April 6, 2018

Cable Car Capital LLC Spring 2018 Letter

Dear Friends,

The Cable Car Composite returned +13.2% in 2017 including +12.8% in the final four months, primarily due to concentrated long positions belatedly participating in the market's euphoria in November. Worldwide equity markets, as measured by the ACWI, returned +24.0% during 2017 including +7.8% in the balance of the year. In the first quarter of 2018, the Composite returned +1.9% and the ACWI declined 1.0%.

At the four-year mark, capital invested with Cable Car at inception was worth more than double the initial investment, net of fees. Through the first quarter of 2018, Composite net returns have compounded at an annualized rate of +17.6%. Firm assets under management were $11.7 million as of March 26, 2018, the date of Cable Car's latest brochure on Form ADV.

I'm excited to share that Cable Car will be launching a co-mingled fund later this year.

Performance

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	CCC	ACWI
2013											+4.2	(0.3)	**+3.8**	+3.9
2014	(3.3)	+3.9	+1.9	+1.6	+3.3	(0.5)	(1.6)	(0.5)	(6.2)	+4.7	(1.6)	+5.8	**+7.2**	+4.2
2015	(3.8)	(0.9)	+17.5	+4.6	+24.9	(6.1)	(2.9)	+4.5	(1.7)	+3.5	+1.9	(4.2)	**+38.4**	(2.4)
2016	(5.5)	+5.1	+0.9	+1.6	+5.1	(1.7)	+1.2	(0.7)	+8.5	(1.3)	+1.6	(0.1)	**+14.8**	+7.9
2017	(0.7)	(1.9)	+4.4*	(1.1)	(5.8)	(2.2)	+1.8	+6.5	(0.8)	+3.1	+16.4	(5.3)	**+13.2**	+24.0
2018	(2.0)	+1.4	+2.6										**+1.9**	(1.0)
Annualized since inception (November 8, 2013)													**+17.6**	+7.9

Narrative

The five largest long positions are currently Insignia Systems (ISIG), Pangaea Logistics (PANL), Retrophin (RTRX), NetDragon Websoft (777 HK), and Dell Technologies Class V (DVMT). Significant performance impact by issuer for the representative account in the 7 months since last report (September 2017 – March 2018) was as follows, expressed in basis points (bps) on beginning-of-period assets:

Contributors		**Detractors**	
Position	*Performance (bps)*	*Position*	*Performance (bps)*
Long ISIG	+880	Short WINS	(294)
Long PANL	+760	Long 777 HK	(273)
Long NRS GR	+142	Short ZN	(177)
~Short NVCN	+111	Short Company I	(88)
Short TSLA	+95	Short Company H	(87)
~Short Company D (MSLP)	+92	Long RTRX	(70)

~Denotes closed positions. The bulk of the WINS position was closed through involuntary buy-ins in December. Please see important disclosures on last page. Attribution includes position-level stock loan rebates.

* Corrected from previously reported +4.7% due to an inadvertently omitted client cashflow.

Net exposure for the representative account at quarter-end was 72% long and 23% short.

Put me in the camp of investors who believe changes in asset prices should have a discernable cause. Market participants rightly poke fun at news headlines that storify insignificant fluctuations in the market as a whole, but that does not mean individual stocks should fall and levitate, as if by magic. When the highest (lowest) price at which the marginal buyer (seller) is willing to transact changes, presumably it changes for a reason. As a matter of philosophy, I believe the only reasons that matter in the long run are changes in the fundamental value of the underlying business, but other factors dominate in the near term. There is intentionality behind major price changes. Someone decides to accumulate a large position. Traders respond to momentum. Shares are lent and recalled. Sometimes, someone breaks the law.

