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ELM RIDGE

“1999”

Fourth Quarter Report • December 31, 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	4TH QUARTER 2024	2024	2023	2022	INCEPTION-TO-DATE ANNUALIZED
NET PERFORMANCE	-1.6%	-5.6%	-15.4%	48.6%	5.6%
GROSS LONG CONTRIBUTION	-2%	1%	7%	15%	11%
GROSS SHORT CONTRIBUTION	0%	-6%	-21%	25%	-5%
S&P 500	2.4%	25.0%	26.3%	-18.1%	7.7%

“We all have our time machines. Some take us back, they’re called memories. Some take us forward, they’re called dreams.”

–Jeremy Irons

*I was dreamin’ when I wrote this
 So sue me if I go 2 fast
 But life is just a party
 And parties weren’t meant 2 last...
 Yeah, they say two thousand zero zero party over
 Oops out of time
 So tonight I’m gonna party like it’s 1999
 –Prince, 1999, 1982¹*

As we close out our 25th year, the markets seem to have gone full circle (see chart next page). We have another new technology that is going to change the world; the public has bought into it hook, line and sinker; and any attention to valuation – what we do – has been thrown to the wayside. (Do you evaluate stock prices in relation to some expected stream of cash that can be sent your way?) Performance-chasing professional allocators and high net worth individuals have shifted away from active equity and cheaper market segments, in favor of the lower reported volatility of private investments for some time. (I would suggest you read Cliff Asness’ “2035 – An Allocator Looks Back Over the Last 10 Years.”²) As a result, it seems that retail investors, amplified by the machines that feed off them, are again driving the market. As one observer opined:

¹ <https://www.youtube.com/watch?v=rblt2EtFfC4>

² <https://www.aqr.com/Insights/Perspectives/2035-An-Allocator-Looks-Back-Over-the-Last-10-Years>

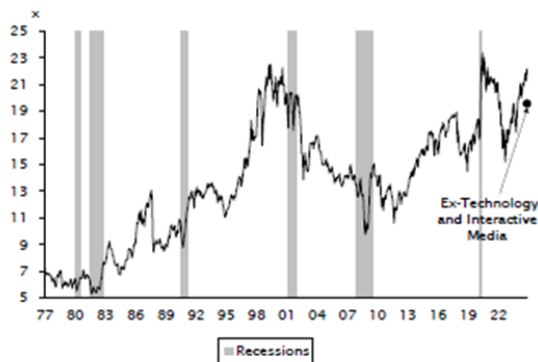
It's almost like a crowd of sports bettors ahead of the big game. They're talking to each other, they're fantasizing how it's going to play out. And so there's no constraint," he says. And the crowd, feeling vindicated, readily rejects any counter-arguments to their optimism.³

We're still smarting from the drubbing we took in early December, when the Russell 1000 Value Index fell every day for almost three straight weeks, while megacap growth stocks drove the overall market, and I would guess, almost all your portfolios, to record highs before settling back down. The (MSZZMOMO) index going long those stocks with the best prior 12-month return (how retail investors judge their worthiness) and shorting the opposite ended up a mere 55% this year, in line with of the Meme Stock Mania in early 2021 and, of course, the end of 1999.⁴ And here we are again: old, dumb and irrelevant – with just too long a memory.

We're now at the point where *Barron's* leads with "Embrace the Bubble"⁵ (the next two paragraphs source from this issue alone, the same one that contained the warning at the top of the page), quoting a strategist who notes that "valuation is a lousy timing tool. While high or low valuations can be predictive of returns over a long horizon, they have little correlation to the market's performance over the next 12 months..." The article concludes with "said differently, something needs to pop [it]. That's something we'll worry about in 2026." We're glad they're so confident about the next 12 months.

