



April 1, 2022

Numbers are rounded to save time and they don't include the fees. See the administrator's statement for precise numbers.

1. Results from Jan 1 - March 31 2022

S&P 500 -4.5%

Militia Capital +22%

We made 3% on longs and 19% on shorts.

We're 225% long and 135% short.

This quarter was going great until Russia invaded Ukraine.

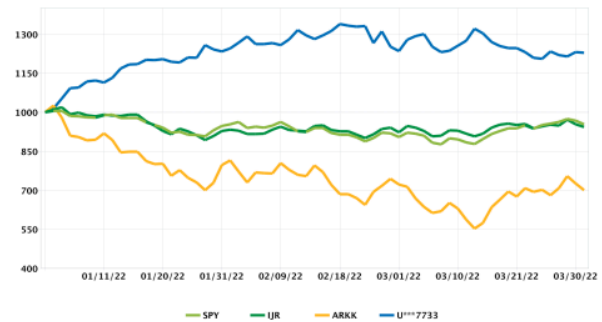
We lost 3.5 percent on Russian longs which was fortunately offset by long positions in the defense companies Lockheed Martin (LMT) and Rheinmetall (RHM.de).

The problem is that Russia is a large supplier of commodities to the world and that's being disrupted during a time when we already have inflation and supply chain problems. This means that our 200% long position, which trades on fundamentals, had a justified drop relative to the market. Meanwhile, shorts ignored fundamentals in the short term as they often do. This stabilized toward the end of the quarter.

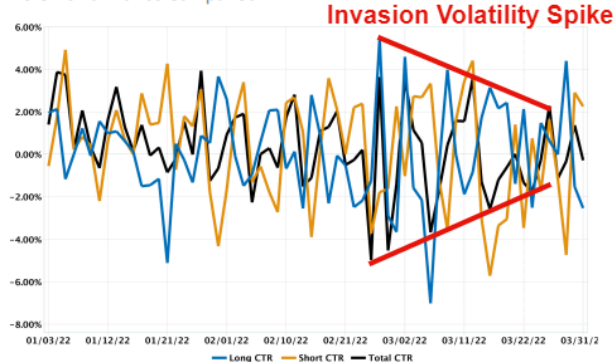
Risk Analysis

| | SPY | UR | ARKK | U***7733 |
|--------------------|---------------------|---------------------|---------------------|---------------------|
| Ending VAMI | 953.82 | 943.58 | 700.81 | 1,228.75 |
| Max Drawdown | 12.87% | 12.31% | 46.09% | 9.94% |
| Peak-To-Valley | 01/03/22 - 03/08/22 | 01/04/22 - 01/27/22 | 01/03/22 - 03/14/22 | 02/18/22 - 03/24/22 |
| Recovery | Ongoing | Ongoing | Ongoing | Ongoing |
| Sharpe Ratio | -0.80 | -0.92 | -1.76 | 2.87 |
| Sortino Ratio | -1.10 | -1.28 | -2.46 | 4.55 |
| Standard Deviation | 1.32% | 1.41% | 4.26% | 1.91% |
| Downside Deviation | 0.95% | 1.02% | 3.04% | 1.21% |
| Correlation | -0.19 | -0.19 | -0.58 | - |
| β : | -0.28 | -0.25 | -0.26 | - |
| α : | 0.84 | 0.83 | 0.57 | - |
| Mean Return | -0.07% | -0.08% | -0.46% | 0.34% |
| Positive Periods | 29 (45.31%) | 31 (48.44%) | 27 (42.19%) | 37 (57.81%) |
| Negative Periods | 35 (54.69%) | 33 (51.56%) | 37 (57.81%) | 27 (42.19%) |

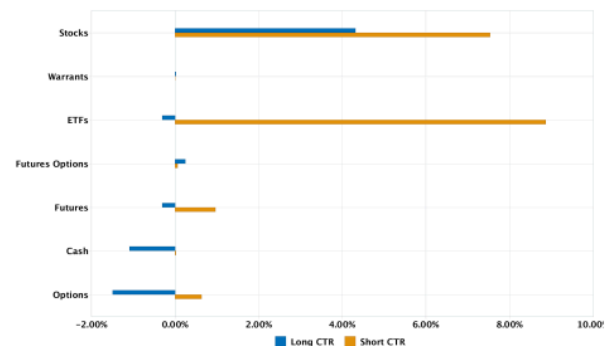
Value Added Monthly Index (VAMI)



L & S Performance Comparison



L & S Performance by Financial Instrument Comparison



This report is generated by Interactive Brokers. It uses gross returns.

