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WAHDY CAPITAL

March 11, 2024

Dear Investor:

In February, Wahdy Capital generated 7.8% in the Long/Short Equity strategy. Our strong performance lifted our year-to-date returns to 16.8% as we continue to capitalize on our investment themes in 2024. Our macro book added 44bp in the month, and Net Exposure ended February at 26.2%. We are pleased with our performance in the month, with 9 longs and 2 shorts each contributing over 50bp in the month.

This month's letter examines the impact of Generative AI in the technology sector.

Returns (2/29/2024)	**Wahdy Capital**	**S&P 500**	**Nasdaq 100**
1-month	**7.8%**	**5.2%**	**5.3%**
Year-to-date	**16.8%**	**6.8%**	**7.1%**
Since Inception*	**85.6%**	**13.0%**	**16.2%**

** Inception Date: September 1, 2023*

Markets rallied in February and the S&P 500 crossed above 5,000 (our index price target) during the month. Earnings performed okay with 64% of the S&P 500 reporting a positive sales surprise. Q1 2024 guidance was soft, with negative EPS guidance outpacing positive guidance by 2.3x. We think equity index performance was driven more from investor repositioning as recession risk ebbs rather than an improving earnings outlook. A 5100+ handle on the index implies earnings at a level of nominal GDP we think is unlikely.

Our short-term outlook is that the economy is currently experiencing goldilocks (higher-than-trend growth with falling inflation) driven by robust employment in the US and weak demand from China. Macro volatility will obfuscate trend growth this year, and we're expecting a weaker (but still positive) second half of real activity. Inflation will continue to fall from a mix of Chinese exports of disinflation, softening in the US labor market, and still-high financing costs.

Moving forward, we think the Fed's March FOMC meeting in two weeks is unlikely to be a significant repricing event, as limited visibility will encourage the Fed to take a cautious approach. Debates around the level of r* continue, and while it is possible that Generative AI or structural labor tightness has moved us into a new regime of productivity, we lean towards NY Fed John William's view that growth is most likely going to move back towards the lower, pre-Covid, level.

What does this mean for valuation? With the long-end anchored around 4%, and a cautious Fed keeping short-rates higher for longer, we expect the yield curve to remain inverted between -25 and -50bp through the year. This should keep the S&P 500 trading between 20 – 21x NTM earnings. The current regime would change with a recession or reaccelerating economy, but neither are probable in the first half of the year. However, if the Fed were to cut rates at a faster than expected clip, the subsequent rise in earnings could narrow the multiple – achieving a "soft landing" for valuation.

Macro volatility is a big theme of ours this year, so we remain vigilant of unexpected shocks which can drive a repricing event.

Our strategy this quarter has been to capitalize on four themes we outlined in January:

(1) A pickup in hyperscale consumption driven by healthy growth in traditional and GenAi workflows.
(2) A weaker outlook across certain verticals within SaaS where companies stand to lose against GenAi enabled rivals or incumbents.
(3) An improving and more visible outlook for datacenter GPU demand.
(4) A worsening environment for semiconductor companies with exposure to auto & industrial end markets.

As we exit Q4 earnings season, we come away with incremental updates to our views:

- Cloud trends are tracking our thesis as customers have moved away from optimizations and towards a reacceleration of consumption and AI workloads. This is showing up in hyperscale demand – Microsoft is already seeing AI workloads double q/q and we expect AWS will see a pickup by mid-2024. More broadly, with macro data holding up, we expect corporate IT budgets to rise this year, which will lead to higher cloud service and platform use. Early consumer AI-apps have already begun to monetize and we expect a much larger cohort across enterprise and consumer use cases to be published over the next 6-12 months.
- Cyber Security budgets continue to grow despite concerns of customer fatigue. While Palo Alto Networks' earnings caused a stir in the industry, we see their performance and outlook driven by idiosyncratic issues and their push to capitalize on their platformization strategy. In particular, endpoint and cloud security is an area we think will accelerate as AI and LLM usage increases. We are excited to see the general release of Copilots in Cyber Security verticals that will improve network, cloud, and data security for companies.
- In Internet & Media, Google's third-party cookie depreciation is shaking up digital advertising (in a bad way), but the push to develop closed garden ad markets among streamers (such as Netflix) illustrates how competition may shift traffic away from a search market and to a direct-to-consumer (DTC) market. In the e-commerce vertical, growth has been lumpy given heightened consumer inflation fatigue, but we're optimistic that online shopping will normalize to pre-Covid trends.
- Semiconductors are in the first innings of an upcycle driven by data center spend, with other end markets expected to pick up steam in the 2H of 2024. As we outlined in our December letter, autos and industrial end markets remain weak, but we think consumer end markets like gaming and smartphones will accelerate drive by AI-themed product refresh cycles.

