THIRD POINT

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Second Quarter 2022 Investor Letter

August 17, 2022

Dear Investor:

During the Second Quarter, Third Point returned -9.3% in the flagship Offshore Fund.

	Q2*	YTD*	ANNUALIZED RETURN†
THIRD POINT OFFSHORE FUND, LTD.	-9.3%	-19.9%	13.7%
CS HF EVENT-DRIVEN INDEX	-5.6%	-7.7%	6.7%
S&P 500 INDEX (TR)	-16.1%	-20.0%	8.5%
MSCI WORLD INDEX (TR)	-16.1%	-20.3%	6.9%

* Through June 30, 2022.
† Annualized Return from inception (December 1996 for TP Offshore and quoted indices).

The top five winners for the quarter were Short A, Macro A, Macro B, Short B, and Short C. The top five losers for the quarter were SentinelOne, Inc., Pacific Gas and Electric Co., Amazon.com, Inc., Crown Holdings, Inc., and Danaher Corp.

Portfolio Review and Outlook

During the second quarter, we significantly reduced risk and took steps to protect capital in a tumultuous market with an uncertain economic backdrop driven by inflation pressures, the prospect of significantly higher interest rates, geopolitical instability, supply chain disruptions, a likely recession in Europe, and a possible recession domestically. Energy and other commodity markets also went parabolic, adding further to concerns about social unrest and the prospect of a sharper than expected economic downturn.

Considering this environment, we de-levered the Ultra funds, and reduced net and gross exposure while increasing our single name shorts and hedges. While this strategy served us well in April and May relative to a sharply lower market, our investments in energy and commodities turned against us in June. We also took mark-to-market losses in structured credit and write downs in our private securities portfolio. Not unexpectedly, the same positioning that protected us from losses in April and May hurt our ability to recover with the market's move in July. Earlier this month, it seemed that the fever had started to break in inflation, led by the move down in oil and certain commodity prices which, in turn, has resulted in a positive shift in our expectations for resilience in consumer and industrial spending. In hindsight, while it might appear that we erred in some of our sales and not moving more quickly to pick up bargains, we needed to observe data to assure us that we were not heading into the jaws of a deepening recession coupled with '70s style inflation.

After taking our exposures to almost zero, in recent weeks we have identified several new positions and covered most of our single name shorts, bringing our current exposure back over 40%. Our largest recent addition has been an investment in The Walt Disney Company, which we bought at near its 2022 lows after having exited at the end of Q4 2021 and in the beginning of this year. We are pleased by the strength they are showing across business lines and the progress of Disney's transformation from "analog" to "digital", following a blueprint familiar to us from past investments. A letter to management sharing our views about additional value creation measures they should consider is available here.

Private Investments Update

In the private portfolio, we experienced markdowns in several of our late-stage investments in Q2. Although those we own have plenty of liquidity runway, valuations have come in as multiples for comparable public companies have compressed and exit timelines have elongated due to market conditions. We have been working closely with our later stage companies and each has submitted an updated business plan that cuts costs and reduces cash burn such that they can reach profitability.

Most of our private portfolio is invested in earlier stage opportunities in the sectors where we have the most expertise: cybersecurity, enterprise software, and IT infrastructure. We believe that these sectors are more likely to remain resilient in a market slowdown, which adds a further degree of security to the disciplined underwriting we apply to each investment and gives us confidence that the ventures portfolio will weather this market cycle.

Credit Update

While as equity investors, we generally hope for the best, as credit investors we know that should the economy turn for the worse, we are well positioned to invest in the sorts of credit cycles we saw in 2001-2004 and 2008-2011, when credit accounted for the majority of the portfolio. In my experience, credit cycles happen slowly and then all at once, so you must act decisively to deploy capital. Every cycle is different and the sell-off so far has been grinding and slow, but we cannot rule out the possibility that credit spreads will widen once again. Nevertheless, this cycle appears different from prior cycles in several ways that are informing our current strategy.

First, the starting point in terms of inflation is greater than prior cycles. It has been safe to assume, especially since the GFC, that the Fed would quickly ride to the rescue if volatility rose too much. Here, for the first time in decades, inflation is the paramount priority and the Fed "put" is far out of the money. That suggests that this credit cycle is quite likely to be longer than recent cycles – higher risk premiums will be appropriate for a longer period. We do not see a "V" shaped recovery in credit this cycle; we think a "U" shape is more likely. Although the reset so far has been painful, we welcome a long period of higher returns in credit, especially since you get paid while you wait.

Second, we see diverging fundamentals in consumer and corporate balance sheets. While the economy is slowing, the overall consumer backdrop is relatively sound. Employment is high, and consumer balance sheets are solid with high levels of savings and moderate leverage. To the extent we have seen over-investment in this cycle we have seen it in financial assets – there are not thousands of excess housing units, cars, or millions of miles of fiber optic cable. We have already seen massive destruction in financial assets (the markdown in crypto alone has been nearly $2 trillion) without a huge impact on the "real economy." This robust consumer backdrop underlies our continuing exposure to the consumer risk-driven aspect of our structured credit exposure. On the other hand, overall corporate leverage is very high, especially in sectors that burnt billions in cash keeping the lights on during the Covid shutdown. We think these areas are likely to be the most interesting credit opportunities if spreads continue to widen.

