CHOICE EQUITIES
CAPITAL MANAGEMENT

October 31, 2023

Dear Investor:

I hope this letter finds you well. Choice Equities Fund generated losses of -14.6% on a net basis in the second quarter, bringing year-to-date net performance to -6.2%. This compares to the Russell 2000's -5.1% loss for the quarter and year-to-date gain of +2.5%. The S&P 500 generated a quarterly loss of -3.3%, bringing year-to-date gains to +13.1%. Since its inception in 2017, the fund has generated annualized gains of +12.2% versus +5.5% and +12.1% for the Russell 2000 and S&P 500, respectively.

EXECUTIVE SUMMARY

In this letter, we provide a brief overview of events of the third quarter of 2023. We then discuss portfolio holdings, briefly revisiting Shake Shack, Inc. Lastly, I conclude with a few thoughts on the current outlook.

QUARTERLY COMMENTARY

Equities markets were up early but finished down for the third quarter as investors continue to evaluate the near-term cyclical outlook. Proponents of differing views each have ample data to support their conclusions. On the one hand, the economy remains resilient and inflation readings are cooling. On the other hand, higher rates are an intentional headwind to growth and are accompanied by reports of greater selectivity of spending from corporations and consumers.

Earnings results likewise support competing narratives. S&P 500 earnings are again coming in a little better than many feared thus far in 3Q. Quarterly earnings levels are settling out to slightly better than flat when compared to the year-ago period, a touch better than the prior quarters' results. However, looking within the index, we see the S&P 493 (all 500 companies minus the Magnificent 7), are generating earnings declines in aggregate. Likewise, the earnings' declines continue further down the cap scale. Small cap earnings were again down ~20% for the second consecutive period. Midcaps similarly produced down double-digit earnings growth. Despite both offering cheaper starting valuations, smaller stocks remained out of favor and followed their earnings trajectory down and traded lower.

PORTFOLIO COMMENTARY

Holdings in our portfolio moved lower along with the downward trend of the market. By and large, our largest positions were the largest drivers of performance for the quarter, with the noted exception of Magnite, Inc. (MGNI), whose shares fell significantly late in the quarter.

In the case of MGNI, and to a lesser degree, Stagwell (STGW), although both companies offer double digit free cash flow yields and attractive growth prospects and both will benefit from a pickup in advertising spend, both remain out of favor until such a turn begins to materialize. Weakness in spending, particularly in Magnite's CTV vertical, appeared midsummer, and has since persisted. This delay in projected customer spending produced a shortfall in revenues and led Magnite's management team to lower their full year EBITDA forecast by ~5-10%. That a lowered outlook would produce a decline in shares is not terribly surprising, but the stock reaction was unusually severe. Looking forward, the spending effects should reverse with a political spending cycle upcoming and the company remains favorably positioned competitively.

Other core holdings continue to trade at attractive valuations. Industrials such as Orion Engineered Carbons, SA (OEC) and Wesco, Inc. (WCC) trade at single digit earnings' multiples and offer attractive multi-year growth prospects. Children's Place, Inc. (PLCE) looks set to generate nearly half its market cap in cash this year and is trading at a mid-20s free cash flow yield on sustainable cash flow levels.

In the case of Croc's, Inc. (CROX), I had the pleasure of joining the Yet Another Value Blog podcast to discuss our investment here at length. Like most consumer brands today, the market seems concerned about the near-term outlook, and in their case, the recent HeyDude acquisition. Even so, our research suggests the terminal value of the franchise continues to be substantial and capable of generating highly attractive cash flows over a sustained period of time. That a well-managed owner of two, billion-dollar shoe brands, with market leading profitability that are both currently the number-one-selling shoe in their respective categories on Amazon, can be purchased at ~7x earnings speaks to the types of values available in the market today.

SHAK - Shake Shack, Inc. is a company in which we have repurchased some shares as valuations in the restaurant space contracted this summer. As a business, the company has a number of things going for it, including a very strong brand with ample white space for store expansion. Additionally, the company has recently made significant strides in improving its store-level operating margins (SLOP). For the first time since before the pandemic, the company regained the 20% margin level after instituting several cost optimization measures. The improvement seems noteworthy as the company has managed to do so despite traffic remaining down nearly 40% at about half of its store locations (those with primarily urban footprints).

