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October 24, 2022

Dear Partners, Friends, and Family,

Enclosed you will find my quarterly update of the funds and the business.

These quarterly updates will be 1 to 3 pages with a longer version at year end. This efficiency is to focus my efforts on the portfolio but still bring you up to date as I navigate throughout the year.

Best regards,

A handwritten signature in black ink, appearing to read 'Edwin Lugo', written over a light gray rectangular background.

Edwin Lugo  
Founder and Managing Partner  
EL2 Capital LLC  
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<b>International Small Cap Performance (ending September 30, 2022)</b>	<b>Month</b>	<b>Quarter</b>	<b>YTD</b>
EL2 Capital International Small Cap Focus Fund LP – Gross of Fees*	-3.68%	-2.50%	-8.54%
EL2 Capital International Small Cap Focus Fund LP – Net of Fees	-3.76%	-2.74%	-8.99%
MSCI EAFE Small Cap Index	-11.44%	-9.74%	-25.58%

\*Start Date as of April 1, 2022

<b>Global Opportunities Fund Performance (ending September 30, 2022)</b>	<b>Month</b>
EL2 Capital Global Opportunities Fund LP – Gross of Fees**	-1.79%
EL2 Capital Global Opportunities Fund LP – Net of Fees	-1.87%
MSCI World Index	-9.25%

\*\*Start Date as of September 1, 2022

### Portfolio Update

The August stock rally thwarted my efforts to invest the cash this quarter, as valuations drifted up, away from what I believe are more reasonable prices for quality businesses. Nevertheless, my buy list continued to grow through my research efforts, compiling a list of over thirty companies that I am ready to pull the trigger when the price is right. In the meantime, and most interestingly, our cash in money market treasuries is yielding over 2%, something we have not seen in a while. For the International Small Cap Fund, we now have five investments with one added in late September as the markets took another dive. We have 73% in cash and the weighted portfolio PE for our investments stand at 11x. For the new Global Opportunities Fund, there is one investment with 90% cash. It started in the beginning of the month and the cash is currently being invested.

### Patience and Perspective

My “Buy Good Stuff Cheap” philosophy may appear lethargic given the market decline in the last 6 months. However, to deliver higher returns over the long term in a long only strategy, I must target investments where the probability of a successful outcome is extremely high, and the risks are low (ex. buying a quality business inexpensively). This is the basis on how I plan to allocate our capital and thus a centerpiece of my investment process. As a result, stock market declines should be an opportunity. Today, my targeted buy prices of quality businesses are still mostly below today’s prevailing quotes. Based on my analysis, the market is still expensive. Using the S&P 500 as a general proxy, it was at 18x PE as of 9/30/22, falling from 25x at the end of 2021, nevertheless the long term average is 16x<sup>1</sup>. Moreover, market corrections on average fall -40% and last 1 ½ years. That means the index could fall another -20% bringing the valuation to 14x PE, and could last another 9 months. Now, there is a wide discrepancy when thinking about these averages, whether price level or timing. Thus no accuracy on any level, and I certainly have no idea. But when deciding to invest today these thoughts must enter one’s mind, especially in the face of heightened inflation. It gives perspective on how far markets can move down, and can paradoxically offer incredible opportunities at great prices. Generally, the companies that I seek to invest are typically well-positioned, growing companies, run by good managers and, as a result, are usually more expensive. But if I disregard the price it can certainly work against us and reduce our returns, despite how good these companies are. In essence, it goes against the principles of successful capital allocation. For example, T. Rowe Price, the Baltimore-based growth manager, in the 1970s and early 1980s suffered greatly despite following their investment process of buying quality growth businesses during a similar period of inflation and recession. Below you will find a chart that took snapshots of their portfolios and their characteristics in roughly 10 year intervals. This was made in

<sup>1</sup> Irrational Exuberance, Robert Schiller – The median and mean are 14.9x and 15.9x, respectively, for the S&P 500 between January 1, 1871 and October 21, 2022.

response to clients in the early 80s, who claimed that T. Rowe’s managers had lost their way, resulting in their underperformance.

**Comparable Annual Portfolio Characteristics<sup>2</sup>**

	<b>1960</b>	<b>1972</b>	<b>1980</b>
5-Year Sales Growth	11%	15%	16%
5-year EPS Growth	7%	15%	19%
Avg Return on Equity in Portfolio	14%	15%	19%
Avg Price to Earnings Ratio in Portfolio	27x	54x	15x

The chart above illustrates that T. Rowe’s team stuck with their strategy, investing in growing companies with high returns on equity, for over 20 years. However, what was disregarded in their investment process in my opinion was valuation risk, particularly in the face of inflation in the 70s. What is striking is the 72% decline in valuation from 1972 to 1980 of their portfolios, simply driven by the derating of the PE multiples, while the investment methodology and business fundamentals were virtually intact. Finally, despite this gut wrenching period in the market, which includes the market declines of 1974 and 1982, they were actually some of the best times to invest in the stock market in the last 50 years, especially when growing businesses were heavily discounted during these downturns.

“Bargains are the holy grail of a true stock picker. We see the latest correction not as a disaster, but an opportunity to acquire more shares at low prices. This is how great fortunes are made over time.” – Peter Lynch

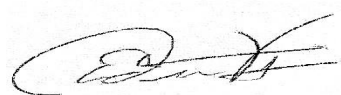
**Business Update**

The Global Opportunities Fund launched on September 1, 2022 (my “everything else bucket fund”). I created this fund to invest in anything that does not fit into the international small cap fund. This includes larger companies globally, and smaller companies in the US. I believe this fund can add value to our partners and friends, broaden the platform, and encompass my complete skillset.

With prices beginning to capitulate in the market, and with our arsenal of cash, we are approaching a time when it may be one the best periods to invest in great businesses for the long term and generate outsized returns. I encourage our friends and partners to invest additional funds over the next 6 to 12 months.

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](mailto: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.*

*Not for distribution to the public.*

<sup>2</sup> Page 211, “T. Rowe Price, The Man, The Company, and The Investment Philosophy”, Cornelius C. Bond