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Peterson Investment Fund I, LP

An Undervalued Portfolio Hedge For Value Investors

Peterson Capital Management, LLC

Peterson Capital Management, LLC

Best Ideas 2018
Hosted by MOI Global

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Past performance does not guarantee future results.

Agenda

1. Current State of Markets
2. Volatility Analysis
3. Undervalued Hedge Opportunity
4. Position Sizing
5. Risks and Considerations
6. Appendix
   - Fund Background
   - Manager Biography

It is useful to consider the psychology of market participants – today, we see significant risk taking behavior and less risk avoidance.

WHAT DO WE KNOW?

- Global Markets at All Time Highs (S&P 500 ~2,700)
- Interest Rates Artificially Low (US 10-Yr 2.3%)
- Shiller PE Ratio at second highest ever recorded (32)
- Buffett Valuation Indicator: Total Equity Market Capitalization divided by GDP highest since 2000 (140%)
- Negative ECB Interest Rates and EU High Yield Index under 2.5%
- Argentina Issued 7% 100 Year Bonds (8 Defaults in under 200 Years)
- Cryptocurrency mania in effect (Bitcoin, Litecoin, and Ethereum up 2,000%, 3,000% and 5,000% respectively)
- Lowest Volatility since before 1990 (VIX 9.6)

WHAT DO WE NOT KNOW?

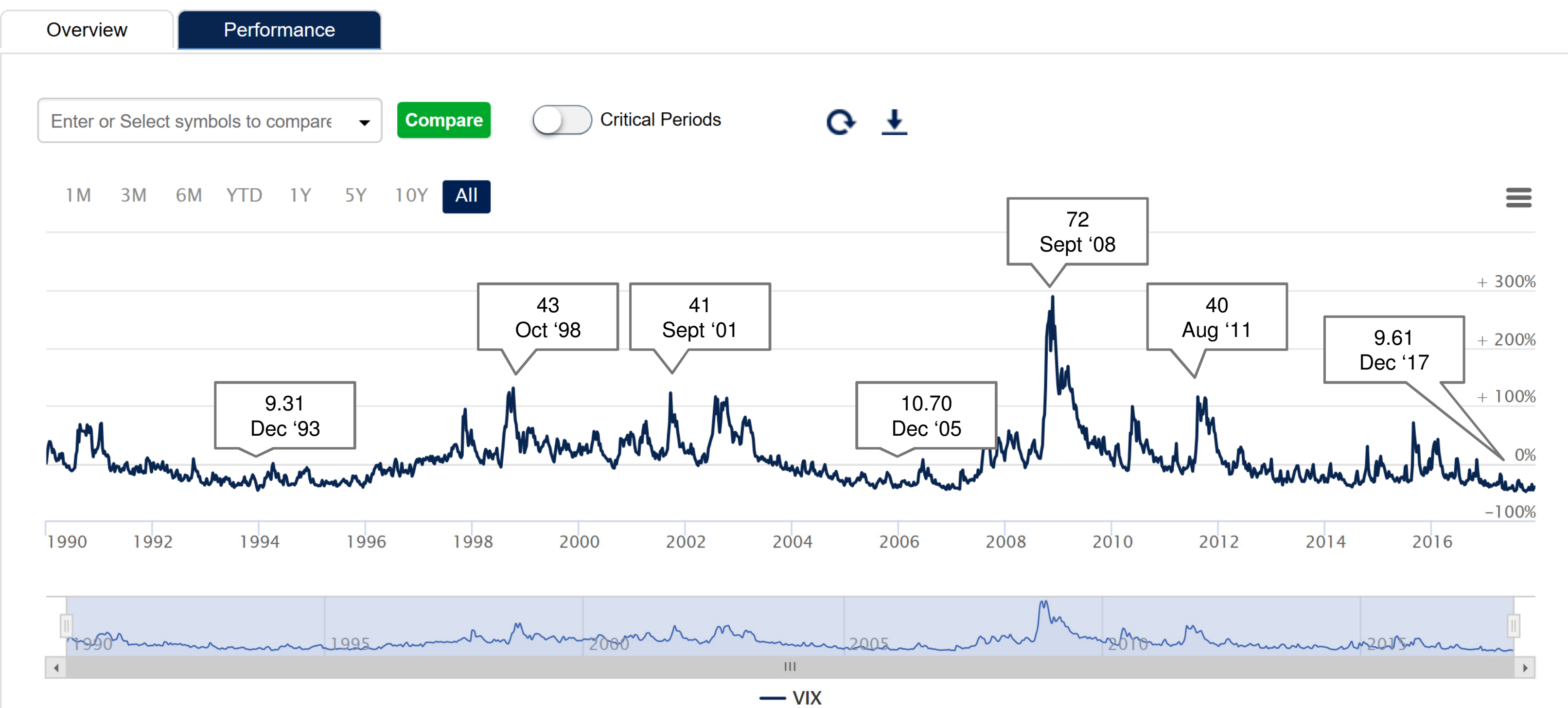
- Macroeconomic Forecasting
- Market Timing

