UPSLOPE CAPITAL MANAGEMENT

Core Investment Tenets

Updated: Nov 2023

General & Personal

1. Know yourself – strengths, weaknesses, emotions
2. Align strengths, weakness, and personality w/investing style – and investing style w/trading strategy (ST vs. LT)
3. Admit when you're wrong and don't know why
4. Be flexible. If you never change your mind (in embarrassing ways) you're doing it wrong
5. Be cautious when investment narratives and your own political views sync up
6. Study past wins/losses. Know and admit where you were lucky. If honest, it should be a decent % of wins
7. Simpler is almost always better – financial model, business model, portfolio construction, trading
8. Don't be a defensive jerk; take special note of pushback that makes you angry or frustrated
9. Studying *how* stocks move (to breaking news, market moves, macro data, etc.) – in conjunction with deep understanding of fundamentals – will teach you far more about investing than any book will
10. Don't do stupid sh*t (think: sizing, crowded positions, etc.) – it's usually obvious and applies 2x for shorts
11. Occasionally, break some of your "rules"
12. Be a macro optimist by default
13. Investing isn't science; believing you're owed attractive returns due to hard work will lead to disaster

Idea Generation

14. The "walking around method" (with a little direction) is generally a good process for finding new ideas (vs. screens)
    a. Randomness is what makes it useful (leads to unique positions/portfolio) – and a terrible pitch to allocators
15. Midcap ($1B - 20B) seems like a sweet spot for longs
16. Seek companies that have the *potential* to be owned "forever"; whether they fit the bill should become clear over time
17. Learn to love saying "no – for now"
18. Kill new ideas fast – but not for reasons that can be identified with 'headline research' alone
19. Being rudely judgmental when evaluating mgmt. is a good risk mgmt. tool for longs and idea generation tool for shorts
20. Some of the best shorts are low multiple value traps/dying businesses
21. Pay attention to older, but thoughtful pitches that haven't worked (yet) or been broken
22. Be suspicious of "story" stocks (e.g. the "next CMG") and anything promoted aggressively to retail
23. When you become an angry long with a broken thesis, consider flipping short
    a. Flipping short-to-long is harder than long-to-short if sub-par/sketchy mgmt. is part of your short process
24. Think twice (at least) when buying the 2nd-tier company/management team within a sector because it's cheaper
    a. Owning best-in-class generally leads to lower turnover, better results, and sounder sleep
    b. Expected catalysts/concrete changes are acceptable reasons to make an exception and own 2nd tier
25. "No points for originality" is fine advice for the short-term – but terrible advice for the long-term
26. Focusing on stocks that are (a) near-debt-free, (b) beaten down due to cyclical worries/issues, and (c) not in secular decline is a good starting point for successful "value" investing (simplistically: buying low multiple stocks)
27. "Dozens" of recent expert transcripts on a SMIDcap company = *watch out*

Fundamental Analysis & Valuation

28. "Don't borrow conviction. Ever." (source: Harry Weller)
29. Just because those with an opposing view (bull/bear) are defensive morons, doesn't mean they're wrong
30. Research process/cadence:
    a. Hustling through the process under pressure & quickly sizing up a position has rarely worked well
    b. One week of research is enough to enter *starter* position – don't let perfection get in the way of a great idea
    c. Laziness can be an asset: doing *some* research, putting pencil down and thinking about an idea in the back of your mind for a few weeks tends to have the best results
31. Consider "return on brain damage" – it's often not worth it
    a. "Sosnoff's Law": returns vary inversely with thickness of research file. If you find yourself working hard to justify entering a position, it's probably not worth it
32. Be able to organize your thoughts on each position in a concise, written manner: 1-page written + comps – with ~20 pages of info upstairs for answering Q's
    a. A longer, consistently structured, and detailed "pitch" *can be* useful for keeping your process organized
    b. Lay out estimates in graphical form
    c. Don't obsess over finding and articulating a 'variant perception'
33. Don't cut corners/make excuses for questionable corporate governance or a sleazy business model
34. Write a 'pre-mortem' for all investments
35. Valuation pushback *alone* is the best pushback
    a. Changes in fundamentals (trajectory) are usually far more important than "valuation"
    b. "Cheap" or "expensive" (i.e. "low/high" multiple) <u>alone</u> is never a reason to go long or short
36. Some of your risks should <u>not</u> have mitigants
37. Don't overestimate the reliability of signals or how much insight you've gleaned from:
    a. Meeting management or listening to 'expert' calls
    b. Insider buying (not pro "stock pickers," make mistakes/have biases + other possible motivations…)

    c. Active buyback (is it really *that* material? Not every company is the next Restoration Hardware)

