election rally." The "space sector" in general saw a boom following the U.S. elections. It was one of the sectors that benefitted the most, but just as the overall "election rally" is fading, so is the rally in space stocks.

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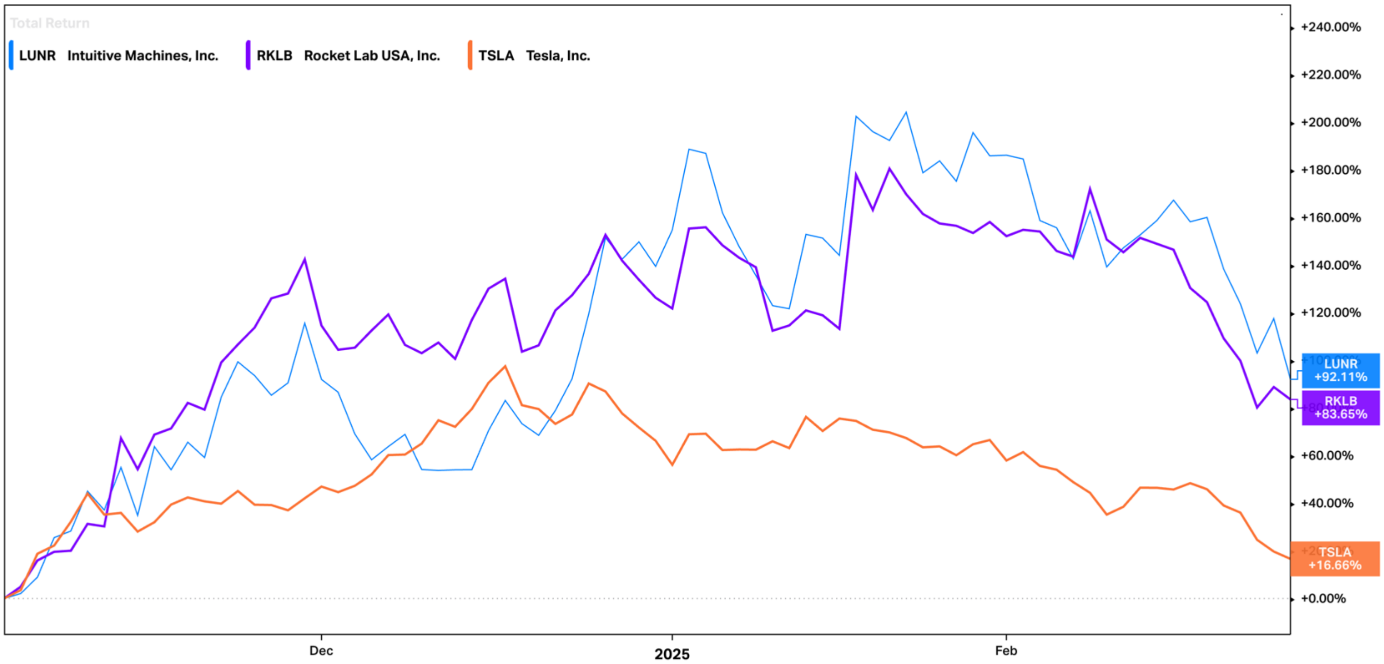
[6] https://investors.intuitivemachines.com/news-releases/news-release-details/intuitive-machines-prices-upsized-1100-million-offering-shares

[7] The grants were part of the commission's Space Exploration and Aeronautics Research Fund (SEARF) program. Blue Origin, Firefly Aerospace, SpaceX and Starlab Space also received grants.



"Space stocks" LUNR and RKLB have moved closely together since the U.S. Elections. Tesla is also shown as a proxy for the post-election rally. Data through Feb. 26th.

That said, LUNR has a clear catalyst coming up with its IM-2 mission and the landing of its "Athena" vehicle on the Moon, expected on March 6th.[8] LUNR's previous mission (IM-1) had issues with the landing, which the company says have been addressed (the IM-1 vehicle, "Odysseus" had a hard landing which impaired part of its functions). Of course, anything and everything could go wrong in a mission like this – the expectation is actually that something *will* go wrong. If the landing is successful, the share price will most likely surge. If the mission fails (hopefully it won't) the stock price will almost certainly take a hit, but this won't be the end for LUNR: no matter what happens with IM-2, IM-3 (the next lunar landing mission) is already scheduled for 2026; in addition, Intuitive Machines is an awardee for multiple of NASA's Near Space Network Services contracts, as discussed in the previous update. The company is well-capitalized and will be around in the foreseeable future. The main risk at this point is political – some unexpected decision by the federal administration that affects funding or priorities for the space program.

