July 6, 2020

June 2020 - Performance Update

Dear Friends & Partners:

If you are an accredited investor, please contact us for performance information.

June was another positive month for both of our investment strategies. Returns year-to-date are below our expectations, but we remain optimistic and confident in our repeatable investment process and our ability to generate outsized returns going forward. We continue to add assets from existing investors. Thank you for your trust and patience. We expect the strength we saw in June to continue in the months ahead. For details on our performance attribution and holdings, please see Appendix I.

The Real Risk to The Market

As we write these words to you, Coronavirus cases are yet again surging across America and Texas in particular. Despite greater testing or maybe because of it, the number of infected individuals in the US continues to grow at a record pace throwing into reverse the "re-opening" plans of many US states. As of July 3rd, with over 50,000 new cases having been reported for two days in a row in the United States, and the rise in the viral growth rates across many states, it is clear that the Coronavirus pandemic, which appears to have been tackled successfully in Europe, is far from over in the United States. On the bright side, the growth in recent infections appears to be primarily affecting younger people and has so far not led to a spike in the number of Covid-19 related deaths in the United States. Only time will tell if this trend of rising infections, but declining death rates, holds.

While the media remains transfixed on reporting about the Coronavirus, investors should always look ahead to understand where true risks (and opportunities) lie. In the famous words of George Soros: "discount the obvious and bet on the unexpected". We believe that the real risk the US equity market is not a surge in Coronavirus cases (which is likely to be contained, if not sooner than later) but rather Joe Biden, and the potential for a Democratic sweep of the Presidency and both chambers of Congress in the November US Election. Last year, in our October Letter to you, we wrote that *"we believe President Trump is likely to be reelected"*.[1] Furthermore, we wrote that our analysis indicated that *"re-election success is determined*

[1] https://www.lrtcapital.com/wp-content/uploads/2019/11/2019-10-October-Performance-Update-Public.pdf

by the state of the economy", which at the time implied another Trump term (ibid).

A lot has changed with the economy since October 2019. The Coronavirus has brought with it not only unprecedented stock market volatility but also unprecedented economic calamity for many Americans. The economic misery faced by many voters is hard to imagine. Record numbers of Americans are relying on food banks to survive.[2] Efforts to combat the spread of the Coronavirus: the stay at home orders, economic shutdowns, and social distancing mandates, have all resulted in enormous job losses, with a devastating impact on millions of Americans, many of whom had been living paycheck-to-paycheck, even before the pandemic hit.[3]

National polls currently give Joe Biden a +9.5% advantage over Donald Trump – a historically high spread[4] - with **even Texas being competitive,** while Real Clear Politics gives Biden a +8.8% edge.[5] Biden is ahead in the polls in virtually every battleground state. Current polls also give Democrats a strong edge in the race to control the US House of Representatives, leaving only the US Senate as a toss-up. Could the unexpected happen? Could the Democratic party sweep all the races and take control of Congress and the Presidency? Yes, they could. Oklahoma, a reliably Republic state, just voted to expand Medicaid.[6] Missouri votes on the same issue in August.[7]

This letter is not political. It does not matter whether you believe that a Joe Biden Presidency and a Democratic takeover of Congress is a good or bad thing – we are only interested in their impact on companies and the stock market. A unified US Government under Democratic control meaningfully increases the probability of MAJOR policy changes in the US. What might those policy changes be? Some examples include:

- Higher taxes, particularly on corporations and the wealthy.
- Higher taxes on capital gains, dividends, and other forms of "unearned" income.
- Limitations on corporate stock buybacks.
- Expansion of Medicare / Medicaid / other government health care programs.
- More vigorous anti-trust policies.

The last three-and-a-half years have been good for investors. The next four or more may be less so. For example, raising corporate taxes from today's 21% to the previous level of 35% could be expected to reduce the value of the average US corporation by about 18%, since for every dollar of taxable profit investors would keep 65c vs. 79c today. Higher taxes on unearned income would further hurt investors. The above considerations are just based on changes in how the economic pie is divided between capital owners and the government. All of this is before we consider the impact of all these policies on real economic growth and investment – almost all of which are likely to be negative. For example, expanding state Medicaid programs – a likely Democratic party priority – will almost certainly lead to higher state taxes to pay for

[2] https://www.cnn.com/2020/06/16/politics/hunger-food-banks-food-stamps-covid-recession/index.html

[3] https://www.cnbc.com/2020/01/21/41-percent-of-americans-would-be-able-to-cover-1000-dollar-emergency-with-savings.html

[4] https://fivethirtyeight.com/features/new-polling-shows-trumps-electoral-college-advantage-is-slipping/?cid=referral_taboola_feed

[5] https://www.realclearpolitics.com/epolls/2020/president/us/general_election_trump_vs_biden-6247.html

[6] https://www.npr.org/sections/health-shots/2020/07/01/886307241/oklahoma-votes-for-medicaid-expansion-over-objections-of-republican-state-leader

[7] https://www.healthinsurance.org/missouri-medicaid/

this program, a reality faced by many states even before the Covid-19 pandemic's impact was fully felt.[8] Other policy proposals may include limitations on corporate buyback (which are tax efficient), therefore pushing companies to either: a) horde cash, thus decreasing overall returns, or b) increase dividends (which are taxable). Either way, after-tax returns to investors would decline. Finally, anti-trust enforcement has been lax in recent years, allowing many companies to merge, acquire competitors and increase their market power - leading some to proclaim, "The Death of Competition".[9] Bad for society? Perhaps, but clearly a wonderful thing for investors. Tougher anti-trust enforcement on the other hand would halt and maybe even reverse this trend, with large technology companies likely being particularly hard hit as a result.

