Alpha Wealth Funds, LLC

“the opportunities never stop”

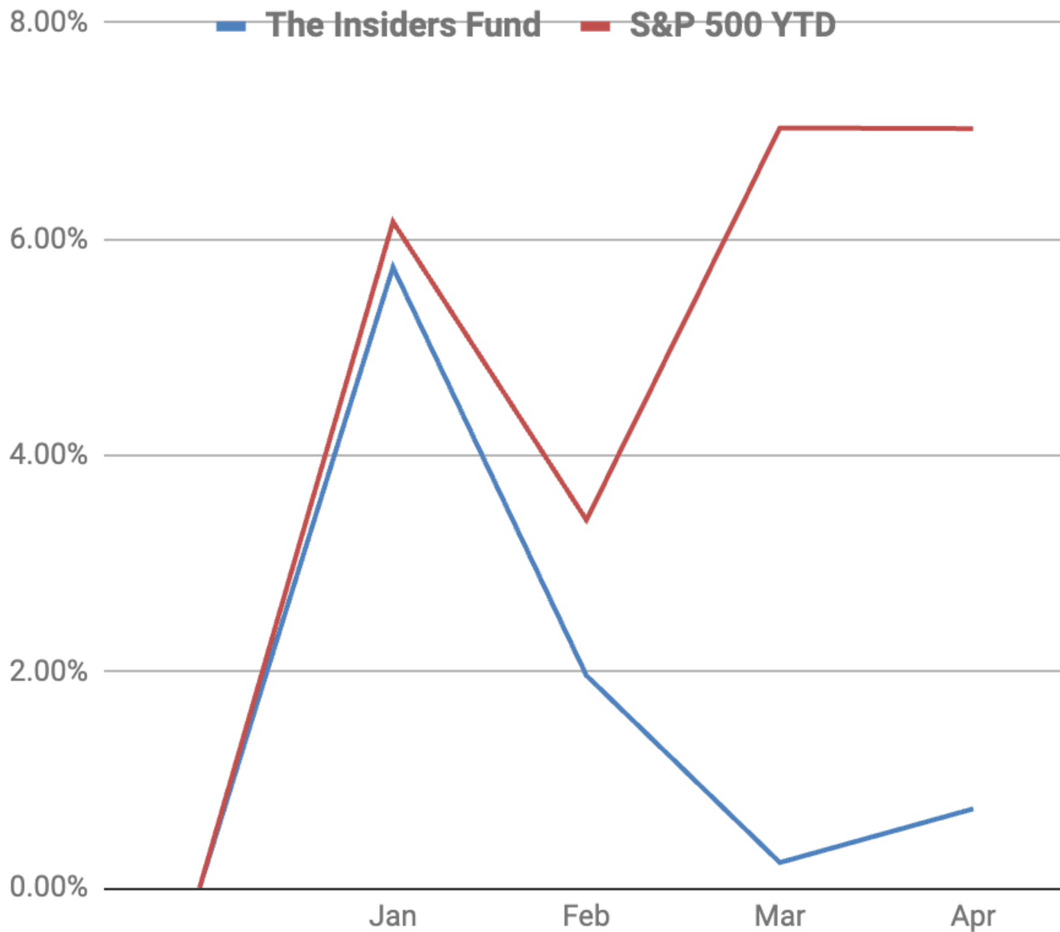
April 2023

The Insiders Fund, LP 1st Quarter 2023 Partner Letter

“The stock market is never obvious. It is designed to fool most of the people, most of the time- Jessie Livermore”

The Insiders Fund was off 1.74% in March and was up 0.37% for the 1st quarter of 2023. The benchmark S&P 500® was up 3.51% in March, bringing its YTD 2023 return to 7.50%. The Insiders Fund's three-year annualized return is 32.51% versus the S&P 500 18.60%. NAV Consulting provides the official returns for the fund. Berkower, a PCAOB member accountancy firm, provides audit and tax forms.

1887 Gold Dust Lane, Suite 203A, Park City, UT 84060
wk. 435-658-1934 ▪ fax: 206.984.4109 ▪ email: hsax@theinsidersfund.com



The S&P 500 Outperformed the Fund During March

This partner letter is much like a report card, and we hope you will indulge us as we attempt to explain and understand what we did with your investment last quarter. Our approach is very different from passive index investing. First, we don't have to invest if we don't see anything worth investing in. We maintain large cash balances until favorable opportunities present themselves. Warren Buffett is fond of comparing the investing game to baseball. There is no three-strikes-you-'re-out rule. You can wait for that fat pitch.

