Dear Investors,

In Q1 2022, Luna returned 9.5% on net assets under management. This brings our performance since inception in Q4 2021 to 15.6%.[1]

Macro Observations

Equity markets in the first quarter of 2022 were primarily driven by two factors:

1) The largest democracy in Europe, Ukraine, was invaded by Russia

2) The U.S. Federal Reserve has started its 14th hike cycle in the last 70 years

The impact of the crisis unfolding in Eastern Europe has near-term and long-term implications for economies and markets around the world. Disruptions to energy markets began almost immediately after Russia started its offensive, and those markets continue to look precarious. Russia is the world's 5th largest iron ore producer (#1 supplier to Europe), as well as being one of the largest exporters of steel and fertilizer globally. Ukraine is a significant wheat producer, known as the "Breadbasket of Europe," as well as being the #1 producer of sunflower seed products in the world. Both sanctions and physical supply chain strain and destruction from the conflict are unlikely to be resolved soon, and pressure on these markets is likely to continue. That being said, each of these markets is unique and will respond differently as relevant companies with the capital and resources assess the economics and feasibility of expanding production and capacity.

Geopolitical events and armed conflicts have historically only had a temporary impact on financial markets with the equity trough typically being at the point of peak uncertainty of the outcome. Historically, this has been early in the conflict, usually in the first weeks or months even when the conclusion is years away. Obviously, we hope for a quick de-escalation in Ukraine and a return to normalcy for the millions being impacted. The likely outcome is unfortunately still unclear, but it is possible the worst of this crisis has yet to be seen.

While the first market driving factor was an unlikely tail risk until it wasn't, the second factor noted above (Fed starts rate hiking) had been widely communicated to, and expected by, market participants. While the sample of Fed hiking cycles is small (13 of consequence since 1950), there are some interesting observations to make.[2]

[1] Net asset value calculations are provided by Interactive Brokers and returns are after expenses and fees. Clients should always check their individual statements for returns which may vary due to timing and other factors. Past performance is not indicative of future returns.
[2] Source: Deutsche Bank Research Note. Hiking cycles of consequence defined as those with rates increasing >100bps in a year.

From the month of the first hike, ~30% of the time, the economy is in a recession within 24 months, and ~50% of the time within 36 months. It can also be observed that typically, the higher the inflation was going into the first hike, the sooner the next recession started.

We generally believe the Fed when they say they are "data dependent." This makes forecasting the rate hike trajectory very difficult and as a result, is not something we spend much time on. However, there are some broad outcomes to consider. On one end, we could continue to experience significant price inflation for several years. Depending on the severity, the Fed will be forced to raise rates (maybe rapidly) to sedate the economy, in hopes that prices in certain categories (used cars, energy, food, etc.) stabilize. It is important to remember that the Fed's tools are "blunt objects," and prices of inelastic items are harder to control with these types of measures. This is especially true when prices are being impacted by external factors like supply chain constraints or geopolitical pressure.

On the other end, maybe prices have already been pushed too high and demand destruction has begun. Stagflation or deflation caused by moderating consumer demand and rising interest rates could pose a threat to employment and housing markets, risking a recession.

<u>Portfolio Commentary</u>

As long-term, value investors, we don't focus on predicting the outcome of macro events with specificity, but instead work to ensure our portfolio will perform well through the largest range of possible outcomes. We try to achieve this by owning a variety of business models, benefiting from distinctly different secular trends, so that we are never overly concentrated to a single factor or tailwind.

This quarter, rising rates pushed down many areas of the market and provided a great buying opportunity across business services software, payments, e-commerce, and several other technology verticals. We view many of these businesses as incredibly high-quality, but they have seen their prices fall dramatically because their meaningful cash flows are often several years in the future and discounted more severely by investors in this higher rate regime. As long-term investors, one of our valuation methods is a discounted cash flow analysis that features a standardized, through-cycle, discount rate which does not fluctuate with the current interest rate environment. We have targeted businesses with high intrinsic values, regardless of the short-term, rate driven declines based on the longevity of these businesses' topline runways and future earnings potential. The recent market declines simply provided opportunity for deeper investment.