This letter is not a prediction about the outcome of the November election. It is entirely possible that Joe Biden's Presidential campaign will implode, that the Democratic Party will self-sabotage and that the election produces a split and gridlocked US Government at after November. The race to control the Senate, for example, is likely to be too close to call till the very end. However, even the **potential** for a Democratic victory is likely to drive significant volatility in the stock market in the months and weeks leading up to the election. It is important to prepare oneself mentally for this coming stock market volatility so as to not giving to panic peddled by pundits. Whatever the election outcome, know this: equities are still the best place to invest for those with a 3+ time horizon. US Treasury bonds, which offer yields below 1% are not going to fund your long-term goals – only equities can do that.

We expect this stock market volatility to be a source of opportunity for investors to acquire shares in companies with outstanding competitive positions at attractive prices. We believe that in times of volatility, like the one we foresee over the next few months, it will be especially important to have a **predictable, repeatable and long-term** focused investment process – like the one we employ at LRT.

We look forward to hearing from you and discussing further where we see emerging opportunities.

Lukasz Tomicki
Portfolio Manager
LRT Capital

[8] https://www.nytimes.com/2020/03/10/nyregion/budget-medicaid-cuomo-ny.html
[9] https://www.mythofcapitalism.com/

Appendix I: Attributions and Holdings

If you are an accredited investor, please contact us for performance information.

Individual account results may vary to the timing of investments and fee structure. Please consult your statements for exact results.

Appendix II: Investment Philosophy

In the past twenty-four months we saw a large increase in the number of LRT Capital partners (the term we use to describe our clients). With so many newcomers, it is important that we write about our investment philosophy again.

Here are the key points:

- Exceptional stock returns come from exceptional business returns on a **per-share** basis.
- We seek to invest in high-quality companies, i.e. those possessing sustainable competitive advantages (moats), the ability to grow and reinvest capital over time, and management that excels at capital allocation.
- We only purchase companies whose shares trade at a discount to our assessment of their intrinsic value.
- It is futile to predict short-term market movements. We seek to hold our investments for as long as possible.
- The financial markets are dominated by short-term traders who see stocks as casino chips. This occasionally allows us to purchase shares in great companies at large discounts to their true worth.
- If we are right about the trajectory of the businesses we invest in, over time we will be right on the trajectory of their stock prices.

We view stock market volatility as a source of opportunity. Volatility allows us to profit by acquiring shares in superb businesses at attractive prices. The more that markets (the "other" participants) are irrational, the more likely we are to reach our ambitious performance objectives.

Over the long run, stocks are the best investment asset class, but our experience has taught us that our investment process will not generate linear returns. In some years, our portfolio will outperform and in others it will generate a below average return. This is a certainty that we must accept. We are long-term investors and we do not try to dance in and out of the market.

In summary, our investment strategy can be summed up in three steps:

- Only seek out high-quality companies.
- Do not overpay.
- Do nothing – patience and discipline are the keystones to success.

Disclaimer and Contact Information

LRT Capital Management, LLC is an Exempt Reporting Adviser with the Texas State Securities Board. Past returns are no guarantee of future results. Results are net of a hypothetical 1% annual management fee (charged quarterly) and 20% annual performance fee. Individual account returns may vary based on the timing of investments and individual fee structure.

This memorandum and the information included herein is confidential and is intended solely for the information and exclusive use of the person to whom it has been provided. It is not to be reproduced or transmitted, in whole or in part, to any other person. Each recipient of this memorandum agrees to treat the memorandum and the information included herein as confidential and further agrees not to transmit, reproduce, or make available to anyone, in whole or in part, any of the information included herein. Each person who receives a copy of this memorandum is deemed to have agreed to return this memorandum to the General Partner upon request.

Investment in the Fund involves significant risks, including but not limited to the risks that the indices within the Fund perform unfavorably, there are disruption of the orderly markets of the securities traded in the Fund, trading errors occur, and the computer software and hardware on which the General Partner relies experiences technical issues. All investing involves risk of loss, including the possible loss of all amounts invested. Past performance may not be indicative of any future results. No current or prospective client should assume that the future performance of any investment or investment strategy referenced directly or indirectly herein will perform in the same manner in the future. Different types of investments and investment strategies involve varying degrees of risk—all investing involves risk—and may experience positive or negative growth. Nothing herein should be construed as guaranteeing any investment performance. We do not provide tax, accounting, or legal advice to our clients, and all investors are advised to consult with their tax, accounting, or legal advisers regarding any potential investment. For a more detailed explanation of risks relating to an investment, please review the Fund's Private Placement Memorandum, Limited Partnership Agreement, and Subscription Documents (Offering Documents).

This report is for informational purposes only and does not constitute an offer to sell, solicitation to buy, or a recommendation for any security, or as an offer to provide advisory or other services in any jurisdiction in which such offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. Any offer to sell is done exclusively through the fund's Private Placement Memorandum. All persons interested in subscribing to the Fund should first review the Fund's Offering Documents, copies of which are available upon request. The information contained herein has been prepared by the General Partner and is current as of the date of transmission. Such information is subject to change. Any statements or facts contained herein derived from third-party sources are believed to be reliable but are not guaranteed as to their accuracy or completeness. Investment in the Fund is permitted only by "accredited investors" as defined in the Securities Act of 1933, as amended. These requirements are set forth in detail in the Offering Documents.

LRT Capital Management, LLC
108 Wild Basin Road, Suite 250
Austin, TX 78746
Office: +1 512 320 9085
www.lrtcapital.com