The return profile can be fast and sudden when that fat pitch comes. Studies show this repeatedly that market returns often happen in compressed periods. Our goal is to patiently wait and achieve the maximum return with the minimum acceptable level of risk. Our approach of carefully analyzing insider behavior is critical to mitigating those risks. We ardently believe

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that no one knows the business better than the people running it, and if they're not buying, we have to think long and hard about why we would.

How a manager beats or underperforms the market is not always readily apparent or easily understood. Not so this quarter. We entered the quarter with way too much cash; over 18% of the Fund was sitting in short-term bank paper (JPST), earning a miserly 1 ⅛% (4.7%/4) SEC 30-day yield. If that wasn't bad enough, our largest exposure was oil and gas, particularly natural gas.

Lest you think stock picking was easy last quarter, consider this; 95% of the market's return was generated by ten stocks, all of which were in technology-related businesses. If you weren't in those stocks, you were lucky to have not lost money. Unfortunately, if you were in them last year, you lost a lot of money.

To quote stock market legend Jessie Livermore-"the stock market is …. is designed to fool most of the people, most of the time."

Winners and Losers:

With the winners, we look at how much we might have left on the table and the taxable consequences. The Fund has special tax treatment, both mark-to-market Section 475 and long-term capital gains, potentially the best of both worlds. In a perfect world, we want our long-term winners to wind up in the long-term capital gains account and our losers in the mark-to-market basket at the end of the tax year.

Energy, particularly natural gas, was the worst-performing sector in the quarter. Natural gas prices, as measured by Henry Hub, declined 50% in the 1st quarter, sinking to multi-year lows. **Comstock Resources** was down 25.4%, and **SandRidge Energy** was off 16.9%. Considering both are very large positions in our portfolio, I'm relieved we even eked out positive returns.

The last few days have shown signs of oil prices picking up. OPEC announced an unexpected one million per day supply reduction because, purportedly, Biden did not start refilling the petroleum oil reserves as he promised after record drawdowns to combat inflation. Biden gets blamed for everything these days, but it was just opportunistic greed on the part of our non-friends, the Saudis.

Natural gas is trading at multiyear lows due to an unusually warm Winter combined with European hoarding and conservation efforts due to the war in Ukraine and the shutoff of Russian gas. It didn't help that a fire at a major LNG export facility forced a shutdown while China locked the country down with its zero Covid policy. China has about-faced its Covid policy and is reopening. LNG exports at the Freeport facility are resuming.

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Natural gas is still trading below pre-invasion prices. U.S. natural gas consumption in both January and February reached its lowest levels since 2018, averaging 104.4 billion cubic feet per day (Bcf/d) in January 2023 and 103.0 Bcf/d in February 2023, respectively, according to the EIA Short-Term Energy Outlook (STEO).

Despite seasonal weather anomalies, the world will use more natural gas, not less, and the U.S. will export more of it with all the LNG projects underway. Natural gas consumption in the electric power sector in the *Western* part of the U.S. was 23% higher in the first two months of this year than in January and February 2022 and 33% higher than the five-year average for the two months combined.

There is an obvious explanation for this increase in usage. It's zero-emission vehicles. The largest car market in the U.S. is California. Last January, they reported that 18.8% of all new cars sold in the previous year in California were zero-emission vehicles (ZEVs), and 40% of ZEVs sold in the U.S. are sold in California. According to Elon Musk, a family of four with two EV vehicles will double their electricity consumption. The current administration's latest EPA mandates will only accelerate this trend.

Although markets are bearish about natural gas prices in the short term, producers are well-financed, and the gas in the ground isn't losing any value and costs nothing to store. Producers have already cut back on drilling rigs, according to Baker Hughes. Short sellers and speculators have an outsized impact in this market. They will get crushed eventually as electricity demand will soak up the natural gas surplus. Solar, wind, i.e., renewables, will inevitably supply a greater proportion of electricity generation, but natural gas will be in demand to replace coal and necessary for the foreseeable future as the sun doesn't always shine and the wind doesn't always blow.

There were no significant winners or losers other than those two nat gas producers. We traded out of CME too soon, but we've been earning our fees there for a couple of years, and it hasn't run away from us.

Top 10 Holdings as of 4/11/23:

We are fully invested now, convinced that the Fed has ended the rate hike cycle even if they haven't publicly announced it. The discussion below is about the current top 10 holdings and, to some extent, about some small but exciting positions. Reading the weekly blog is also great for seeing more of our thinking, particularly on smaller trades.

