April 19, 2022

Dear Partner:

The Greenlight Capital funds (the "Partnerships") returned 4.4%[1] in the first quarter of 2022, compared to a 4.6% decline for the S&P 500 index.

To start with a quote for a change, Vladimir Lenin said: "There are decades where nothing happens, and there are weeks where decades happen."

A lot happened this quarter, culminating in an unexpected bout of violence, which frankly, we thought society had evolved beyond and we would not witness again in our lifetimes. Millions are focused on analyzing what Will Smith did.

We joke, of course. But if you look at everything happening in the world, it would just be pure tears without a little humor. Russia invaded Ukraine and we have war, pestilence, famine and plague. There is a decent risk that *Pax Americana* has come to an end, along with the 13-year-old bull market.

The common refrain about COVID was that it sped up changes and trends that were already happening. We believe the same is true of the war. Inflation, supply chain problems, and shortages of energy, food, raw materials and labor were already issues that the war has now accelerated. Stocks had already begun to decline as well.

There is some evidence that inflation is destroying demand, which is slowing the economy. For many, paying higher prices for food, gas and rent means fewer resources for discretionary purchases. The question isn't whether the Federal Reserve will cause demand destruction and a recession; inflation is likely to do that all by itself. And while government policy is not responsible for every supply chain disruption, extremely aggressive monetary and fiscal policies have facilitated embedded inflation.

Yes, the Fed now realizes it has an inflation problem. And it sounds serious about fighting it. But talk is one thing and actions are another. If the Fed was *SERIOUS* about stopping the inflation problem, it would be as aggressive and creative in tightening as it was when it was easing.

In a 2018 speech, Federal Reserve Chairman Jerome Powell highlighted that "doing too little comes with higher costs than doing too much" when "inflation expectations threaten to become unanchored. If expectations were to begin to drift, the reality or expectation of a weak initial response could exacerbate the problem. I am confident that the FOMC would

[1] Source: Greenlight Capital. Please refer to information contained in the disclosures at the end of the letter.

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resolutely 'do whatever it takes' should inflation expectations drift materially up or down or should crisis again threaten."[2]

But is the Fed *doing whatever it takes* or is it just talking tough, while in reality *implementing a weak initial response that could exacerbate the problem*?

We think it is clearly the latter. In the Fed's *Monetary Policy Report to Congress*[3] from February 2021, it highlighted something called the "balanced-approach (shortfalls) rule" that is designed to calculate what an appropriate Fed Funds rate would be given various inputs including unemployment and inflation. Currently, this would indicate an appropriate rate of about 7%.

There is endless debate about raising interest rates by a quarter percent or a half percent. With the Federal Funds Target Rate still at 0.25%-0.5%, this feels like trying to figure out whether it's best to clear a foot of snow from your driveway with a soup ladle vs. an ice cream scooper. This certainly isn't doing *whatever it takes*.

The market is beginning to price in its doubts about the Fed's resolve and likely failure to return inflation to its 2% target. Even as the Fed resets the market's expectation to a faster tightening cycle, inflation expectations are increasing and long-term bond prices are falling.

The good news, to the extent there is any, is that year-over-year inflation will likely fall for a bit from the current 8.5% rate. Some goods that saw prices spike rather dramatically, like used cars, are already declining. At the end of the quarter, the inflation swap market projected 5.3% inflation over the next year followed by 3.3% the year after. However, this is up from year-end expectations of 3.6% and 3.0%, respectively.

We believe the policy response to high energy prices is likely to lead to even higher energy prices. The U.S. government has chosen to subsidize demand by granting gas tax holidays and releasing strategic oil reserves, while continuing to thwart supply by demonizing producers, criticizing windfall profits, stifling investment in energy infrastructure and threatening extra taxes. Notably, energy prices feed into food prices. Agriculture is quite energy intensive and natural gas – which is at elevated prices and in short supply – is a key input into fertilizer. So, we remain bullish on future upside surprises to inflation.

For the quarter, our long portfolio lost 7%, which was almost completely offset by gains on our shorts and index hedges. Macro, led by inflation swaps and gold, generated slightly more than all the return.

The long portfolio attribution bifurcated into Green Brick Partners (GRBK), which fell sharply and was responsible for much more than all the loss, and pretty much everything else, which did quite well.

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[2] Speech by Chairman Powell, Monetary Policy in a Changing Economy, August 24, 2018
[3] The Federal Reserve System, Monetary Policy Report – February 2021, Part 2: Monetary Policy

The largest winners were Rheinmetall (Germany: RHM), Teck Resources (TECK) and CONSOL Energy (CEIX). When we rhetorically asked the question in January at our 2022 Virtual Partner Meeting whether there would be peace in our time, we certainly didn't expect war to break out within weeks. The war dramatically changed the outlook for European defense spending, which caused RHM to surge from €83.06 to €190.20 during the quarter. TECK (up 42%) and CEIX (up 66%) both advanced following surges in metallurgical and thermal coal prices, respectively.

