UCLA Anderson School of Management

Student Investment Fund

Peterson Capital Management

May 2015

Peterson Capital Management, LLC

Contents

Matthew P. Peterson, CFA

Matthew Peterson is the Managing Partner of Peterson Capital Management, LLC. Matthew has over a decade of experience with global financial services firms including Goldman Sachs, Morgan Stanley, Merrill Lynch, American Express and Ameriprise Financial.
Prior to forming Peterson Capital Management, LLC, Matthew split time between Wall Street and London as a Capital Markets Manager in the Financial Services Vertical at Diamond Management and Technology Consultants. Matthew worked as a member of both the US and UK offices with expertise spanning 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.

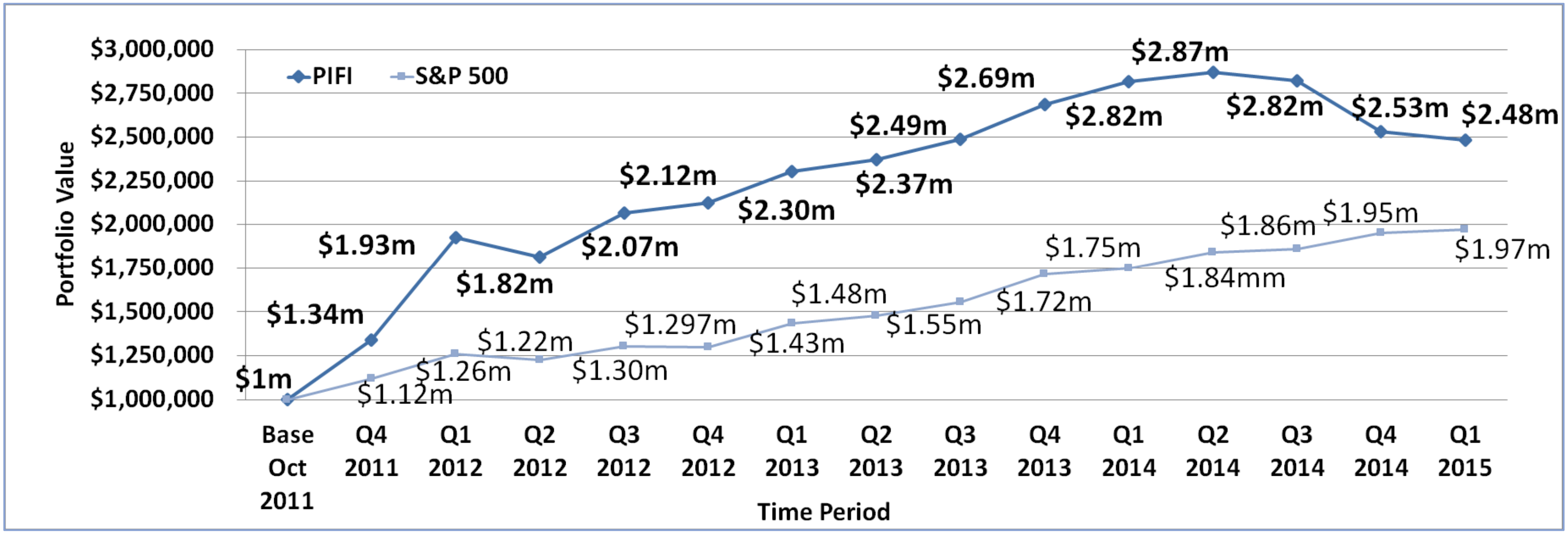
Matthew Peterson, CFA
Managing Partner
matthew.peterson@petersonfunds.com

Phone: 858.754.9379
Mobile: 917.822.1599
www.petersonfunds.com

Peterson Capital Management, LLC
426 Rosecrans Ave
Manhattan Beach, CA 90266

Historical Performance: Value of $1mm USD in PIFI vs. the S&P 500

Peterson Investment Fund I, LP launched in Q4 2011 has returned over 148% in 4 years.
The fund has now outperformed the S&P 500 including dividends by over 50%.



