To: Clients of Eagle Point Capital
From: Matt Franz and Dan Shuart, Principals
Subject: Spring 2022 Portfolio Update
Date: April 1, 2022

In this update, as in previous, our objective is to explain what you own and why you own it. As long-term owners, we focus on the key factors driving the businesses behind our stocks. This letter aims to explain those factors so that you, like us, can focus on fundamentals instead of prices. If our business's earnings increase over time, so too will their stock prices. But before we discuss what is in our portfolio, we first want to discuss how we construct our portfolio.

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"The whole secret of investment is to find places where it's safe and wise to non-diversify. It's just that simple. Diversification is for the know-nothing investor; it's not for the professional."

— Charlie Munger

10x10

The 10x10 framework is the cornerstone of our portfolio construction philosophy. 10x10 means ten stocks, each purchased with 10% of our capital.

Why ten stocks?

A ten stock portfolio balances our stomach for volatility with our desire for above-market returns and our ability to intimately know and understand our businesses.

Conventional wisdom holds that diversification is a "free lunch" and that more is always better. We disagree. We do not diversify excessively. Good investments are hard to come by and we would rather concentrate our capital into our best ideas than spread it over many mediocre ones.

We view our stocks as businesses and our portfolio as a conglomerate. If we owned ten private businesses in different industries, conventional wisdom would say that we are diversified. We see no reason why owning businesses privately or publicly should change that assessment.

Diversification, like anything, has diminishing marginal returns and becomes detrimental when taken too far. Studies[1] show that a ten-stock portfolio experiences less than half of the volatility of a single stock. Increasing the portfolio size from 10 to 1,000 only reduces volatility an additional 25%.

While we disagree that volatility measures risk, we still think investors should consider a portfolio's volatility. If a portfolio is too volatile, investors won't have the stomach to stick with

[1] Statman, Meir. "Many Stocks Make a Diversified Portfolio?" *The Journal of Financial and Quantitative Analysis*, vol. 22, no. 3, Sept. 1987, pp. 353–363.

it. Further, unusual and unprecedented events happen all the time. That's why we are reluctant to concentrate our portfolio into fewer than ten investments. We want to live to invest another day.

The best strategy is worthless if investors can't stick with it. Joel Greenblatt ran outside capital at Gotham Partners for ten years and averaged 50.0% annual returns (before fees). He owned just six stocks at a time and they were often in precarious financial or competitive positions. Despite his high returns, Greenblatt closed Gotham in 1994. The portfolio's extreme volatility was too stressful and not worth the money. Greenblatt was tired of watching his net worth plunge 20%+ multiple times per year.

We intend to run EPC for much longer than ten years, and are willing to trade potentially slightly higher performance for a strategy we and our clients can stick with for decades.

Why 10% each?

We commit 10% of our capital to each new position in order to create a high barrier to entry into the portfolio. If we are not comfortable committing 10% of our personal net worth to the investment, we shouldn't commit 1%.

A 10% commitment forces us to look down (at risks) before we look up (at rewards). We do not want to buy lottery tickets. We want to buy businesses that are like cockroaches — very hardy and almost impossible to kill.

One of EPC's core principles is to make fewer, better decisions. More decisions mean more opportunities to be wrong. We are confident we can add value via security selection. We are not confident we can add value by overweighting our favorite stock and underweighting our least favorite. If we had a least favorite, we'd sell it. 10% allocations ensure each decision we make has a meaningful impact on performance.

Compounding

"The first rule of compounding: never interrupt it unnecessarily."

— Charlie Munger

Once we make an investment, we let it run. We don't trim or double down. Our winners will naturally compound into larger positions. Our losers likewise take care of themselves by becoming smaller portions of the portfolio.

We want to avoid cutting the flowers and watering the weeds. Imagine if Warren Buffett or Jeff Bezos had trimmed Berkshire or Amazon in order to maintain an arbitrary portfolio allocation.

Removing position-sizing decisions allows us to focus on the key question at hand: is the business an attractive long term investment? So long as the answer is "yes" we continue to own it and do nothing. If the answer becomes"no" we sell it and move on to our next idea.

Terry Smith of Fundsmith sums up our philosophy when he says: "Buy good companies. Don't overpay. Do nothing."

Cash

Investing is all about opportunity costs. Cash earns almost nothing — far less than we expect our businesses to earn. Therefore, we prefer to be virtually 100% invested at all times. We don't know how to time the market and don't attempt to tactically raise and lower cash. Cash rises and falls organically as a result of our security selection decisions.

Guidelines, Not Rules

The 10x10 framework is a guideline, not a rule, and we occasionally diverge from it. We don't always own exactly ten stocks (we own 11 at the moment) or invest precisely 10% into each. We have, occasionally, added slightly to a position when we felt the price was particularly attractive. The 10x10 framework is a guideline that orients us toward success. It is a default setting we only override in exceptional circumstances.

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Attached to this letter, we've written more about each of our businesses to explain why we own them, how they've performed, and our expectations for their future. We also explain the recent changes we've made to our portfolio.

But first, we'd be remiss if we did not **thank you for your continued support and trust.** Investment managers can only afford to be as patient as their clients allow. Your patience and trust contribute as much to our success as anything we do at Eagle Point Capital.