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Alphabet, commonly known as **Google,** is our largest holding at 12%. This is a surrogate but safer exposure to the Nasdaq 100 than the index itself. Google has a giant net cash exposure earning respectable returns. Its cash far outstrips Apple, Microsoft, Meta, or any company. Alphabet sold off sharply on Microsoft's announcement that they were coming after Google's search franchise based on ChatGPT and their significant investment in Open AI. I suspect this will become a two-horse race, Google and Microsoft. Google has a long history with artificial intelligence and has made significant investments in large language models such as ChatGPT.

Furthermore, Alphabet is a trade. We sense a market overreaction to the perceived assault on Google's dominant search franchise. Search is mistakenly assumed to be an advertising business by many, but I agree with the CEO of Microsoft. "The most profitable large software business is 'search,' says Satya Nadella.

Energy Transfer (ET) is one of the country's largest natural gas pipeline and petroleum companies. It represents ~ 8.25% of the portfolio. It is mainly immune from commodity price fluctuations as most of its revenue is based on fixed-price contracts for transporting oil and gas along the pipes. It pays out a current 9.75% yield. ET has had massive insider buying as well.

Natural gas is the preferred fuel for electricity generation. Domestic power generation is transitioning from coal to cleaner burnin gas and renewables. Foreign demand for LNG is off the charts in part due to the Russian weaponization of the energy markets. Russia has the largest natural gas reserves in the world. The United States is a close second. The US is adding capacity to transport natural gas from the producing fields like Haynesville to LNG export facilities. The Marcellus and Utica, the country's largest natural gas deposits, lack pipeline capacity for LNG exports. For now, natural gas may have abundant supplies and downward pressure on prices, but long-term fundamentals are likely permanently altered due to the European boycott of Russian gas.

Comstock Resources (CRK) constitutes a 5.76% weighting. Comstock is one of the largest producers in the Haynesville, a premier natural gas basin with direct access to the high-value Gulf Coast markets and the LNG corridor that is so much in demand. They claim to have the industry's lowest cost structure. They have ~1600 high return Haynesville/Bosser net drilling locations, which should support decades of drilling. Significant recent insider buying reinforces my confidence in this name. However, the short-term outlook is bearish as a warm European winter, and inventory buildup has pressured nat gas to multi-year lows.

EOG Resources at 6.34% weighting is a low-cost domestic oil and gas company with acreage in all the major producing basins. The company has a strong balance sheet, a variable dividend

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structure and a culture of returning free cash flow to shareholders. Director Kerr purchased $2.6 Million of stock in January at $130.49

Albemarle Corp represents 4.85% weighting. ALB is the largest U.S. lithium chemical mining and producing company. The global automotive demand for this critical battery mineral will unlikely ebb anytime soon. There haven't been recent insider purchases, but the price has dropped to levels where insiders have stepped up in the past. The prospects for Albemarle are only getting stronger.

Ironically we lost money on our position in Albemarle last quarter. It's hard to imagine that Albemarle can't be a huge beneficiary, yet it acted much like fossil fuels, the commodity price significantly correcting after a huge 2022 runup. China specific issues like EV subsidies ending, overproduction, fears of a recession, and analysts going from bulls to bear on Albemarle created wild swings in price. We took losses on it but have since reinitiated our position at significantly lower prices.

I'm long term bullish on the EV market and alternative energy. There is no substitute on the horizon for this unique metal, Lithium. It's essential to the batteries that power electric vehicles, utility scale battery packs, and all forms of personal and household electronics. We own positions in Livent, Lithium America, Fluence, and even a position in a lithium ETF, LIT.

SandRidge (SD), at 5.21%, is an under-the-radar oil and natural gas producer. Its primary areas of operation are the Mid-Continent in Oklahoma and Kansas. I met with management at the Enercom conference in August and blogged about it in the Enercom notes in The Insiders Report. In addition, I recently had a virtual meeting with management aided by one of our partners, a retired senior executive in this industry.

SandRidge has no debt, no hedges, and boasts that. ~75% of wells can operate profitably at $40 WTI crude and $2.00 Henry Hub gas price. They won't have to pay taxes for the foreseeable future either due to the huge $1.7 billion net operating loss carryforward. Its largest holder is Carl Icahn. He controls the board of directors and management.

SPDR S&P Regional Banks KRE is a 4.14% weighting. The SPDR® S&P® Regional Banking ETF seeks to provide investment results that, before fees and expenses, generally correspond to the total return performance of the S&P® Regional Banks Select Industry Index (the "Index"). Seeks to provide exposure to the regional banks segment of the S&P TMI Membership in the Select Industry Indices is based on the GICS classification, as well as liquidity and market cap requirements.

