Split Rock Capital Management

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To: All Investors
Re: Annual Letter 2023, Letter to Investors

Dear Investors:

In 2023 Split Rock Capital Management returned 31.69% net of fees.[1] Our annualized return since inception is 12.68% vs 13.31% for the S&P 500 (dividends included). $100,000 invested at inception has grown to approximately $261,420 vs. $273,420 if invested in the S&P 500 (dividends included).

Year	S&P 500[2]	Split Rock *(Gross)*[3]	Split Rock *(Net)*[4]
2015[5]	1.18%	(0.42%)	(0.47%)
2016	11.96%	13.19%	12.19%
2017	21.87%	19.47%	18.47%
2018	(4.41%)	(1.68%)	(2.68%)
2019	31.49%	13.43%	12.44%
2020	18.40%	12.07%	11.07%
2021	28.71%	35.37%	34.37%
2022	(18.11%)	(7.12%)	(8.12%)
2023	25.83%	32.69%	31.69%
Cumulative Return Since Inception	**173.42%**	**180.79%**	**161.42%**
Annualized Return Since Inception	**13.31%**	**13.69%**	**12.68%**

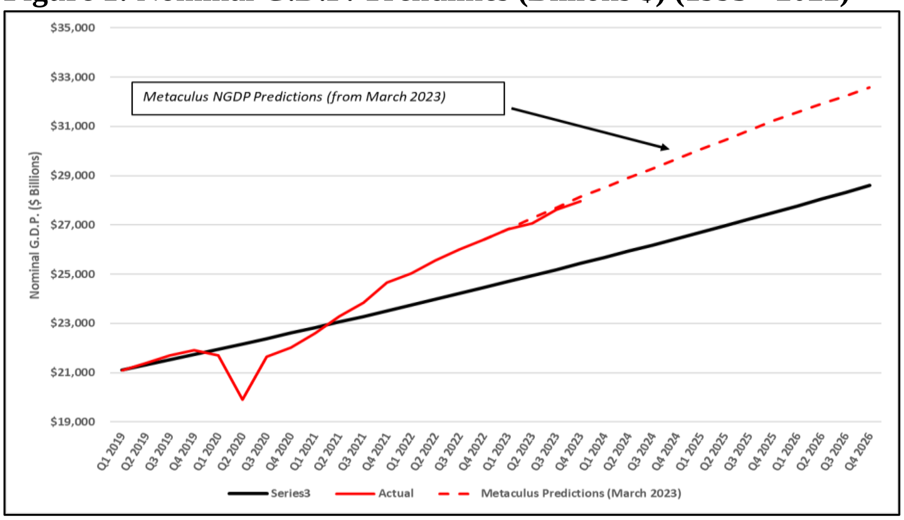
Please refer to the disclosures (1 to 5) at the end of this letter as well as the disclaimer on the page 5
All results have not been audited

General Market Commentary

As usual we'll provide a brief update on general economic conditions, centering around Nominal GDP growth. As noted in last year's letter, NGDP had been growing at an above trend pace starting in 2021 and continuing through 2022. As of late 2022 it looked as if the pace of acceleration had slowed but still overheating.

At the time of our last letter, market forecasts predicted NGDP to remain above trend out 2026. In the chart below we replicate that analysis, filing in *actual* NGDP data for 2023. We can see actual NGDP (solid red for 2023) closely tracked last year's prediction for NGDP (dotted red for 2023). We keep last year's prediction (dotted red out to 2026) for reference, though we should note that *current* NGDP predictions (as of March *2024)* closely align with last year's predictions out to 2026. NGDP is currently about 9.9% above the 2019 Trendline (last year we were 8.0% above trend).

Figure 1: Nominal G.D.P. Trendlines (Billions $) (1995 - 2022)[6]



We will continue to track this metric based on the 2019 trendline for the next few years, but it's important to remember that, just as we saw in the below trend growth in the 2010s, as time goes on the desirability of returning to trend lessens. As the economy adjusts (and because money is sticky in the short run, but not the long run), eventually a new starting point for a trendline should be established. We are almost certainly at the point now, though that is a bit subjective. In our opinion, by not re-establishing the trendline in the last few years, the Fed has lowered its credibility for returning to trend in the future. If it had returned to trend by sometime in 2022, we could be much more confident in the Fed returning to trend during the next deviation, say in 2029. *Now*, we are much less confident that they will return to trend in the future. That said, this credibility issue must be balanced with acknowledging that the economy has likely adjusted to the new "permanently higher plateau" for NGDP (i.e. it doesn't make sense to return to say the 1970 NGPD trendline all in the name of "credibility" as the economy has clearly had time to adjust to any permanent NGDP deviations from the 1970s)