At the current stock price levels, and with a clear catalyst ahead, we are not sellers. We plan to hold through the IM-2 mission and may exit depending on the price reaction.

[8] It is a truly exciting mission. You can read more about the mission and its objectives here: https://www.intuitivemachines.com/im-2 .

<u>New Addition</u>: Gossamer Bio (GOSS)

In the previous update I mentioned that we are building positions in two small-cap companies. I can now disclose the name of one of them. Gossamer Bio is a clinical-stage biotech company developing seralutinib, a promising drug for the treatment of pulmonary arterial hypertension ("PAH"), a rare chronic disease.[9] Normally, this pitch would stop at the word "biotech," and the decision would be an automatic "pass." The reason being that biotech stocks are too risky and not a good fit for our investing philosophy, as they are typically stocks with binary outcomes (they either return many multiples or, more often, go to zero), usually dependent on the outcome of a clinical trial, which we have zero edge in forecasting. What then, makes Gossamer special? It is a combination of the following factors: very low valuation compared to the potential market opportunity (even after taking into account the possibility of failure); strong positive signaling by insiders as well as knowledgeable individuals and entities; and a credible explanation for why the market misunderstands this company.

The drug

With seralutinib, Gossamer is targeting the PAH market (~$7bn per year) as well as the larger Pulmonary Hypertension and Interstitial Lung Disease ("PH-ILD") market (estimated at $14bn per year). Seralutinib's Phase 3 clinical trial for PAH is underway, and Gossamer plans to start enrollment for a second Phase 3 trial targeting PH-ILD patients later this year. The company has <u>enough cash at hand to fund both Phase 3 clinical trials</u>. There are several FDA-approved drugs treating PAH, and multi-drug therapy is common. Seralutinib offers a novel mechanism of action compared to existing medications, targeting the underlying causes of the disease rather than just the symptoms. PH-ILD represents an even greater market opportunity, as there is currently only one FDA-approved drug.

"Left for dead" by the market

Gossamer has been in investing "no man's land" since the results of seralutinib's Phase 2 trial came out, in December 2022. Though successful, as it met its primary endpoint, the trial results disappointed investors. The improvement in the primary endpoint (a measurement of the reduction in blood pressure) was less than the market had hoped for and, critically, substantially less than the improvement that had already been achieved by a

[9] PAH is a progressive disease that causes increasingly high blood pressure in the arteries that lead to the lungs, eventually leading to heart failure and death. Sadly, there is currently no cure; existing treatments can only slow down the progression of the disease.

competitor drug, sotatercept.[10] [11] In addition, seralutinib failed to show a statistically significant improvement (it did show an improvement, however it was not statistically significant) in the secondary endpoint, the distance patients could walk in 6 minutes ("6MWD"). This matters, because 6MWD is the *primary* endpoint in the upcoming Phase 3. In addition, around the same time, other biotech companies were making progress in developing competing drugs for the same disease and with the same mechanism of action as Gossamer's. Following the Phase 2 trial results Gossamer decided to halt development of all other drugs in its pipeline and focus entirely on seralutinib, which among other things meant no foreseeable major catalysts for the stock until the Phase 3 trial would be close to completion (which, as of December 2022, was at least two years away). Given all the above, it is not shocking that the stock price plummeted: GOSS was down -75% immediately following the release of the Phase 2 trial results and continued declining over the following months, all the way down to -95%. The market pretty much priced Gossamer as a "bust" heading to zero.

There are however reasons to believe that the market's reaction to the Phase 2 results is misplaced, and that seralutinib is a more effective drug than what topline results suggest. The first reason has to do with the trial's timing. With regard to timing, the trial took place during the height of the Covid-19 pandemic: enrollment started in November 2020 and was completed in April 2022. The company contends that this resulted in a selection bias towards healthier patients / patients in earlier stages of the disease (the reason of course being that during the height of the pandemic patients in more advanced stages would not risk visiting a hospital to participate in a clinical trial – remember, this is a pulmonary / cardiovascular disease.)[12] The company also contends (and clinical data support this) that the drug's efficacy is higher on patients in later stages of the disease. In Phase 3 they plan to enroll more severely affected patients, which in turn they expect will result in greater reported improvement.[13] The second reason has to do with the Phase 2 trial's design. The trial protocol did not include stratification by functional class

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[10] Acceleron Pharma, the company developing sotatercept, was acquired by Merck in late 2021 for $11.5 billion, while sotatercept's Phase 3 clinical trial was underway. The Ph. 3 trial was a success, and on the day its topline results were released Merck added *another* $8 billion to its market cap. Acceleron had other drugs in its pipeline as well (though sotatercept was the acquisition's main objective) so this is not exactly an apples-to-apples comparison to Gossamer; it does however give a sense of the market value potential should the Phase 3 trial be successful. Gossamer's current market cap is approximately $280 million.