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The Silicon Valley Bank run and sudden collapse caused a general run on the banking system and more than likely ended the Federal Reserve's aggressive rate hiking cycle. Several regional and community banks sharply sold off on the contagion effect. There were numerous insider buys in many names you've never heard of. We bought a few shares across the board, believing this was the "classic blood on the streets" moment. As a way of participating without doing the necessary deep dive on complex bank balance sheets, we purchased the KRE and a smaller amount in XLF. XLF is profitable, but we're still in the red with KRE.

This selloff also occurred during the 1st quarter earnings blackout period, so it's difficult to ascertain the level of confidence management has in the business. However, I suspect we'll see many more insider purchases as the blackout lifts, and based on this and our latest understanding of the banking crisis, we may move more money into this beaten-up sector.

We also purchased shares in **Charles Schwab**, the 10th largest bank in the country and one of the world's largest custodians of stock market assets. Several insiders purchased material amounts of stock in defense of the name as reports circulated that Schwab's bond portfolio was so deep in the red that the company had negative equity. We are in the red here as the stock has had no rebound from the numerous insider buys.

Devon Energy at 3.37% rounds out our exposure to domestic U.S. oil and gas producers. Devon has had consistent CEO open market purchases of stock. Devon Energy Corporation is an independent oil and natural gas exploration and production company. Devon's operations are focused onshore in the United States. The company's portfolio of oil and gas properties provides stable, environmentally responsible production and a platform for future growth.

Operating cash flow increased by 74 percent in 2022. Free cash flow reached its highest level in Devon's history. Fixed-plus-variable dividend payout more than doubled in 2022 to $5.17 per share. Board approved an 11 percent increase to the fixed quarterly dividend in 2023 Devon's Share-repurchase program on track to decrease share count by 5 percent. Oil production reached an all-time high of 316,000 barrels per day in the fourth quarter. Proved reserves increased 12 percent to 1.8 billion Boe at year-end 2022. We have nice paper profits in Devon.

Lockheed Martin at 2.21% weighting helps us sleep better at night. The world is a dangerous place, more dangerous than at any time in my lifetime. Even in the Cuban missile crisis era, the U.S. only had one nuclear-armed adversary. Now we are confronted with the alliance of two nuclear superpowers. One of them is an economic juggernaut that we helped create by outsourcing manufacturing for years to China. China and Russia have publicly stated their intent to replace the U.S led world order that has provided security and prosperity to Americans since

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World War II. Lockheed is the largest U.S. defense contractor and is as much portfolio insurance as it is an investment.

We have a small investment but high reward potential in a defense contractor, one of two companies competing on a top-secret stealthy autonomous drone program for the U.S. Air Force. The Air Force plans on having thousands of these drones accompany manned 5th and 6th-generation fighter jets in a fully networked space and ground combat theatre. It's referred to as the trusted wingman program. Again, Kratos is a possible winner. The Airforce has been testing numerous Kratos Valkyrie drones for a few years, and a contract award could be imminent. KTOS only accounts for 1% of the portfolio but could go up 10x or more if they win this contract.

On the last Zoom call, I discussed that our oil and gas holdings were where insiders were buying. It was also 25% of the portfolio. That's the limit of exposure to any sector I am generally comfortable with. I asked your opinions about increasing exposure, where I saw the most significant reward potential. We are now at 31%. Combine that with the energy exposure that the lithium economy represents, our portfolio is now 40% correlated to fossil fuels and alternative energy.

Artificial intelligence may get the limelight and headlines today, but there's no computing without vast amounts of electricity. There's no 21st-century or industrialized economy without electricity. That's the business of the future, and whether it's generated by fossil fuels, sun, wind, oceans, geothermal, nuclear, or fusion, it all results in the same thing, an unending consumption and demand for electricity. Of course, there will be volatility with these commodity products, but the market mistakes it as cyclical. It's not cyclical- it's existential.

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Our Outlook:

Two-Year U.S. Treasury Note

The world changed on March 10th when the Government shut down Silicon Valley Bank. The Fed stopped hiking rates even though they won't acknowledge that. They might not even know it. They continue to pretend to raise rates to combat inflation, but in reality, the Fed follows the 2-year Treasury futures market, according to bond guru Jeffrey Gundlach. Forget what you read and hear from industry pundits and Federal Reserve mouthpieces. The market has spoken. If you look at the CME futures chart above, it's as clear as the nose on your face. Interest rate hikes are over. (note bond prices move inversely with rates)

After Silicon Valley Bank was shut down, analysts began scrutinizing the unrealized losses on all bank's long-duration assets and their current mark-to-market value. The beginnings of a nationwide bank run in regional banks were well underway when the Federal Reserve, Treasury,

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and FDIC stepped in over the weekend and created an emergency new lending facility to banks offering loans at 100% of face value on their held-to-market Agency and Treasuries regardless of their reduced market value today. Customers have woken up and are moving huge sums of deposits out of low-yielding bank accounts to money markets and Treasuries. Banks can't compete with the interest rate that Treasuries pay.

