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## ELM RIDGE

### “Una Vez Mas”

Third Quarter Report • September 30, 2024

*“Graham and Dodd investors are people who place a very high value on having the last laugh. In exchange for the privilege, they have missed out on a lot of laughs in between.”*

– Michael Lewis

ELM RIDGE	3RD QUARTER 2024	2024	2023	2022	INCEPTION-TO-DATE ANNUALIZED
NET PERFORMANCE	-5.7%	-4.0%	-15.4%	48.6%	5.7%
GROSS LONG CONTRIBUTION	-2%	3%	7%	15%	11%
GROSS SHORT CONTRIBUTION	-4%	-7%	-21%	25%	-5%
S&P 500	5.9%	22.1%	26.3%	-18.1%	7.7%

*You think you're using me  
 Like this game's new to me  
 But you ain't confusing me  
 You just want jewelry  
 Another f'in shopping spree  
 But that ain't stopping me  
 And I ain't stopping you  
 See we'll be cool as long as you  
 Just play your part*

–Rick Ross, *Wale & Meek Mill, Play Your Part, 2010*<sup>1</sup>

*Floyd Mayweather: “You a psychic? What you do for a living?”  
 Rude Jude: “I talk \$%^& about you for a living. That’s what I do for a living. You beat up people.”*

–Rude Jude, *Shade 45, 2014*<sup>2</sup>

The economy is weakening. Interest rates should fall. Let’s buy what has worked and sell cyclicals. The economy is strengthening. In that case, the Fed is going to work extra hard to kill it and then interest rates will fall. Guess what? We can buy what has worked and sell cyclicals. No matter what happens, momentum will continue. No need for further analysis.

Sheetal and I were talking politics the other day and he didn’t understand why people would accept things that make no logical sense. “Why does Mittal Steel sell at less than 3x EBITDA [cash generation] while RBC Bearings<sup>3</sup>

<sup>1</sup> <https://www.youtube.com/watch?v=SySinpkU6M>

<sup>2</sup> <https://www.youtube.com/watch?v=xdvmj1tVE2U>

<sup>3</sup> We do own MT but have no position in RBC.

trades at almost 20x?” I responded. We know better than to assume rational behavior (organizations are not singular actors but collections of employees facing different incentives) in our chosen field, but don’t spend the time to unravel that same type of logic elsewhere.<sup>4</sup> Today I had the privilege of reading a Fintech (i.e. credit companies that get rewarded for the speed with which they hand out cash) report arguing that “improving credit” helped drive the group up 25% in the quarter, despite citing stats that showed growing delinquencies just two paragraphs down. If it’s working, it’s working. An index [MSZMOMO] that goes long stocks with the best 12-month performance and short those with the worst is up a mere 45% this year – and we’re getting smoked because we ain’t buying it. We think investors are once again treading into dangerous territory, and you think I’m a broken record.

Who cares if the S&P trades at a multiple of forward earnings more than 30% above its 30-year average, at a level only exceeded (by just a bit) during the tech bubble and a couple of months during the pandemic? Who cares if the margins supporting those earnings are nearly double those that prevailed for the 60 years into 2010? Who cares if the Magnificent Seven are now setting their sights on each other? Who cares if reported profits get a bump here and there by short-changing the future (cutting marketing and R&D, or by sticking it to subscriber customers who need time to re-engineer aggressively priced products out of their workflow)?

Our first quarter thought piece on where agency capitalism seems to be leading us was merely an exercise in theoretical cogitation. Never mind the growing number of people, on both sides, asking government to re-tip the scales that boosted corporate profitability over the last couple of decades. Investors have nothing to worry about.

We’ve been at this for some time. So how long a leash can we take? After all, I am the same irritant who saw fit to argue with a driver who pointed out how some Old Testament’s prophesies have come to pass. (I’m too far gone to remember which ones.) “If I make a bunch of general predictions and wait 6000 years, I could be a prophet too. If you give me enough time, I’ll go Joe Willie and guarantee that the Jets win a second Super Bowl.”

But the end of this investing regime could come any day. And if the payoffs were equal, we’d be more inclined to limit our bets. However, as we noted two years ago, there is so much money riding the same horses that the payoffs from any stumble can be rather outsized. If we decided to ride along, we wouldn’t know if “this is the big one” until we had already lost half our money.<sup>5</sup>

You have done well by ignoring our warnings. Your confidence has been bolstered by the media (including the social variety), which would have you believe that you can somehow discern between a temporary setback and one that will deliver a more lasting blow. (It took Microsoft 15 years to get back to its 1999 high while tumbling 75% along the way). Our drivel is of little concern. It’s just what we do.<sup>6</sup>

## Extraordinary Popular Delusions and the Madness of Crowds

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*“Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, one by one.”*

–**Charles MacKay, Extraordinary Popular Delusions and the Madness of Crowds, 1841**

*There can be few fields of human endeavor in which history counts for so little as in the world of finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present.*

– **John Kenneth Galbraith<sup>7</sup>**

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<sup>4</sup> For instance, I watched the TV show *Billions* through quite a few seasons where I recognized that their depiction of the hedge fund world was way off base, yet bought the legal half of the series hook, line and sinker.