Lucy Chou - lchou@luna.partners | Nate Rubinstein - nrubinstein@luna.partners

To diversify our technology exposure, we made a small number of deep investments in the basic materials and industrial sectors. Our portfolio's largest investment through the quarter was domestic steel producer, Cleveland Cliffs (CLF).[3] We have included a summary of some of the strengths we see for the steel industry and CLF specifically in the next section.

The possibility of a recession is never zero, but certain periods present an over-abundance of potential catalysts that make one more likely. The litany of potentially negative near-term catalysts for the market are concerning, but we're comforted by two factors. First, rarely if ever, does the whole market respond to macro factors in exactly the same way. There are always pockets of outperformers, even in bear markets. Our flexibility to invest in any industry, geography and size allows us to seek these investments out. The second, we are long-term investors. A recession will not last forever, and high-quality businesses will survive, if not grow stronger. A recession under that long-term lens, is a short (to medium)-term macro factor, and we view it as a potentially great opportunity to buy the right businesses.

Owning great businesses that are being inversely impacted by macro factors is one of the many lenses we use when managing our allocation decisions. We want to be appropriately diversified, but at the same time, when the right circumstances align, have the capital necessary to strike while the iron is hot.

The Case for CLF

For those less familiar with the steel industry, the last paragraph of this section gives a short overview. The US steel industry has many attractive features including:

1) **Consolidated Industry.** An industry of over a dozen separate mill operations two decades ago has consolidated to 4 major players making up most of the domestic market. This consolidation has been both horizontal and vertical.
2) **Raw Material Trends.** Iron ore deposits are fewer due to depletion, ownership is more concentrated, and ore grades are lower (Newer Electric Arc Furnaces which recycle scrap steel are experiencing decade low Prime scrap supply).[4]
3) **Consumption is Strong.** Steel is an integral part of our economy, found in a wide variety of consumer appliances, vehicles, buildings, and infrastructure etc. The US consumes 90+ million metric tons a year,[5]

[3] These letters will be used to highlight certain holdings in our portfolio. CLF was selected as it was our largest holding this quarter, but if you are a prospective client and would like a full list of our holdings during the quarter, please contact us.
[4] Source: Cleveland Cliffs public filings, Steel Research Associates LLC.
[5] Source: World Steel Association. 2021 forecast as of Oct 2021 92M tons of demand.

but many tailwinds exist that support higher future demand including infrastructure spending, green transformation (EVs, EV infrastructure, most renewable energy sources require large amounts of steel etc.) and manufacturing onshoring, to name a few.

4) **Limited Dependence on Foreign Markets.** ~25% of US consumed steel is imported, down from ~33% five years ago.[6] Falling imports have pushed domestic producers to maximize production with limited new capacity planned. This has been caused in part by higher freight costs, disruption in foreign markets, tariff regimes and other trade related factors. There are sufficient raw material deposits in North America to meet most of the US's demand. For example, scrap for recycled steel producers is largely sourced domestically.
5) **Strong Prices Remain Persistent.** A combination of the above, on top of the price increases seen during COVID, have pushed Hot-Rolled Coil (HRC) steel (common commoditized form) futures out as far as 2024 to well above the top of the range seen in the decade before COVID. Despite the US steel market being mostly domestically sourced and produced, we believe prices of commodities like iron ore and met coal as well as HRC Steel in the US are impacted by global events. US HRC Steel futures for Q2'22 are up 50%+ since the start of the Ukraine conflict.[7]
6) **Made in the US is Cleaner.** Steel operations in the US are amongst the lowest carbon emitting operations in the world. China produces an estimated 2.5x more CO2 per ton of steel produced relative to the US (other major producers like India, Korea and Russia emit at least 50% more CO2 per ton).[8] We are cognizant of the environmental impact of our investments and are encouraged by ongoing trends in the industry to reduce greenhouse gases like expanded EAF capacity and implementing carbon capture projects.