Militia uses the S&P 500 as a benchmark because it shows the fund's correlation and volatility relative to risk assets, not because you should gauge our performance to the S&P 500 quarter to quarter - we are not positively correlated, after all.

2. M/I Homes

I wrote an article about the US home builder Century Communities (CCS) three years ago and bought the stock when shares traded for \$23. Since then they made \$25/share net profit and now the stock trades for \$53. Today I prefer M/I Homes (MHO) because it's absurdly cheap - this is my highest conviction long bet since I began investing.

MHO trades for 3 times earnings and 65% of liquidation value. Debt to equity is low. They have a couple year supply of land which is worth far more due the housing boom and inflation but this gain isn't on the balance sheet. A buyback for 6% of shares outstanding was just completed in the last couple of quarters and now they started a new buyback for 7% more.

They're located in the hottest US housing markets - especially Florida and Texas. I live in Tampa, one of their markets. Here it seems like genuine demand from people wanting to live here rather than speculation. I've heard similar views from Militia investors living in Texas and down in Miami. One of MHO's current projects is 10 minutes from me and it's one of the best options. I wanted to buy a unit but bought more shares of MHO instead because the price gap is just too big. Raleigh is another one of MHO's markets and there's a [video](#) of a huge crowd showing up to an open house - do they seem like

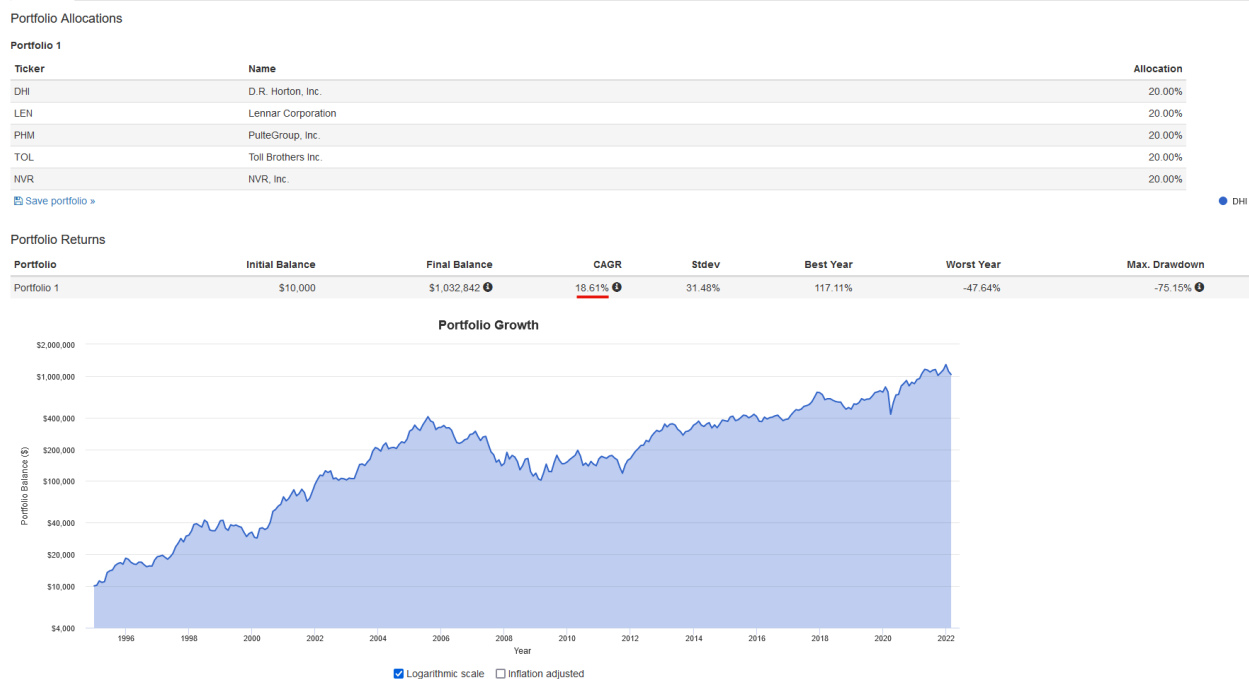
speculators, or people looking for a home to live in?