To me, investing in the stock market is partly reducible to the attempt to answer a sometimes unanswerable question: what explains price changes for each security? It is an endlessly interesting puzzle, where each situation is unique. Identifying and anticipating the value drivers for the performance of a business may or may not be the same as identifying the drivers of its share price. Expectations may or may not be anchored on metrics publicized by management or other market participants. There are limits to arbitrage and the market's ability to correct prices that are "wrong." Yet, I believe the search for meaning behind the invisible hand of the marketplace is a necessary step in formulating predictions.

In a sufficiently complex system, the answer may be indistinguishable from randomness. That is the basic assumption that underpins most quantitative analysis. Ironically, quants are sometimes the ones being "fooled by randomness," mistaking deterministic processes for the vagaries of chance. Likening the independent marginal decisions of market participants to Brownian motion works well enough in the short run, but only until the inevitable convergence of price and value. I remember being astonished when a statistics professor first described that convergence to me as a bad thing. "Jump risk" is a shortcoming of quantitative models, when events make clear that prices were not so random, after all. I am personally far less interested in explaining random price processes in nearly efficiently priced securities than in looking for potential opportunities for a "jump."

Because I traffic primarily in situations where the discrepancy between price and value is readily apparent, I am often trying to understand and predict what might close the gap. Randomness is an unsatisfactory explanation for what causes the discrepancy in the first place or might prevent prices from correcting. In an ideal world, I would be able to at least form a hypothesis about why every position in Cable Car's portfolio is being bought and sold in the marketplace. For example, I grew comfortable adding to DVMT in February in part by understanding the reasons for arbitrageurs unwinding the VMW spread trade.

All that is a way of saying that I have many theories but very little real insight into why PANL more than tripled a few weeks after the lengthy discussion in my last letter, only to come all the way back down again in the ensuing months. Irrespective of the reasons, I was delighted by the portfolio management opportunities presented by the volatility, as is often the case. My views on the quality of the business are entirely unchanged; if anything they have been reinforced by subsequent earnings reports.

One thing I have observed repeatedly in these letters is that securities with limited capitalization or float sometimes make it easier to isolate the impact of the actions of a small number of market participants. At times last year, it felt almost as though an identifiable group of people were colluding to manipulate the share price of securities in Cable Car's portfolio, primarily short positions associated with bad actors. Due to my focus on identifying wrongdoing, I am sometimes a little quicker to perceive deliberate market manipulation in certain situations rather than a quantitative algorithm gone awry. It came almost as a relief to see market exuberance extend to some long positions, without any of the usual suspects involved.

However, that is not to suggest that markets are entirely healthy. The increasing prevalence of indexation is causing serious misallocation of capital that is becoming increasingly evident on the margin. As an individual allocation strategy, throwing one's hands up and buying all securities in a particular index or on a given exchange is a good way to earn market returns. As a collective approach, it is insanity that reduces overall market returns by wastefully allocating capital to unproductive enterprises. If an index contains a small number of fraudulent companies, the impact on returns to each individual holder is small, but it is an undesirable outcome for society. In size, passive flows can begin to support the valuation of securities that never should have traded, thereby crowding out more productive opportunities for capital formation. Passive investing relies heavily on sufficiently robust deterrence of fraud accompanied by gatekeeping processes to ensure that capital is allocated only to at least minimally deserving businesses.

If we are going to have a world in which capital allocation decisions are made passively, some entity still needs to evaluate which securities are eligible for allocation in the first place. Reverse mergers and conflicts of interest inherent in underwriting mean that the status of "public company" is insufficient. Unfortunately, neither the national securities exchanges nor the index providers seem capable of fulfilling a gatekeeping role. The annual FTSE Russell reconstitution process has become a closely watched event, and each year short sellers cringe at the handful of outright frauds that will be given a new lease on life, wondering whether we should cover positions just because they are near the threshold for inclusion in the Russell 2000.

FTSE Russell has a reasonably robust reconstitution process, but qualification for inclusion in the indices is an entirely mechanical process, dependent on company classification, size, and shareholder structure. Index providers make no determination of whether public filings are accurate. That can prove a temptation to companies willing to misrepresent their headquarters location or conceal concentrations of ownership that could prove disqualifying. Russell index inclusion and expulsion decisions can and do have extreme market impact when unthinking trading activity by large passive managers is magnified by limited float.

