MPE
CAPITAL

Dear Investors,

I'd first like to thank you all for entrusting me with your hard-earned capital. Allocating your capital is a responsibility that I don't take lightly and I place utter importance on investing in opportunities that present a very low probability of permanent capital loss.

For the year ending December 31, 2017 we earned a gross return of 20.2%, versus 21.8% for the S&P 500. Net returns will vary based on qualified or non-qualified client fee structures. Please refer to your more detailed performance statement to see your net returns and ending year account balances.

My primary goals in writing these letters will be to: update you on how your investment in MPE Capital is doing, further explain my investment philosophy, and most importantly manage expectations so that we can sustain an enduring partnership. Nearly all of my personal capital is invested alongside yours, aligning our interests in achieving a very satisfactory investment result over a long period of time.

INVESTMENT OBJECTIVE

Just the same way that you don't set the distance of a marathon once the race is over, I don't think the same should be done when measuring investment results. I think it is crucial to determine our long-term goals beforehand so that we can objectively measure our progress over time. The benchmark to which I will compare our performance to will be the S&P 500 Total Return Index, this is the S&P 500 including the re-investment of dividends.

I believe a prudent alternative to investing with MPE Capital is investing in a low cost passive index fund like the S&P 500. The reason you are paying higher fees than investing in a low-cost passive index fund, and the reason that I partake in the onerous task of evaluating investment opportunities, is to deliver net returns above our benchmark. I don't see why MPE Capital should exist if we fail to add value over a long period of time.

EVALUATING INVESTMENT MANAGERS

I believe that the performance of any one investment manager should be evaluated over a full economic cycle to minimize the effects of luck and to determine if that manager can truly add value in terms of superior risk adjusted returns. Performance in any one calendar year or quarter is completely random and thus meaningless. Even strong performance over a period of a few years can be strongly attributed to luck. I would urge you not to place much emphasis on our results for any given quarter or calendar year but to judge our results over a full economic cycle.

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IMPORTANCE OF LONG-TERM THINKING

Too many investors are overly focused on short-term investment performance. I would argue that our results over a period of less than a few years are purely random. We invest in operating companies whose results will fluctuate due to a myriad of reasons, many of which are completely out of their control (e.g. the overall economy). Even the best companies can experience temporary setbacks during periods of economic contraction. We cannot control the economic cycle and therefore our short-term results are also out of our control.

However, over the long run, assuming the businesses we invest in continue to grow their worth and widen their competitive advantages, our investment results should follow the same level of growth experienced by the underlying businesses we invest in.

RESULTS FOR THE YEAR

We ended the year underperforming the S&P 500, about neck and neck gross of fees. The two biggest contributing factors were our large cash balance of about 40-50 percent and the lack of attractive opportunities to deploy capital. In my opinion, to deliver returns similar to that of the overall market while employing only half the capital is not a terrible result. Our high cash balance is in no way a market timing call but more a product of the opportunities available to us (valuations have just been too rich for my taste).

I personally find cash to be a terrible investment as it is guaranteed to depreciate a few percentage points every year. Hopefully in the coming year we will find opportunities to deploy our large cash balance and thus subsequently reduce the performance drag. My goal is to always be fully invested as I believe it’s impossible to time the market. However, at the same time, I will not lower my investment standards just to allocate capital.

None of the above reasons are an excuse for our underperformance but they should shed some light on the drivers of our performance for the year. In any case, I will reiterate that evaluating our performance over any single calendar year is absolutely meaningless. Our objective is to outperform and add value over a period of five to ten years, over a full economic cycle.

In closing, I would like to thank you all again for entrusting me with the allocation of your hard-earned capital. I look forward to reporting to you again next year.

Sincerely,

Michael P. Ershaghi