Despite the fact that there was nothing wrong with GRBK's corporate performance, the shares fell from $30.33 to $19.76 during the quarter. Analysts reduced 2022 and 2023 EPS expectations by about 2%, leaving the shares at 4.7x and 4.3x those estimates. The problem was with the sector, as most homebuilders fell by similar percentages.

Homebuilding stocks de-rated as a consensus formed around a pending collapse in housing. The narrative is that house prices have risen, interest rates (and therefore mortgage rates) are rising, sales and housing starts are slowing, inventories are building, and cancellations are rising. Supposedly, this implies that house prices are about to collapse, leaving homebuilders in a precarious position. Everyone remembers what happened when the last housing bubble popped. The market appears to be saying that it is about to happen again and that the sector is now un-investable at pretty much any valuation.

We beg to differ. The comparisons to 2006 appear strained. Back then, there had been an enormous amount of overbuilding. There were on average 3.5 million existing homes for sale. The 30-year mortgage rate averaged 6.4% and homebuilders were highly levered. Substantial housing was built for second homes and outright speculation, and it was financed with very loose underwriting standards.

Since the housing bust, we as a nation have underinvested in housing, leading to a shortage of around 2 million units. Today, there are only 870,000 existing homes for sale, mortgage rates are around 5%, underwriting standards are tight, speculation is minimal, and homebuilders have low financial leverage. In Dallas, GRBK's largest market, *existing* homes for sale are down 21% in the last year and down 77% compared to 3 years ago.

Most of the indicators of a housing slowdown that the bears are highlighting do not, in fact, reflect a traditional slowdown. Rather, they reflect the industry's inability to construct houses. Labor and material shortages have lengthened construction times, which causes inventory to build on balance sheets. It's difficult to start additional new houses when labor isn't available and you can't close a sale when the windows are missing due to shortages. The result is that homebuilders have not overbuilt and are not sitting on speculative inventory to be liquidated into a hypothetical downturn.

We agree that at some point mortgage rates might have an impact on demand. But, at this point, homebuilders are more constrained by supply than demand, and some decrease in demand is unlikely to pose a serious risk to earnings, let alone balance sheets. Furthermore, it isn't just home prices that have risen. Rents have risen as well. In these inflationary times,

there are few inexpensive housing options. It's worth noting that homebuilding stocks and home prices did well during the inflationary second half of the 1970s.

Speaking of rising interest rates, it is difficult to find a company that we think benefits more from rising rates than Brighthouse Financial (BHF). For the better part of half a decade, we have experienced the "bear case" that BHF is beholden to capital markets and particularly sensitive to low interest rates. Our view is that the shares have been inexpensive despite a low interest rate environment. With the environment changing, it turns out that the capital market sensitivity goes both ways. Goldman Sachs estimates that the interest rate increase *just through the end of March* will add $2 billion to BHF's distributable earnings over the next 5 years. That would seem significant compared to BHF's entire equity market capitalization of $4 billion. Two billion dollars would equate to about $26 per share. The stock ended the quarter at $51.66.

Gains from a higher interest rate environment need not be temporary. The company is now presented with an opportunity to reduce interest rate risk either by hedging or by transferring risk of its legacy business to a third party reinsurer. BHF has not attracted a new top 30 institutional shareholder in more than a year and its share price fell by less than one percent during the quarter. Management is taking advantage of the rising discount to book value by repurchasing shares. The improved environment should enable even faster share repurchases, which we would encourage the company to pursue.

As noted above, our short portfolio had a strong result this quarter. The gains were broad-based, led by falling values for our basket of bubble stocks and a substantial fall in the price of a medical device company that reported disappointing results.

In the middle of January we adapted our portfolio positioning to better reflect our view of the problematic economic environment and to the possible end of the bull market. We added more index hedges and increased our macro positions in corporate credit default swaps and inflation swaps. Generally speaking, we have directed our research efforts to focus primarily on short ideas. As a result, we had no large additions to the long portfolio during the quarter.

We added small new positions in International Seaways (INSW), Ryanair Holdings (Ireland: RYA), TD SYNNEX Corporation (SNX), Southwestern Energy (SWN), and Weatherford International (WFRD).

INSW is an owner and operator of oil tankers and product carriers. Demand for oil fell during the pandemic, leading to a prolonged period of low charter rates for tankers. We acquired our shares during the quarter at an average price of $15.30, or less than 60% of INSW's liquidation value. With oil demand having now recovered to pre-pandemic levels and no shipyard slots available for the construction of new tankers for several years, we expect a tighter market, and with it, INSW's discount to its NAV to close. Management has been a good steward of capital, acquiring ships during low points in the cycle and repurchasing shares at attractive prices. INSW shares ended the quarter at $18.04.

