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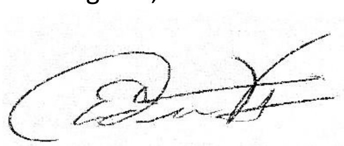
July 25, 2022

Dear Partners, Friends, and Family,

Enclosed you will find my quarterly update of both the fund and the business. This is the first of hopefully many updates.

These quarterly updates will be 1 to 2 pages with a longer version at year end. This efficiency is to focus our efforts on the portfolio but still bring you up to date as we navigate throughout the year.

Best regards,



Edwin Lugo
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Performance *(ending June 30, 2022)*	**Month**	**Quarter**	**YTD**
EL2 Capital International Small Cap Focus Fund LP – Gross of Fees*	-2.98%	-6.19%	-6.19%
EL2 Capital International Small Cap Focus Fund LP – Net of Fees	-2.97%	-6.43%	-6.43%
MSCI EAFE Small Cap Index	-11.96%	-17.55%	-17.55%

**Start Date as of April 1, 2022*

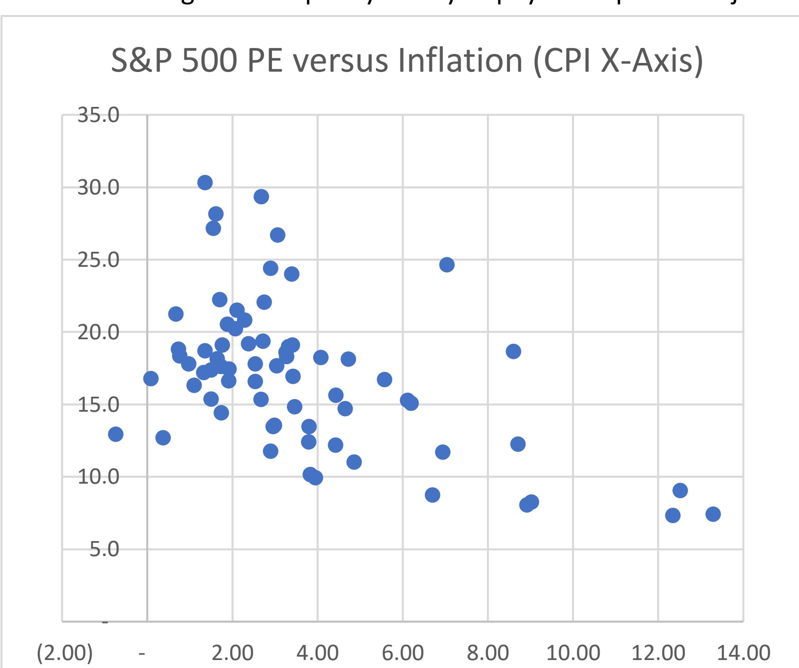
Portfolio Update

We continue to be mostly in cash as most quality companies are still expensive. Nevertheless, slowly with the market decline we are beginning to see them come into our valuation range. Why slowly because prior the overvaluations were extreme. For instance, some outstanding operators that we have been monitoring closely still trade at 25x to 35x earnings (yes in one case over 90x price to earnings before the recent drop). Nevertheless, our cash deployment will likely accelerate from turtle pace to walking pace as we wade through the decline and continue to build our list of opportunities. If stock prices continue to fall further, then we will certainly become much more aggressive in our long only strategy. So far, we have 4 positions representing 25% of the portfolio with 75% in cash. We hope that more cash will be invested as more opportunities unfold possibly over the next 3 to 6 months.

The companies in the portfolio today have a few things in common that highlights the way that we are thinking and executing the investment process. Firstly, all 4 businesses have greater than 10% management ownership. This is important for us as we want management to financially be on the same page with us. They also have a track record of creating value for shareholders. Two of the four are buying back shares given their low share prices. In terms of growth, the range of revenue expansion for these businesses over the last 5 years have been at least 2% organically and over 10% for some including acquisitions. The expectation is similar for the next 5 years. All are cheap with a weighted average PE level of 9.7x or about a 10% free cash flow yield, coupled with healthy balance sheets.

Going forward, we are looking to add more solid and growing businesses with good returns on capital that are mispriced. Typically, these are hard to find cheap because they normally trade at higher valuations since the market is quite efficient. Thankfully psychology plays a role in pricing securities and brings irrationality into the market, which then gives us the opportunity. Fortunately, we are not mandated to be fully invested or to be over-diversified as our brethren in the mutual fund world. We can and will be patient, wait for the right pitch, and invest when the odds are extremely in our favor.

“The trick is to get more quality than you pay for in price. It’s just that simple.” – Charlie Munger



Inflation and Valuation

Inflation is in the forefront of everyone’s mind at this time and we thought it would be good to explore its relationship with equity valuations, and what it means for our portfolio. Historically, the relationship between inflation, measured by the Consumer Price Index (CPI), and valuation, measured by the price to earnings ratio (PE), have been inversely related, essentially the higher the CPI, the lower the PE. The chart on the left is illustrating this relationship from December 1954 to May 2022. You will see the PE of the S&P 500, as a proxy for developed markets, on the Y-Axis and the CPI on the X-Axis. Each point is the PE and CPI for a specific year. The relationship between these 2 metrics we think helps explain the current environment and helps guide our expectations. Though we do not care to forecast markets, we feel that it is important to get an awareness of the macro environment. Examining this chart shows that inflation tends to be between 1% and 4%. The outliers of inflation, less than 1%, you will generally see much higher valuations, and in contrast, above 5%, you will see the possibility for much lower valuations. Therefore, if you believe that we get 6% inflation or more, then it is likely PEs for the S&P 500 could be between 7x and 12x, thus the range of stock prices may have to be lower. Today the S&P 500 is at 17x PE.

In terms of our portfolio, this translates into potentially more opportunities for us going forward. Over the last few years, it was more difficult for us to find worthwhile investments when equity valuations were very high. We believe this was sparked by many years of very low inflation, which eventually evolved into euphoric market conditions. In fact, for many quality companies there was a disconnect between the cash a company generates and its long-term value. Partially thanks to an increase in the CPI, today's environment is becoming much more valuation sensitive as the market mindset seems to be moving towards mathematical reality. We think Mr. Orlando Bravo, one of the founders of Thoma Bravo, a private equity firm specializing in technology, said it best when describing today's environment.

"It's not just a bear market – It's back to a time when companies are valued on after-tax free cash flow"

……Imagine that….

Business Update

Last quarter we mentioned our "everything else bucket fund". In other words, anything that doesn't fit in international small cap will go into this new fund – that is the strategy – thus little to no overlap between both funds. This allows us to take advantage of larger opportunities that can also compound our capital. To satisfy our marketing department (at least our future marketing department), we renamed it the EL2 Capital Global Opportunities Fund. We believe this fund can add value to our partners and friends, broaden our platform, and encompass our complete skillset. It should be available by September 1, 2022 for those who have an interest.

For more details, inquiries and/or documents to invest into the International Small Cap Focus Fund or the Global Opportunities Fund please email me at elugo@el2capital.com or text me anytime at 410-258-1452.

Sincerely,

Edwin Lugo
Founder and Managing Partner
EL2 Capital LLC

Any performance discussed in this letter represents past performance, which does not guarantee future results. Current performance may differ from figures shown. The Fund's investment return and principal value will change with market conditions.

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