

Spear Advisors Q2 2023 Fund Letter

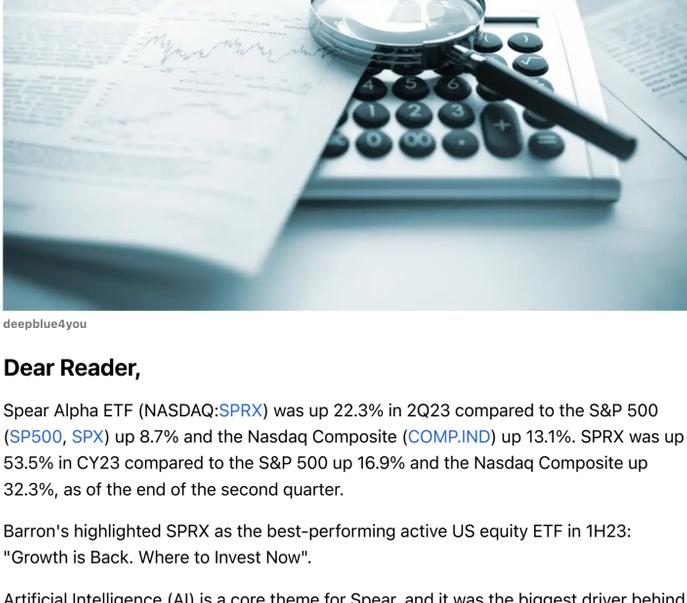
Sep. 14, 2023 11:45 AM ET | [Spear Alpha ETF \(SPRX\)](#) | [AMD, AMZN, CFLT...](#) | [1 Comment](#) | [2 Likes](#)

 **Ivana Delevska**
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Summary

- SPEAR is a fundamental asset manager and ETF issuer specializing in investments in industrial technology value chains.
- Spear Alpha ETF outperformed the S&P 500 and Nasdaq Composite in 2Q23, with a 22.3% return.
- Barron's recognized SPRX as the best-performing active US equity ETF in 1H23.
- SPRX's strong performance was a result of its focus on AI hardware and related software infrastructure opportunities.



deepblue4you

Dear Reader,

Spear Alpha ETF (NASDAQ:[SPRX](#)) was up 22.3% in 2Q23 compared to the S&P 500 ([SP500](#), [SPX](#)) up 8.7% and the Nasdaq Composite ([COMP.IND](#)) up 13.1%. SPRX was up 53.5% in CY23 compared to the S&P 500 up 16.9% and the Nasdaq Composite up 32.3%, as of the end of the second quarter.

Barron's highlighted SPRX as the best-performing active US equity ETF in 1H23: "Growth is Back. Where to Invest Now".

Artificial Intelligence (AI) is a core theme for Spear, and it was the biggest driver behind our strong 1H23 performance. But rather than focusing only on AI applications (such as ChatGPT), we are focused on uncovering opportunities across the value chain, including AI hardware and related software infrastructure.

The strong demand for AI hardware that commenced in 1Q23 continued in the second quarter, with all major cloud service providers ((CSPs)) allocating a significant portion of their capital expenditures to AI and guiding to a meaningful step up in capex in 2H23 and 2024. During the quarter, positive trends from early-cycle semiconductor manufacturers expanded to other areas, such as broader data center infrastructure. Multiple companies, including Microsoft/Azure and Amazon/AWS, highlighted that the impact of cloud spend optimizations on demand is now being counterbalanced by the emergence of new AI workloads.

While most investors expect a recession in 2H23, we believe that we are on a path to recovery as most end markets we cover already went through a recession-like downturn. However, as we emerge from the downturn, the risk of inflation picking back up is starting to resurface. Consequently, higher-for-longer interest rates are likely to limit the pace of the recovery compared to prior upturns.

While economic growth is likely to remain more muted compared to prior recoveries, we believe that we are on the cusp of the next AI-driven technology wave which is creating many outsized investment opportunities. We expect that AI will play a critical role in structurally addressing productivity and inflation.