Third, we have yet to see a violent liquidity driven sell-off in credit. Redemptions from credit have been huge, but the combination of coupon income and a lack of supply have thus far kept forced selling to a minimum. Over the past week we have seen inflows to credit, indicating that there is still a lot of liquidity in the market. It is unusual to see this large a move in the market without some "forced selling", although the best source of information for truly market clearing levels is in the new issue market. Issuers that can afford to wait to come to market are waiting, however, we are seeing some supply for issuers that cannot or do not want to wait – banks are unloading "hung" bridge loans at significant discounts. This should lead to a rolling re-pricing of the market – the phenomenon that likely accounts for the "point of no return" effect in spreads. More proactive sellers that "do the math" on balance sheets may find that some capitalizations are no longer viable if refinanced at current market rates head for the exits. Notwithstanding recent moves, we expect these rolling re-pricings to mark the next stage wider in spreads.

Structured Credit Update

During Q2, we continued to see a divergence between fundamental credit quality and volatility-induced pricing in structured credit. This was especially pronounced in our residential mortgage (RMBS) exposure, which comprises about 50% of the portfolio and is primarily made up of reperforming mortgage securitizations. This space has experienced mark-to-market declines due to rising rates, widening credit spreads, and a scenario shift pointing to a higher probability of recession. However, in contrast, our monthly remittance data shows elevated mortgage refinancing rates (outside of scheduled monthly principal amortization), delinquencies trending as expected, and low loss severities. **The current yield on the RMBS portfolio is in the high teens, and we believe the fundamentals of constrained housing supply, borrowers with 40-50% equity in their homes, and over 10 years of performance history make this a compelling asset class in the wake of the**

broader market sell-off. While daily headlines trumpet new highs for mortgage rates, these borrowers typically have balances around $150,000-$200,000 and current mortgage rates of 4.5-5.5%. With the significant equity built up in their homes, they can take out a hybrid mortgage potentially below 4% and unlock 10-20% of home equity value. As a result, we continue to see those elevated refinancing rates.

Our RMBS exposure also reflects the bottom 25-40% of the capital structure, and we have termed out senior financing via securitization for one to two years at rates around 1.5-3.0%, substantially lower than currently available rates, which is not reflected in current pricing. This RMBS profile looks more stable from a total return perspective than segments of legacy non-agency RMBS and "RMBS 2.0" like Credit Risk Transfer (CRT), where the risk can represent the bottom 1-3% of the capital structure. Our current reperforming mortgage portfolio benefits from an efficient senior cost of funds via securitizations done in 2020 and 2021 closer to 2%, while the underlying loans have been re-priced to today's significantly wider yields. As a result, the current yield is in the high teens to a more conservative stress case scenario and reflects a high risk-adjusted return that cannot be recreated today given current yields.

The other half of the portfolio is primarily invested in consumer ABS, including auto loans, whole business franchises, student loans, and unsecured consumer loans. Broadly, consumer ABS performance in the portfolio has been relatively flat amidst the volatility given the shorter duration (inside of two years), steady amortization and current yields around 12%. Like our residential mortgage exposure, underlying loan performance in consumer ABS deals has been stable. We have seen the headlines in multiple segments of fintech firms where their origination volume path and credit underwriting models have been called into question. Despite those firm-specific headwinds and a higher cost of securitization due to higher rates, we have been able to securitize our consumer loan exposure at attractive levels while actively de-risking our exposure to the unsecured loan sector. We are focused on being flexible across this asset type and have rotated our strategy into reinvesting in securities and not actively buying new loans. Our trading approach has allowed us to shift quickly from buying loans and securitizing last year to buying securities in the new issue and secondary market at wider yields this year.

We view structured credit is a compelling asset class as evidenced by our allocation of 20% of our capital to this space; as interest rates increase, we can reinvest into a higher yield environment with a blended current yield around 15%. We are also invested in currently amortizing assets that present reinvestment opportunities. At steady state, the portfolio will amortize by 1/3 in 12 months. The current portfolio duration of 3 years (rate hedged ~60%) allows us to be defensive on credits and reinvest at higher yields. Specific assets, including housing and automobiles, have outperformed in inflationary periods. Structured credit enables access to these asset types and buying seasoned loans with loan-to-value (LTV) upside from the underlying asset adds more credit protection. Our investment focus is on securitizations backed by hard assets with inflation upside, bonds with more credit support and early amortization triggers, and negotiating for more robust capital structures in new issue debt.

Structured credit is unique within the credit markets as the yields are based on a specific loss assumption. We have seen an estimate of wider credit spreads and a recessionary scenario priced into our mortgage investments. We believe our investments in reperforming mortgages present an attractive potential risk-adjusted return because we have a direct relationship with mortgage servicers and can monitor performance, and the current yield is higher than most other fixed income securities with a hard asset backing the collateral. Looking forward, we see an emerging opportunity within the $1 trillion CLO market as high yield currently trades tighter than structured credit and may experience defaults as companies seek to refinance in a higher rate environment.

Sincerely,

Daniel S. Loeb

Daniel S. Loeb
CEO & CIO

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