We are grateful to you for supporting EPC's long-term approach to investing. Our clients have proven themselves as exceptional and stoic investors, which provides us all with a significant competitive advantage. We are honored that you entrust us with your capital, and we are proud to be your investment partners.

Please contact us (**matt@eaglepointcap.com** or **dan@eaglepointcap.com**) with any questions about your account or your investments.

If you know any like-minded investors who would enjoy this letter, please forward this to them or put them in contact with us.

You can expect to hear from us again on or around October 1, 2022, with another portfolio update. In the meantime, you can read our previous letters and blog at www.eaglepointcap.com. We encourage new readers to join our mailing list to receive future updates.

Best,

Matt and Dan

The portfolio-specific portion of this letter is for clients and prospective clients only. Please contact us to access the entire letter.

Rule of Three

Francois Rochon of Giverny Capital is one of the investors we admire most. He coined the Rule of Three, which we've decided to clone and adopt as our own. It is a rule of thumb based on empirical stock market data that will help level-set expectations.

1. One out of every three years, the stock market will decline by 10% or more.

2. One out of every three stocks we buy will not perform as expected.

3. One out of three years, we will underperform the index.

Every few years, people forget that stock prices crash every few years. This is good news since crashes produce bargains, and bargain purchases tend to produce higher returns. When we think and act like long-term business owners, volatility becomes our friend and not our foe.

Fundamentals

Attached is a copy of a short memo of our fundamentals. It explains our goals and methods. Investing is simple but not easy, and success is made or lost on the application of fundamentals.

Eagle Point Capital LLC — Fundamentals
June 25, 2020

Once, after winning two consecutive national championships, the Green Bay Packers lost a game due to sloppy play. Coach Lombardi called a meeting the very next day. When all the players were assembled, Lombardi held a football high up in the air and declared, "Gentlemen, this is a football!" From the back of the room, running back Paul Hornung shouted back, "Coach, can you slow down?"

In investing, as in football, success is made or lost on the application of the fundamentals.
This document sets forth the fundamental operating principles of Eagle Point Capital. Through the up and down markets ahead, we will always return to the principles below to inform our attitudes and actions.

- Our objective is to avoid the permanent loss of capital while maximizing the increase in long-term, after-tax purchasing power of our funds. Put another way, we aim to build an indestructible long-term compounding machine.

- To achieve this objective we seek to make concentrated investments in businesses that:
  1. We understand.
  2. Have a demonstrated and enduring competitive advantage.
  3. Have a resilient balance sheet.
  4. Have honest and able management who run the company for the benefit of shareholders.
  5. Can be purchased for a reasonable price that affords a margin of safety.

- In other words, we aim to purchase, at a rational price, interests in easily-understandable businesses whose earnings are virtually certain to be materially higher five, ten, and twenty years from now. We prefer cockroach-like businesses — very hardy and almost impossible to kill.

- We think independently and do our own research. We don't rely on the opinions of analysts or journalists, both of whom may have different motivations than ours. We rely primarily on S.E.C. filings for information.

- We do not diversify excessively. Good investments are hard to come by and we would rather concentrate our capital into our best ideas than spread among many mediocre ones. We typically own six to ten businesses and put 10% of our capital, at our cost, into each.

- We think and act like business owners. As owners, we focus on the fundamentals of the business and do not obsess over price fluctuations. When possible, we use periods of unjustified pessimism to purchase high quality companies at attractive prices. Likewise, we prefer to use

periods of unjustified optimism to sell companies for more than we feel they are reasonably worth. The market is our servant and not our master.

- The best way to measure our success is to compare Eagle Point Capital's return, after fees, to the S&P 500's total return (including the reinvestment of dividends) over five-year periods. Measurement over a shorter timeframe may reflect luck more than skill. The S&P 500 is our benchmark because it is widely followed, offers the potential for large, low-cost investments, and, we expect, will produce satisfactory long-term returns. Over time, we expect good relative returns to the S&P 500 to become excellent absolute returns.

- All accounts are managed *pari passu*. Clients may elect one of two fee structures:
    1. A two percent annual fee on assets under management charged quarterly in arrears.
    2. 25% share of profits in excess of a 6% hurdle rate, subject to a high water mark, charged annually in arrears. This option carries no management fee.

- Clients will receive a letter twice a year detailing what they own and why they own it. Our reports will be candid, emphasizing the positive and negative factors important to appraising intrinsic business value. Our guideline is to tell you the business facts we would want to know if our positions were reversed. We owe you no less.

- Eagle Point Capital is not in the business of predicting the general stock market or business fluctuations. If you think we can do this or that it is essential to an investment program you would be best suited looking elsewhere.

- We cannot guarantee results to clients. What we can and do promise is that:
    - Our investments will be chosen on the basis of value, not popularity;
    - We will attempt to bring risk of permanent capital loss (not short term quotational loss) to an absolute minimum by obtaining a wide margin of safety in each investment; and
    - We have virtually our entire net worth invested alongside Eagle Point Capital's clients. We eat our own cooking.

Many of you who are already familiar with Eagle Point Capital may feel, like Paul Hornung, that this material is unduly repetitive. However, we would rather have many bored clients than a single client with any basic misconceptions. As Charlie Munger says "A majority of life's errors are caused by forgetting what one is really trying to do." A firm grasp of our fundamental operating principles will help us stay the course in the future.