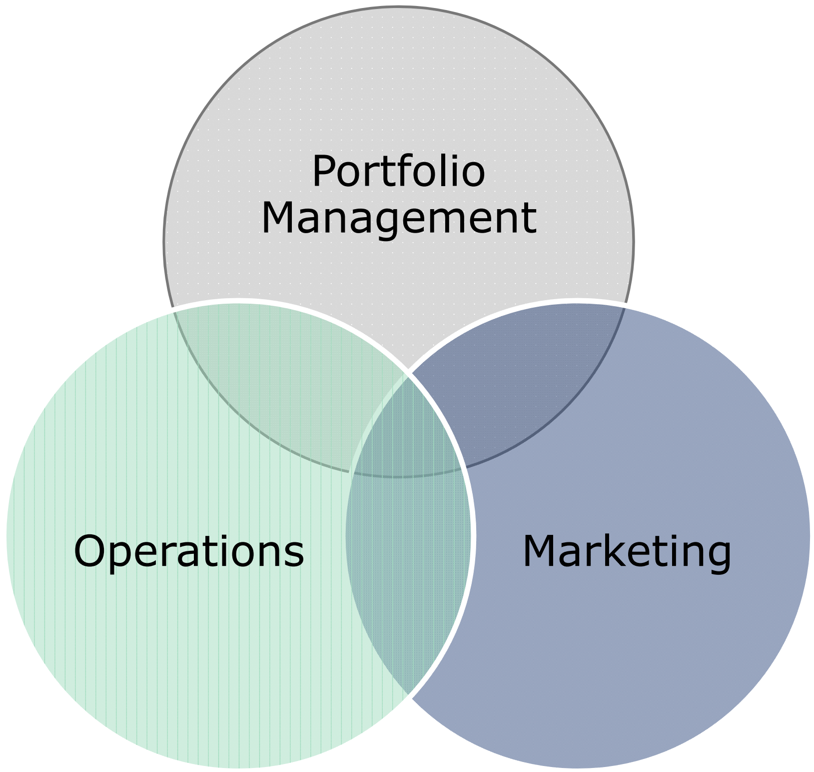
Period	Percent Change in PIFI After all Fees and Expenses (1)	Percent Change in S&P 500 with Dividends Included (2)	Relative Results (1-2)
2011	+33.99%	+11.82%	+22.17%
2012	+58.58%	+16.00%	+42.58%
2013	+26.39%	+32.39%	-6.00%
2014	-5.82%	+13.69%	-19.51%
1st Quarter 2015	-1.84%	+0.92%	-2.76%
Annualized	+29.36%	+21.22%	+8.14%
Cumulative	+148.25%	+97.03%	+51.22%

1.

Hedge Fund Management

- Portfolio Management
- Operations
- Marketing

Managing a Hedge Fund Requires More than Portfolio Management



In a perfect world one would expect assets to flow to those producing the greatest returns. However, operations and marketing are also essential to the success of most hedge funds.

1a.

Hedge Fund Management

- Portfolio Management
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Peterson Capital Management, LLC

To become a good investor requires at least three legs under your stool:

Financial Analysis

- The foundation for trying to make money in the market
- The analysis taught in Universities
- Accounting, financial statement analysis, etc.

Financial Theory

- CAPM
- Efficient Market Hypothesis
- Random Walk

Human Side

- Very few textbooks on the subject
- Behavioral finance tells you a bit about this subject
- It is the difference between theory and practice

While markets are not perfectly efficient, neither are they completely inefficient

How can theory and practice differ?