RYA is the largest low-price European airline. During the pandemic, RYA expanded upon its industry-leading low-cost position by upgrading and improving the fuel efficiency of its fleet and by reducing its airport costs. RYA has created a competitive advantage by hedging near-term fuel prices. As a result, we expect RYA's earnings to exceed expectations as demand for air travel further recovers. We established our position at an average price of €13.93, or 11.6x this upcoming fiscal year's EPS forecast. RYA shares ended the quarter at €13.59.

We reinitiated a position in SNX as we believe the company's recent merger with Tech Data has created the top global IT distributor with potential for significant EPS accretion through cost and revenue synergies. The company recently held its first analyst day since the transaction closed in September at which management laid out a path that we believe will achieve EPS of $20 in a few years. We acquired our stake at an average price of $105.33, or just over 9x current year consensus EPS. SNX shares ended the quarter at $103.21.

SWN is the second largest producer of natural gas in the U.S. The company is well-situated to satisfy growing domestic and export demand. Over the short, medium and long term, Europe now intends to reduce its reliance on Russian energy and increase its use of U.S. LNG. Based on its 2021 year-end reserves – which assumed a $3.60/MMBtu long-term natural gas price – SWN has a PV-10[4] value of $13.83 per share. By the end of the first quarter, the U.S. natural gas 5-year forward curve averaged $4.28/MMBtu, while international seaborne LNG was close to $20/MMBtu. Over the intermediate term, with the benefit of substantial global investment in infrastructure, we expect prices for U.S. and international natural gas to converge. We acquired our shares at an average price of $6.58. SWN shares ended the quarter at $7.17.

WFRD is a global oilfield services company that provides drilling tools and other products and services required to produce oil and gas. Due to poor execution and a lot of debt, the company went bankrupt in 2019. It has since emerged as a less levered, better managed, and cashflow generating business. WFRD now has the wind at its back as many years of underinvestment in exploration and production have left the world structurally short of oil. The company stands to benefit from the significant increase in exploration and production capex that is underway. We acquired WFRD shares at an average cost of $32.27, or 5x EV/2022 EBITDA, while its three largest peers trade between 11x and 13x EV/2022 EBITDA. WFRD shares ended the quarter at $33.30.

We exited our long position in EchoStar after holding it for a year with a 22% IRR. We became concerned that the company is having trouble growing subscribers. We also sold Jack in the Box after almost 2 years with a 55% IRR. We became concerned about focus shifting to a recent acquisition and more challenging earnings comparisons going forward.

We have one business update and a few personnel developments to announce.

[4] PV-10 is a calculation of the present value of reserves using a 10% annual discount rate.

Our London-based subsidiary ceased trading operations at the end of the quarter. While we will no longer be trading from the U.K., we will continue to have a London presence and research analysis focused on Europe. As a result of this change, Alex Ten Holter will be departing Greenlight after 14 years with us. We thank him for his dedication and wish him much success!

Andrew Simon joined us as a trader in New York in February. Andrew brings to us 22 years of experience with Kingdon Capital Management, where he was originally responsible for portfolio accounting and trade reconciliation. He was promoted to the trading desk in 2004 and traded equities, derivatives and futures in the U.S., Europe and Asia. We expect Greenlight to be the longest post Andrew holds in his career and we look forward to celebrating that in the year 2045. Welcome, Andrew!

Elizabeth Zhu joined us in March as an Executive Assistant. Liz has taken over for Christine Bosco, who moved down the hall to work with the team at the Einhorn Collaborative. Prior to Greenlight, Liz spent over seven years in the Alternative Investments department at Pacific Investment Management Company (PIMCO). She graduated from Binghamton University with a degree in Sociology. Welcome, Liz!

As we shared at our 2022 Virtual Partner Meeting, we promoted our CFO Barrett Brown to Partner. Barrett came to us in 2019 after a long career as a partner at PwC before becoming CFO of Viking Global Investors. Barrett has done a fabulous job leading our finance and operations team, with the challenge of spending half his Greenlight career working from home. Congratulations, Barrett!

After nine years with Greenlight, Garett Jones has decided to pursue an entrepreneurial opportunity outside of the industry in his new(ish) home in North Carolina. After three years with us, Tariq Barma has left Greenlight to pursue a new venture. We thank them both for their contributions and wish them well.

At quarter-end, the largest disclosed long positions in the Partnerships were Brighthouse Financial, Change Healthcare, Global Payments, Green Brick Partners and Teck Resources. The Partnerships had an average exposure of 113% long and 81% short.

"Everything's funny – in the right context and done by the right person."

– Chris Rock

Best Regards,

Greenlight Capital

Greenlight Capital, Inc.

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