The S&P 500 is up nearly 400% in 9 years since March 2009, it is prudent to position yourself to thrive through the next bear market.

Today, volatility (VIX) is at one of its lowest points in 27 years.

Volatility is cheap. The lowest volatility in decades provides a very unique opportunity for a low cost hedge using multi-year put contracts.

Last Sale	Change	Open	High	Low	Prev Close
9.61	-0.55 (-5.41%)	10.00	10.06	9.43	10.16



Source: Chicago Board of Exchange http://www.cboe.com/index/

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Volatility and high asset prices are key variables in the Black-Scholes option pricing model

Low volatility and high prices translates to historically low cost hedging opportunities.

Definition	Greek	Symbol	Variable Today	Put Price Today
Asset Price	Delta	δ	High	✓ Low
Volatility	Vega	ν	Low	✓ Low
Delta Rate of Change	Gamma	Γ	Low	✓ Low
Risk-free rate	Rho	ρ	Low	High
Time to expiration*	Theta	θ	High	High
Strike Price	Strike	X	Low	✓ Low

Buying a put has become cheap, and when you need it, it will be expensive.

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How can one take advantage of high equity prices with low volatility?

- Buy one 10% out-of-the-money put for protection
- Sell one 30% out-of-the-money put and one 40% out-of-the-money put to help pay for the protection

To avoid trying to time the next bear market, one can use long term LEAPS contracts. Contracts used today expire in January of 2020. In August 2018, contracts will be available for January 2021.