The most common argument against US housing is that there will be a repeat of 2008. However, The Big Short outlines the primary cause of that crisis: There were *zero* lending standards. Literally anyone, or even their pet, could get a mortgage. Given the leverage, this allowed people to gamble and create fast paper profits, which is extremely addictive. This was even rational - the sucker was the bank, which had most of the downside risk. The opposite is true today, where banks won't give loans to anyone without solid proof of income and a good credit score. I was declined a mortgage in 2016 from my longtime bank due to a non-traditional job despite offering a 40% down payment. The government over regulated mortgage lending standards, in fact. I follow mortgage insurers and their standards are rigid, too. And finally, home builders will be overly cautious given that still-recent pain.

Another big argument is that rising interest rates are bad for home prices. I covered that in my CCS article, pointing out that builders like Lennar did well during periods of rising rates in the '90s. As rates go up I expect people to shop for smaller homes and/or in worse locations, but ultimately pay whatever they can afford while supply is constrained. I see homes almost as a consumer staple - I joked to some friends, "When your lady wants a house, you get a house." Only higher priced homes will reach supply:demand equilibrium in the short term. Home builders can just build cheaper homes, which is still a high margin business.

The world's supply chain issues include home building products. Some argue that this hurts home builders but I think the opposite. As long as all builders have these constraints they will unintentionally act as a cartel. Think through how home building differs from other businesses, which are far more time sensitive and have products that can't be tailored to consumer demands in the short term.

A common criticism of home builders generally is that they're low quality businesses. This is a good example of a consensus narrative that's wrong. This chart cherry picks the five best home builders - but still, low quality businesses *can't* compound at 18.5% for 25 years:



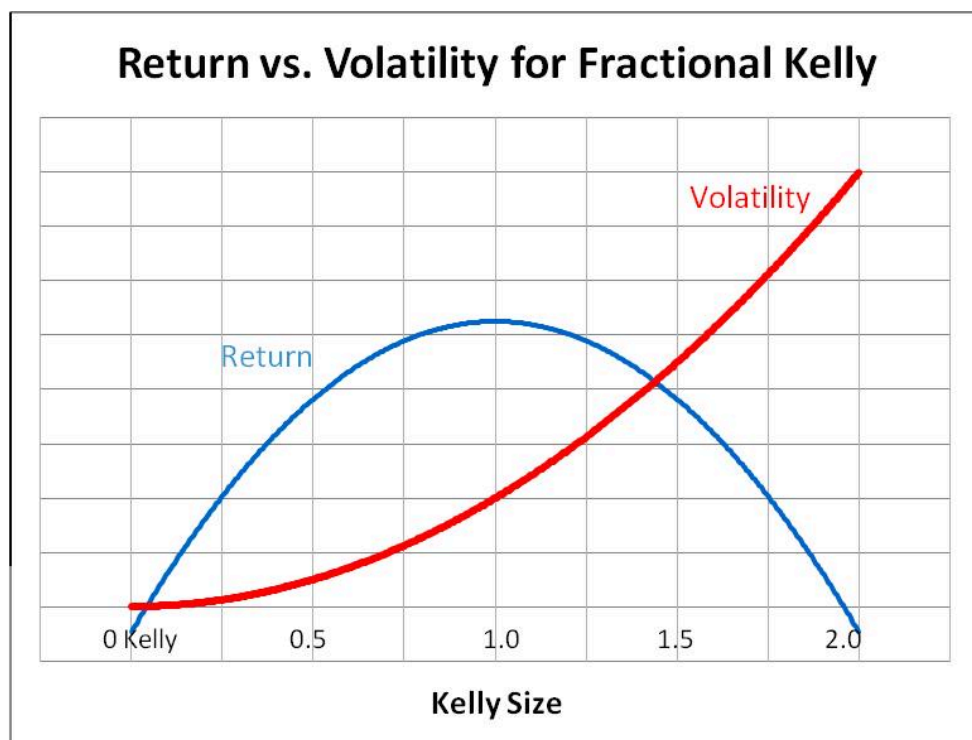
3. When To Trim Your Militia Capital Investment

