January 14, 2025

Dear Investors,

The Headwaters Capital Management, LLC ("Headwaters Capital," "Headwaters," or the "Firm") portfolio declined -6.6% (-6.8% net) during Q4 2024 compared to a +0.6% return for the Russell Mid Cap Index over the same period. For the full year, the Headwaters portfolio returned +14.0% (+13.1% net) compared to a +15.3% return for Russell Mid Cap Index. A brief discussion of the performance and trading activity during the quarter is presented below.

Headwaters Capital Performance:

	Q1 24	Q2 24	Q3 '24	Q4 24	2024	Cumulative Since Inception (1/4/2021)
Headwaters Capital (Gross)	10.6%	1.3%	9.0%	-6.6%	14.0%	39.9%
Headwaters Capital (Net)	10.4%	1.1%	8.8%	-6.8%	13.1%	34.9%
Russell Mid Cap Index	8.6%	-3.4%	9.2%	0.6%	15.3%	37.0%

**Performance for the Headwaters Capital portfolio has been calculated by Liccar Fund Services from 1/4/2021-12/31/2023.*

***Performance for the Headwaters Capital portfolio has been calculated by Longs Peak Advisory Services from 1/1/2024-12/31/2024.*

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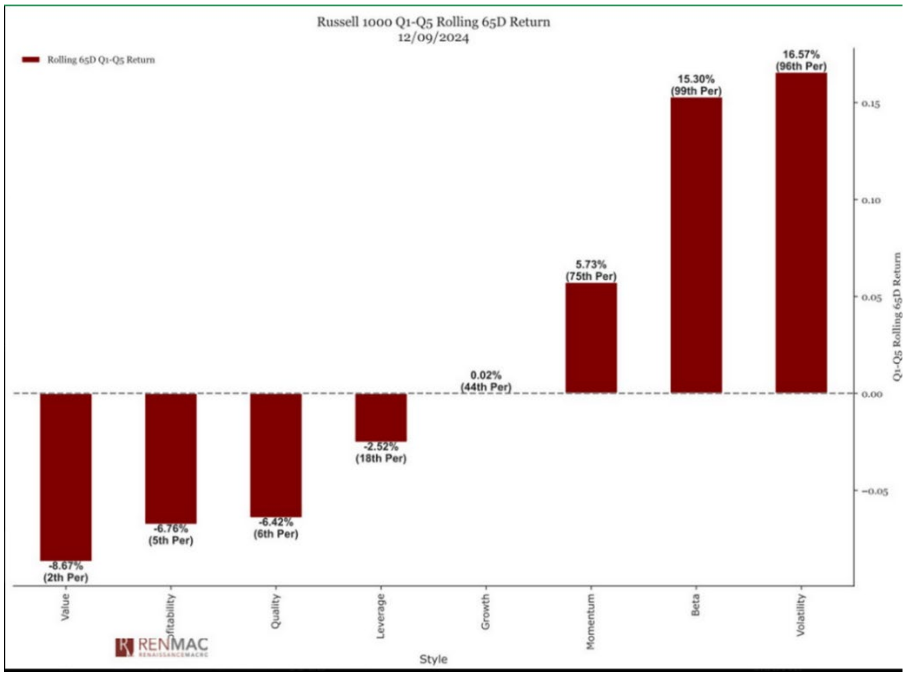
Q4 2024 Performance Discussion – 2021 Déjà vu

It is hard to be frustrated with a +14% return in a single year; however, following strong absolute and relative performance during the first 9 months of 2024, Q4 was a disappointing way to finish the year. This was the portfolio's second worst relative performance quarter, basically matching the relative underperformance experienced in Q1 '21 (tough bookends for the cumulative performance of this portfolio). While the portfolio had the usual outperformers and underperformers, the most impactful driver of performance was a broad rotation out of quality assets into highly speculative assets. Arguably the poster child for this broad based increase in risk appetite was bitcoin, which returned +45% during the quarter.

Performance within US equities was similar with the highest beta stocks generating the best returns (proxy for risk appetite), while quality and profitable stocks significantly lagged. The chart below is a good visual representation of the dispersion in performance during Q4 and illustrates the rotation into more speculative parts of the market. While the chart is more applicable to large cap stocks and only covers performance through 12/9/24, it still captures the rotation that occurred early in the quarter and is also representative of the rotation that occurred in small cap stocks.

[1] The composite performance ("portfolio" or "strategy") is calculated using the return of a representative portfolio invested in accordance with Headwaters Capital's fully discretionary accounts under management opened and funded prior to January 1, 2021. The performance data was calculated on a total return basis, including reinvestments of dividends and interest, accrued income, and realized and unrealized gains or losses. The returns also reflect a deduction of advisory fees, commissions charged on transactions, and fees for related services. For further information about the total portfolio's performance, please contact Headwaters at the email address listed.



More specifically for this strategy's benchmark, the top two performing factors during Q4 for the Russell Mid Cap Index were high beta (+10.1%) and non-earning companies (+8.3%), while high return on equity was one of the worst factors (see appendix). Given the quality focus of this strategy, I am not surprised that the portfolio lagged in this market. It is déjà vu given that the portfolio's worst quarter of relative performance was Q1 of 2021, which coincided with the top of the last speculative bubble.

Speaking of 2021, I am surprised by the market's amnesia as it seems to be repeating similar mistakes that were made only a few years ago. The parallels to the 2021 bubble are striking. PLTR, the Russell Mid Cap Index's largest holding and one of the poster children of the 2021 bubble, is a good example. PLTR more than doubled in Q4 entirely driven by multiple expansion, which at the end of the year, surpassed its peak achieved in Q1 2021!

