GREENHAVEN ROAD
PARTNERS FUND

May 2024

Dear Fellow Investors,

In the first quarter, the Partners Fund returned approximately 6.5% net. Investors, please check your individual statements for your returns.

In these letters, I try to outline my thought process behind the portfolio and the context around which it is built. In the past several letters, I have made a case for the return of stock picking versus blind indexing. I have also argued that "small caps" are due their turn as we look ahead following a long period of neglect by the market.

Recently, I was asked to serve as a reference for an emerging fund manager who meets all of the criteria for the Partners Fund:

1. One-person investment committee
2. Concentrated holdings
3. Reasonable amounts of capital (AUM)
4. Significant personal investments ("skin in the game")
5. Original thinking
6. Mindset: getting rich is not the point

We do not have an investment with the manager, but I have known him for almost a decade and am very familiar with his work, and we have been invested in the same company multiple times.

The person conducting the reference check works for a firm that endowments hire to evaluate managers. University endowments have a principal-agent problem. The people managing the endowment are not *principals* because they are not managing their own money; they are instead *agents* of those who do own or ultimately benefit from the endowment's money. This dynamic dramatically skews their incentives towards job preservation vs. maximizing risk-adjusted returns, which a principal typically would do. A senior team member at a large endowment can earn well into the seven figures each year that they hold their position. As an agent, being at the center of the herd is quite a logical strategy.

A consultant to an endowment is effectively an agent's agent with similar incentives for relationship preservation as the number one priority. There likely are rewards for "shooting the lights out" but the greater risk is poor performance leading to the termination of a relationship.

The safest choice for an endowment manager is to invest in bulge bracket private equity. Nobody gets fired for hiring KKR or Blackstone – it takes years for the actual performance to be known, and private equity marks generally have much less volatility along the way.

Over the course of the thirty-minute conversation, it became clear that the consultant really wanted to recommend the manager for whom he was doing reference checks. He saw the benefits of an investment committee of one but was concerned about the manager's mental health during difficult periods without having a fellow team member to provide mutual support. He also saw the benefits of a unique portfolio. I sensed that he would place his own money with the manager but was grappling with the decision to recommend it for the university. At the end I said, "You are on the right path, just do it," to which he responded, "I have been saying that to myself the whole time."

I believe that we too are on the right path. The concentration of individual managers is a feature, not a bug – we are not recreating the S&P 500 by having a dozen managers each with 40 holdings. The "Original thinking" is also a feature, not a bug – blindly buying mega cap tech will work until it does not.

I just got back from the Berkshire Hathaway meeting in Omaha where I had lunch with fellow portfolio manager Ryan O'Connor of Crossroads Capital. We are not invested in Crossroads presently, but I am including his annual letter (link) because I think he makes an interesting case against the Magnificent 7 and for two companies that are also owned by managers that we are invested. Ryan is a wonderful writer but, given that he only writes once a year, his letters are longer than most, so I will provide page numbers for the sections I am citing.

Ryan's case against passively purchasing the S&P 500 going forward is underpinned by the potential for the vast profit pools of the Mag 7 to be competed away (pages 9-14). Comprising approximately 30% of the S&P 500, the Mag 7 include Tesla, Apple, NVIDIA, Google, Microsoft, Amazon, and Meta. Ryan points out that these companies have elevated margins that are vulnerable to competition and rely on China for a substantial part of their revenues.

> *"As things stand, over 20% of the Mag7's revenue in total comes from China's domestic market. The fortunes of the Mag7 in the decade ahead are inextricably linked to China – and history has demonstrated that the industries China wants to dominate don't make money. Whether it's textiles, cellphones, chemicals, solar panels – you name it – the endgame always remains the same: The industry is quickly commoditized as Chinese companies demonstrate a willingness to compete fiercely and be satisfied with profitability and margins that are a tiny fraction of what other global players require, crushing their ability not just to compete, but to merely survive. Investors who ignore this fact do so at their own peril."*

Owners of a large index are often largely indifferent to competition-driven changes in market share and profits. If Ford takes market share from GM, who cares? They are both in the S&P 500; one goes down but the other goes up. In the China scenario Ryan lays out, the potential "spoilers" such as BYD and Huawei are not in the indices, so the "heads, I win" / "tails, I win" dynamic is not at play.

If Ryan's thesis is correct, it will take years to fully play out. Just this past week, the Biden administration announced quadrupling tariffs on Chinese electric vehicles. The Mag 7 are wonderful companies and may very well successfully navigate any competitive threats and loss of revenue from China while maintaining elevated margins and multiples… but they also may not.

The other section of the letter I would point you to is the write-up on Vistry (VTY.LN) (pages 15-26). Vistry is a business in transition, exiting its traditional home building business to focus on a partnerships model where the company develop properties in conjunction with municipalities. The partnerships business is far less capital intensive with a very high ROE, and the transition is unlocking significant cash to fund a billion-dollar share buyback that is already underway. Ryan draws parallels to the U.S.-listed NVR, which is one of the best performing stocks over the last 20 years, outperforming even Apple.

Vistry is a company that appears more cyclical than it is and does not screen well because the historical numbers, which largely reflect the legacy housebuilding model, do not fully reflect the transition underway. Vistry has downside protection in the form of a clean balance sheet and multi-bagger upside potential from their pipeline and partnerships strategy, among other factors. Owning Vistry requires putting the pieces together, differentiating between the economics of the traditional housebuilder model vs. execution via partnerships, and assessing capital allocation plans. This is what the managers in the Partners Fund do best: they focus on companies that are small, misunderstood, and generally have several catalysts. Vistry is owned by at least two managers in the Partners Fund, and we have a small position in the main fund. Nintendo, which is also featured in Crossroads letter, is a very large holding of another manager in the Partners fund as well.

We are principals, not agents, and I believe that, on a look-through basis, we own compelling companies that have been sourced by managers who are highly aligned and talented stock pickers.

As I have said at the end of every letter, our fund of funds is going to be different. It will be smaller, the underlying holdings will be more esoteric, and I hope the managers will continue to collaborate more over time. I believe that it will be "good different," but only time will tell. Thank you for joining me on this journey. I will work hard to grow your family capital alongside mine.

Sincerely,

Scott

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