Selling and trimming investments is emotionally hard. Knowing the right framework and systemizing it helps to take that emotion out.

The Kelly Criterion gives the mathematical answer on how big to bet: bet more as edge gets bigger and downside risk gets smaller. If a rigged coin has a 60% chance of coming up heads then Kelly says to bet 20% of your net worth on heads. If another has an 80% chance of coming up heads then Kelly says to bet 60%. Investing has a complex distribution of outcomes and it's really not worth getting too deep into the math unless you enjoy it. Here's the plain English answer:

- Betting too big lowers return, which can even go negative. Letting investments grow too large as a percent of net worth is bad. Trimming as you win is mathematically correct.
- Half Kelly reduces variance a lot while reducing edge only a little. This is the most you should bet, especially since it adds a margin of safety when the edge is smaller than it seems.
- An even smaller fraction of Kelly is better for risk averse investors or when there's lots of uncertainty.
- Bets with correlated tail end risk all count towards the same bet size. For example, six crypto investments aren't really six individual bets. Two high gross leverage long/short funds like Militia aren't individual bets, either. They might not seem correlated, until very suddenly they do.

This visualizes the Kelly Criterion:



Net worth is also important. Someone with \$300k may risk a larger % than someone with \$30 million. Reaching financial freedom has big upside, while growing \$30 million faster doesn't change much. Plus net worth doesn't include someone's future earning potential but probably should, so the guy with \$300k is really betting a smaller % than it seems.

This table gives the % of net worth I suggest trimming a Militia Capital investment down to as we win:

| Net Worth | Low Risk Tolerance | Moderate Risk Tolerance | High Risk Tolerance |
|---------------|--------------------|-------------------------|---------------------|
| <\$1 million | 10% | 20% | 40% |
| \$1-5 million | 7.5% | 15% | 30% |
| \$5+ million | 5% | 10% | 20% |

Kelly is a function of both edge and risk. My edge will go down as the fund grows but I will gradually pursue a less risky strategy as that happens, which I explained in section 3 of the Q3 2021 letter. Thus, the %s in the above table are fixed over time.

4. Alluvial Capital

A common question I get today is, “Well David, if I’m already risking enough with you, what am I supposed to do with my money? Every option seems bad - indexes, bonds, real estate, cash, etc.” I agree and I’m not investing any money in these.

My answer is to invest with Dave Waters at [Alluvial Capital](#)¹. His strategy is to invest in offbeat global microcaps, long only and with no leverage. He’s a passionate, skilled investor. His fees are fair, a tell that he actually gives a damn about his investors unlike most funds. I’ve read dozens of his investing theses which are simple and great.

His edge is lower than Militia Capital, but his tail end downside risk is tiny. Dave’s risk is that he picks bad companies and the stocks go nowhere or even down a bit for years. I don’t see an outcome where he totally blows up² so risking up to the same % as the above table with him makes sense, despite his smaller edge. His risk is completely uncorrelated to Militia Capital’s. My personal goal is to eventually have 5 such uncorrelated investments for my entire investment portfolio.

Dave is more skilled than he gives himself credit for and will do well even when he graduates to larger companies when he reaches hundreds of millions in assets some day, if he decides to get that big.

If other skilled investors I know of have an opening some day I’ll suggest them, too.