<sup>5</sup> The NASDAQ lost some 47% during the last 10 months of 2000 while we returned 89% in the other direction. From there it fell by a similar amount over the next two years while we returned more than 60%.

<sup>6</sup> <https://www.commart.com/project/24444/geico-it-s-what-you-do-campaign>

<sup>7</sup> “A Short History of Financial Euphoria,” 1990. And yes, we used this one two years ago as well.

For a different take, I would point you to Cliff Asness' more academic and data-supported paper, "The Less-Efficient Market Hypothesis" for the 50<sup>th</sup> Anniversary Issue of The Journal of Portfolio Management.<sup>8</sup> He argues that as information has flowed more freely, markets have become less-efficient, as evidenced by value spreads (the ratio of the most expensive stocks to the cheapest using a variety of measures) trending upward – with current conditions mirroring those seen in 2000 and 2008. While the wisdom of crowds comprised of **independent** members should lead to efficient markets; if they act in unison, that wisdom turns to unchecked dogma.

And, as Cliff notes, "has there ever been a better vehicle for turning a wise, independent crowd into a coordinated clueless even dangerous mob than social media? Instantaneous, gamified, cheap, 24-hour trading ... on your smartphone after getting all your biases reinforced by exhortations on social media from randos and grifters ... delivered to you by those companies' algorithms which famously push people to further and further extremes. What could possibly go wrong?" Indeed, as noted above, the incentive structure of agency capitalism can turn Santayana's wisdom on its head.<sup>9</sup> Even if professionals understand the lessons of the past, they have no choice but to mimic the crowd and are thus still condemned to repeat a similar journey.

## Una Vez MAS (Margot,<sup>10</sup> Anthony<sup>11</sup> & Selena<sup>12</sup>)

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*"Good Judgment comes from experience, and a lot of that comes from bad judgment."*

–Will Rogers

*"History Doesn't Repeat Itself, but It Often Rhymes"*

–Mark Twain

The Great Financial Crisis/Big Short was just too long ago. Lessons learned, right? So commercial mortgages and corporate debt have replaced Margot Robbie's subprime loans. CMBS and CLOs have replaced the slicing/dicing of Anthony Bourdain's CDOs. And following the hot hand, as described by Selena Gomez and Nobel Prize winning economist Richard Thaler, hasn't changed at all (although we don't yet have the bets on bets).

I'm old enough to remember how the late '80s Private Equity LBO craze (*Barbarians at the Gate*, *Wall Street*) ended in a bloodbath.<sup>13</sup> Meanwhile, as the Compounder Bros<sup>14</sup> cheer on a new wave of serial acquirors, I can't help but recall their predecessors (look up Jack Welch, Dennis Koslowski, Bernie Ebbers, Maurice Greenberg, etc.) who took that playbook to excesses through the turn of the century, only to unravel during the broader market downturns in 2002 and 2008.

I also have the misfortune of recalling how regional banks and insurance companies, who threw money at excess commercial and multifamily construction during the 1980s, came hurtling toward bankruptcy in 1991. Indeed, one of my earliest research tasks at Bernstein was trying to find out which ones were likely to make it to the other side. Today, we have the results of a decade of volatility-laundering (Cliff again<sup>15</sup>) allocators throwing money at private

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<sup>8</sup> <https://www.aqr.com/Insights/Perspectives/The-Less-Efficient-Market-Hypothesis>

<sup>9</sup> "Those who cannot remember the past are condemned to repeat it."

<sup>10</sup> <https://www.youtube.com/watch?v=1Rhs3PVAP4o>. The fact that my brain wandered from Margot Robbie, Anthony Bourdain and Selena Gomez to Una Vez Mas in a couple of minutes might give you a glimpse into a tortured mind. And I had the nerve to laugh when my friend JC took even less time to veer from a discussion on the increasing frequency of power outages to flatulence in the Stop & Shop's condiment section.

<sup>11</sup> [https://www.youtube.com/watch?v=kxN\\_qPuefrM](https://www.youtube.com/watch?v=kxN_qPuefrM)

<sup>12</sup> [https://www.youtube.com/watch?v=Pxr\\_FzpPM2Q](https://www.youtube.com/watch?v=Pxr_FzpPM2Q)

<sup>13</sup> [https://en.wikipedia.org/wiki/Private\\_equity\\_in\\_the\\_1980s#LBO\\_bust\\_\(1990\\_to\\_1992\)](https://en.wikipedia.org/wiki/Private_equity_in_the_1980s#LBO_bust_(1990_to_1992)),

<sup>14</sup> <https://www.valuwalk.com/a-warning-to-the-compounder-bros/>

<sup>15</sup> <https://www.institutionalinvestor.com/article/2bstqfcskz9o72ospzlds/opinion/why-does-private-equity-get-to-play-make-believe-with-prices>

credit, which bids up the price (bringing down the returns or boosting the riskiness) of the asset being chased. It's not just office buildings. Inflation-adjusted private multifamily construction spending is up five-fold over the past decade, now double what it was heading into the Financial Crisis, with vacancy rates on the rise. According to Moody's, just 29% of the Seafood Stew/CMBS loans that have matured so far this year have been paid off (compared to the 80% levels that held through 2022), 25% has been modified with 46% technically in maturity default.<sup>16</sup> While the largest banks, hampered by new capital rules, have mostly steered clear, life insurers and some regionals are providing the dumping ground once again.