SPOTLIGHT: THE IMPACT OF GENERATIVE AI IN THE TECHNOLOGY SECTOR

When OpenAI launched ChatGPT in November 2022, the result was a simultaneous arms race and gold rush that is changing the way we interact with the internet, develop software, and create content. While cloud infrastructure, service providers, and platform vendors have been investing in and utilizing forms of Artificial Intelligence and Machine Learning since the early 2010s, ChatGPT's LLM technology is making AI accessible in an entirely new way. And much like how Marc Andreesen and Eric Bina's Mosaic browser helped spark the internet boom(s), we believe that ChatGPT will create entirely new sectors based upon LLM and AI technologies.

Two key technologies underpin LLMs and make Artificial Intelligence happen: Machine Learning and Natural Language Processing.

Machine Learning (ML) uses large datasets to train a model in making predictions. Imagine you were to train a model on a database of 100 photos where 25 depict snow, 45 a small deer, and 30 of water. At the simplest level, Machine Learning would enable the model to predict what a hypothetical 101st image would be. As more data and parameters are added, the computations and sophistication dramatically increase in complexity.

Natural Language Processing (NLP) allows computers to process text and voice data by combining linguistic modeling (like syntax) with Machine Learning. At the simplest level, this allows for a machine to assign a meaning to verbal or written language data. More advanced tools enable sentiment analysis, speech recognition, and speech or text generation. AI technologies, like ChatGPT or Gemini, are Large Language Models (LLMs) which are built on a model developed by Google known as a Transformer. Transformers apply deep learning techniques to NLP tasks, enabling them to process sequential data and calibrate generated text or content resulting in text, images, and responses that sound human.

From an investment angle, we see the development and adoption of LLM and AI as having wide repercussions throughout the entire technology sector – it is reshaping our coverage universe in real-time. New industries are emerging to support the data input for model development; datacenters are already reconfiguring their nodes to fit AI-workloads which has sparked a boom in server equipment and GPUs; the digitization of the real-world is accelerating the demand for cloud services and data management; and the launch and scale of AI applications is creating novel use-cases and driving hardware product refresh cycles.

To build LLMs, developers and researchers need substantial amounts of annotated data to train their models. Annotated data, supplied by vendors such as TELUS International or CloudFactory, provide the training sets models need to run the machine learning process. These datasets include things like images with detailed and specific notes – the quality of annotation can have a significant impact upon the success of the LLM in generating useful content or recognizing an image. Models trained on inferior data sets are not going to perform well, and part of ChatGPTs success so far has been their use of higher quality datasets.

Hosting, training, storing, and using LLMs will drive demand for new types of datacenters. Amazon and Meta have both announced plans to build new data centers and reconfigure existing ones for AI workloads. Datacenters tend to be dominated by CPUs – which are great for general purpose compute tasks but are much slower at completing AI workloads. This is because CPUs do things one-at-a-time while GPUs can process in parallel and complete multiple tasks at once, which is especially helpful to perform the kind of matrix multiplication and computational techniques needed for Machine Learning. We are already seeing this impact on GPU and datacenter server demand, with hyperscale capex expected to rise double digits in 2024.

As datacenters retool for AI training workloads, inferencing – generating the output – will be done locally on your smartphone, on the edge, or in traditional CPU-based datacenters. A new wave of chips specifically designed for speedy inferencing will enable novel use-cases for AI and accelerate adoption, driving product refresh cycles across business and consumer hardware. Samsung's new AI-enabled smartphone launched just this January is seeing demand so strong that the company has already raised shipments from 12 to 13 million by the end of March – that's more than Google's Pixel smartphone sold in the entire 2022.