5. Dying of Money

In February 2021 Michael Burry suggested the book [Dying of Money](#). It’s about the Weimar and American inflations. This was a timely read considering MoM inflation hit [10% annualized](#) in February.

I mentioned four ways to play inflation in my Q3 2021 letter:

- Short [long term government bonds](#)
- Betting on [future interest rates going up](#)
- Long [commodities](#)
- Long companies with debt that can raise prices

The first three already made big moves so the asymmetry is gone. However, there are still many public companies in the fourth category that haven’t moved enough yet like Energy Transfer (ET), Brookfield Asset Management (BAM), and Berry Global Group (BERY). Those are natural gas pipelines, leveraged real estate of all types and plastic packaging factories, respectively. More conservative options are the supermarket chain Ingles Market (IMKTA) or the utility Fortis (FTS). I believe all of these companies can

¹ Dave didn’t solicit me to write this and hasn’t sent investors my way. I’m not being paid to suggest his fund. He’s just my top pick (that’s accepting money) to compliment Militia Capital after sorting through hundreds of funds.

² Besides something extreme like his broker becoming insolvent, theft, etc.

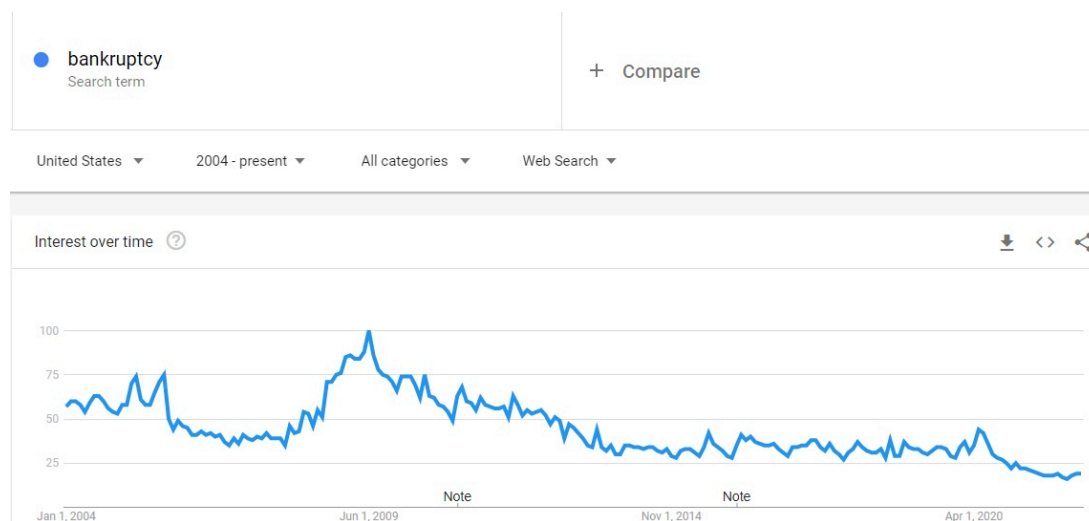
raise prices with inflation but aren't too vulnerable if we have a recession.

Here's a thought experiment if you don't understand this bet. Say there are two nearly identical companies each with \$10 billion enterprise value. The first company has market cap \$2 billion and debt \$8 billion while the second has market cap \$10 billion and no debt. Then say that we get 20% more excess inflation and the value of the businesses go up 20% with it. In this case, the market cap of the first company doubles while the market cap of the second only goes up 20%. The lender is the loser. This is over simplified but the idea is generally right.

This passage about hyperinflation in the Weimar Republic explains why I shifted away from melting ice cube type shorts for now:

Business failures and bankruptcies became few. The boom suspended the normal processes of natural selection by which the nonessential and ineffective otherwise would have been culled out. Practically all of this vanished after the inflation blew itself out.

We're not having hyperinflation but the impact is still big. This is why monetary and fiscal policy sometimes make stock prices react positively to bad macro news:



7. Vegas Update

I'll be in Vegas playing the World Series of Poker main event day D. I'm available on July 5th and 7th so let me know if you're in town and want to meet.

Thanks for your investment,

David Orr

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