In Theory	In Practice
• Markets are efficient, objective and price assets right • You should not be able to buy assets for less than their fair value	• Markets are made up of people who swing to emotional extremes
• People are risk averse and riskier assets must return higher returns than safe assets	• Riskier assets appear to provide higher returns but they don't always do so • If risky assets could be counted on to provide higher returns, then they would not be risky
• An appropriate risk premium is included into risky assets	• Sometimes the premium is too little, sometimes too much and sometimes just enough
• You want more of something for a lower price and less of it at a higher price (Demand curves slope downward and to the right)	• people tend to warm to investments as they rise and shun them when they fall (Investments are like Giffen goods)

The best way to conceptualize the market is as a pendulum

The market is always swinging:

- risk tolerance vs. risk aversion
- optimism vs. pessimism
- fear vs. greed
- credulousness vs. skepticism

The Big Secret: The average is not the norm

"What the wise man does in the beginning the fool does in the end"
- Warren Buffett

3 Stages of a Bull Market	3 Stages of a Bear Market
1. A few smart people believe there will be improvement (Time to buy) 2. Most people believe things are getting better 3. Everyone believes that things will only get better forever (Time to sell)	1. A few smart people see that things are turning down 2. Most people think things are getting worse 3. Everyone thinks things will get worse forever (This is where we reached in 2008 and 2009)

Regardless of what asset class we are talking about, if we all agree on when it is time to buy and sell, then we all agree that it is what you pay that matters

1b.

Hedge Fund Management

- Portfolio Management
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Peterson Capital Management, LLC

Peterson Capital Management, LLC: Sample Service Providers

Administrator / Gatekeeper

Yulish & Associates
2 Turquoise Way
San Francisco, CA 94131
Phone: 415-641-8600
Fax: 866-514-0105
www.yulish.com

Legal Support

Brill Law
235 Montgomery Street
17th Floor
San Francisco, CA 94104
Phone: 415-954-4480
www.brill-law.com

Compliance

Gordian Compliance Solutions, LLC
150 Spear Street, Suite 825,
San Francisco CA 94105
Phone: 415-762-2845
Fax: 415-970-5062
www.gordiancompliance.com

Corporate Banking

Wells Fargo Bank
3110 N. Sepulveda Blvd.
Manhattan Beach, CA 90266
Phone: (310) 545 4062
Fax: (310) 545 7423
www.wellsfargo.com

Audit / Tax

Spicer Jeffries LLP
5251 S. Quebec Street, Suite 200
Greenwood Village, CO 80111
Phone: (303) 753-1959 | Ext. 22
Fax: (303) 753-0338
www.spicerjeffries.com

Technical Solutions

Global Solutions India
Office No 601, Orbit Heights
SP Road, Pune - 46101
Phone:91-20-23804029
www.globalsolutionindia.com

Prime Broker

Interactive Brokers Group
8 Greenwich Office Park
Greenwich, CT 06830
Phone: (800) 442 2757
www.interactivebrokers.com

Qualified Plan Custodian

AdvantaIRA Trust, LLC
1520 Royal Palm Sq Blvd #320
Fort Myers, Florida 33919
Phone: 786.275.5870
Fax: (786) 497 3531
www.advantaira.com

Peterson Capital Management, LLC: Additional Terms and Conditions

Investment Logistics

- Minimum investment (i.e. $250,000)
- Open for investment (i.e. Monthly)
- Liquidity (i.e. 36 month lockup)
- Early redemption parameters (i.e. 3% charge)

Fees

- Management 0.9%
- Hurdle Rate 5%
- Performance 25% above 5%
- High Watermark Provision

Client Communication

- Performance Summaries (i.e. Quarterly)
- Partner Letters (i.e. Quarterly)
- Statements of LP account (i.e. Quarterly)
- Audit (i.e. Annually)

Tax

- Tax Documentation (i.e. K-1; Annually)

1c.

Hedge Fund Management

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Hedge Fund Marketing Channels

- Internal Referrals
- Professional Network
- High Net Worth Investment Advisors, Family Office, Corporate Platforms
- Regional Sales Teams
- Public Speaking Engagements (e.g. Non Profit, University, Corporate, etc.)

2.

Peterson Investment Fund I, LP

Peterson Investment Fund I, LP (PIFI): Operational Philosophy

PIFI is built on a foundation of integrity designed to last for generations. PIFI focuses on minimizing asset turnover, minimizing frictional costs, and minimizing operational expenses. This practice over the long term will directly enhance returns and provide significant value to our clients, the limited partners (LPs).

