April 2019

	MRCM Long Short Small Cap	IWM (Russell 2000)
Q1 2019	**5.2%**	**14.6%**
2018	17.1%	(11.1%)
2017	37.7%	14.6%
2016 (Jul-Dec)	1.6%	18.7%

	MRCM Long Only Large Cap	SPY (S&P 500)
Q1 2019	**14.1%**	**13.5%**
2018	(5.6%)	(4.6%)
Dec 18 - Dec 31	0.1%[1]	(0.5%)

Note: All returns are net of management and performance fees.

If one thing is clear to me, it is that the market has an incredibly short memory. All of the perceived risks during Q4 of last year miraculously went POOF! as the S&P returned to nearly all-time highs. To be fair, certain concerns have been de-risked, such as the fed hiking rates into a slowing economy, while others remain (albeit in a dark corner of a desk drawer that we choose not to open). Consensus seems to be that while the US and global economy are in-fact slowing, the decline will be managed successfully to create a soft landing. I cannot say for certain whether or not this assumption is justified and it is therefore impossible for me to opine on what the market will do for the remainder of the year. Instead I must focus on the individual names that we own, constantly checking and rechecking my analysis to ensure that the risks I assume in owning a stock are justified by the returns that I expect the investment to generate. This process is combined with my level of conviction to determine whether the company should be in our portfolio or how large it should be.

The tendency for institutional investors to benchmark to an index is not uncommon. From a manager's perspective, the ability to gather assets is often tied to relative performance, regardless of the risks assumed. Furthermore, studies have shown that fund flows have a convex relationship with performance; in other words, beating the benchmark leads to greater inflows than underperforming the benchmark leads to outflows. These factors can incentivize investors to myopically focus on relative returns and act in a more risk-tolerant (or even risk-seeking) manner. My personal and family investments into the funds should counterbalance these incentives, allowing me to ignore such silly comparisons and focus on what really matters: attractive risk-adjusted returns over a long horizon. Sometimes I will assume exposure or risks that others are avoiding and sometimes I will hold cash until I can find better opportunities.

The Long Only portfolio was up 14.1% net of fees during the first quarter. We achieved these returns despite averaging almost 20% of our portfolio in cash, a situation which remains today. When the right opportunity to invest this money presents itself, based on the factors described above, I will do so. For the time being I am happy to keep it on the sidelines with the added benefit of earning up to 1.9% in interest paid by Interactive Brokers on idle cash balances.[i] I recognize that our cash balance has somewhat mooted performance during the first quarter. Should I maintain the dry powder for the remainder of the year, this fact will persist.

A new portfolio position in the Long Only fund is Four Corners ("FCPT"). FCPT is a triple net-lease REIT which stands for Real Estate Investment Trust. The triple-net part simply means that their tenants are responsible for taxes, insurance, and maintenance in addition to the other expenses that tenants typically cover. Without having to pay these expenses, which can sometimes be hard to predict, FCPT has significant clarity into what its future earnings / dividends will look like.

I have followed FCPT since it spun-out from Darden in 2015 and previously owned the stock. While the company trades toward the higher end of its peer group, I believe that this valuation is justified. From a qualitative standpoint, FCPT properties are entirely leased to restaurants with a focus on casual and quick service establishments. While the shift to a digital economy has and will likely continue to impact foot traffic, restaurants are clearly insulated from these headwinds. Other REITs that have varying degrees of retail exposure cannot say the same. From a quantitative perspective FCPT stacks up nicely as well. Its tenants are financially stronger as indicated by their EBITDAR coverage ratio of 4.6x vs peers at 2.0-3.6x. Lastly, FCPT is relatively under-levered which gives them capacity to grow without significant share issuance. Management has proven to be strong operators since the separation, having made smart acquisitions and dispositions in the process of growing their portfolio from 418 to 610 properties. Bottom-line results followed suit with the dividend growing by 19% over the 3-year period. This is not the position in our portfolio with the highest growth prospects, but it does offer a stable 4.0% dividend yield and potential upside from further M&A (either as an acquirer or seller). While their significant exposure to Olive Garden remains a topic to monitor, I believe a negative outcome is very remote given the tenant's fundamental performance / credit quality and FCPT's ability to repurpose its properties. The biggest risk is a meaningful rise in interest rates which seems unlikely following Powell's recent bait and switch due to deteriorating fundamentals and market volatility.

The Long Short portfolio returned 5.2% net of fees during the first quarter. I've been doing some work on analyzing our exposure and would like to run through it here as I believe this should help give greater clarity regarding the portfolio's characteristics. As the name suggests the portfolio has long positions, which make money when prices rise, as well as short positions, which make money when prices fall. The combination of these positions reduces our exposure to market performance, as measured by net exposure (long positions minus short positions). For instance, if the portfolio had \$100 of stock ABC and shorted \$75 of stock XYZ, the net exposure would be 25%. If both ABC and XYZ traded exactly in-line with the market and the market rose by 10%, the portfolio would return +2.5% (+10% on the 100% long ABC and -7.5% on the 75% short XYZ). During the first quarter our portfolio's net exposure averaged 66%.

While this statistic is insightful, it does not tell the full story. To get a better picture we have to dive into a little algebra. We all remember the classic $y=mx+b$ equation that describes a line on the X/Y axis (m represents the slope and b is the intercept with the Y-Axis). Stock returns can be analyzed using this equation where the x-axis represents the overall market return, the y-axis represents the stock's return, and the slope is referred to as beta. Companies that tend to move more than the market have a beta >1.0x while companies that move less than the market have a beta of <1.0x. For instance, a cyclical company with a lot of debt will likely have a beta >1.0x while a consumer staple company with a lot of cash would likely have a beta of <1.0x. Taking this into consideration, you can see why a pure net exposure metric does not reflect actual market exposure. Instead, a beta-adjusted net exposure metric provides a more complete picture. On this basis we averaged just 10% during the first quarter (as an aside, we averaged 32% last year)[ii]. Essentially, for every \$100 invested in the fund we only had \$10 of actual market exposure. This low level indicates that the returns of our portfolio are driven less by how the market performs (i.e. how much up/down the Russell 2000 is), and more by how our holdings perform relative to the market.

During the quarter I initiated a short position in Super League Gaming Group ("SLGG") following its initial public offering in March (as mentioned above, our position makes money on short positions when the stock falls). The company is attempting to build an amateur e-sports league but, to put it bluntly, there ain't much meat on the bones (as based on aggregate user count, user engagement, product quality). While I believe e-sports has a long-growth runway, companies that already have a vast network or own intellectual property will most likely succeed. I can see the company burning through their recent capital raise over the next two years and experiencing significant insider selling once the lock-up expires later this year. I put together a more complete write-up that can be accessed on my website at www.merionroadcapital.com/letters.

Thank you for the continued trust you place in me as a steward of your capital. I will always do my best to achieve attractive returns but will never accept excess risks in the process of doing so.

Sincerely,

Aaron Sallen

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[i] Interactive Brokers pays the benchmark less 0.5% which as of writing this is 1.9% on cash balances of $100k or more. Lower cash balances earn a proportionally lower interest rate. https://www.interactivebrokers.com/en/index.php?f=1595

[ii] Monthly beta-adjusted net exposure based on opening and closing levels for the period. Quarterly and yearly figures based on average of each month. We had a small position in several SPAC warrants that I assume to have a beta of 2.0x.

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