The Insiders Fund has made its bread and butter by concentrating where we had an edge, from insider buying and selling, but last year taught us that we need to have a macro view.

- There is little substantive insider buying which points to much greater risk in the market than the averages belie. We are also in the 1st quarter earnings blackout period, so signals are muddied.
- Inflation will be stickier and harder to bend to its will due to underlying macroeconomic forces the Fed has no control over. The Fed can weaken demand by raising interest rates, but they have little control over supply costs. If anything, rising interest rates increase costs while dampening demand.
- Reshoring supply chains to the U.S. or near the U.S. to friendly countries will be expensive and inflationary. For example, Walmart has been importing deflation from China for years. Made in the U.S.A. is a costly undertaking.
- The world moving to zero emissions is vastly expensive. The journey and cost have been grossly misunderstood and underestimated. Billions have been invested, and electric cars are far more costly and harder to find. Industrial-scale solar doesn't work without enormous lithium battery packs or gas-powered backup generation when the sun doesn't shine. It will require significant investment. Going green may be necessary, but it's expensive.
- The fastest rate hikes in history will have many casualties. We are only now seeing the consequences, which there will be many, some obvious, some not even imagined. The bond market, that part of the market that the Federal Reserve cannot control, has seen this and anticipated something will break for a long time now. The yield curve is the most inverted it's been in 40 years.
- The Fed may want to hike rates further, but they must take some responsibility for the carnage on banks' balance sheets. Almost all banks own underwater long-term agencies and treasury securities. The Fed initiated a run on the regional banks when they shut down just two regional banks in March.
- Due in part to increased interest rates, the U.S. debt interest payments will exceed the Defense budget by 2025, according to the Congressional Budget Office.
- The soaring dollar may cause instability in emerging and developing bond markets. Wars, famine, and immigration crises are all possible outcomes.
- Record amounts of multifamily apartments and commercial office building loans will be coming due soon and have to be refinanced at much higher interest rates putting more strain on the banking system and creditors.

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- The Fed's decision to hold interest rates higher for longer is on a collision course with ballooning deficit payments due to higher interest rates. In addition, a group of Republican congressmen has reportedly held hostage Speaker of the House Kevin McCarthy over commitments to address the deficit and balanced budgets.

The Fed may want to raise rates, but the market is speaking. Unforeseen financial risks are spreading like cracks on the ice upsetting their inflation mandate. That's what the bond futures market is broadcasting, the rise in gold and the surprising rise in the price of bitcoin. The net result, the Fed is out of bullets. Inflation is here, and putting the inflation genie back in the bottle will be much more challenging. Equity investments are among the best ways to keep up with inflation-eroded purchasing power.

When does the bear market end? It's already over in tech land, technically speaking. Bear markets tend to be short-lived. The average length of a bear market is 289 days or about 9.6 months. We're now 15 months into this correction. It's impossible not to speculate when it will end, but with so much uncertainty in the world, no one really knows. Anyone that tells you differently is either disingenuous or naive.

The best thing I have heard recently is something that Rick Santelli, a CNBC editor, said last week. "by the time the Fed stops hiking, the market will have already taken off."

Once again, we thank you for your trust and confidence in having us assist you in managing your money. Please feel free to discuss any concerns or thoughts you want to share. Although we plan on doing a partner Zoom call next week, there is no substitute for one-on-one conversations. I especially look forward to those calls. If you would like to schedule, please do so at calendly.com/hsax/phone.

Zoom Partner Call Info: We will go over the latest thoughts on the market, risks, and opportunities, or any matters you would like to bring up.

Topic: The Insiders Fund Partner Meeting (will be recorded)
Time: April 19, 2023, 03:00 PM Mountain Time (US and Canada)

Join Zoom Meeting
https://us02web.zoom.us/j/84092263111

Meeting ID: 840 9226 3111

Stay tuned for the email calendar invite.

1887 Gold Dust Lane, Suite 203A, Park City, UT 84060
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Sincerely yours,

Harvey Warren Sax

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