Moreover, further gains look achievable, particularly after developing a better appreciation for the impact a roll-out in kiosks across the store base could affect. As another fast casual peer, Panera's successful deployment of kiosks provides likely the most informative case study. In their case, as an early adopter when customers were still developing familiarity and acceptance around using the new technology, the company saw a sustained lift in average order sizes as customers ordered more items. Additionally, after a certain level of volumes began going through the new automated ordering platforms, the company was able to re-allocate certain employees and labor-hours to other uses. On net, the company saw a sustained mid-single digit or better boost to store volumes, lower costs and better operating leverage that drove a couple-hundred-basis-points improvement in restaurant level operating margins. Shake Shack looks capable of achieving something similar. Such an improvement in profitability could have a material impact on total store economics and accelerate cash flow and revenue growth. For a concept that has ample white space that appears to be just hitting its stride, a boost to store level profitability could drive a meaningful improvement in earnings power.

OUTLOOK

Much as the big picture elements of the market remain the same, I suspect I probably sound like a broken record by now highlighting the valuation divergences across market cap ranges. Still, the market remains highly concentrated across a handful of large cap tech stocks, which trade at historically high multiples. By contrast, small and mid-cap stocks have severely lagged their larger peers over recent years. Recently, the Russell 2000 fell below pre-pandemic trading levels, as well as mid-summer levels of 2018. As a result of these declines, small and mid-cap valuations are now historically attractive. For example, today's forward earnings multiple of the S&P 600 is 11.5x, a level only approximated briefly three other times since the index's inception in 1999. All prior instances of trading at such levels produced subsequent returns at double digit annualized levels across multiple years. I have again included a handful of charts in the Appendix that perhaps more vividly support these comments.

As I was preparing to wrap up our comments on the outlook, I was struck by some comments of two high profile investors that appeared in Barron's over the weekend. That the two investors might have opposing views on the outlook – given their differing investment styles and the something-for-everyone nature of today's market environment as we consider rising rates, increasingly stressed geopolitical divisions, and still strong consumer spending but corporate outlooks that appear to be weakening on the margin – is not particularly surprising.

The comments below stem from Andy Server's interviews with Seth Klarman and Peter Lynch. Klarman's take:

> The market is scary and vulnerable. The geopolitical strains seem heightened rather clearly. I think in some ways the magnitude of the disaster of the Fed holding rates at zero for a decade is now much more clear.

Regarding Lynch, the Barron's column stated:

> He said "we've been in a bear market for two years, except for basically 10 stocks. Stocks are almost selling for less than cash. Look at the Russell 2000." Is he bullish on the Russell 2000? "Absolutely," he says. "I love it when stocks go down."

To me, what was perhaps the most interesting takeaway given their differing views, is that I believe both can be true. And both will likely prove to have been correct in time.

CONCLUSION

As I have highlighted above, I am excited about today's opportunity set and our prospects for the years to come. Even so, I know our approach will not yield outperformance each and every quarter, but I continue to believe it will be well worth our while over the long haul. Perhaps more importantly, given the overwhelming majority of my investable assets are invested alongside yours, we would never ask investors to assume risks we ourselves will not.