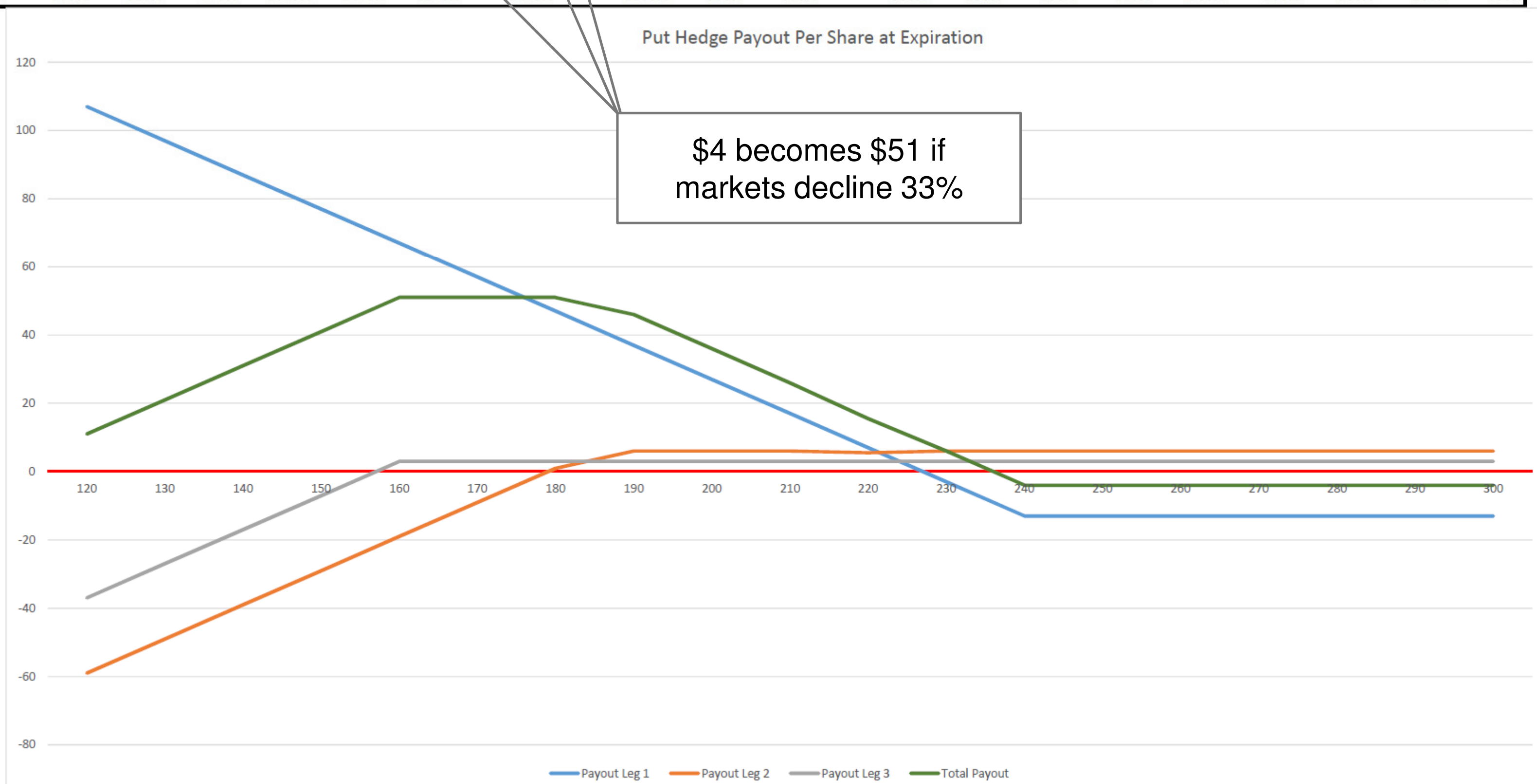
2018 put spread hedge payout model

		Strike	Put/Call	Price	270 SPY Price Today
Leg 1	Buy	240	P	13	-11%
Leg 2	Sell	185	P	6	-31%
Leg 3	Sell	160	P	3	-41%
Trade Cost				4	

This inexpensive asymmetric hedge provides an incredible 10-12x gain should SPY decline between 28-45%. A positive multi bagger total payout results from SPY declines ranging from 15-60%.

SPY Price	120	130	140	150	160	170	180	190	200	210	220	230	240	250	260	270	280	290	300
Index Return	-56%	-52%	-48%	-44%	-41%	-37%	-33%	-30%	-26%	-22%	-19%	-15%	-11%	-7%	-4%	0%	4%	7%	11%
Payout Leg 1	107	97	87	77	67	57	47	37	27	17	7	-3	-13	-13	-13	-13	-13	-13	-13
Payout Leg 2	-59	-49	-39	-29	-19	-9	1	6	6	6	5.5	6	6	6	6	6	6	6	6
Payout Leg 3	-37	-27	-17	-7	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3
Total Payout	11	21	31	41	51	51	51	46	36	26	15.5	6	-4	-4	-4	-4	-4	-4	-4
Percent Gain	275%	525%	775%	1025%	1275%	1275%	1275%	1150%	900%	650%	388%	150%	-100%	-100%	-100%	-100%	-100%	-100%	-100%

