Dear Investors,

In Q1 2023, Luna returned 15.9% on net assets under management. This brings our performance since inception in Q4 2021 to -7.7%.

The Macro

The quarter presented another rollercoaster ride for investors (and central banks). Market sentiment and Fed outlook appeared to seesaw between potentially more aggressive hikes in the face of continued inflation / strong employment and conservatism following the collapse of Silicon Valley Bank (SVB). What is becoming clear, is that we are in the final innings of this Fed hiking cycle. With the top of the Fed Funds Rate range at 5% and the market signaling a preference towards "no hike" at the May Fed meeting, it may already be over. The treasury yield curve, while still inverted, is starting to look flatter, which is an additional indication of a pivot or pause on the horizon.

The SVB (and Signature Bank) failure will go down as another example of the fragility of markets and the risks of mismanagement. The bank's mishandling of interest rate / duration risk and the insufficient deposit insurance at non-SIBs (Strategically Important Banks), compounded by the velocity of money in the 21st century (SVB was the fastest bank run in history), ultimately led to its collapse. Whilst the government ultimately backed all of SVB's deposits, they remain ambiguous about future actions if the environment worsens. They have made no guarantees that they will step in with the same fervor if additional banks fail, leaving significant uncertainty. It is our opinion that more permanent policy and supervisory changes are needed to ultimately resolve these risks long-term. With an estimated ~40% of nationwide deposits uninsured, deposit activity may continue with outflows from regional banks into SIBs, causing more stress in the banking sector.

At first glance, there is some contradiction in Fed action as they "ease" by bailing out SVB but continue "tightening" in the form of more rate hikes. However, the policy tools being used to handle these separate issues are very different. If rate policy represents the stretching of a large fabric, the bailouts in March are the repairing of small tears to maintain the strength of the fabric. If small tears can be patched before they grow, continued stretching of the fabric may be possible. Our guess is that SVB was not the type of credit event (tear) the Fed was expecting or desiring. Defaults are a classic aspect of many rate hiking cycles, if not a desired outcome of policy, in order to put downward pressure on economic activity and price growth. While there may not be a "good" type of default, having, for example, an over levered retailer default is a healthy part of rejuvenation in the economic cycle. A bank default poses a higher risk to the system since lending and other bank functions are critical to a healthy economy long-term.

There has been an orderliness to this hiking cycle with clear-*ish* forward communication and the use of the dot plots (the pros and cons of which have been previously discussed). We are unlikely to see such regimented and incremental moves when the Fed is eventually forced to lower rates. As the latest (but recycled) trope goes, "They raise until something breaks." Optimistically, maybe the damage that has already been done is as close to the precipice as we will get this time around. With cognizance of the banking weakness, both here in the USA and abroad (lest we forget Credit Suisse also collapsed this quarter only to be bought out by rival UBS), the Fed is undoubtedly re-assessing how much more tightening will be necessary. The silver lining in the recent bank runs is that credit tightening will likely occur. This should put the same type of downward pressure on the economy that the Fed has been trying to achieve through its rate hikes.

Equity markets traded with extreme dispersion as individual earnings performance and sector factors drove large differentials in returns. This was true even at the index level, with the Nasdaq up ~17% while the Dow was essentially flat. Lower rates and stable economic data proved nice tailwinds for stocks generally. Caution still seems very abundant in the marketplace with participants predicting a recession later this year (after wrongly predicting it would occur in H1). However, if most of the market is anticipating a recession event, it leaves the pool of incremental sellers much smaller if / when such an event occurs. From the perspective of which market direction would be more painful for investors, it is probably higher. The relative underperformance from under-investment will ultimately compel capital back into the markets. We also believe many management teams took the opportunity to "sandbag" 2023 guidance given the pessimistic economic forecast. This may lead to earnings "beats" in Q1 and Q2 as the environment shapes out better than expected.

Our Portfolio

Our performance in the quarter was aided by strength in large-cap technology with our largest contributors being MELI and META. General strength in the Internet and Software sectors during Q1 also led some of our mid-cap technology holdings higher (GWRE and WDAY).