As new use-cases are developed for and with AI, the amount of data, infrastructure, and security required to deliver applications will increase and drive demand across the entire cloud, software, and cyber security ecosystem. With over $50b in global funding invested in AI in 2023, we expect the first wave of business and consumer apps to reach scale by mid-2024. Microsoft is already seeing AI accelerating Azure usage and are among the first publishers to launch and monetize AI Copilots. In cybersecurity, and other high-knowledge industries, Copilots are expected to increase adoption and productivity rates.

We believe that Generative AI is in the initial stages of what will ultimately be a transformative technology, much like the internet. Unlike other recent technologies, which were often expensive to build and implement, Generative AI is seeing faster adoption thanks to its ease-of-use and already reshaping the competitive dynamics within the industries we cover.

Yet with all the fanfare, there will be winners and losers within every layer of the tech stack. Our goal as investors is to navigate the industry dynamics, product-market fit, and strategic operating plans of management to identify the firms most and least likely to succeed and position for them. We are excited for the opportunity and see our style as the right way to invest in this emerging frontier in the technology sector.

Our future letters will drill down on the unique investment opportunities we have identified across the technology sector from Generative AI and how we are positioned to capitalize on this once-in-a-generation transformation.

Wahdy Capital is currently accepting capital from new investors. Please email us at wahdy@wahdycapital.com for more information.

Sincerely,

Muhammad Wahdy
Portfolio Manager
Wahdy Capital

Wahdy Capital is long/short equity manager based in San Francisco, USA. We cover roughly 100 companies in software, semiconductors, and media verticals within the technology sector. Our official strategy inception date is September 1, 2023. Our incubation period was between December 31, 2022 and September 1, 2023.

The information contained in this letter is being provided to investors in the Wahdy Capital Long/Short Equity strategy, a SMA strategy offered on Interactive Brokers. Wahdy Capital is a California registered investment adviser. Being registered does not imply a level of skill or endorsement.

Performance is reported net of all fees.

Monthly Performance Net of Fees

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023									**12.94%**	**-7.55%**	**44.96%**	**6.92%**	**57.39%**
2024	**8.37%**	**7.81%**											

Our process is deeply fundamental and primarily bottom-up with a focus on the idiosyncratic drivers of companies based upon industry dynamics, product-market fit, and the strategic operating plan of management. We let ideas drive our net positioning, and generally expect to land between low-to-mid net on average. Macro plays a role in our portfolio as we express views on the short end of the yield curve and duration. Beyond trade ideas, the research we do in macro feeds into our expectations of analyst estimate revisions and equity market multiples.

Derivatives are used in the portfolio, primarily in the macro book, or to express an incremental view on a company into or through a catalyst. Total derivative cash exposure is limited to 10% of NAV. We monitor and manage risk across multiple dimensions as a macro and factor aware strategy. We historically reported net exposure in cash delta terms but, starting in February 2024, will report net exposure in total beta and options adjusted terms. Our portfolio is typically concentrated between 30-50 names, where we use beta adjusted position limits to manage risk.

Our buy and sell discipline revolves around internally generated price targets. New positions require a 40% annualized expected return. We exit positions when price targets are hit. Stock positions with greater than a 10% drawdown are monitored and reevaluated but does not necessarily imply a cut. We monitor short interest, liquidity, and other factors in our aim to reduce risk.

Specific companies or securities discussed in the letter are meant to demonstrate Wahdy Capital's investment style and the types of industries and securities we invest in and are not selected based upon past performance. The analysis and conclusions of Wahdy Capital contained in this letter include estimates, assumptions, statements, and projections that reflect assumptions by Wahdy Capital related to results that are anticipated and are inherently subject to significant economic, competitive, and other uncertainties and have been included for illustrative purposes. No representations express or implied are made as to the accuracy or completeness of such statements, assumptions, estimates, or projections. Wahdy Capital may buy, sell, cover, or otherwise change the nature, form, or amount of its investments without further notice and in Wahdy Capital's sole discretion and for any reason. Wahdy Capital disclaims any duty to update any information in this letter.