Individual investors are back to telling us value fuddy duddies how dumb we are. We read how "last week, famed value manager Bill Nygren was shopping for razor blades when a drugstore employee who recognized him from TV approached him. "He says, 'I bet your portfolio isn't up as much as mine. I have everything I own in Bitcoin,'" Nygren

Exhibit 1: The S&P 500 Forward-P/E Ratios 1977 Through Early-November 2024



Source: Corporate Reports, National Bureau of Economic Research, Empirical Research Partners Analysis.

recalled. "And, you know, he's right." And they're back to turning on Warren Buffet as well, stating that he violated his own rule from his 1988 shareholder letter ("We are just the opposite of those who hurry to sell and book profits when companies perform well but who tenaciously hang on to businesses that disappoint") by buying more Occidental Petroleum. I guess the difference between "business" and "stock" is mere semantics. After all, for the public, they are one and the same.

The cultists are kicking our butts, as they continue to double down and let it all ride. Why would we ever own bitcoin when we can buy MicroStrategy at twice the price? "Have Fun Staying Poor," (HFSP for short) they tell us. The cool crowd knows how to play to their retail

acolytes just as Palantir Technologies works its Palantarians ("Nah Coach, I'm Methodist,"⁶). "We are moving to NASDAQ," a board member posted, "because it will force billions in ETF buying and deliver 'tendies' to our retail investors. Player haters be aware that we've been hated for decades."⁷ [The company went public in 2020.] Don't you worry that in the last two months, this insider used the opportunity to unload \$3 million of stock or that "Daddy Karp," the CEO, cashed out of a mere \$1 billion.

³ *Barron's*, 12/13/24 "Crypto, Stocks, and Wacky ETFs Are Going Wild. Will Things End Well?"

⁴ Empirical Research, 12/5/24.

⁵ *Barron's* 12/13/24.

⁶ So said a kid on my brother's freshmen baseball team who brought a lefty catcher's mitt to practice, when the coach asked if he was ambidextrous.

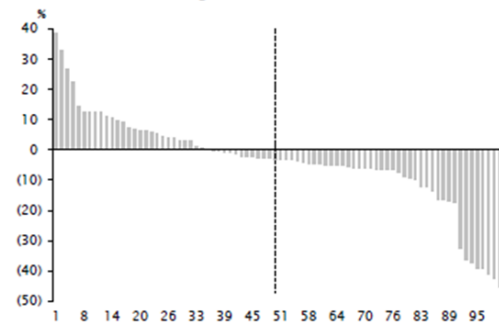
⁷ *Wall Street Journal*, "The Investing Cult Fueling MicroStrategy's Ascent: 'Have Fun Staying Poor'" 12/22/24.

I'm getting ready for the guff I'll get at the upcoming 28th Annual Bachelor Party Ski Trip. My friend Hickory will confidently opine that I'm a stodgy old man incapable of understanding how this time is different. He'll repeat some version of the popular story that this time does differ from the pre-2000 dot-com bubble, in that the Magnificent 7 have real earnings. But this reflects a clouded memory, spawning a load of bull.

While the dot-coms soared into the new century (just as MicroStrategy, Palantir, Tesla⁸ and Affirm have in the last few months), it was the arms dealers, or the Four Horsemen of the Internet (e.g. Microsoft, Intel, Cisco, and Dell), that powered the markets in that episode, almost exactly as the Mag 7 are doing today. The Horsemen were also profitable and doing quite well. But they were trading at high multiples of earnings boosted by selling to a customer base that hadn't figured out how to monetize the new technology. While a mostly new batch of companies did eventually figure out how to capitalize on the internet, an investment in the Horsemen would have lost (as some of you did) more than half your money over the ensuing decade (with Microsoft's -49% price return being the *best* of the bunch). In fact, you wouldn't have broken even for almost two decades – that is if you were willing to run with a portfolio that became 90% Microsoft. Would you have been willing to stay the course?

And while momentum investing can be a successful strategy, particularly over shorter periods, it has demonstrated some nasty skew (i.e., when it's bad, it's really bad) after a big run (take a look at the right side of the accompanying chart). But what if it's 1998 redux and not 1999? Could we defy history and get another year of this? It could happen.