Performance contributors

In addition to [Nvidia \(NVDA\)](#), which once again was a significant contributor to our outperformance in the quarter, we observed a broadening of the recovery to other areas of data center spending. The majority of our investments performed well during the quarter, with a few areas that stood out:

Outperformers:

- **AI hardware/Semiconductors** was again our best-performing sector, but in addition to [Nvidia](#), [AMD](#) and [Marvell \(MRVL\)](#) delivered strong results. Several cloud service providers noted that their capex purchases have expanded from just GPUs to CPUs and broader networking. We are maintaining our large exposure to semis as we believe we are early in the recovery cycle and are exploring other investments across the data center value chain.
- **Enterprise (B2B) Software** companies such as [Shopify \(SHOP\)](#) and [HubSpot \(HUBS\)](#) continued to perform well after a strong 1Q23. While we maintain our conviction in these companies, we were able to capture some alpha and redeploy it into underperforming areas where the recovery was more uneven.

Underperformers:

- **Cloud Infrastructure** and **Cybersecurity** data points are starting to improve, with several companies pointing to an end to cloud optimizations, which have been weighing on growth. But the bottoming process has been uneven, with many companies still talking about staggered deals and lengthening sales cycles. Despite all the AI hype, several leading data and cybersecurity companies have lagged this year. As an example, [Snowflake \(SNOW\)](#), while up YTD, continued to underperform tech indices and detracted from our strong performance.

During the quarter, we sized up our position in [SentinelOne \(S\)](#), a high-quality cybersecurity company that sold off after a forecasting error that was not well understood by investors. SentinelOne is currently the cheapest and highest growth publicly traded cybersecurity company, growing at >90% over the last twelve months and expected to grow over 30% over the next twelve months, and trading at a 5x Enterprise Value to Revenues (below the 6x sector average). In addition, we initiated a new position in [Confluent](#), a real-time data streaming platform that we believe will play a crucial role in AI. The company offers a cost-effective alternative to a self-managed solution, resulting in a resilient growth profile even through this downturn.

Despite the recent outperformance, most of our holdings, specifically ones levered to enterprise spending, are still down 50-80% from their peak levels, highlighting the severity of the tech pullback and the runway ahead. We believe that while investors have started pricing in the AI hardware opportunity and there is significant hype around AI applications, the potential opportunity for data/compute management and cybersecurity created by AI remains significantly underappreciated.

Portfolio composition and risk management

As of the end of the quarter, the largest exposures in our portfolio are in the following areas:

- **Cloud/Data Infrastructure (24.8%)** benefiting from massive growth in data and compute/storage requirements. Our largest holdings are: [Snowflake](#), a cloud-computing-based data warehousing company; [Cloudflare \(NET\)](#), an integrated global cloud network; and [Confluent \(CFLT\)](#), a data streaming leader.
- **Cybersecurity (24.1%)** benefiting from a major technology shift from changes in enterprise infrastructure and continuous evolution of threats (with AI adding an incremental layer of risk). Our largest holdings are [Zscaler \(ZS\)](#), a leader in "zero trust" network security; [CrowdStrike \(CRWD\)](#) and [Sentinel One](#), both leaders in endpoint security.
- **Artificial Intelligence Hardware (17.5%)** benefiting from new developments in generative AI. Our largest holdings are [Nvidia](#), [Marvell](#), and [AMD](#), which we believe, are best positioned to benefit from the positive trends in AI adoption and demand broadening to CPUs and networking.

Despite the lingering economic uncertainty and the potential risk of a resurgence in inflation as we come out of this downturn, we believe that we are in the early innings of the next tech cycle. Here are the reasons that instill our confidence:

- **Recovery in early-cycle semis.** This recovery is following a typical pattern where early-cycle semis are leading the rest of enterprise technology out of the downturn.
- **Cloud service providers ((CSPs)) ramping capex investments.** Amazon ([AMZN](#)), Microsoft ([MSFT](#)), [META](#), and Google ([GOOG](#), [GOOGL](#)) Amazon capital expenditures are expected to exceed \$100bn over the next twelve months, with a significant portion geared toward AI. The next step is providing this hardware as a service that will benefit not only the CSPs, but an entire ecosystem of companies (data, cybersecurity, etc.).
- **Cloud optimizations coming to an end.** Several companies, including Microsoft and Amazon, noted that as we are starting to see anniversary cloud optimizations, new workloads are starting to offset the impact.