Note the correlation between PLTR's valuation and the price of bitcoin, which again highlights the broad rotation into speculative assets. Just so readers are clear, PLTR was trading at 51x **SALES** at the end of 2024. I don't know much about PLTR, I'm only using this as an example. Paying that kind of multiple generally makes it difficult to achieve strong returns in the future. For example, the last time PLTR traded at this level, the stock returned -68% over the following year. I could choose plenty of additional charts like this (ARK Innovation ETF, fringe AI stocks, quantum computing, etc), but I think readers get the idea that I believe there are pockets of frothiness in the market.

This rotation into highly speculative assets is even more surprising given that it coincided with a sharp rise in interest rates. Readers may remember that rising interest rates popped the 2021 equity bubble given that nosebleed valuations had been justified by interest rates near zero. Yields in Q4 2024 began to approach levels not seen since 2007 and reached levels 3x higher than in 2021, yet speculative assets marched higher. Needless to say, Q4 was a confusing time in the markets. In a period like we just experienced, I believe it's best to remain patient, ignore the speculation and focus on acquiring great businesses at appropriate prices. Ultimately, this discipline will drive long term outperformance.

It may be reassuring to investors that following the last speculative rally in Q1 21, the Headwaters portfolio went on to outperform the market by +23% gross (+18% net) over the next 3.5 years until another round of euphoria returned to the market in Q4 '24 (past performance is not a guarantee of future performance). Why did the portfolio outperform over the next 3.5 years? It continues to be my belief that earnings ultimately drive stock price performance over longer time periods. As such, I believe HCM's focus on patiently owning quality businesses while paying the appropriate multiples for this earnings growth enabled the outperformance. Over shorter periods of time, investor enthusiasm can drive the price of any asset higher. However, speculative rallies always reach an unsustainable point and gravity, in the form of earnings and cash flows, always take over.

While the quarter was a frustrating end to the year, the portfolio still performed in-line with the market. If you believe that quality small caps remain cheap and simultaneously believe the philosophy underpinning this strategy, the recent market performance presents an opportunistic time to allocate to the Headwaters Capital strategy. If you are interested in learning more, please reach out to me directly.

Q4 2024 Portfolio Review:

Top Contributors: Climb Global ("CLMB") +23%: For the second quarter in a row, CLMB was the strategy's top contributor. Organic growth for this specialty IT distributor continues to exceed expectations given the company's cybersecurity and data center focus, two areas of IT spending that remain healthy.

Top Detractor: Transmedics ("TMDX") -60%. I should probably just leave TMDX as a placeholder in the contributor/detractor section. TMDX was the top contributor in Q2 (and I trimmed the position at that time given stretched valuation). Fast forward to Q4 and the narrative around this company has completely changed. Investors grew concerned that the company has reached market saturation for its organ transplant device given that market share gains began to moderate. In addition, clinical trials from competitive technologies drove concerns about future competitive threats. On the market saturation point, I continue to believe that the utility of TMDX's device combined with the efficiencies enabled by its logistics network will drive ongoing transplant center adoption. Additionally, concerns around competitive threats are likely overblown given that FDA approval of any potential device is years away. At that point, TMDX's market dominance and ongoing product innovation will make it difficult for new entrants to displace TMDX.

Trading Activity

Trading activity during the quarter was limited and consisted of adding to existing positions. Quality assets rarely go on sale and, as such, it was an opportunistic time to selectively allocate to existing holdings.

Appendix

Russell Midcap

Exhibit 29: Russell Midcap Performance Attribution Analysis
1m, 3m and YTD performance attribution (as of 12/31/2024)

	December		Last Three Months	
	Return	Contrib.	Return	Contrib.
Core Index	-7.0	—	1.2	—
Market Cap Size Quintile				
Q1 (Largest)	-7.5	-3.7	1.4	0.8
Q2	-6.8	-1.5	0.1	0.1
Q3	-6.4	-0.9	-0.9	0.0
Q4	-6.3	-0.6	1.1	0.1
Q5 (Smallest)	-6.5	-0.3	-0.1	0.0
P/E Quintile				
Q1 (Lowest)	-7.9	-1.1	-0.6	0.0
Q2	-6.9	-1.3	-1.3	-0.2
Q3	-7.2	-1.5	-2.0	-0.3
Q4	-6.7	-1.4	1.5	0.5
Q5 (Highest)	-6.7	-1.5	4.0	0.9
Nonearnings Stories	-7.8	-0.2	8.3	0.3
ROE Quintile				
Q1 (Highest)	-7.7	-1.9	1.5	0.5
Q2	-7.5	-1.6	-1.7	-0.3
Q3	-6.6	-1.6	1.7	0.5
Q4	-6.9	-1.1	-2.1	-0.3
Q5 (Lowest)	-6.0	-0.8	4.4	0.7
Beta Quintile				
Q1 (Lowest)	-6.5	-1.6	-2.4	-0.5
Q2	-6.7	-1.4	-1.0	-0.1
Q3	-7.3	-1.4	0.3	0.2
Q4	-7.9	-1.3	-2.0	-0.2
Q5 (Highest)	-7.0	-1.4	10.1	1.7

Source: Bank of America Merrill Lynch

As always, if you have any questions about the portfolio or the market, please do not hesitate to contact me.

Christopher Godfrey

Important Disclosure

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Investing in small- and mid-size companies can involve risks such as less publicly available information than larger companies, volatility, and less liquidity. Investing in a more limited number of issuers and sectors can be subject to greater market fluctuation. Portfolios that concentrate investments in a certain sector may be subject to greater risk than portfolios that invest more broadly, as companies in that sector may share common characteristics and may react similarly to market developments or other factors affecting their values.

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