MERION ROAD

April 2020

	MRCM Long Short Small Cap	IWM (Russell 2000)	Barclay Hedge Fund Index
Annualized Since Inception	**16.9%**	**1.3%**	**2.2%**
Q1 2020	**(7.0%)**	**(30.7%)**	**(10.8%)**
2020 YTD	**(7.0%)**	**(30.7%)**	**(10.8%)**
2019	19.5%	25.4%	10.7%
2018	17.1%	(11.1%)	(5.2%)
2017	37.7%	14.6%	10.3%
2016 (Jul-Dec)	1.6%	18.7%	5.4%

	MRCM Long Only Large Cap	SPY (S&P 500)
Annualized Since Inception	**1.1%**	**0.1%**
Q1 2020	**(13.3%)**	**(19.5%)**
2020 YTD	**(13.3%)**	**(19.5%)**
2019	25.0%	31.2%
2018	(5.6%)	(4.6%)
Dec 18 - Dec 31	0.1%	(0.5%)

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

The S&P 500 lost nearly 20% in the first quarter while the Russell 2000 (small cap index) fared even worse, falling more than 30%. Given the prevalence of the coronavirus pandemic, there is little need for me to expand upon the situation here. Instead I will focus on my investment philosophy through this period. It is worth reiterating that an underlying tenant is my optimism in the United States economy and belief that equities are a superior asset class for investors able to bear periods of downside volatility.

The spread of the coronavirus in the United States and ensuing quarantine has resulted in an exogenous shock to our way of life that has been both rapid and severe. Business closures and spiking unemployment have led to liquidity concerns, a reduction in near-term earnings estimates, and the risk of a sustained recession. The sum of these factors has driven asset prices lower.

Liquidity risk is a function of a company's available cash resources relative to their obligations. My perspective has been that it would be a fool's game to predict exactly when the situation will revert to normal; even our best predictions can easily be altered by unforeseen events such as virus reinfections or an improved treatment regimen. I do not want to "bet" on these unknowables and as such have avoided companies that are most at risk of running out of cash due to a prolonged period without revenue. It is sometimes hard to exit a position I believe in, especially when the long-term thesis still holds. But by removing emotion and focusing on the pragmatic reality, the decision becomes clear.

While most companies will experience lower earnings over the next few quarters, the corresponding impact to their valuation can be mixed depending on the components of valuation. Assets such as IP, network effects, brand equity, physical infrastructure, and customer relationships should not be impacted when the pandemic passes. Yet, as often happens during downturns, the good gets thrown out with bad as stocks tend to trade together (in statistical terms, correlations move to 1). This tendency is partly due to the rush to safety as investors want to hold cash at any cost. It is exacerbated by the prevalence of passive management, with fund flows leading to indiscriminate selling pressure across all companies. For active investors it presents an opportunity to pick up stocks at unfairly discounted prices.

While it is almost certain that GDP will contract for a quarter or two, investors and analysts have debated the length of the recession and slope of the recovery. I do not have a strong sense on either; I believe it will be a fairly quick turnaround but can very well see myself proved wrong. This uncertainty has led the market to accelerate the rush to safety broadly, as capital is pulled from equities, and also specifically, with exposed industries selling off the hardest. Firstly, empirical research shows that market timing is an unprofitable endeavor. We simply are not as good at it as we think we are. In order to make timing work we have to be right both on the way out and on the way back in, and I am just not sure that I, or the investment community as a whole, can consistently do that. This is one of the reasons why a long-term investment horizon is critical.

Perhaps more interestingly, investors have punished certain industries as either being exposed directly to coronavirus, like cruise lines and restaurants, or tangentially through a prolonged recession, such as advertising and consumer discretionary. But this mentality of sell first, ask later abdicates our responsibility as analysts. In fact, we should be looking to buy those companies that are beaten up but able to survive. These are the value buys that will look obvious in hindsight.

