January 31, 2023

Dear Clients & Friends:

2022 INVESTMENT REVIEW

STRATEGY	2022 Rate of Return*	Comparable Index Return
Unhedged Securities (Taxable)	-23.4%	-19.5%
Unhedged Securities After Tax (Estimated)	*-22.3%*	
Hedged Securities (Taxable)	-11.8%	-3.2%
Hedged Securities After Tax (Estimated)	*-14.6%*	
Fixed Income (Non-Taxable)	-9.5%	-13.2%

* Average Client Account, Net of Management & Trading Fees[1]

The stock and bond market averages had a bad year.

It was mostly a bad year for Janian's strategies too, although there were some positives which we will highlight later.

The gimlet-eyed[2] among you will note that Fixed Income is back in the Strategy table above. While we're not particularly excited about fixed income's return prospects, after the crummy returns of the last two years we are not as pessimistic about fixed income as we outlined in our 2020 Year-End Letter. Accordingly, for a portion of the portfolios of clients who need lower-risk returns over a short time horizon, we have again begun offering a fixed income, i.e., bond-buying, strategy.

We'll briefly discuss each strategy's 2022 on the following four pages.

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[1] Please contact us if you'd like an explanation of how we calculate these returns. The *After Tax* returns ignore State and 'NIIT' taxes.

[2] https://en.wikipedia.org/wiki/Gimlet_(tool)

Unhedged Securities

% Change		
	Unhedged Securities Strategy, Net of Fees*	VTI
2018	(12.53)	(5.13)
2019	28.95	30.80
2020	35.09	20.95
2021	28.31	25.70
2022	(23.41)	(19.50)
Annualized	8.41	8.72

*Fees = Management & Trading Fees

The Unhedged Securities strategy[3] trailed the stock market. It was ahead until the rally in October and November, which we mostly missed due to our cautious positioning.

The positions held by the taxable Unhedged Securities strategy continue to match those held in the long portfolio of the taxable Hedged Securities strategy, which currently is long 21 securities[4].

The stock market was driven by the rise in inflation and central banks raising interest rates in reaction to that. For example, the NASDAQ, which is dominated by 'growth' companies whose hoped-to-be-growing future profits' value significantly depends on the interest rate used to discount those profits, was -33% for the year, while the S&P 500 Energy index, which is dominated by companies whose products' prices are driven mainly by inflation, was +66%.

Janian had no exposure to 'energy' and a goodly amount of exposure to 'NASDAQ-mimicking' stocks. We had a less-than-fully invested long portfolio all year, which helped soften the damage. At the individual security level, there was not much change. Of the securities currently in the Unhedged Securities portfolio, 12 (representing ~85% of the portfolio's current exposure) were in the portfolio in the first quarter of 2022. For most[5] of the long portfolio, our estimates about the long-term prospects for the security-issuing companies did not change much, as they did not have meaningful changes to their management or their markets' structure.

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[3] VTI = Vanguard Total Stock Market ETF.

[4] The Unhedged strategy is often long an equity index in order to be more fully invested. It has no such index position at the moment.

[5] Tho not all; and, unhappily, the meaningful change that did occur was all negative. This is the nature of bear markets.

We'll illustrate with the story of one current long position, Anterix ("ATEX").

ATEX "holds licensed spectrum in the 900 MHz band with coverage throughout the United States, Alaska, Hawaii, and Puerto Rico" and "focuses on commercializing its spectrum assets to enable the targeted utility and critical infrastructure customers to deploy private broadband networks."[6] At the beginning of 2022, ATEX had a net cash balance of ~$100MM, a projected all-in annual operating expense level of ~$70MM for each of 2022 and 2023 (dropping to ~$40MM per year sometime after that), and deals signed with three utilities "with proceeds of over $200 million" plus an additional "14 experimental licenses [pilot programs] that are out there", of which its management believed "in excess of $400 million" worth was in the "third and final phase the closing stage of the process." As it had earlier, management told investors "Turning to our fiscal year 2024 forecast, based on our market traction and current pipeline, we maintain our estimate of securing approximately $1.8 billion of contracted proceeds. We also maintain our forecast of receiving initial prepaid cash proceeds of $300 million to $500 million associated with these deals by the end of March 2024."