Exhibit 9: Large-Capitalization Stocks
The Top Quintile of Nine-Month Stock Price Trends
The Distribution of *Subsequent* Twelve-Month
Buy-and-Hold Relative Returns¹
After a Top-Decile *Trailing* Twelve-Month Performance
1953 Through November 2024



Source: Empirical Research Partners Analysis.

¹Capitalization-weighted data.

While valuation is lousy at timing, it is the only thing to cushion the rebound when the stuff hits the fan. As Jimmy Cliff crooned, “the harder they come, the harder they fall, one and all.”⁹ When the New Economy broad markets took a nosedive in 2000, our longs rallied more than 40%. By the way, even if you were smart enough to pick the Horsemen at the end of 1998, before they doubled the following year, you still would have been down more than 50% a decade later.

Velvet Ropes and Yellow Tape

“Time moves in one direction, memory in another.”

–William Gibson

“Fads are the kiss of death. When the fad goes away, you go with it”

–Conway Twitty

As for the rest of the market, we haven't gone full circle back to 1999's split between the New and Old Economies. While almost anything non-tech was tossed aside when we started Elm Ridge, this time around the valuation gaps among non-tech stocks (and even inside the tech world) are as large as those between the two groups. Institutional investors seem to have huddled around a few “good companies” that can trade at any multiples provided they don't disappoint on a quarterly basis and continue pursuing the financial engineering supported by the former low interest rate regime. As long as the stocks are working, the Street, following its customers' interests, will continually ratchet up targets and come up with all sorts of mathematical contortions to keep them comfortably above their current

⁸ Oh, silly me. Tesla does earn a profit and thus its 200+x PE is fully justified.

⁹ <https://www.youtube.com/watch?v=7Znh0OM9jiA>

prices (such as one analyst using a 32.6x multiple on '26 EBITDA while another chose a 57.6x PE target for stock providing less than a 2% earnings yield).

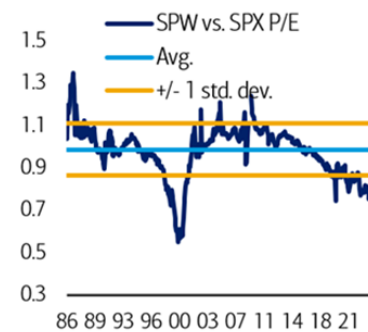
At this point, the fact that our portfolio is sporting a 14% free cash flow yield (measuring the annual yearly cash return that they can direct toward their shareholders without hurting their businesses or incurring more debt) or more than 3x the risk-free rate (and about 5x that of the market) is irrelevant. Why would you ever want to own a low-cost commodity chemical producer such as Lyondell, with a 7% dividend yield that grows 5%/year (as they also buy back enough stock to keep the cash payout flat). OneMain makes small high-interest rate loans to subprime borrowers; so that can't possibly be a business worth investing in, even though their return on equity hovers around 50% and they pay an 8% and growing dividend. I left these examples to the end, so I wouldn't put you to sleep early. But there are extraordinary opportunities that no one seems to care about – for now.

So long as our companies can capitalize on misvaluations by shrinking their share base (boosting the ownership stake of the remaining shares, as opposed to offsetting the options dilution from constantly selling insiders), they are building value. And when the regime changes, just a small move can send our stuff soaring as happened in both 2000 and 2022. For instance, we have half our portfolio in energy and materials and yet each of AAPL, NVDA and MSFT are valued higher than these two S&P sectors combined.

It's a small price to pay, that in return for looking like dumbasses for long stretches of time – and when the public is most interested in our business – we can capitalize on their folly. We just need to learn how to have more fun staying poor.

Exhibit 12: Average stock trades at a wide discount to the index

Equal-weighted S&P 500 forward PE vs. cap-weighted (as of 10/2024)



Source: BofA US Equity & Quant Strategy, FactSet
BofA GLOBAL RESEARCH

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.

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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