All four of the major US players are public, but as we looked at the asset portfolios of each, CLF stood out as being clearly differentiated.

1) **Most Vertically Integrated Player.** Iron ore is the primary ingredient needed to make steel, and CLF sources all their iron ore needs internally from owned reserves not expected to be exhausted for many decades. Most of their coke and coal are sourced internally with the remainder supplied via multi-year agreements with one of the US producers. Steel scrap is also majority sourced internally since their

[6] Source: U.S. Department of Commerce, International Trade Administration.
[7] Based on Q2 2022 futures from the day before Russia's invasion of Ukraine (2/23/2022) until the end of Q1 2022. Future prices per NYMEX.
[8] Source: Global Efficiency Intelligence, November 2019 report: "An International Benchmarking of Energy and CO2 Intensities" and Worldsteel 2020 Steel yearbook. Note: Includes Scope 1 and 2 emissions.

acquisition of Ferrous Processing and Trading Company (FPT). This level of vertical integration gives CLF greater cost control relative to competitors who are more reliant on sourcing raw materials from third parties at "market prices."

2) **Production Mix Optionality.** CLF owns a mix of blast furnaces (virgin steelmaking) and electric arc furnaces (recycles steel scrap) allowing for a wider range of production capabilities. These capabilities benefit from a refined iron ore product called Hot Briquetted Iron (HBI), developed in-house, that can be used across both furnace types as iron feedstock. This diverse mix of furnaces and raw material capabilities allows CLF to run the collective asset portfolio more efficiently as market conditions change.
3) **Great Value.** At year-end 2021, the business was trading at ~3.0x last twelve-month (LTM) EBITDA and ~3.5x LTM EPS, with strong prospects of even higher earnings in the next twelve months. We estimate, even in a conservative steel price environment for 2022 from what is being implied by the current futures curve, the business's FCF yield will be 20%+ at the stock's current levels (~$32 a share).[9]

CLF today has a record amount of liquidity and has been aggressively working its leverage lower even as it announced authorization for $1bn in share repurchases last quarter (~10% of market cap. at announcement). We view its management team amongst the best operators in the industry, and senior management is deeply invested in the business with the CEO, Lourenco Goncalves, amongst the largest individual owners. CLF today is in many ways the brainchild of Goncalves who has transformed the former mining company, by acquiring and integrating two of its largest customers over the last few years, into the largest flat-rolled steel operation in North America.

With only a few quarters of performance as a fully consolidated company under its belt, the market may still be playing catch-up with just how cash flow generative CLF can be. We continue to closely watch the commodity futures markets for any significant near- or long-term deterioration in market expectations, but current levels make us very optimistic. Despite all the strengths noted, this is a cyclical business, and we monitor end-market activity, supplier commentary and inventory levels for potential signs of deterioration.

Steelmaking Basics: Steelmaking is the process of taking a variety of raw materials including iron ore (iron products), metallurgical coal and steel scrap and applying significant heat in a smelting, refining and milling process that can create a variety of steel products. Steelmakers sell their steel to a range of large individual consumers, like automotive manufacturers, as well as converters and distributors that further process

[9] Although the information in this letter has been compiled from data considered to be reliable, the information is unaudited and reflects our opinion. As a result, there's a risk that the information is not accurate. Past performance is not indicative of future returns.

commoditized supply for specific uses. The biggest costs in the process are typically the raw materials, labor, and energy, as well as the capex needed to maintain the assets. Many commodity benchmarks exist for standardized products like HRC and rebar, with additional high-strength, stainless and plated characteristics fetching various premiums to the relevant benchmarks depending on customer specifications.