We have spoken with a variety of operating executives in the utility industry. We unanimously have been told that ATEX is viewed as (1) offering a desirable product (2) that works (3) at an attractive all-in price, and (4) is run by reasonable, capable people who (5) have credibility in the industry. We have also been repeatedly told that (6) utilities are VERY slow in making new equipment purchasing decisions, (7) utilities and their regulators have other pressing matters on their to-do list, and (8) eventually, a swath of the U.S. utility industry is likely to adapt ATEX's products … but when exactly that happens is very tough to guess correctly.

At the beginning of 2022, ATEX's stock was ~$59 per share, implying a market capitalization net of cash of ~$900MM. By our math, that was ~3.5X the cash 'profit' that management predicted it would receive by March 2024, with greater than ~$1B predicted to come later. Visible progress in 2023 was slow (ATEX signed only one more utility with total proceeds of $80MM), but management reiterated "confidence in meeting our targets" several times.

With only slow visible progress and rising interest rates cutting the discounted value of the 'profit' predicted to be received by March 2024 and later, the stock market marked ATEX's stock price to a 2022 close of $32.17 (implying a net market capitalization of ~$560MM). Janian increased the position by ~7%[7] in February 2022 (at $55), ~2% in March (at $59), and ~10% in October (at $34). We still think that ATEX's stock is undervalued.

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[6] https://finance.yahoo.com/quote/ATEX/profile?p=ATEX

[7] of the January 1, 2022 number of shares.

Hedged Securities[8]

% Change

	Hedged Securities Strategy, Net of Fees*	Index of Similar Hedge Funds	50% VTI, 50% BND
2013	18.52	11.14	15.69
2014	10.21	1.42	9.26
2015	(6.65)	(2.33)	0.40
2016	6.00	0.10	7.63
2017	10.17	9.98	12.39
2018	(9.64)	(9.42)	(2.59)
2019	20.90	10.71	19.76
2020	2.68	4.60	14.33
2021	27.38	12.14	12.02
2022	(11.82)	(3.81)	(16.33)
Annualized	6.02	3.21	6.74

*Fees = Management & Trading Fees

As described above, it was a weak year for our longs, both absolutely and in security selection relative to the market (i.e., we were too patient and incorrectly did not jump to the 'hot' trades of being long energy, etc.). However, it was a strong year for our shorts in both dimensions. Three short winners each contributed >1%[9], which is unusual since we typically (and indeed did in 2022) limit shorts to <3.75% in size. All three of those shorts are currently not in the portfolio.

The single largest short winner was Tesla ("TSLA"). 2022 pushed Janian's lifetime return on TSLA securities to ~+0.5%. In the past, we impatiently and incorrectly described TSLA's current CEO to some of you as the "nemesis" of Janian's approach to investing. We write about this to help us memorialize for ourselves this lesson in perseverance.

[8] BND = Vanguard Total Bond Market ETF.

[9] There were an additional 13 short winners that contributed between +0.5% and +1.0%.

Fixed Income

	% Change	
	Fixed Income Strategy, Net of Fees*	**BND**
2013	16.77	(2.14)
2014	(11.50)	5.96
2015	(4.38)	0.39
2016	3.89	2.57
2017	2.13	3.62
2018**	0.16	(1.66)
2019	N/A	N/A
2020	N/A	N/A
2021	N/A	N/A
2022	(9.50)	(13.15)
Annualized	(0.51)	(0.56)

*Fees = Management & Trading Fees

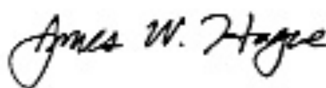
**Thru 2018Q3

The Fixed Income strategy's portfolio had few changes during the year. The strategy is essentially to buy bonds and hold them to expiration, and we expect that "few changes" will be the case for most years.

Janian's business is now more than a decade old, and in the second part of this letter's Appendix we share some thoughts about the why and how of Janian. In the first part, we discuss the macro environment and suggest what that might imply, given Janian's "how."

Best wishes for a happy and healthy 2023 to you and your family.

