Q4 2020 Investor Letter | *February 2, 2021*

Dear Investor,

For the three months ended December 31st, 2020, the Bonsai Partners portfolio appreciated 36.0% gross, and 32.3% net of fees and expenses. The S&P 500 Total Return Index returned 12.1% over this same period.

For the full year 2020, the Bonsai Partners portfolio appreciated 275.3% gross, and 247.0% net of fees and expenses, compared to 18.4% for the S&P 500 Total Return Index, as presented below.

At the end of the quarter, gross exposure was 97.8%, with 2.2% held in cash.

Bonsai Partners Historical Returns Summary

	2020	2019	2018	Since Inception	Annualized *Since Inception*
Bonsai Gross Return	**275.3%**	**60.6%**	**-17.9%**	**384.4%**	**105.2%**
Bonsai Net Return	**247.0%**	**56.4%**	**-18.1%**	**344.5%**	**97.3%**
S&P 500 Return	18.4%	31.5%	-8.6%	42.2%	17.4%

Performance data shown represents past performance. Past performance is not indicative of future results. The period October 22, 2018, to April 30, 2021, presents time-weighted returns of a representative Bonsai Partners, LLC ("Bonsai") managed account with the same strategy and risk profile as Bonsai Partners Fund, LP, (the "Fund") which launched on May 1, 2021. Results from May 1, 2021, reflect the time-weighted returns of Class A shares of the Fund.

Gross returns from October 2018 to April 2021 include transaction and commission fees. Gross returns from May 2021 to the present include transaction and commission fees and fund operating expenses, such as administrative and audit fees but do not include management or performance fees. Net returns reflect the gross returns (as described) reduced by a 1.0% management fee and a 10.0% performance fee above a 6.0% cumulative compounding hurdle.

All performance figures are calculated internally by Bonsai Partners and are therefore estimated, unaudited, and subject to adjustment. The investment return and principal value of an investment with the Fund will fluctuate so that an investment, when redeemed, may be worth more or less than its original cost. Actual performance for a particular investor may be lower or higher than quoted performance due to different fee structures, share classes, beginning periods, capital additions or withdrawals, or individual compliance related mandates. Please refer to important additional disclosures at the end of this letter.

After a year of dramatic highs and lows, I am reminded that nothing is ever as good or as bad as it seems. This is as true now as it was last March.

Michigan's legendary football coach: Bo Schembechler, is remembered for balancing his team's emotions throughout each football season. After a devastating loss, he lifted his team up, and after a blow-out-victory, he dressed his players down for even the smallest missed assignments.

Allow me to channel my inner football coach: many of the worst investment mistakes occur while riding-high after a win. As the saying goes: "in victory, tighten your helmet."

We had a good year in 2020, but I assure you, my helmet is on as tight as ever.

I look forward to working with you in 2021.

Performance Review

The power of compound interest never ceases to amaze me. The 36% return we experienced this quarter contributed ***nearly 100% incremental returns*** to our full-year results.

I rarely short stocks anymore (we haven't yet) because they cannot deliver the compound interest we seek. By going short, we end up paying compound interest to someone else rather than earning it ourselves.

These are unusual times, and they require unusual prudence. Everything we own is anchored in measurable intrinsic value, and despite the lopsided nature of our portfolio (I'm working on it), each position remains rational.

Great Investors Break the Rules

Recently, I engaged in a broad-ranging conversation with Good Investing TV. Below, I expand on one of the topics we discussed.

Investing is an art form, and like any artist guiding their brush over canvas, the investor weaves together facts and observations to create their vision of the world.

What is true in art holds in investing; the masters don't follow the rules, they break them. Greatness comes from redefining the game rather than simply playing it.

Learn the rules like a pro, so you can break them like an artist.

- Pablo Picasso

In his early years, Pablo Picasso didn't have a unique style, instead, he adopted a conventional one; striving to be the best realist painter he could be. While his early works were impressive enough, they were also unremarkable due to the crowded field around him. It was not until later in his life that he introduced his unique style.

Since art and investing are acts of self-expression, the limitations in these fields are largely self-imposed. To combat these boundaries, tools like self-reflection and introspection can help unlock innate potential. Only after conquering our internal limitations can we see those imposed on us by the game we are playing.

Good investors and artists adapt themselves to the world around them, however, masters find the game forced upon them suffocating. Great investors (and artists) therefore are the ones who rebel against the system and break away to form their own. I refer to this as finding investment (or artistic) "white space."

By breaking free of convention and creating a game that suits the individual, masters remove themselves from their competition rather than trying to beat them. We remember the Picasso's and Buffett’s of the world because, for a time, they stood alone.

George Bernard Shaw famously said: *“The reasonable man adapts himself to the world: the unreasonable one persists in trying to adapt the world to himself. Therefore, all progress depends on the unreasonable man.”*

By being unwilling to compromise, masters force others to adapt to their game rather than the other way around.

Imagine a piece of paper with a circle drawn within it. Whatever sits inside the circle is the boundary of the conventional game, and everything outside it is the white space of free expression. The catch? The center circle is forever widening, and the amount of white space is forever shrinking. Just as our universe continuously expands, so does the boundary of conventional wisdom. In investment and art, the playing field gets ever-more crowded by the minute.

Whenever a new idea or concept becomes part of the investing (or artistic) zeitgeist, that area of white space becomes adopted as conventional; the circle widens. In other words, what was once 'avant-garde' eventually becomes mainstream.

The once-radical ideas that made Warren Buffett and Charlie Munger wealthy are no longer novel because of their consensus appeal today. These strategies do not offer unusual rewards anymore because they are a part of today's conventional asset appraisal process. Just as cubism or rap was once considered radical, these genres are now mainstream and arguably crowded.