In our 2021 Annual Letter, we looked at house prices after trying to control for inflation and mortgage rates. Below we update our graph from that letter, noting the increase in the interim two years (adjusted monthly payments were about $2,000 two years ago, and have now risen to over $2,800 as of January 2024 and having hit a high of almost $3,200 in October 2023)

Figure 8: Estimated Monthly Mortgage Payments
(Indexed to $500,000 Purchase Price in 2021 dollars, 30-Year Fixed Mortgage, 20% Down Payment) (1987-2024)[7]

Interest rates are of course are a central driver here. While difficult to predict, we note some general changes of late. The 10-year treasury yield is currently around 4.2% with predicted NGDP a bit over 5% in the coming few years (a spread of 0.9%). This spread is slightly *larger* than the spread we've seen in the years after the 2008 Great Financial Crisis. For example, from mid-2011 to mid-2018, the average 10-year treasury yield was 2.2% vs 4.1% annualized NGDP growth over the same time frame (a spread of 1.9%). Of course, even this spread will not be fixed and can very over time, subject to other economic factors (some have surmised that foreign governments increasing/decreasing their propensity to hold treasuries will have an effect on yields and this spread). We don't have an actionable opinion on this and will only note the change and continue to track it going forward.

Footnotes and Sources

[1] Assumes a 1% annual management fee. Not included in these calculations is an approximately $200 charge per account per year for fixed costs (minimum account fees, trading commissions, etc.). Split Rock Capital Management runs various separately managed accounts. While the strategy is the same, due to differing start dates, etc, the various accounts can have differing holdings and therefore differing performance numbers. While over the long term we expect these differences to even out, over the short run that can vary meaningfully. That said, on inception date, we started an initial portfolio (our *only* account at the time) which we have always, and will continue to use, as our tracking portfolio. To maintain consistency, and remove any selection bias, all historical performance numbers are from solely this account, regardless if the other accounts outperform or underperform this main tracking account in the past or going forward. Above performance numbers are from our original portfolio account. This was the only account setup as of our 12/15/2015 inception date, and the only account that has been continually open since inception.
[2] Includes dividends. Please note that these "S&P 500" numbers use SP500TR. The performance numbers may very slightly from the official S&P 500 performance numbers listed elsewhere on a year to year basis. However, over time, the differences should cancel out. For example, our SP500TR numbers for 2016 was 21.87% which was slightly above the official 21.83% for the S&P 500. However, in 2018 the differences largely evened out, with our SP500TR reporting a return of -4.41% while the official S&P 500 return was -4.38%. The differences in annual returns are largely canceled out over the entire 2-year time frame, and we expect differences between the two performance metrics to be even less of longer periods of time.
Also please note: Split Rock Capital Management runs various separately managed accounts. While the strategy is the same, due to differing start dates, etc., the various accounts can have differing holdings and therefore differing performance numbers. While over the long term we expect these differences to even out, over the short run that can vary meaningfully. That said, on inception date, we started an initial portfolio (our *only* account at the time) which we have always, and will continue to use, as our tracking portfolio. To maintain consistency, and remove any selection bias, all historical performance numbers are from solely this account, regardless if the other accounts outperform or underperform this main tracking account in the past or going forward.
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[5] Partial year only; from inception date of 12/15/2015 to 12/31/2015.
[6] Source: https://fred.stlouisfed.org/series/GDP ; https://www.metaculus.com/questions/13973/us-annual-headline-cpi-inflation/ ; https://www.metaculus.com/questions/13952/us-real-gdp-growth-annual/
[7] Ignores property taxes, insurance, etc. and strictly uses the formula: P [i(1 + i)^n] / [(1 + i)^n – 1]
Sources: https://fred.stlouisfed.org/series/CSUSHPINSA ; https://fred.stlouisfed.org/series/CPIAUCSL ; https://fred.stlouisfed.org/series/MORTGAGE30US

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The following descriptions, while believed to be accurate, are in some cases abbreviated versions of more detailed or comprehensive definitions available from the sponsors or originators of the respective indices. Anyone interested in such further details is free to consult each such sponsor's or originator's website. The past performance of an index is not a guarantee of future results. Each index reflects an unmanaged universe of securities without any deduction for advisory fees or other expenses that would reduce actual returns, as well as the reinvestment of all income and dividends. An actual investment in the securities included in the index would require an investor to incur transaction costs, which would lower the performance results. Indices are not actively managed and investors cannot invest directly in the indices. S&P 500®: Standard & Poor's (S&P) 500® Index. The S&P 500® Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad US economy through changes in the aggregate market value of 500 stocks representing all major industries