38. The lower the 'quality' the more important the purchase price (valuation)
39. "Turnaround stories": when consensus gets on board with the "story" logical valuation rules go out the window
40. Family-run & controlled businesses can be a great – or terrible – thing. What motivates them?
41. Probability of a take-out should be a secondary consideration for longs – but a priority for shorts
42. Be wary when consensus trots out abnormal valuation methods (e.g. disc'd future value based on 2030 P/E)
43. Things I'll pay a premium for (not exhaustive):
    a. Top quartile management
    b. Sustainable organic growth *and* high/steady or expanding ROIC
    c. Under-utilized balance sheet
    d. Simplicity
    e. Scarcity value / elevated take-out odds
    f. Under-managed business with new, competent management
44. Things I want a discount on (not exhaustive):
    a. Acquisition-driven growth
    b. Fully-utilized balance sheet
    c. Unchanging complexity
    d. Cyclicality
45. Beware of beloved investment banking clients and perma-hedge fund hotels (often one and the same)
46. For shorts:
    a. Qualitative > quantitative (though both are important); get the "story" and investor positioning right
    b. "Why fight Mike Tyson, when you can kick grandma in the shins?" (source: Chris Brown, Aristides Capital) – this isn't an absolutism, but never forget there's no shortage of lousy public companies

Portfolio Management

47. My ideal portfolio has 20 positions (~10 longs, 10 shorts)
48. Availability of good ideas should be primary guide for net/gross; performance/drawdowns a close second for gross
49. Portfolio returns matter most, but individual positions drive them; don't sweat diversification losses too much
50. There is a time and place for high turnover and for low turnover – don't get complacent in either regime
51. Keep a list of every position handy that includes one crystal clear sentence/bullet on *why* it's in the portfolio
52. Shorts = worse than useless if not monetized; not covering after a big drop isn't *too* different from "panic-selling" longs
    a. Nothing goes to [zero] in a straight line and taxes should be a secondary consideration (at most)
    b. Balancing all of the above with knowing when to "press" shorts is the hardest part of the L/S game
53. Assume you'll frequently be wrong and size accordingly
    a. ~10% <u>max</u> @ init for single name longs generally seems right; < half that (at most) for shorts
        i. With very few exceptions, longs need to "earn" their way to the top of the book
    b. Start smaller in names further out from your core competencies – no matter how much you like the idea
    c. In general, size positions at "psychologically-neutral"[1] levels: at such a size, *you* don't care much whether the position goes for or against you). Have specific reasons for positions to be above or below this level
    d. Size using cost basis for longs – be patient and don't break your rules here
    e. Size "battleground" shorts *very* conservatively (0.25% – 2%) – so you *don't have to* actively manage them
    f. Individual shorts should very rarely be "fully-sized"
54. The ability to effectively course-correct – both mentally and operationally – is a super-power
55. Self-described "value" investors should mostly avoid shorting "growth" stocks
56. Pay close attention to counter-intuitive reactions to good/bad news; but, don't ditch common sense
57. When you start getting cocky, cut back. Look at "Wall Street's Wheel of Fortune" (see next page) <u>every day</u>
    a. Short-selling is **<u>never</u>** (ever!) easy; when it feels that way, take off or flip some exposure
58. Have *some* kind of catalyst for most shorts (sure, multiple is high, but what will make the stock go lower?)
    a. "Valuation shorts" can occasionally be okay – e.g. paired against specific longs (hedge-like) or combined with obviously flawed business model (must be willing to quickly cut/run)
59. Require a catalyst for exiting longs (better use of capital counts) to force yourself to let them run
60. Avoid execution complexity and unnecessary gross exposure; I'm usually worse off using options vs. underlying
61. If you missed a long and it's higher (or a short, lower), don't automatically write-off the idea because you feel dumb
62. You are not alone in preferring "quality" over garbage. Understand performance implications
    a. "High-grading" (moving up in quality) is a de-risking activity (and vice versa) – make sure this is intended
63. Assuming I have no clue what's going to happen on the macro front leads to a better, more resilient portfolio
    a. That said, outright ignoring macro will get you killed; there is a similar, more extreme parallel with geopolitics
64. Don't have too much/little respect for "price action"; with concentration, former leads to mediocrity, latter to blowing up
65. Obsess over closing gaps related to what you think *will* happen vs. what you *hope* will happen