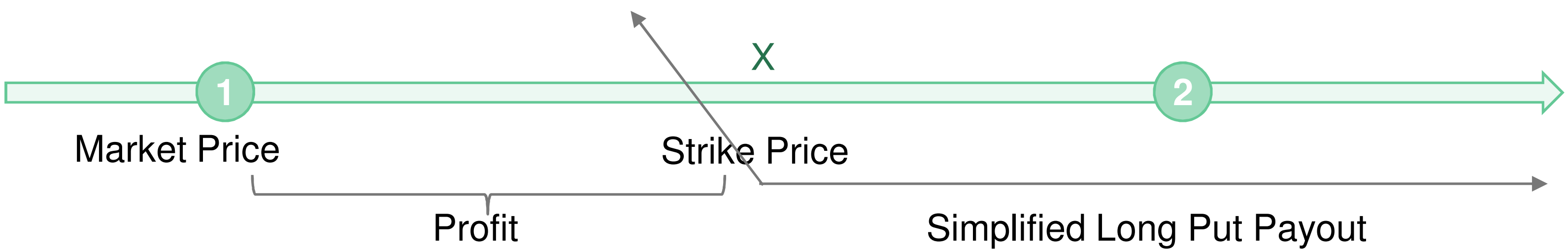
$4 becomes $51 if markets decline 33%



Puts today offer an undervalued hedge with asymmetric upside during a bear market