Sincerely,



James W. Hague
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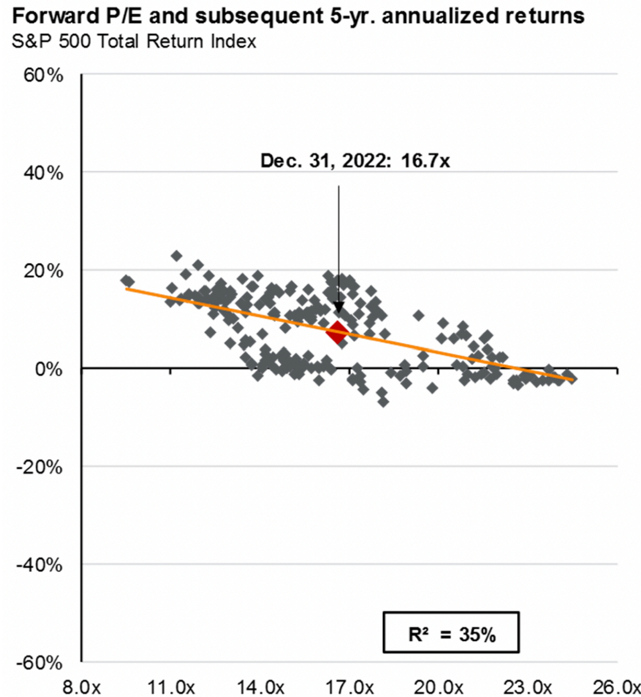
APPENDIX

Janian's Macroeconomic Outlook

We do not know what will happen in 2023. History suggests that stocks' returns will be mediocre over the next five years[10].



We acknowledge that there's no guarantee that that will happen[11].

We continue to believe that in the very long run (10+ years), stock prices are likely to go up; that in the shorter term stock prices, and security prices in general, might be volatile and suffer losses for some periods; and that some businesspeople are exceptionally capable, and some are incompetents, fools, or thieves. Accordingly, our uncertainty about the macroeconomic outlook does not change our strategies' investment processes.

[10] Thanks to J.P. Morgan Asset Management for the chart.

[11] We included a similar chart and made a similar point in the 2013 Year-End Letter … and the VTI was up 54% (11.4% annualized) four years later. We then did the same in the 2017 Year-End Letter … and the VTI was up 8% (1.6% annualized) five years later.

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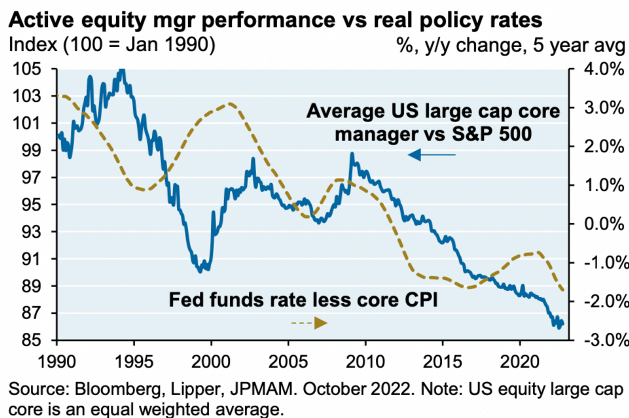
It is important to note that these investment processes are valuation sensitive. Such sensitivity has been persona non grata for many years in the eyes of central bankers. J.P. Morgan's Michael Cembalest recently wrote the following about this:

2023 EYE ON THE MARKET OUTLOOK • MICHAEL CEMBALEST • J.P. MORGAN | January 1, 2023

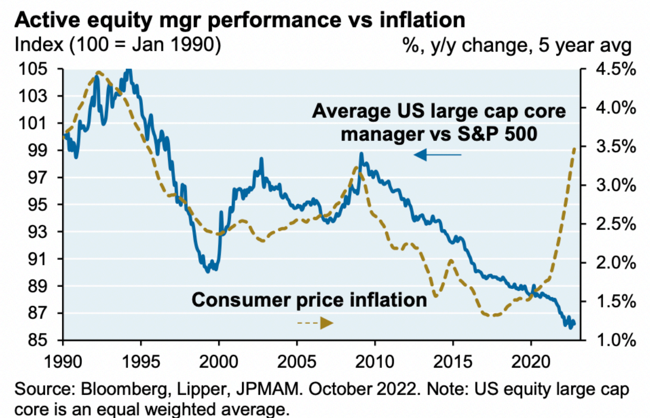
Topic #4: Tracking the performance of active managers

Financial repression by Central Banks began after the 2009 recession and led to collapsing risk premia and falling relative valuation spreads in equities and risky credit markets. This was particularly true in Europe where the ECB bought bonds on the edge of junk (split-rated), which narrowed credit spreads between good companies and bad, and where liquidity in all forms kept insolvent companies alive. **By 2018, the BIS had already found that "zombie" companies in the developed world had risen to 12% of market cap from just 1% in 1990**. This number likely rose further by the beginning of 2021.