We continue to manage risk actively and assess the potential risk/reward of each individual holding, incorporating the trajectory of earnings and valuation. During market pullbacks, we generally do not decrease risk, but manage it by increasing our idea velocity and asset turnover.

We aspire to perform in line with diversified indices on the downside, and generate differentiated performance on the upside, given our concentrated portfolio of investments.

Frequently Asked Questions
Few points on liquidity and market pricing related to ETFs that may be helpful based on frequently asked questions:
Liquidity. The liquidity of an ETF is determined by the underlying holdings, not by the size (AUM) or volume traded of the ETF itself. The ETF is backed by the assets it holds and market makers constantly create/redeem shares.
Market Makers. When investors buy/and sell shares they often (but not always) buy/sell directly from the market maker who has created the shares and holds them in inventory. This ensures that there is always a market to buy/sell ETFs, rather than having to match a buyer with a seller (as it is for equities).
Market pricing. The price of the ETF changes constantly and moves with the underlying securities. To get the most accurate pricing when buying/selling an ETF investors should look at the actual bid/ask quote and spread. The ETF shares are backed by the fund's holdings which in our case are custodied at US Bank.
Tax Efficiency: Due to their ability to exchange shares in-kind, ETFs can be more tax efficient than hedge funds or mutual funds.
For Fund prospectus and more info visit our website [spear-funds.com](#).

DISCLOSURES:
The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance current to the most recent month-end please call 1-833-340-7222. The total expense ratio is 0.075%.
For a prospectus or summary prospectus with this and other information about the Fund, please call (888) 123-4589 or visit our website at [www.spear-funds.com](#). Read the prospectus or summary prospectus carefully before investing.
"Alpha" strategy seeks to identify investment opportunities in which the performance of a company's stock will exceed that of the market over time. B2B stands for business-to-business. Free Cash Flow (FCF) is the cash a company generates after taking into considerations the cash outflows that support its operations and its capital expenditures. S&P 500 is a stock index that tracks the share prices of the 500 largest companies in the United States by market capitalization.
Investing involves risk including possible loss of principal. The fund is subject to both growth and value equity risk. Investing in growth companies that are based on an issuer's future earnings may be more volatile if revenues fall short of expectations. Investing in value companies that remain unfavored or are undervalued for long periods of time could have a negative on the fund's performance. Companies in the industrials sector may be adversely affected by changes in government regulation, world events, economic conditions, environmental damages, product liability claims and exchange rates.
Technology, Space, Robotics and Automation companies are particularly vulnerable to rapid changes in product cycles, obsolescence, government regulation and competition, both domestically and internationally, which may have an adverse effect on growth and profit margins. Market or economic factors impacting these companies that rely heavily on technological advances could have a major effect on the value of the Fund's investments. SPRX is non-diversified and may invest in a greater percentage of its assets in securities of an issuer in the industrial or technology sectors. An adverse event to an issuer in the industry may negatively impact the fund's performance. Applying ESG (Environmental, Social, Governance) sustainability criteria to the investment process may exclude securities of certain issuers for non-investment reasons and therefore the Fund may forgo available market opportunities.
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Original Post

Editor's Note: The summary bullets for this article were chosen by Seeking Alpha editors.

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Thank you for sharing. It seems that we share a similar focus on high-growth, technology stocks. I own / have owned GTLB, CRWD, S, and I'm currently watching ZS, CFLT, and MNDY.

One stock that I see you own, and that my peers seem to like, is NET. I find it hard to get excited about them, given that they are essentially another version of hosting, and having worked at Equinix and Digital, I've seen that wave come, go, and come again, now with CoreWeave and the new AI hosting wave.

Is there a moat there that I am missing?

Regards,

ET

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