We look forward to continuing to use these letters to highlight various aspects of our strategy and update investors on our portfolio.

Warm regards,

Lucy & Nate

Appendix – Performance Since Inception

	Q4 2021	Q1 2022	Since Inception
Luna Partners	5.6%	9.5%	**15.6%**
S&P 500	10.6%	-4.9%	**5.2%**
Nasdaq Composite	8.3%	-9.1%	**-1.6%**
Dow Industrial	7.4%	-4.6%	**2.5%**

Note: Equity market returns above based on underlying index prices. Standard and Poor's 500 is a popular stock market index representing 500 large companies on US stock exchanges. The Nasdaq Composite is a stock market index that includes all the stocks listed on the Nasdaq Exchange. Dow Jones Industrial Average is a price-weighted stock market index of 30 prominent companies listed on US stock exchanges.

Luna Partners' performance is based on net asset value calculations provided by Interactive Brokers and calculated net of expenses and fees. Luna's portfolio typically consists of 10-15 long, US based public equity positions. Returns are after expenses and fees and presented on a time-weighted basis to be comparable to the index returns in the table. Past performance is not indicative of future returns.

Lucy Chou - lchou@luna.partners | Nate Rubinstein - nrubinstein@luna.partners

Luna Partnership LLC is a state registered investment adviser located in Miami Florida.

The views outlined in this newsletter are those of Luna Partners and should not be construed as individualized or personalized investment advice. Any economic and/or performance information cited is historical and not indicative of future results. Economic forecasts set forth may not develop as predicted. Although the information in this report has been compiled from data considered to be reliable, the information is unaudited and is not independently verified. We do not guarantee that the forgoing material is accurate, complete, or up to date. As a result, there's a risk that the information is not accurate.

Performance results reflect the deduction of advisory fees, brokerage commissions, and fund charges. Performance results reflect the investment of dividends and other earnings. This information is provided to you in a combined form, solely for your convenience and ease of review. Past performance is never a guarantee of future results. All investments have investment risks such as fluctuation in investment principal including the complete loss of principal invested.

Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for a given client or portfolio. Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of entire principal and potential illiquidity of the investment in a falling market.

Any questions regarding the applicability of any specific issue discussed above should be addressed with Luna Partners. All information, including that used to compile charts and/or tables, is obtained from sources believed to be reliable, but Luna Partners has not verified its accuracy and does not guarantee its reliability. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio.

Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Luna Partners or from any other investment professional. To the extent that you have any questions regarding the applicability of any specific issue discussed above to your individual situation, you are encouraged to consult with Luna Partners or the professional advisor of your choosing. All information, including that used to compile charts, is obtained from sources believed to be reliable, but Luna Partners has not verified its accuracy and does not guarantee its reliability.

This newsletter does not constitute an engagement with Luna Partners. The information contained in this newsletter is general in nature and offered only for educational purposes. No investment decisions should be based upon this newsletter's contents. This newsletter is not a substitute for engaging Luna Partners for a personal consultation whereby all of your financial circumstances, risk tolerance and investment objectives can be considered. Information pertaining our investment advisory operations, services, and fees is set forth in the Advisor's Form ADV Disclosure Brochure, a copy of which is available from your investment adviser representative upon request. Please contact us at 201-953-5874 or by email at lchou@luna.partners with any questions you may have, or if you would like to review this report or your current investment strategy.

This newsletter was created by Luna Partners utilizing information provided by Interactive Brokers. The pricing for the investment positions listed in the report is based upon information received from the account custodian. The performance listed in this report may vary from the information provided on your account statement provided by your account custodian. Luna Partners is independent of Interactive Brokers. Luna Partners is relying upon the information provided by Interactive Brokers, and Luna Partners has not audited or otherwise verified the accuracy of the methodology, calculations or information in this report. As a result, the methodology, calculations and information presented in the report are not guaranteed by Luna Partners.