ASHVA
Capital Management LLC

February 2022

Dear Limited Partner,

This letter is organized into three main sections. The first section deals with our general investing principles, which serve as the basis for the investing strategy that we utilize. This section helps new Limited Partners come up to speed on our fund strategy but also serves as a reminder for our long-term Limited Partners on why we invest the way that we do. The second section deals with my current observations on the US economy and the US equity market. The final section summarizes the 2021 performance of the Ashva Capital LP fund.

General Principles

I view each investor letter as not only an opportunity to share our performance with our Limited Partners but also an opportunity to share our basic investing principles. We are long-term oriented investors who believe that equities remain one of the few asset classes that will produce real returns over a long time horizon. Our primary investment strategy is to buy high-quality companies that can produce consistent earnings growth, not overpay and hold for the long-term. In addition to owning great companies, we employ various options strategy to both enhance returns, provide downside protection, and generate consistent income. We have a global mandate that allows us to focus on the best companies regardless of where they're geographically located. We also take a long-term view in our equity investment selection. While most investors are consumed by trading on the latest macroeconomic data or short-term earnings results, we invest with a 3-5 year timeframe in mind. This "time-arbitrage" allows us to find investments that many short-term investors miss. Over the course of my own investing career, I've seen the vast majority of investors begin to myopically focus on monthly, weekly and daily performance. Ironically, many of these institutional investors have the ability to take multi-generational views but fail to use this advantage over other market participants.

In addition, we firmly hold the belief that valuation matters. The market correction that began in 2022 is in my view a reflection of the fact that valuations had become unhinged from their underlying fundamentals, particularly in the tech sector. Since the bottom of the Covid crash in 2020, growth stocks have clearly been in favor. However, I don't fully agree that there is a clear-cut dichotomy between growth and value. Every investment opportunity has a combination of growth characteristics and a certain valuation. My goal with the Ashva Capital portfolio is to purchase companies that combine the highest growth in sales and earnings at the best possible valuations or lowest prices. Lately investors had been paying up for innovation and the stocks viewed as disrupters in their industry. Eventually prices for these companies had decoupled from current revenue and earnings. The biggest casualties in the correction that began in early 2022 are the "concept" stocks that outperformed in 2020 and 2021. In the markets, mean-reversion remains a constant. Whenever share prices get decoupled from the underlying fundamentals there is always a reckoning. Usually, a recession or economic weakness is the catalyst. However, this time around the threat of rising interest rates and a Fed focused on beating inflation proved to be too much for the high-flying tech sector.

Those of you who have been investing with us over multi-year periods know that I chose to focus on the US equity market early last year as I was finding better value. The recent correction has provided ample investment opportunities that are attractive from both a fundamental and valuation perspective. We added Facebook to the portfolio after the stock cratered following a disappointing 4Q21 earnings conference call. Essentially, investors were disappointed by the weak guidance of 3-11% revenue growth for 1Q22. From our perspective, the revenue from the core business (Facebook, Messenger, Whatsapp) is coming under pressure from competitors such as TikTok. At the same time, revenue and earnings from the Metaverse (virtual reality) business have yet to pick up dramatically. For investors with a longer-term time horizon the current share price provides excellent value.

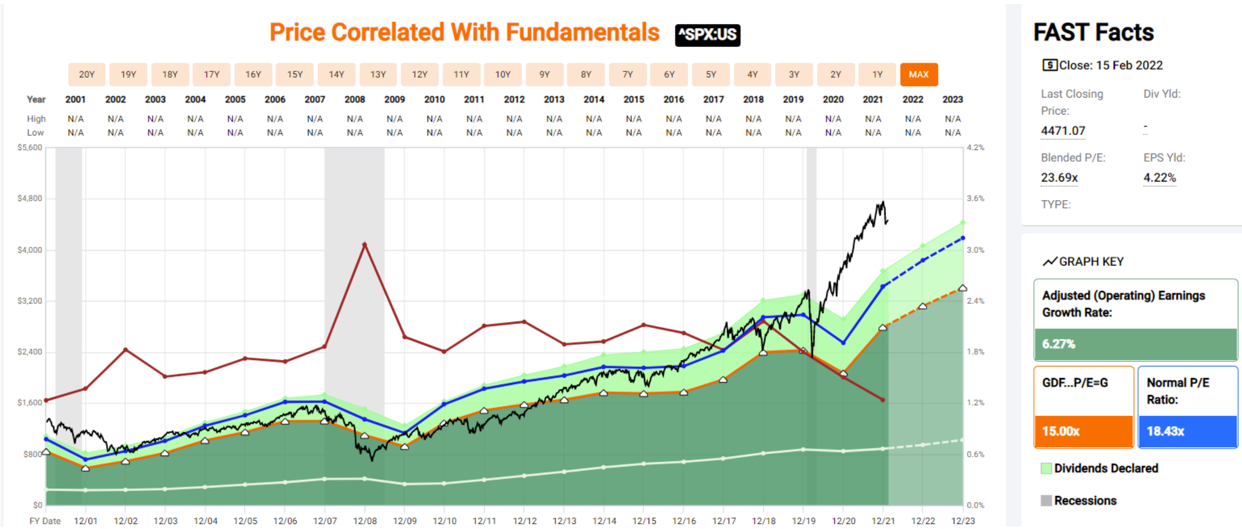
Another position that we've recently added is Peloton. The company had built up excessive inventory of its exercise bicycles and had to right size production. The shares are down approximately 80% from their 52-week high. Ultimately, I think the company is a highly attractive acquisition target for Apple, Amazon or even Nike with a total market cap of only $11.5 b.