It's therefore no surprise that the average equity manager and hedge fund manager struggled to outperform during this decade of financial repression. The charts below illustrate this trend: the blue lines in each chart show the performance of large cap core equity managers and hedge fund managers compared to an S&P 500 benchmark. When the blue lines are declining, active managers are underperforming. On the left, we show performance vs the real Fed Funds rate, and on the right vs inflation. If we are in fact heading back to a world of positive real interest rates, value-oriented portfolio managers may be facing more positive stock-picking and bond-picking conditions than they have seen in some time.



Source: Bloomberg, Lipper, JPMAM. October 2022. Note: US equity large cap core is an equal weighted average.



Source: Bloomberg, Lipper, JPMAM. October 2022. Note: US equity large cap core is an equal weighted average.

The average U.S. large capitalization core equity manager has underperformed the S&P 500 by ~4-5% over the last five years, while Janian's Unhedged Strategy has matched it[12]. If the "conditions" for our approach improve, we aim to increase that outperformance.

[12] https://www.officialdata.org/us/stocks/s-p-500/2018

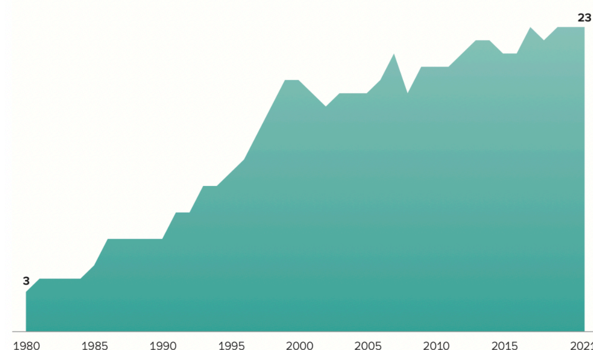
Wait, you don't run a fund?

Happy Tenth Anniversary to Janian!

Many, many thanks to our clients for your business. Different sometimes does not get past first glance, and Janian's business model is different. It swims against the tide of history.

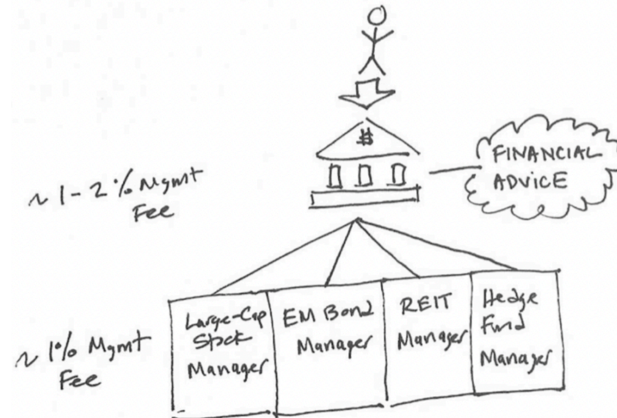
Through the 1970s, most Americans seeking professional investment advice received it from a bank employee, a.k.a. a 'wealth manager' or a 'stockbroker,' or their employer's pension fund managers. Pension fund managers were, and are, typically paid less than bank employees and, in general, delivered worse investment results[13]. Before the 1980s, and this is still mostly true today, banks and bank employees mostly did not present themselves as experts in generating attractive risk-adjusted investment returns; to the contrary, the banks generally presented themselves as taking as little risk as possible, and bank employees were compensated for selling ('raising assets'), not investment results, and so they primarily directed their energies to said selling. When overlaid with the tautology that average talent produces average results, the result to the average client of professional investment advice was below-average market returns.

Of course, a problem (in this case, industry structure leading to below-average results for the average client) is an entrepreneur's opportunity to solve - and the professional investment advice industry reacted. Led first by pensions, much of the industry - i.e., most banks - separated the selling function from the investing function. 'Stockbrokers' became 'wealth advisers' or 'financial planners' and ceded most investment activity to the fund management industry. Beginning in the 1980s, this sub-industry - for regulatory reasons, mainly comprised of mutual funds - rapidly became a much greater percentage of U.S. household financial assets on the premise that by focusing on investment results, said results would, on average, be better.



[13] Such worse results that, in 2023, very very few pension funds employ 'direct investment' staff; instead, most pensions outsource their direct investment work to third-party fund managers.

Dis-integrating an economic activity comes at a cost: now two layers need to be independently managed, i.e., two cost layers instead of one (previously integrated) layer. This led to an industry structure that now looks like this, starting with an individual stick figure needing some investment advice and resulting in ~2% all-in management fees to the average individual:



There's a problem with this: the aforementioned average = average tautology remains true. Then, overcoming a 2% cost burden when the average annual return of the U.S. stock market is ~10%[14] is, on average, impossible.