Unfortunately, as we saw this summer, whenever investors begin to worry about the economy or the markets, they tend to sell (or short) our stocks first. Compounder Bros are not worriers by nature. We need to leave some room in our portfolio to fuel our counterpunches after absorbing the initial flurry. Thus, we have been quick to take gains when a few of our longs moved up rapidly toward fair value. But most of our holdings are still reporting double digit free cash flow returns and are giving us back most of that money – so we'll keep pocketing that cash while we wait for the market to catch on.

And once again we wait. It's what we do.

## DISCLOSURES AND NOTES TO PERFORMANCE

*Past performance should not be construed as an indicator of future performance. Inception is January 2000.*

*(a) The performance figures are estimates and unaudited. (b) All returns presented are calculated on a time weighted, total return basis (include all dividends, interest, accrued income, realized and unrealized gains and losses and commissions). Gross Returns do not reflect the deduction of a 1.5% management fee, applicable fund expenses, or a 20% performance allocation. Net Returns include dividends, net interest, and reflect the deduction of a 1.5% management fee plus applicable fund expenses; they are also net of a 20% performance allocation, if applicable; (c) These returns are not GIPS compliant. These returns are not AIMR compliant as they represent only the performance of the Series A, Class 1 shares. Individual investor returns may vary due to several factors, which include but are not limited to: the timing of subscriptions and redemptions; differences in fee structures; individual investor account high water marks, and differences in tax treatment. Because of certain governmental regulations, not all accounts are New Issue eligible. New Issues contributed approximately 9.6% gross to the performance figures presented for the year 2000, 0.6% gross for the year 2001, 0.09% gross for the year 2002, 0.48% gross for the year 2003, 0.47% gross for the year 2004, 0.30% gross for the year 2005, 0.17% gross for the year 2006, 0.24% gross for the year 2007, 0.03% gross for the year 2008, 0.01% gross for the year 2009, 0.03% gross for the year 2010, 0.05% gross for the year 2011, 0.00% gross for the year 2012; 0.05% gross for the year 2013; 0.05% gross for 2014; 0.01% gross for 2015 and 0.00% thereafter; (e) All performance figures are before-tax returns. Actual after-tax returns depend on an investor's individual tax situation and may differ from those above. (f) All historical performance and exposure statistics reported in this letter prior to October 1, 2001 refer to Elm Ridge Value Partners, L.P., a 3(c)1 limited partnership. (g) All S&P 500 performance percentages are shown with dividends reinvested. The S&P 500 has not been selected to represent an appropriate benchmark to compare Elm Ridge Management's performance, but rather is disclosed to allow for comparison of Elm Ridge Management's performance to that of a well-known and widely recognized index and is not intended to imply that the fund's portfolio is comparable to this index either in composition or elementary risk. The S&P 500 Index is a market-capitalization weighted index containing the 500 most widely held companies chosen with respect to market size, liquidity, and industry. The index is calculated on a total return basis with dividends reinvested. (h) The Form 13F that is filed on a quarterly basis by Elm Ridge contains the required details concerning our portfolio.*

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<sup>16</sup> Empirical Research, "Commercial Real Estate and the Banks: A Sight of Rate Relief," 10/2/24. Based on CMBS Office loans.

*Where indicated, select performance results included in this document are hypothetical returns which have been compiled by Elm Ridge Management. Hypothetical performance results may have inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. One of the limitations of hypothetical performance results is that they are prepared with the benefit of hindsight. There are numerous other factors related to the markets in general or to the implementation of any specific trading strategy which cannot be fully accounted for in the preparation of hypothetical performance results and all of which can adversely affect actual trading results.*

*Any hypothetical performance results do not include the reinvestment of dividends, interest, and capital gains, and do not reflect the deduction of Elm Ridge Management's investment advisory fees. Thus, actual return will be reduced by the advisory fees and any other expenses which may be incurred in the management of the fund. All investments involve risk including the loss of principal. Cumulative and annualized returns are shown. Cumulative returns represent the amount, including all interest or dividends and capital gains received on an investment over a period, usually expressed as a percentage of the amount invested. Annualized returns represent the increase in value of an investment, expressed as a percentage per year.*

*Contribution figures are estimated and may not sum due to rounding and compounding effects. Estimated Gross Long and Short Contributions are calculated independently by compounding the respective monthly returns.*

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