WINS last year and LongFin (LFIN, no position), the subject of an SEC enforcement action today, are only the most recent and egregious examples. I have suggested to FTSE Russell that a higher amount and narrower definition of float would be appropriate, but they do at least try to apply their current standards consistently. But what of other gatekeepers? Why is avoiding tracking error so important to passive managers that they are willing to contribute to obvious mispricing? In my view, ETF sponsors who turn a blind eye to and contribute to self-evident market abuse – sometimes then profiting from it in collusive securities lending arrangements – are abdicating fiduciary duties to their clients and undermining the integrity of markets.

Moreover, national securities exchanges have a legal obligation to consider the public interest, the protection of investors, and the maintenance of fair and orderly markets in making listing determinations. Nevertheless, it seems like the imprimatur of a national exchange listing means next to nothing these days. It is hard to understand how NASDAQ could responsibly agree to the initial and continued listing of LFIN or WINS, for example. Meeting a few technical size and distribution requirements that are laughably insufficient to prevent market abuse should not be the sole criterion for exchange listing, particularly when public interest concerns are already apparent. Worse still, there are numerous examples of exchange failures to timely and properly enforce their own listing rules.

While exchanges are not responsible for validating every disclosure by their clients, once significant public interest or market manipulation concerns have become evident, there should be an open and transparent process for addressing problematic securities. I fear that absent intervention from regulators and the courts, these issues will only worsen over time.

For my part, I intend to continue engaging closely with regulators and other gatekeepers, even on topics where there is not an immediate trading opportunity. Over time, flagging issues I observe as a market participant to the relevant authorities has become a core part of my approach at Cable Car, which I expect to continue. In December, Cable Car hired counsel in this area.

That brings me to cryptocurrency. From past efforts to help combat the predatory activities of unregistered binary options and CFD brokers, I have been alarmed by the rise of similar behavior among cryptocurrency exchanges. My largely fruitless efforts to find legal means of obtaining more short exposure to the mania have instead prompted unusually fruitful dialogue with regulators. In March, I submitted a public comment on a proposed CFTC rulemaking with a simple message: it's a matter of basic fairness and investor protection that cryptocurrency exchanges need to register with the CFTC and the SEC.

I believe there is a great deal more regulatory activity to come. In addition, private rescission actions seeking to recover funds from the distribution of unregistered securities in initial coin offerings are an emerging front in the backlash against excesses in the cryptocurrency markets. I am in the process of exploring whether Cable Car may be able to assist these efforts and would welcome conversations on the subject. Cryptoevangelists should cheer these developments, which like exchange listing policies in the stock market can help prevent misallocation of capital and ensure that legitimate business models compete for investment on an even playing field.

Business update

Although I have been an evangelist of sorts myself for the separately managed account structure for emerging managers with small bases of capital, I have long expected to transition to a co-mingled fund eventually. It is no secret that Cable Car has encountered some growing pains. Complex transactions like the private placement last year are a headache to implement across now more than 40 accounts, and the scale economies of a pooled vehicle are becoming clearer with greater assets under management. Still, I was in no hurry to switch until learning of a major and likely unintended consequence of the tax legislation last year. One of the few tax increases in the law inexplicably eliminated the federal deduction for investment expenses, which includes investment management fees and, fatally for my business model, incentive fees.

In a traditional hedge fund partnership, partners pay tax on their *net* capital gains after the incentive allocation has been deducted. By contrast, in a separate account, clients pay tax on the *gross* capital gains realized in the account before the incentive, which is treated as a fee. Until this year, the incentive fee was tax-deductible as an itemized deduction subject to certain limitations. Without the deduction, a qualified client in the upper brackets would effectively become a minority partner on their own capital under Cable Car's incentive-only model.

