Investor Letter - April 2021

- **Returns for Drawbridge Small Cap and Small Cap Growth exceeded their benchmarks this quarter.**
- **Portfolio turnover and volatility rose, as anticipated, after increasing our risk exposure.**

Relative performance of both Drawbridge strategies improved in the first quarter and returns surpassed their respective benchmarks. This was the goal of our recent adjustments to stock selection and portfolio construction. While we primarily focus on achieving performance objectives over three to five-year periods, we are encouraged by these positive early results.

Last summer we determined our risk controls had been limiting our exposure to many of the best performing stocks in our universe. We were placing too much weight on valuation and earnings quality in a market where those factors were not being rewarded. Balancing potential risks and rewards, we relaxed those constraints and repositioned both strategies through the fourth quarter as we found attractive candidates.

We entered 2021 with refreshed portfolios, but as interest rates rose Technology stocks, where we had significant exposure, began to fade. Cyclicals (Financial, Industrial, Energy, Materials) saw improving relative strength. Following our discipline, we sold deteriorating stocks to buy stronger, accelerating names from this new sector leadership.

Drawbridge's discipline is designed to adapt to changing market conditions. Without altering the core elements of accelerating earnings growth and favorable price momentum, our process has the flexibility to emphasize different portfolio characteristics. Like automotive engineers who weigh more horsepower against better gas mileage, we seek to strike the right balance across absolute and risk-adjusted returns, volatility, drawdowns and correlation.

Every investment decision involves tradeoffs between expected return and risk. We are allocating a portion of each strategy to stocks with higher valuations, lower earnings quality, or greater volatility with the expectation of improving returns. Time will tell if we got the mix right.

We expect this more aggressive portfolio posture to remain appropriate if markets continue to embrace risk and penalize caution. We spend considerable effort studying markets to discern investor sentiment in order to capitalize on changing trends.

Concentrated portfolios have low correlation to their benchmarks so our relative returns may vary substantially from quarter to quarter. Our objective is to outperform consistently over three to five-year horizons. While we know from experience that performance setbacks will occur from time to time, our discipline is designed to right itself.

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US Small Cap Growth

	Q1	1 Year	3 Year[3]	5 Year	Inception[3]
Drawbridge SCG - Gross	16.9	50.8	11.4	13.0	12.9
Drawbridge SCG - Net[1]	16.5	49.2	10.0	11.6	11.4
SCG - Net of 48bp[2]	16.7	50.1	10.9	12.5	12.3
Russell 2000 Growth	4.9	90.2	17.2	18.6	16.6
S&P 600 Growth	12.3	86.8	15.1	16.9	16.9

Small Cap Growth outperformed both benchmark indices in the first quarter, although longer term returns continue to lag. Alpha remains strong thanks to the strategy's substantially lower volatility.

The top contributor to first quarter returns was Fulgent (FLGT), a provider of at-home COVID tests. eXp World Holdings (EXPI) and Rent-A-Center (RCII) also enjoyed substantial gains. The most significant detractor from returns was Grow Generation (GRWG), which in hindsight was sold at an unfortunate time.

At the sector level, Finance and Health Services were the top contributors. Our Financial sector holdings increased as we added five bank stocks such as Live Oak Bancshares (LOB) and Sandy Spring Bancorp (SASR). We also found attractive domestic Energy stocks including PDC Energy (PDCE) although a retracement late in the quarter caused this sector to detract from returns.

US Small Cap

	Q1	1 Year	3 Year[3]	Inception[3]
Drawbridge SC - Gross	13.9	52.1	7.6	12.5
Drawbridge SC - Net[1]	13.7	50.1	6.6	11.6
SC - Net of 48bp[2]	13.8	51.3	7.1	12.0
Russell 2000	12.7	94.8	14.8	14.3
S&P 600	18.2	95.3	13.7	13.9

For the quarter, Small Cap returned modestly more than the Russell 2000 Index. Longer term returns trail benchmarks, and alpha over the trailing 36 months turned negative. The cumulative performance from inception had been ahead of our benchmark at every quarter until December. The present performance deficit is the result of the disappointing fourth quarter.

The quarter's contributors were led by Rent-A-Center (RCII) and Shyft Group (SHYF), both of which are seeing accelerating growth as US economic activity recovers. At the sector level the top contributors were Industrial Services, Finance, and Producer Manufacturing.

As we sold positions to fund purchases of more compelling stocks, a few were sold at a loss. This short list was led by Stamps.com (STMP) and Quidel (QDEL). A new position in Small Cap, eXp World Holdings (EXPI), showed an unrealized loss at the end of the quarter as well. Commercial Services and Non-Energy Minerals were the only two sectors with negative contributions for the period.

As with Small Cap Growth, the largest increases in sector weights were in Financials and Energy. We offset this by selling our two positions in Technology Services, Match Group (MTCH) and NIC (EGOV), the latter of which agreed to merge with a larger competitor.

Looking Ahead

While we avoid making forecasts, we do monitor macroeconomic developments for potential risks and opportunities. Uncertainty is especially high as the world is recovering from last year's unprecedented economic carnage. We're watching a number of factors that could support equity markets.

- Consensus forecasts anticipate the fastest GDP growth since the Reagan administration.
- Corporate balance sheets are surprisingly solid and profit margins remain high.
- Consumers appear primed to satisfy pent-up demand for goods and services.
- The Federal government seems intent on fiscal stimulus never witnessed in America.
- The Federal Reserve is receptive to inflation running well above its 2% target for some time, in the belief that cost pressures will prove transitory.

On the other hand, the list of major risks is worrisome.

- GDP growth is inflated by easy comparisons and fiscal stimulus that will eventually expire.
- Ballooning expenditures will require enormous sales of Treasury debt.
- Devastated supply chains must be replenished.
- Raw materials and producer prices are surging, and shortages may impact many industries.
- Jobs and employment remain well below pre-COVID levels and many workers have left the labor force.
- Wage growth remains subpar, and inflation could threaten household financial security.
- Mutated variants of SARS-CoV-2 or problems with vaccines could hit consumer and investor sentiment and pressure governments into restrictive policies.
- Global growth is restrained by repeated missteps in Europe and credit contraction in China.

Imagine trying to predict how these variables might affect markets? Our process is designed to recognize and react as events impact earnings and share prices. Today Drawbridge portfolios are tilted to benefit from economic strength, rising inflation, and rising long term interest rates. We also hold plenty of names that are exposed to other factors and may respond differently to these trends.

If economic progress weakens, if sentiment changes dramatically, if earnings leadership migrates, you can expect us to reposition our portfolios accordingly to protect against drawdowns and take advantage of better opportunities.

Over decades of experience, the intersection of accelerating earnings growth and improving market sentiment has proven to be a rewarding place to invest. We remain confident that this will continue to be true in the future.

We deeply appreciate the trust you place in us. Please feel free to contact us with any questions or for further discussion.

All the best,

Glenn Fogle
Chief Investment Officer
Drawbridge Asset Management

For more information or to obtain a GIPS Composite Report, please email info@DrawbridgeAM.com or call 918-477-8267.

[1] Regent Financial Services (Drawbridge's parent) retail advisory client funds incepted US-SCG. Since inception net performance reflects management fees averaging 1.45% and **is not** representative of institutional client fees. Please refer to the GIPS Disclosure and US-SCG institutional fee schedule.

[2]Supplemental information. Returns derived by applying a management fee of 0.48% per year. Actual investment advisory fees incurred by clients may vary.

[3]Returns for periods longer than a year are annualized.