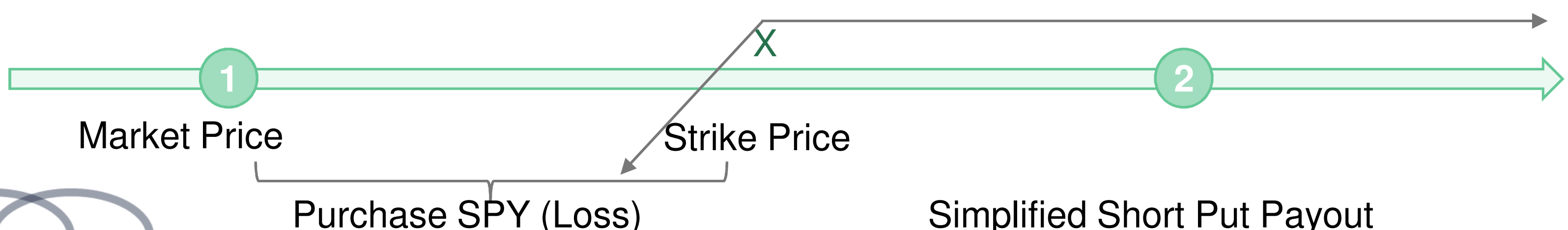
Long Put Potential Expiration Outcomes

1. SPY Price Falls Below Strike = Profit (Strike minus SPY Price)
2. Price Above Strike = Loss of Premium



Short Put Potential Expiration Outcomes

1. SPY Price Falls Below Strike = Loss (Purchase SPY)
2. Price Above Strike = Gain of Premium



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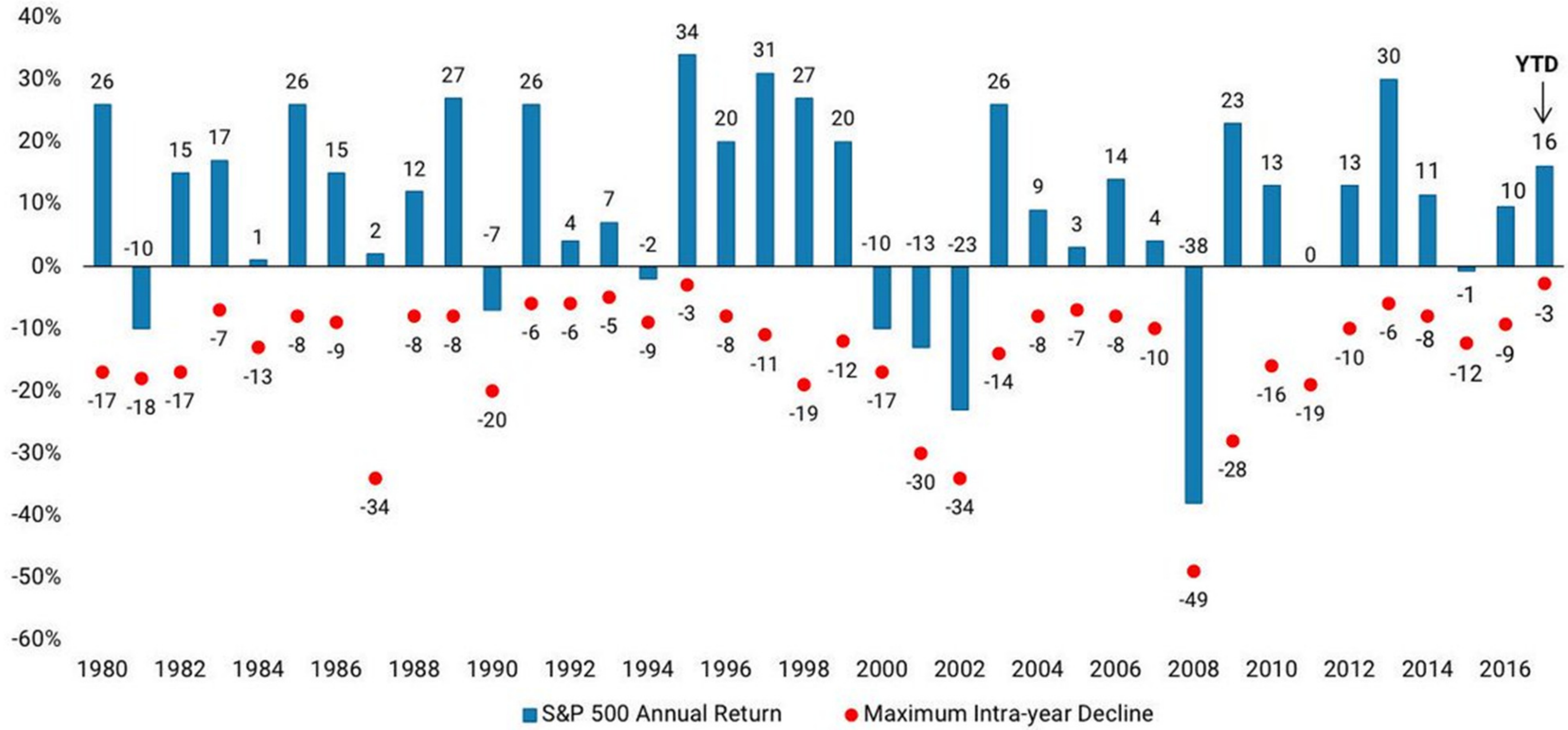
Historical S&P 500 annual returns and drawdowns since 1980

In an analysis of 37 years, annual intra-year drawdowns have exceeded 30% 4 times. 2008 was the only full year with an annual loss greater than 35%.



Source: Bloomberg, Morgan Stanley Research as of November 21, 2017.

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Position sizing has major return implications and the Kelly criterion can be used to optimize capital compounding

Kelly % = W – [(1-W)/R]

- W (win) = Number of Positive Outcome Trades / Total Trades
- R (gain / loss ratio) = Total Positive Trade Amounts / Total Negative Trade Amounts

Observations

- Drawdown > 30% in 4 of 37 years
- Drawdown >15% in 13 of last 37 years
- Multiyear index declines/drawdowns have reached nearly 50%

Assumptions

- Repeatable opportunity if volatility remains low
- We are likely to experience another drawdown sometime within next 5 or 10 years

Conclusions

- With wide assumptions, Kelly states 6% average portfolio allocation. Half Kelly at 3% (300 bps) is a wise allocation.
- Allocating 100 bps yearly to a multi-year position, one can build into 300 bps over 3 years, creating 40% portfolio upside in a crisis

Risks and Considerations

- Position will lose 100% if SPY does not decline nearly 15% before expiration (January 2020)
- SPY declines of 30% or more result in the required purchase of the index fund
- Should the SPY decline beyond 60%, this position will have short term negative returns

Our mission is to provide a world class capital appreciation vehicle that builds enormous wealth for our long-term partners.