We exited one holding in Q1, which was Etsy (ETSY). This was driven by a multitude of factors including concern around consumer spending in 2023, recent share price appreciation, and a troubling short-seller report. In February, Etsy became the latest target of Citron (a research firm focused on fraudulent and terminal business models). The report claimed that Etsy is "One of the Largest Counterfeiting Platforms in the World." There were two primary concerns we had from the report that contributed to our ultimate decision to exit the investment for now.

First, while we found the claims to be exaggerated (wildly, in some instances), we could not dismiss them entirely. There is some truth in Citron's report – to exactly what degree, we are uncertain. We were also particularly cautious because of the nature of the allegation. It wasn't an attack on a peripheral part of the business or for example, a subjective opinion on a management team's ability to execute, but rather, if true, a key existential threat – whether it be from a legal perspective or a realization that the TAM, when excluding counterfeit demand, is much smaller than expected.

As we think about the diligence we conduct on our investments and the theses that we underwrite, there are four categories of consideration: known knowns, known unknowns, unknown knowns, and unknown unknowns. Most of our investment process and continued portfolio monitoring is focused on moving as much as we can into the known knowns category. For known unknowns, despite our best efforts, these are items that we cannot fully quantify or forecast with high accuracy. However, as we invest, we do so with conscious awareness that these risks (known unknowns) exist and are acceptable in relation to the potential upside. Unknown knowns are things we know but overlook and misinterpret. It could be a key factor that makes or breaks a thesis but prior to the occurrence, we aren't aware of its significance. To combat this blind spot, we regularly re-test and re-diligence the investment theses we underwrite, often utilizing the other Luna partner as a pseudo *red team.* The final category unknown unknowns is the opaquest and where we are most likely to be blindsided. These are the factors we don't know exist, and don't consider in our analysis. However, if we get our thesis right, this should be both the smallest category as well as the least important.

Unfortunately for our Etsy investment, Citron's allegation was an unknown unknown. It was not something we evaluated in our initial underwriting, and we quickly realized after we "knew" it, that in the absence of a significant disclosure from the company, it was going to become a known unknown. However, as noted previously, with our known unknowns, we must evaluate and be willing to take the risk on them. In this case, combined with the stock's recent price appreciation and muted consumer spending outlook, we did not consider the upside left in Etsy worth the risk.

Second, this is a good example of our application of behavioral economic principles when making portfolio decisions. At the end of the day, each stock price is decided based on buyers and sellers, voting with their money. Even if the allegations are found to be uniformly false and the fundamentals of Etsy are unchanged, what if other investors believe the malfeasance? The outcome, at least in the short-term, is as if the allegations are true. This market tendency to assume guilt until innocence is proven is not uncommon, and while there is this downdraft on the name, combined with our own hesitation around the truth in the allegations, we felt no need to keep the company in our portfolio. We will continue to monitor Etsy's progress and its communication on these allegations (with innocence can come opportunity.)

This exemplifies another point in our investment philosophy. We have no loyalty to our positions. While we always invest with high conviction, no allegiance outweighs the potential realization that we are wrong about an investment or have witnessed a possible change in the fundamental story. Our aim is at all times to hold the best 10-15 names that match our desired risk / reward profile. Our intention is never to trade on short-term noise but rather ideally to hold our positions for a period of years. However, we are cautious to balance that inclination with the recognition that there is a difference between being assured in our convictions and obstinance.

One new position was opened in Q1, which was Sibanye-Stillwater (SBSW). This is a "starter" position (less than 3% of the portfolio), but recent volatility and company developments created an attractive entry point. SBSW is an international metals and mining company, headquartered in South Africa. We will provide more information on the holding and our investment thesis in later letters.

We continue to believe 2023 has the makings of a great year for active management. We look forward to keeping you updated on our progress and remain grateful for your steadfast support.

Warm Regards,

Lucy and Nate

4/1/2023

Appendix – Performance Since Inception

	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Since Inception
Luna Partners	5.6%	9.5%	-39.1%	4.6%	8.1%	15.9%	**-7.7%**
S&P 500	10.6%	-4.9%	-16.4%	-5.3%	7.1%	7.0%	**-4.6%**
Nasdaq Composite	8.3%	-9.1%	-22.4%	-4.1%	-1.0%	16.8%	**-15.4%**
Dow Industrial	7.4%	-4.6%	-11.3%	-6.7%	15.4%	0.4%	**-1.7%**

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.

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