Our long only large cap fund lost 13% during the quarter. This was an active period from a repositioning standpoint. Most notably I fully exited our position in IAA, which had been a top 3 holding. While the salvage auto industry is generally recession resistant, a pandemic in which people are ordered to stay at home and not drive is a unique scenario that can cause them financial strain. While my perspective on IAA's long-term outlook has not changed, I realized that their cash availability, leverage profile, and fixed costs, presented a near-term liquidity risk that I did not feel comfortable with. I shifted our position to their superiorly run (though more expensive) competitor, Copart ("CPRT"). The decision to maintain our exposure to the salvage auto industry is one of those that may run counter to initial intuition. Yes, miles driven will be fall and, yes, revenue / margins / profitability will be down. But with over $1bn in cash, significant owned real estate, and the tailwind of the GEICO share shift, CPRT should make it out ok. For the time being the market does not seem to care, with CPRT underperforming the S&P by 10% since the beginning of the crisis (using the market peak on February 19th). But once people leave their houses, accidents will unfortunately pick back up and CPRT's business will prove to be quite resilient.

In a different vein, I fully exited our mid-sized position in Everbridge ("EVBG"), a critical event management and mass notification software company. I had built a small holding in the middle of last year and scaled it up after Q2 when the stock lost 40% on concerns around quarterly bookings (never mind the long sales cycle and lumpiness of any given quarter). In any case, the position performed well first as bookings rebounded and more recently as investors deemed it a safe haven, with pandemic fears driving increased demand for their products. The latter seems a bit too short termism for me and I simply decided to reallocate elsewhere. For instance, I built a position in American Express ("AXP"). Transaction volumes will likely fall over the next few quarters, and may even continue to go lower should we enter a protracted recession. But their two-sided network, highly valued customer engagement, and brand equity make this business quite durable. At 9x last years' earnings, AXP seems attractively priced for when business picks up.

The long short small cap fund lost 7% during the quarter. Despite the negative return, I am encouraged by the resiliency of the portfolio in what was an incredibly challenging period for small cap stocks. As we all know, small caps have much lower trading volume than their larger counterparts; when investors are looking to take risk off, these are the securities that can swing the most in an almost irrational manner. I observed this on more than one occasion and took advantage of the price the market was offering.

In January I started building a position in Rocky Mountain Chocolate Factory ("RMCF"), a chocolate manufacturer and retail franchisor. This was obviously poorly timed. Nonetheless, I am optimistic about the company as they have good liquidity, a fairly variable cost structure, and significant upside optionality. RMCF has had many challenging years but its outlook changed dramatically at the end of 2019 with two events. A hedge fund successfully ran an activist campaign and secured two board seats through a cooperation agreement announced in December. Their key points of contention were the company's inability to grow its topline, lack of manufacturing efficiencies, and capital allocation. Notably, RMCF has the capacity to produce 5.3mm pounds of chocolate but only made 2.2mm last year. RMCF subsequently announced a key strategic partnership with Edible Arrangements. While the stock barely responded to this news, I believe it can be quite significant.

RMCF products will be made available on the Edible Arrangements website and through their more than 1,000 franchised locations. This is a huge improvement to their existing distribution network, tripling their physical points of sale and greatly increasing their nascent e-comm presence. To align incentives, Edible Arrangements have been granted warrants that vest upon hitting certain revenue hurdles. While the details are confidential, we know that the highest hurdle equates to $46mm in annual revenue. Using some assumptions around the split of in-store vs. e-comm and their associated margins, this would equate to roughly $10mm in incremental EBITDA to RMCF (a 250% increase to their current level). As part of the agreement Tariq Farid, the founder and CEO of Edible Arrangements, personally invested $1mm in the company at a price nearly 100% higher than the current valuation and joined the board. He has an incredibly impressive background and should be a real asset. While the immediate future could be (extremely) bumpy, if everything works out, I believe the stock is worth multiples of its current valuation.

As always, thank you for being a part of the fund. I hope everyone stays safe and healthy.

Sincerely,

Aaron Sallen

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