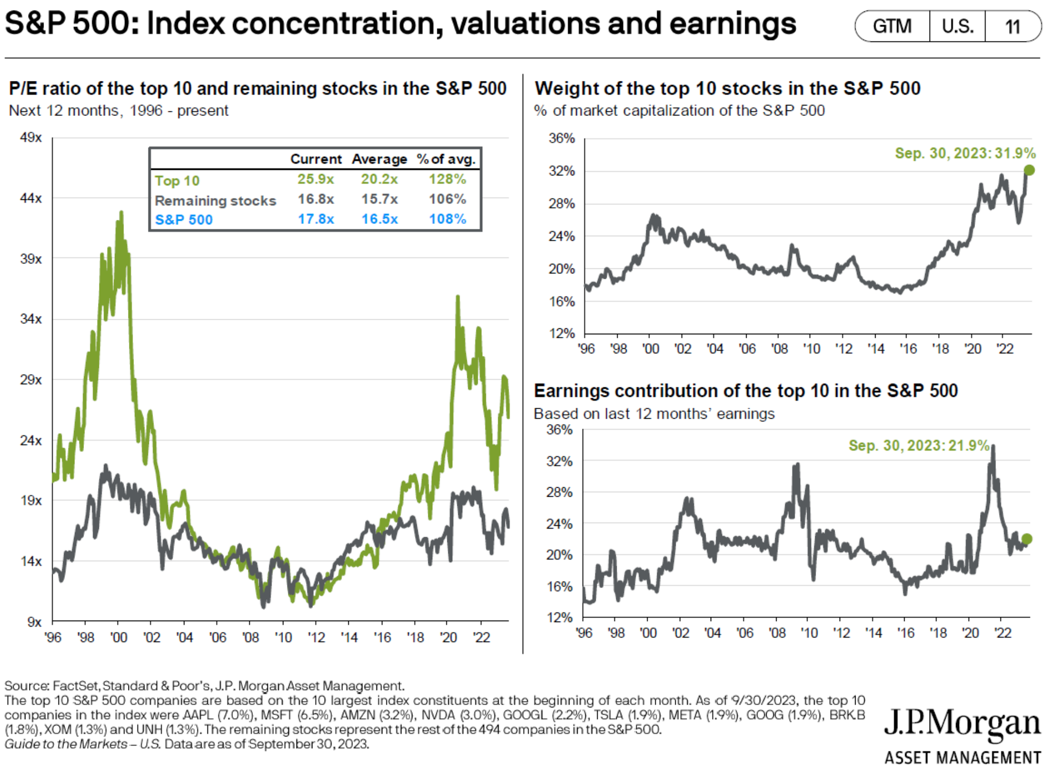
Thank you for your continued support as we work to grow our capital together. As always, we are happy to discuss our investment outlook with you at your convenience. Please reach out any time.

Best regards,

Mitchell Scott, CFA
Portfolio Manager

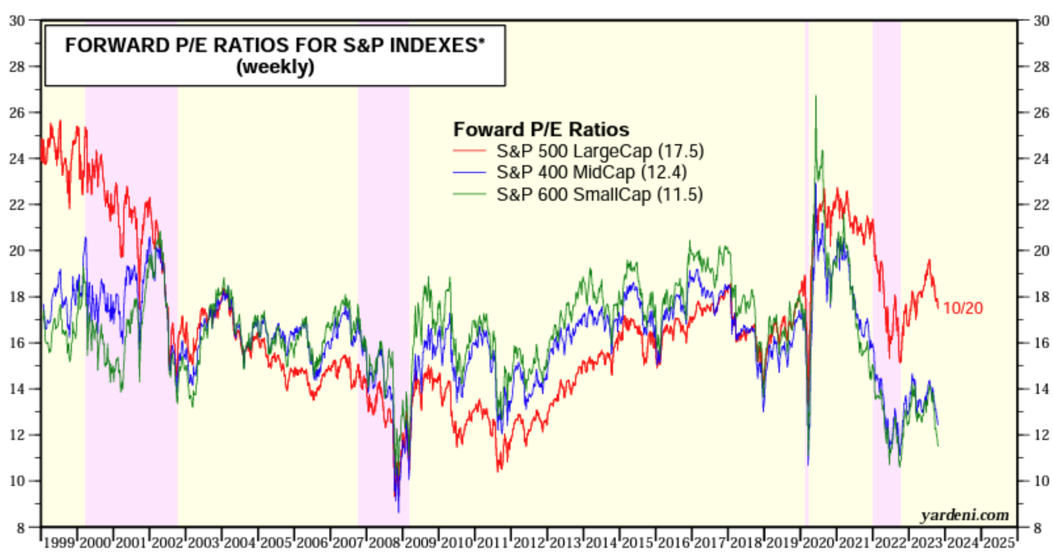
1. All market and company data is sourced from Factset and company filings and is current as of 9/30/23.
2. CEF uses the S&P 500, Russell 2000 and the Barclays Hedged Long/Short indices as its primary benchmarks. The S&P 500 and Russell 2000 are common large and small cap US equities-based indices. The Barclays Hedged Long/Short index (an index of equities-based hedge funds) serves as an appropriate benchmark over the long-term given the index has a similar long-term goal of capital appreciation through equities investing.
3. CEF Net Returns are consistent with the 1% management fee and 18% performance fee offered to clients.

APPENDIX



JP Morgan

- Charts highlight the top 10 stocks by market cap weighting and their associated valuations.



Yardeni Research

- Forward PE multiple for small, mid and large cap stocks highlight their attractiveness on an absolute and relative basis.