1 **We concentrate on our best ideas**

- We see no benefit in executing on our 25th best idea so we concentrate on our best ideas to help us outperform the benchmark

2 **We minimize the use of leverage**

- Leverage increases portfolio risk and generally requires payment of interest. So avoiding it allows us to "kill two birds with one stone." In an expansionary market leverage may enhance gains but in a contracting market leverage can be devastating. We avoid leverage to decrease volatility and unnecessary costs and use it only marginally when unique situations exist.

3 **We employ a margin of safety policy to investing as a means to limiting our downside risk**

- After determining an entry price we introduce a margin of safety. Executing on this principle requires patience and control.
- Ultimately this leads to buying deeply discounted shares for prices that are often unavailable in open stock market

4 **We limit portfolio turnover to reduce frictional costs for investors**

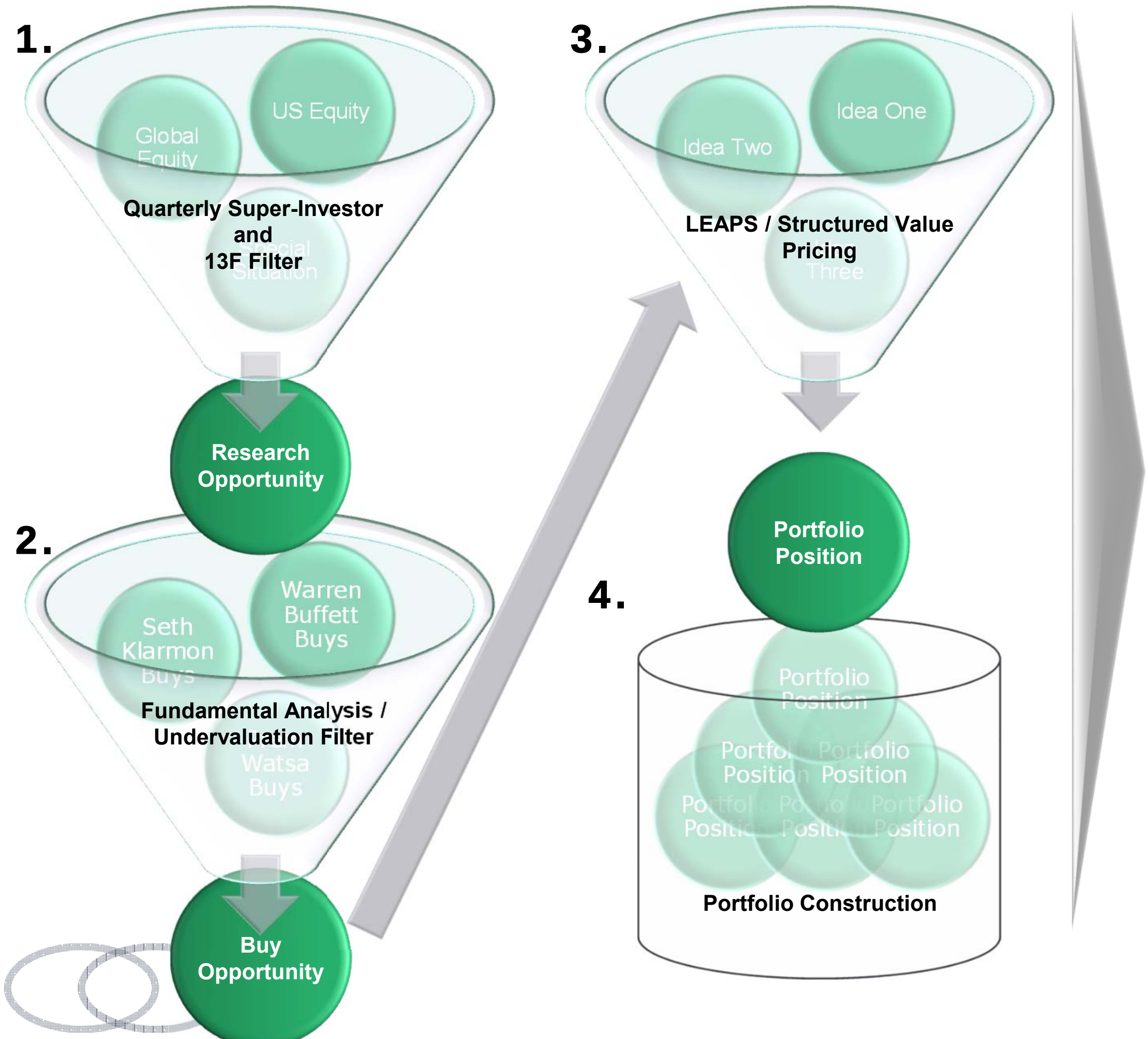
- We limit taxes, transaction fees, and other frictional costs to ultimately increase limited partner returns
- Frictional costs, if not contained, will erode returns over time and we look for every opportunity to maximize gains