Fund Overview

Peterson Investment Fund I, LP (PIFI) is a hedge fund focused on long term value strategies modeled after the tradition of the original Warren Buffett partnerships.

PIFI's approach is an investment paradigm that involves buying securities when shares are underpriced based on fundamental analysis. The PIFI investment objectives include capital preservation, long-term capital appreciation in excess of the benchmark (S&P 500), and limitation of downside risk.

PIFI has returned 135% in fewer than seven years using a method Peterson terms "structured value." Structured value combines modern portfolio products such as long term equity anticipation securities (LEAPS) to offer insurance to counterparties on stocks the fund wishes to own. This is distinctly different from using these products for short term trading. Instead, PIFI's approach allows for the collection of a premium immediately and commits the fund to purchase the counterparties undervalued securities in the event that they become even cheaper. When market conditions are volatile and counterparties are fearful, owners of stock are sometimes willing to overpay irrationally for downside protection on valuable businesses. Ultimately PIFI has the ability to purchase shares of stock for prices below those in the market and will then hold them for long term appreciation building an equity portfolio of great firms at discounted prices.

Period	Net LP Returns
2011*	33.99%
2012	58.58%
2013	26.39%
2014	-5.82%
2015	-25.46%
2016	7.18%
2017 YTD	+16.02%
Annualized	+14.79%
Cumulative	+134.44%

* Figures are representative of since inception returns on October 1, 2011.

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1. **We concentrate on our best ideas**
   - We see no benefit in executing on our 25th best idea so we focus on our best ideas to help us outperform the benchmark.
2. **We minimize the use of leverage**
   - We avoid leverage to decrease volatility and unnecessary interest expense and use margin sparingly only when unique situations exist.
3. **We employ a margin of safety policy to investing as a means to limiting our downside risk**
   - After calculating firm intrinsic value we include a margin of safety to our entry price. Preferably we seek opportunities to purchase equity for less than the stock market price.
4. **We limit portfolio turnover to reduce frictional costs for investors**
   - Frictional costs (e.g. taxes, transaction fees, etc.) will erode returns over time and we look for opportunities to minimize costs and maximize gains.
5. **We align investor and manager incentives and eliminate conflicts of interest**
   - Alignment of General Partner (GP) and Limited Partner (LP) interests is the primary consideration for every operational decision because shared interest between all partners will help maintain the fund's integrity over the long run.

Matthew P. Peterson, CFA

Matthew Peterson is the Managing Partner of Peterson Capital Management and he manages Peterson Investment Fund I. Matthew has over fifteen years of experience as a fund manager and with global financial services firms including Goldman Sachs, Morgan Stanley, Merrill Lynch, American Express, and Ameriprise Financial.

Prior to forming Peterson Capital Management and launching Peterson Investment Fund I, Matthew split time between Wall Street and London as Capital Markets Manager in the Financial Services Vertical at Diamond Management and Technology Consultants. Matthew worked as a member of both the U.S. and U.K. offices, with expertise spanning from risk management to derivative processing. During his tenure with Diamond, Matthew worked with top-tier investment banks, global payments firms, and international insurance companies to deliver high impact solutions to his clients' most challenging business problems.

In 2010, Diamond was purchased by PWC, and became Diamond Advisory Services.

Before Diamond, Matthew worked with Merrill Lynch, and founded M. Peterson Financial Services, a financial planning firm that offered client planning services to American Express Financial Advisors.

Matthew holds a Chartered Financial Analyst (CFA) designation. He earned his Bachelor of Science in economics and minor in mathematics from the University of Puget Sound. Matthew has lived and worked in China, England, and the United States. Matthew resides in Manhattan Beach, California, with his wife, Gamze, and their two children, Isabel and Adrian.

Goldman Sachs

Morgan Stanley

Diamond
Management & Technology Consultants

Merrill Lynch

RSA

Ameriprise Financial

American Express

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