This problem's entrepreneurial opportunity has typically been addressed primarily by trying to reduce the cost of the fund management layer (i.e., 'low-cost index ETFs') and only secondarily by lowering the cost of the selling layer (i.e., direct distribution of said ETFs, i.e., forget about a wealth advisor or financial planner and DIY with Vanguard products).

But what if you had access to above-average investment talent[15]? Then you could turn the industry solution of the last few decades (reduce fund management costs!) on its head and, additionally, reduce the financial planning/wealth advisement costs … and, perhaps, still produce above-average results for a relatively small number of clients.

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[14] https://www.sofi.com/learn/content/average-stock-market-return/

[15] This investment talent must desire to manage a relatively small amount of funds so that it does not get dragged into average results. See https://cdn2.hubspot.net/hub/305037/file-809445518-pdf/novus_research/how_aum_growth_inhibits_performance.pdf?t=1400251676926&submissionguid=f5c05d4c-e8bb-4c3b-80cf-9572d3274ea8.

That's Janian's business model, which was ten years ago and is still today unusual in the industry:

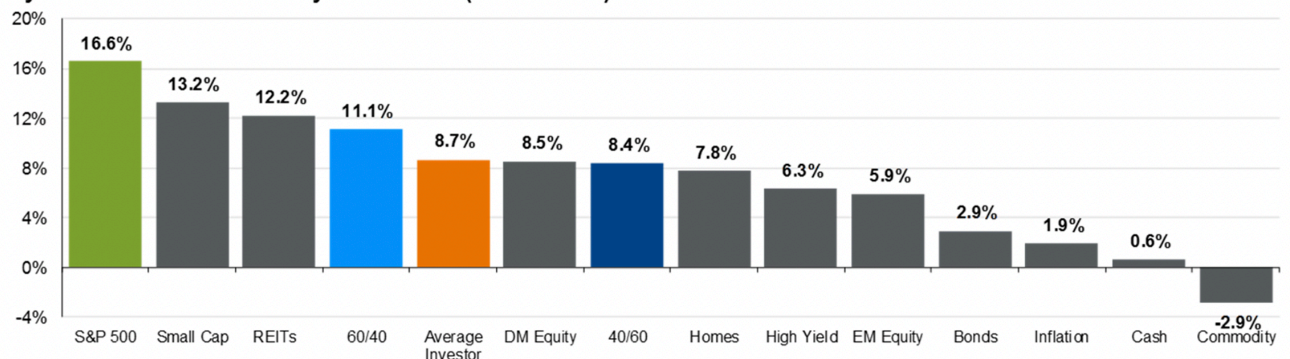
- Combine financial planning and direct security selection
  (and thus remove a step in the traditional distribution of investment advice, which saves costs and provides more information directly to the client - but continue to deliver via a single 'best' portfolio for each strategy)

- Aim to be a low-cost provider
  (by emphasizing performance compensation as Janian's big economic upside and simultaneously offering low management fees versus competitors)

- Stress close personal relationships
  (by taking only individuals as clients, emphasizing the uniqueness of the planning for each client, and focusing on client retention, not new sales)

Janian has not yet developed a large enough assets-under-management base to trigger a key lever toward the second point[16], but we are closer to doing so. Once that happens, the difference between Janian's business model and traditional approaches will be all the starker.

Meanwhile, at a bigger-picture level, Janian continues to have a meaningful opportunity[17] to help clients generate higher long-run returns than the average investor, who is, of course (on average) either advised by traditional advisors or DIY:



This chart points out that, even though Janian takes pains to compare itself to market averages, the average investor gets far less than market average returns[18]! That harsh fact strongly suggests that

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[16] Like most advisors, Janian grants a volume discount to each individual client. Janian ALSO grants a volume discount to ALL clients once assets-under-management per individual full-time employee is greater than $25MM.

[17] Thanks to J.P. Morgan Asset Management for the chart.

[18] 8.7%/11.1% = ~3/4ths of a 60% stock and 40% bond portfolio, and 8.7%/16.8% = ~ ½ of a 100% stock portfolio for 2012-2021.

(1) most DIY investors should outsource, and (2) most professional investment advisors must either obfuscate their clients' returns ('that's a fund manager's responsibility, and I'm not a fund manager') or cultivate a client base that doesn't care or is unable to do anything about their long-term returns. And thus, Janian has an opportunity to do things differently.

So far, ten years in, we've met that opportunity. Here's to the next ten too, and beyond.

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