5 **We align investor and manager incentives and eliminate conflicts of interest**

- We avoid every unnecessary expense to ensure profits directly enhance the bottom line

Alignment of GP and LP interest is the number one consideration for every operational decision. Our belief is that a shared interest between all partners will help avoid conflicts of interest that arise at many investment firms today and will allow us to maintain the integrity of the fund over the long run.

Creating a Long-Term Value Portfolio With a Pricing Advantage



1. Prioritizing Research

- Tens of thousands of public companies exist so prioritizing research on value-based super-investor selections means we are dedicating time to the correct value investment opportunities.
- We closely monitor over 50 super-investors and their public filings to identify the very best opportunities.

2. Identifying Undervalued Buy Opportunities

- Each quarter we identify several dozen new research prospects. We apply fundamental analysis and seek to identify the most undervalued investments from within this basket.

3. Purchasing Process

- Once a purchase decision is made and price determined, we apply "structured value" methods to buy our equity.
- Utilizing the sale of LEAPS, we are first paid a premium before we purchase the stock for our portfolio
- Our purchase method provides a discount to market prices and an additional margin of safety.

4. Portfolio Construction

- Our highly selective process focuses on firms admired by the best value investment minds in the world.
- We construct an optimally diversified long-term value portfolio from firms selling for deep discounts to their intrinsic value.
- We are often paid a premium to buy the stock providing a market discount.

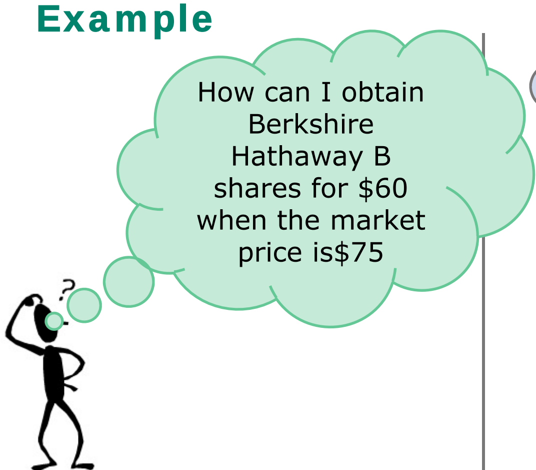
Obtaining Equity at Below Market Prices

Structured value provides an incredible advantage over the traditional buy and hold strategy. We are paid a premium up front that reduces our net purchase price to a level often below the market price.

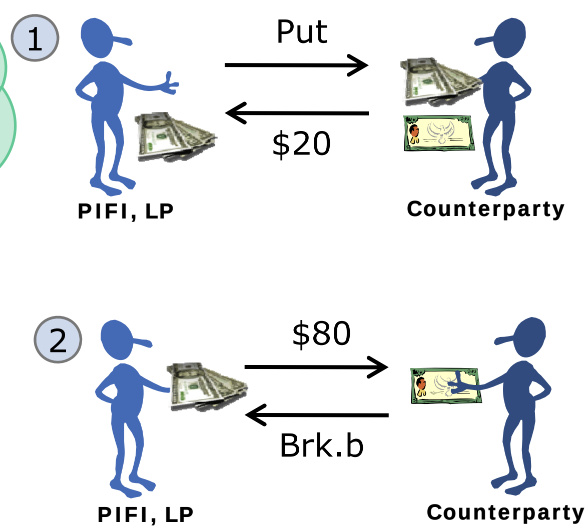
Example

1. Identify shares of undervalued stock that we wish to own
2. Sell insurance in the form of LEAPS on the shares we wish to own
3. Collect a premium for the contract immediately and commit to purchase undervalued securities in the future if they remain below our specified price
4. Hold contracts until expiration

Example



Outcome



Opening Position: Write a 15 month cash secured put contract with a strike of $80 and a price of $20.