For the first time since probably March 2020, I can remark that I'm actually excited by the potential investment opportunities available to us. We plan to fully use the current market weakness to add new positions to the portfolio. We are currently at the beginning of an interest rate hiking cycle. My current view is that although the Fed is talking up its inflation fighting credentials, it's unlikely they'll hike aggressively enough to tip the US economy into a surprise recession. However, the key metric to watch is the US treasury yield curve. More specifically, I would watch the 2-year and 10-year curve. The curve is flattening but has yet to invert. Even in the event of an inversion, it typically takes 6-24 months before a recession starts. Thus, I don't believe the current correction will turn into a crash and expect that there are at least 18 -24 months left in the current bull market.

US Equity Market Observations

If 2020 was the year of the virus, then 2021 was the year of the vaccine. The decision to focus on the US equity market proved to be fortuitous in hindsight as the S&P500 rose 26.89% in 2021. Going forward, it's highly unlikely that US equities will produce a repeat performance. As you've probably noticed, the market has begun 2022 with a significant correction. The S&P500 started at 106 in 1980 and closed out 2021 at 4,766.18. Over those 42 years the average annual compound rate of return (including dividends) has been slightly above 12%. Going back even further the index has produced an average return of 10.5% since its inception in 1957 through 2021. Despite political, social and economic uncertainty mainstream US equities have been a tremendous asset class.

However, the US equity market has produced above average returns over the past three years and is now highly overvalued. The orange line in the chart below shows where the S&P500 would be trading if it traded at a historical 15x trailing P/E multiple. Similarly, the blue line represents where the index would be trading if it traded at its historical average P/E multiple of 18.43x. You can see that whenever the index has traded at or below the orange line it was a good time to invest. The market is currently trading at a 24x blended P/E multiple and is significantly above its historical average. From current levels there are basically two paths the market can take. The first would be a prolonged sideways move that would allow earnings growth to catch up with the current valuation levels. This in my opinion is the best outcome. The second path is a violent correction similar to the Covid crash that resolves the valuation mismatch almost immediately. As investors we must be prepared for both outcomes.



Our Performance

Given the overvaluation present in the US equity market, I had implemented a hedged strategy using options in 2021. The positive aspect of hedging is that it will protect your capital in a downturn and allows you to sleep peacefully at night. The negative aspect of hedging is that it's expensive. As a result, our returns lagged the overall market. The Ashva Capital LP fund ended 2021 up 7.61%. In comparison, the S&P500 was up 26.9%. Although I'm disappointed by the comparative results, I still believe hedging our downside risk was important given the highly overvalued state of the US equity market. Many of the stocks that were winners during the pandemic have corrected significantly. Peloton is now trading near its IPO price of $29 after hitting a peak of approximately $160. Similarly, Meta Platforms (Facebook) is now trading near a 52-week low of $215 after reporting a weak set of 4Q21 results. Investors are bracing for the Fed to start hiking rates beginning in March after inflation hit 7.5% in January, the fastest pace since 1982. If 2021 was the year of the vaccine, 2022 is going to be the year of inflation.

As Warren Buffett has stated, interest rates act like gravity on asset values. Long duration assets such as equities are negatively impacted as interest rates rise. Essentially, investors discount back future cash flows at higher rates, resulting in a lower present value. Although the Fed has been slow to react, they are slowly coming to the realization that inflation is not going to be transitory. We're in a new era in regard to inflation in the US economy. 2022 is already proving to be more volatile than the past three years and as a result our hedged equity strategy will ultimately payoff for our Limited Partners.

Sincerely,

Ankur Shah

Ankur Shah
Managing Member

Ashva Capital Management LLC