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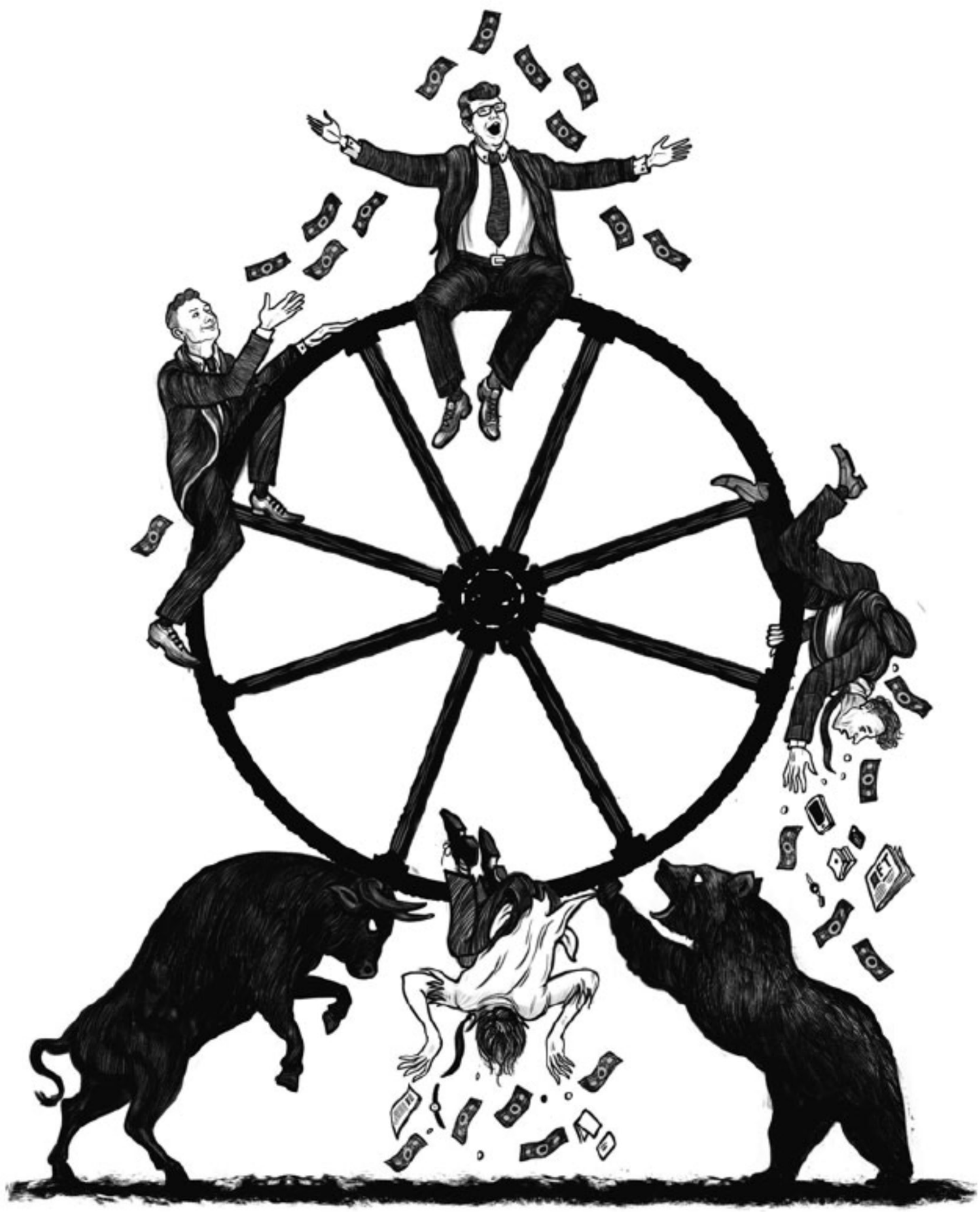
[1] Term from Alex Gurevich's *The Next Perfect Trade*.

Wall Street's Wheel of Fortune (from *Capital Returns*)



Wall Street's Wheel of Fortune
(illustration by David Foldvari)

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