In response, I first reduced fees for all clients. Now, I am in the process of working with attorneys and tax advisors to form an offshore mini-Master fund structure. I will have more to say about the new entity soon, but for the moment I want to update readers while emphasizing that this letter should in no way be viewed as a solicitation. It is not an offer to purchase any security, and any such offer will be made solely by means of an offering document provided only to eligible investors.

With that said, I'm excited about the possibilities the fund presents. In particular, Cable Car has been overly dependent on a single prime broker for sourcing hard-to-borrow shorts. Multiple counterparties may help mitigate buy-in risk and expand the opportunity set. I feel to a certain extent as though I have been fighting with one hand tied behind my back, and I look forward to having new tools at my disposal.

In advance of launching the fund, anticipated in the third quarter, I will necessarily be taking a more proactive approach to marketing. Since spreading the administrative costs of running a fund over a larger asset base will benefit all clients, I intend to make a hopefully one-time marketing push prior to launch. While this letter is not a solicitation, if you are subscribed to this mailing list, please be aware that you will hear from me at some point to gauge your interest in investing with Cable Car. For those of you who are personal friends or just have passing interest in what I have to say, I will not be offended in the slightest if you only want to read. However, please send me a note if you'd prefer not to receive fundraising communications at all.

On the plus side, I now have some added motivation to put out letters in a more timely fashion. If you like, consider this my Q1 2018 letter, delivered in record time!

Thanks for reading.

Jacob Ma-Weaver, CFA

Important advertising disclosures

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The SEC requires that references to past specific recommendations, including attribution calculations, be based on a reference account and that at least ten holdings be disclosed. Cable Car's largest account serves as the reference account. Detailed computation methodology and a list of all holdings' contribution to the account's performance are available upon request. The holdings identified in this letter do not represent all securities purchased or sold for advisory clients, and past performance is no guarantee of future results.

Please note that Cable Car maintains a selective public disclosure policy regarding positions that may be competitively sensitive, difficult to borrow, or otherwise unlikely to benefit from publicity. Clients retain full portfolio transparency, and Cable Car will generally disclose subject securities to non-clients upon request.

Cable Car Capital LLC ("Cable Car" or the "firm") is a limited liability company with principal place of business in San Francisco, CA. The Cable Car Composite reflects the performance of the firm's concentrated, hedged value investing strategy. The composite contains all fully discretionary accounts managed by the firm, and it is the firm's only composite. Cable Car claims compliance with the Global Investment Performance Standards (GIPS). To obtain a compliant performance presentation and composite description, contact Jacob Ma-Weaver at jacob@cablecarcapital.com or (415)857-1965. Verification and performance examination reports are also available upon request.

ACWI is a trademark of MSCI, Inc. "The MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets." ACWI total returns are presented including dividends net of withholding taxes. Composite returns are presented net of all expenses and fees, including accrued but unpaid performance fees. Returns are expressed in USD.

Cable Car implements its strategy in part through short sales and makes limited use of derivatives and leverage. Gross exposure is limited to 200% and portfolios maintain a net long bias. Additional disclosures regarding the risks associated with the firm's investment approach are contained in the firm's brochure on Form ADV. The firm's list of composite descriptions and additional information regarding valuation policies, performance calculation, and performance presentation is available upon request.

The performance of individual client accounts can vary significantly from the performance of the composite, particularly due to the inclusion of retirement accounts which cannot accommodate short sales. The timing of cash flows, type of account, base currency, fee arrangement, and the availability of investment opportunities for each account may lead to significant divergence from composite returns. In 2014, net returns of accounts funded for the full year ranged from 6-10%. The range was 22-55% in 2015, 11-29% in 2016, and 5-21% in 2017. For the three-year period from 2015-2017, the annualized monthly standard deviation of the composite was 22.9% versus 10.5% for the ACWI. While the composite is benchmarked against the ACWI in order to compare performance to broad market equity returns, client portfolios are not managed to any particular benchmark, and performance is likely to vary from the performance of any given index.