[11] Sotatercept has been approved by the FDA and Merck is marketing it under the brand name Winrevair.

[12] For comparison, sotatercept's Phase 2 trial enrolled its last patient in June 2019.

[13] According to the company's COO, a review of the patients already enrolled in the study (more than half of the target enrollment is already completed) indicates that they are indeed in more advanced stages than the Phase 2 trial patient population, with a risk profile that matches that of the sotatercept trial.

("FC")[14] between the placebo and the seralutinib arms. As a result, the placebo patient population was split 47.6% – 52.4% between FC II and FC III patients respectively, whereas the seralutinib patient population was heavily skewed (68.2% – 31.8%) towards the healthier FC II patients. Again, clinical data shows that the drug effect is more pronounced on FC III patients, and therefore the difference in the FC III percentage between the two populations led to overall improvement from seralutinib being understated in the topline results.[15] The Phase 3 study protocol does include stratification by FC. More broadly, the company contends that Phase 2 was not designed specifically for the 6MWD endpoint, whereas Phase 3 is.

Additional optimism comes from the results of the Phase 2 extended study, which have been very positive. Patients who completed the Phase 2 trial were given the option to continue receiving seralutinib for an additional 48 weeks, under an Open Label Extension ("OLE") study.[16] 86% of those opted in. The OLE study data shows that patients receiving seralutinib *continued to improve* for at least 72 weeks after the beginning of the treatment; for comparison, sotatercept's benefits greatly diminished after the 24th week. Very importantly, OLE results also show a great safety profile for seralutinib, as there have been no severe side-effects. Both of these bode very well for the prospects of an eventual FDA approval, as well as for seralutinib's commercial potential should it be approved.

While it is hard to come up with a sales estimate for a seralutinib-based drug, the market potential is certainly there. The $11.5 billion Acceleron acquisition mentioned above is not the only PAH-related large pharma acquisition: in 2017 Johnson & Johnson acquired Swiss biotech Actelion and its PAH drugs portfolio for $30 billion in cash, in one of the largest pharma acquisitions in recent years.[17]

Recent developments

The above provide some reasons as to why the market's reaction to the phase 2 results may have been exaggerated. Furthermore, over the past year the following have taken place:

- Large insider buys by the CEO and the COO
- New executive hiring: in December 2023 Gossamer announced the hiring of Robert Smith as its Chief Commercial Officer. Mr. Smith was previously leading sotatercept US pre-launch activities at Merck, and

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[14] The term refers to a classification of the severity of symptoms and functional limitations in patients with PAH. There are four functional classes in total: the higher the class, the more severe the symptoms.

[15] Note that during the trial patients might have received background medication – meaning that even those in the placebo arm would receive PAH medication.

[16] Meaning, they knew they were receiving the drug; unlike the base trial, when patients are unaware if they are receiving the drug or a placebo.

[17] https://www.biopharmadive.com/news/jnj-actelion-acquire-deal-30-billion-PAH/434839/

before that he led US sales operations for Actelion (the Swiss pharmaceutical that was acquired by Johnson & Johnson in 2017 for $30 billion). Mr. Smith took a pay cut in his base salary to join Gossamer, and his compensation is heavily skewed towards the stock option component. He is undoubtedly a very knowledgeable individual when it comes to this market, and this career choice indicates high confidence that seralutinib will get FDA approval.