Closing Position: In the event that share prices are below $80 we will purchase stock with a net cash outflow of $60. Out of the money expirations result in a 33% return on our collateral (Premium / Collateral)

Key Terms

- **LEAPS:** Long Term Equity Anticipation Securities exchange traded through the Chicago Board of Exchange provide the holder the right to buy or sell associated equity to their counterparty at a predetermined price in the future.
- **Out of the money:** refers to the condition where a securities market price is above our commitment or strike price and we will not purchase the stock.

The Black-Scholes-Merton Option Pricing Model (BSM)

You can think of the BSM as “stock price times a probability minus the present value of the exercise price times another probability

Symbol	Greek	Definition	Put Price if Greek is High	Put Price if Greek is Low
T	Theta	Time to expiration	High	Low
S_0	Delta	Asset Price	Low	High
X	Strike	Exercise Price	High	Low
Rf	Rho	Risk-free rate	Low	High
σ	Vega	Volatility	High	Low

Ideal Sale

<u>BSM Model</u>

$C_0 = [S_0 * N(d_1)] - [X \times e^{-Rf * T} * N(d_2)]$

$d_1 = \{\ln(S_0/X) + [Rf + (0.5 * \sigma^2)] * T\} / \{\sigma * \sqrt{T}\}$

$d_2 = d_1 - (\sigma * \sqrt{T})$

Ideal conditions for selling put contracts:

- Long Dated
- Low Asset Price
- High Strike Price
- Low Risk Free Rate
- High Volatility

Most importantly, only sell a put when you are prepared and willing to own the underlying asset.

Who might be applying the Kelly Criterion today?

Baupost: Seth Klarman

- 93% of portfolio in 10 positions
- 14% in Micron Technology (MU)
- 7% in Cheniere Energy Inc. (LNG)

Hayman: Kyle Bass

- 6 positions
- 46% in General Motors (GM)
- 21% in Nationstar Mortgage (NSM)

ESL Investments: Eddie Lampert

- 4 positions
- 55% in Sears Holdings (SHLD)
- 24% in AutoNation (AN)

Pabrai Funds: Mohnish Pabrai

- 7 positions
- 24% in Horsehead (ZINC)
- 22% in General Motors (GM)

Fairfax: Prem Watsa

- 98% of portfolio in 10 positions
- 35% in Resolute Forest (RFP)
- 31% in BlackBerry (BBRY)

Pershing Square: Bill Ackman

- 7 positions
- 40% in Allergan (AGN)
- 20% in Can. Pacific Railway (CP)

Fairholme: Bruce Berkowitz

- 8 positions
- 22% in Bank of America (BAC)
- 13% in Sears Holdings (SHLD)

WL Ross & Co: Wilbur Ross

- 4 positions
- 54% in Navigator Holdings (NVGS)
- 17% in EXCO Resources (XCO)

Based on equity holdings disclosed in 13F-HR filings with the SEC and data from The Manual of Ideas, December 2014. Excludes cash, leverage, certain non-U.S. holdings, and non-equity securities.

A Few Quotes to Live By

"All intelligent investing is value investing - acquiring more than you are paying for. You must value the business in order to value the stock."

- Charlie Munger

"Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it."

- Warren Buffett

"Investors should purchase stocks like they purchase groceries - not like they purchase perfume."

- Benjamin Graham

"When prices are high, it's inescapable that prospective returns are low (and risks are high)."

- Howard Marks

Q & A

Open Questions