Investor Letter
Second Quarter, 2021

- Drawbridge Small Cap surpassed its benchmark during the quarter while Small Cap Growth lagged.
- Both strategies lead their respective benchmarks through the first half of 2021.
- Tactical adjustments made last fall continue to benefit relative returns as expected.

Marketplace dynamics during the second quarter presented us with headwinds and crosscurrents.

◊ Despite surging commodity and consumer prices, inflation expectations moderated during the second quarter.
◊ Uncertainty rose regarding the strength and duration of the economic resurgence.
◊ Longer term interest rates declined along with credit risk premia, and equity investors moved back towards traditional growth sectors and familiar large cap names.
◊ For many momentum strategies, June was one of the worst relative return months in twenty years.

Because price momentum is one of Drawbridge's primary alpha factors, trendless markets present a performance headwind. Often the prior trend reasserts itself, but sometimes new leadership emerges. This risk of being overexposed to underperformers is magnified for concentrated portfolios with significant benchmark tracking error like those we manage.

Having profited from the stronger relative performance of cyclical stocks during the first quarter, both Drawbridge strategies entered April overweighted in Value sectors relative to their respective benchmarks. During June we responded to the market's leadership rotation by increasing our exposure to Retail, Consumer Services, and Technology stocks.

Sector bets can contribute to outperformance, but when momentum shifts, adjusting relative sector weights is the prudent response. Even with conviction in the earnings of the companies we own, it is difficult to have the same confidence in the multiple investors will pay for those earnings in the future.

Recognizing this uncertainty, we infer the future from the present. Losses can accumulate rapidly when valuations are elevated, so we manage risks according to the lessons we have learned over the past thirty years.

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The tactical adjustments we implemented late last year to accept greater risks have been serving us well. One change was to relax our low turnover target, which enabled us to manage risk more effectively by selling holdings with deteriorating performance. This enabled a second, more significant enhancement of placing more weight on a stock's near-term return potential (and momentum) without losing sight of the longer-term outlook. This expanded our set of attractive stocks without compromising our investment criteria.

US Small Cap Growth

During the second quarter Drawbridge Small Cap Growth returned (0.3%) before fees, trailing the 3.9% gain of its benchmark. Its year-to-date return of 16.5% leads the benchmark's 9.0% gain.

	Q2	1 Year	3 Year[3]	5 Year[3]	Inception[3]
Drawbridge SCG - Gross	(0.3)	26.0	9.1	13.0	12.2
Drawbridge SCG - Net[1]	(0.6)	24.6	7.8	11.6	10.8
SCG - Net of 48bp[2]	(0.4)	25.4	8.6	12.5	11.7
Russell 2000 Growth	3.9	51.4	15.9	18.8	16.6
S&P 600 Growth	3.8	57.5	13.2	16.9	16.1

The strongest contributor to the quarter's gains was retailer Dick's Sporting Goods (DKS), followed by Bonanza Creek Energy (BCEI) and PDC Energy (PDCE). Energy was the portfolio's top contributing sector. The largest detractor from Q2 performance was Ultra Clean Holdings (UCTT), a provider of semiconductor manufacturing equipment. Two airline stocks, Spirit Airlines (SAVE) and Mesa Air Group (MESA), also hurt returns, as did real estate platform eXp World Holdings (EXPI).

The robust US economic rebound produced widespread accelerating earnings growth. We entered the quarter overweighted in Financials, Energy, Materials, and Industrials because price momentum had been stronger in these more economically sensitive cyclical sectors. Market sentiment turned more cautious on the strength and duration of above-trend growth, and we adjusted our holdings to reflect the resulting rotation from cyclicals towards more traditional growth sectors. We increased exposure to Retail, Consumer Services and Health Technology stocks and sold positions in Finance, Transportation and Producer Manufacturing.

US Small Cap

Drawbridge Small Cap outpaced its benchmark again in the second quarter, with a gross return of 8.8% versus 4.3%, bringing its year-to-date return to 23.9% versus 17.5% for the index.

	Q2	1 Year	3 Year[3]	Inception[3]
Drawbridge SC - Gross	8.8	37.5	9.3	14.1
Drawbridge SC - Net[1]	8.6	36.4	8.3	13.1
SC - Net of 48bp[2]	8.7	36.9	8.8	13.5
Russell 2000	4.3	62.0	13.5	14.5
S&P 600	4.5	67.4	12.2	14.2

The Energy sector was the most significant contributor to the quarter's gains, led by Callon Petroleum (CPE) and Matador Resources (MTDR). The second largest contribution came from Financial stocks, where the standout was Santander Consumer USA (SC). Dick's Sporting Goods (DKS) led the contribution from a strong Retail Trade sector.

The largest detractors in the quarter were eXp World Holdings (EXPI) and Rent-A-Center (RCII), but losses were minimal. In fact, the gains from our two top contributors alone more than offset the impact of all positions that declined during the quarter.

Sector adjustments followed a similar pattern to Small Cap Growth. We decreased weights in Finance and Producer Manufacturing, and increased exposure to Consumer Services and Electronic Technology.

Looking Ahead

The Drawbridge investment process has never required economic forecasts, but we do monitor macro developments for emerging risks and opportunities for our portfolios. Last year's global shock and recovery are without precedent, which has led to greater than usual uncertainty.

Although stocks seem overdue for a pullback, any serious market selloff would probably require:

- The prospect of falling earnings, possibly in a recession; or
- Materially higher interest rates; or
- An unforeseeable exogenous crisis.

We think the most significant event for equities during the second quarter may have been the June Fed meeting. As confidence in the "transitory" nature of inflation was being tested, the Fed gave no sign of reducing the current pace of monetary easing, but also signaled that interest rates might rise sooner and faster than markets had been expecting. Investors seemed to like what they heard, believing that central banks will raise rates by just enough to hold inflation in check, but not so much as to throttle the economy. Long rates have declined since that meeting and equity indices have reached record highs.

One cautionary note is the recent narrowing of market leadership. During June's streak of new highs for the S&P 500, barely 50% of issues were trading above their 50-day moving averages. This is the lowest reading at a new high since 1999. More stocks need to participate, or indices will struggle.

Index momentum remains positive, earnings and estimates are rising, and the Fed clearly wants to remain benevolent. Investors have plenty of fresh capital and few attractive alternatives, and they have tended to see dips as buying opportunities. With money supply growing faster than the real economy requires, excess funds are likely to continue flowing into financial assets.

We think stocks can eventually move higher, if at a slower pace and with greater volatility. Drawbridge may be less optimistic than most about the Fed's ability to reduce monetary stimulus and raise rates without damaging the economy, but this will not affect stocks until more investors lose confidence.

We do expect price momentum to return as a source of alpha. Trends always eventually emerge that reflect investor enthusiasm and expectations. We are hopeful that midyear earning reports will provide more clarity, but as always, we remain focused on finding companies with improving fundamentals and accelerating growth.

Wall Street analysts and top-down managers spend a great deal of energy tweaking forecasts, but the future is unpredictable. We believe the best way to prepare for it is to own a portfolio of fundamentally strong companies and to react as the evidence changes. Drawbridge's bottom-up process improves our probability of achieving superior risk-adjusted returns over time.

We greatly appreciate the trust our investors place in us. Please do contact us with any questions or for a deeper 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.