- Deal with Chiesi: in May 2024 Gossamer announced a partnership with Chiesi Farmaceutici S.p.A ("Chiesi"), a privately held pharmaceutical company with strong presence in the pulmonary and rare disease spaces. Chiesi provided a cash injection of $160 million and may inject an additional $326 million as certain agreed milestones are reached. The two companies will split development and commercialization costs moving forward, with the exception of the PAH Phase 3 trial for which Gossamer is still 100% responsible. Gossamer and Chiesi will split profits in the U.S. market, while Chiesi obtained exclusive rights outside the U.S., in return for which Gossamer will receive royalties starting in the mid- and elevating to the high-teens of international net sales. The market's reaction to the deal announcement was initially positive, however the stock price declined in the days and weeks that followed, presumably on the grounds that this deal limits Gossamer's upside in the event that the Phase 3 trial is successful. This is true– however, the deal also greatly reduces Gossamer's funding needs post-trial, mitigating the dilution risk. It also signals confidence on Chiesi's part that seralutinib will be successful.[18]
- Competitor drug failures: two biotech companies (Keros Therapeutics and Aerovate) that were developing competing drugs to seralutinib halted development after disappointing Phase 2 results.[19] This leaves Gossamer as the sole biotech with a drug currently under development for PAH and PH-ILD. For comparison, right before announcing its *Phase 2b* topline results, Aerovate had a market cap of ~$700 million.[20] Gossamer currently has a market cap that is less than half of that, even though it is at a more advanced stage and better funded than Aerovate was.
- Enthusiastic reviews by the scientific community: in conversations we've had with cardiologists and pulmonologists they've all been very upbeat about seralutinib's potential. There seems to be a deep divide

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[18] The $160 million that has already been disbursed represents ~5% of Chiesi's annual revenue – not a negligible amount.

[19] In Keros' case there was also a safety incident during the Ph. 2 trial.

[20] Keros had a market cap of ~$2.8 billion right before announcing the trial halt but it has more drugs in its pipeline, so that's not really an apples-to-apples comparison.

between the opinion of the academic community and that of the market, which perhaps creates an opportunity.

Gossamer has a market capitalization of less than $300 million and trades below its cash at hand, meaning that the market assigns a near-certainty of failure to its Phase 3 trial. To be very clear, this is a stock that could be at zero by the end of the year. **However**, the price right now reflects an unreasonably high probability that this will be the case. Due to the reasons outlined above, I believe that the actual probability of a successful Phase 3 trial is meaningfully higher than the market-implied one. The thesis here is **not** that the drug will be a success. The thesis is that Gossamer, which (1) is well-funded; (2) has already completed more than half the targeted enrollment; and (3) has no competition in enrolling patients as all other similar trials have been halted, will be able to complete the enrollment for its PAH Phase 3 trial without issues. Simply completing the enrollment within the announced timeline should result in a substantial increase in the market-priced probability that seralutinib will be a success. Our plan is to gradually reduce our stake as we get closer to the actual results announcement.[21]

We started accumulating in Q4 2024 at a price around $0.90/sh. and continued adding to our position up to last week. Our weighted average cost basis is $1.07/sh.

Other Positions

Uranium: We maintain most of our uranium positions, though their weight in our portfolio has diminished. The downturn in the uranium market has been nothing short of brutal. Possible explanations for the continued decline are an unwinding of the "A.I. trade" and a perceived – or anticipated – easing in the relations with Russia. Even if AI creates *zero* incremental energy demand *and* all sanctions on Russia are lifted (both unlikely events), the uranium market will *still* be in deficit; its long-term fundamentals remain great. We are not sellers at the current price levels. As discussed in previous updates, the uranium market is particular in that the large majority of transactions (>80%) are in term contracts – spot market is only a small component. Spot price movements tend to track those of the term prices, as is logical. At times however, and for a host of possible reasons, spot prices may go down while term

[21] This is likely the plan for most investors buying right now. Shouldn't this then cause a sharp price decline leading up to the results announcement date? Not necessarily: as we get closer to the announcement date, buyers who plan to hold through the announcement (targeting a large quick return if the results are positive) will buy the stock, "canceling out" sales from existing shareholders who don't want to take the results risk. Of course, the exact effect will depend on the relative positioning, on how much the stock will have already appreciated by then, etc.

prices go up – this has been the case for the past several months. The spot price will recover, but it will take a bit more patience.

Alibaba (BABA): Chinese stocks are making another comeback, and BABA in particular has really taken off. In addition to robust results, the company recently unveiled its own AI models. As of the end of 2024 we were still holding BABA options worth slightly less than 1% of our portfolio. These have greatly appreciated this year and we are still holding most of them. We also added to our position in late January with (then) out-of-the-money call options expiring in April – these are already in the money and have generated a handsome return. As I've discussed in previous updates, this is a dramatically undervalued stock, *should China become "investable" again*. Even the slightest change in investor sentiment vis-à-vis China would result in a dramatic and quick price appreciation – which is what is happening in the past month or so, and also the reason we decided to play this through options. The stock has been going up in a straight line since mid-January and is now up 69% in 45 calendar days. We are taking some profits here.

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

With warm regards,

For Phestos Fund, LP

Nikos Angelopoulos

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