To stand-out in a system of self-expression, masters push ever further outward into the frontier of what is possible. This is where shrewd investors (and artists) express themselves freely and obtain unusual rewards.

When the industrial revolution began, owning one of the first steam engines offered significant technological advantages. However, as others adopted this technology as well, the competitive edge it offered eroded.

Similar to early adopters of the steam engine, exploiting a fruitful white space doesn't offer a permanent advantage; it's fleeting. Only through adaptability and continuously identifying new white spaces are excess returns safe.

Ironically, while investors today often hunt for 'deep moat' businesses, they don't have one themselves. Investing and art are both 'know-how,' or skill businesses, and this in itself only offers a limited advantage. As I write this, my competition is likely swimming across "my moat" to steal away the excess returns I might earn.

While this is true, I don't need to have a wide moat to sustain outsized returns. Instead, my moat comes from continuously changing its shape or widening it. If I can do that, our returns will be safe. In investing, being more adaptable and flexible allows us to see and exploit new white spaces, wherever they might be. By doing so, I can keep the swimmers stranded in the middle of the water.

Without a culture of adaptation and experimentation, an investor's long-term alpha reverts to zero. This logic is at odds with conventional thinking: that a clearly defined and repeatable investment process is the best way to earn outsized returns over the long-term.

I'll close by referring back to the words of Picasso from above: *"Learn the rules like a pro, so you can break them like an artist."*

Investors must learn from the past greats: Buffett, Graham, and others, but they should not confuse learning as copying. As a friend put it more elegantly than I could: "children copy, masters break the rules."

Above: Ferdinand I By Darius Hulea.
For more of his work: https://www.behance.net/DariusHulea

Portfolio Review

The fourth quarter of 2020 was relatively quiet from a portfolio management perspective. We added to our Travelsky position from cash as well as the sale of our small position in Genasys.

It's worth mentioning that we no longer own any microcap stocks, and I believe this reflects some learnings gathered since inception. While I certainly hope to find great companies at the smallest market cap possible, I don't necessarily believe I have to be present in illiquid and small securities at all times for us to obtain great returns. Adverse selection bias and liquidity traps make wading in these waters quite unforgiving, so I'll tread lightly before dipping my toe in again.

As you can see above, Redbubble continues to grow within our portfolio, which is good for performance and difficult for portfolio management. I hope and expect to replace some of this exposure with new ideas over the coming quarters, but only as I find them.

Position Update

Redbubble (ASX: RBL)

Redbubble is a three-sided marketplace connecting digital designs to customers looking to express themselves. The company's shares appreciated 33.3% during the quarter.

Not much changed for Redbubble this quarter outside of its share price. Toward the beginning of the quarter, the company reported strong results. Soon after, with the approval of the Moderna and BioNTech vaccines in October, skepticism about future e-commerce growth caused the shares to decline ~25%. After this correction, Redbubble shares once again resumed their upward march, as underlying data continued to suggest strength in the business.

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Despite where we are in the market cycle, Redbubble remains surprisingly attractive from a valuation perspective. I remain confident in the long-term prospects of the company, even if there might be bumps along the way.

Micron Technologies (Nasdaq: MU)

Micron is a manufacturer of memory semiconductor chips. Micron's stock appreciated 60.1% during the quarter.

Micron's shares significantly appreciated this quarter for a couple of reasons. First, and most importantly, the DRAM market appears to have begun its cyclical rebound. As a result, we will likely see higher pricing and profitability through at least the calendar year 2021, hopefully meaningfully longer.

Another (and less meaningful) driver was that semiconductor stocks have become 'en vogue' once again. I may not be old, but I've been around the sector long enough to know that when generalists start getting excited about a 'new paradigm' around semiconductors, it's time to be wary.

I wouldn't call Micron overvalued, but I'd certainly say it's more fairly priced today compared to when we first purchased it a few months ago.

Pushpay (ASX: PPH)

Pushpay is a leading provider of software and generosity solutions for the faith sector. Pushpay shares declined -13.2% during the quarter.

The corporate governance issues I noted last quarter for Pushpay persisted in the fourth quarter and continues to erode my confidence in those running the company. I intend to speak more about this issue again next quarter as I'm still getting to the bottom of this issue and how to best respond.

The one bright spot this quarter came from the resignation of a board member who I believe was a key source of governance issues. However, even upon that announcement, the company jointly issued a perplexing 4-to-1 stock split, which didn't exactly inspire confidence that we are headed in the right direction.

Further, I was underwhelmed by the announcement of their new CEO: their former chief customer officer. Although the new CEO seems well-liked, it is unclear why this was the best leader they could find considering Pushpay is an exciting multi-billion dollar company.

I hope the new CEO can allay my concerns and win back trust. In absence of that, Pushpay may be living on borrowed time in our portfolio. The company itself remains quite attractive but I've trimmed our position to reflect my change in conviction level in the people.

Travelsky Technology (HKEX: 0696)

Travelsky is the leading provider of software and systems for airlines and airports in China. Travelsky shares appreciated 13.1%.

Travelsky's business continues to steadily rebound from COVID-19, with domestic passenger traffic (the lion's share of their volumes) approaching last year's traffic levels by December (-9.6%). This is still hard for me to reconcile considering where the United States and Western Europe are presently with the pandemic.

The company remains on strong financial footing and they continue to invest in its technology to ensure their long-term viability. I continue to closely monitor Travelsky and expect their international travel business (largely still shut-off) will begin to recover as the rest of the world starts reopening again in 2021.

LKQ (Nasdaq: LKQ)

LKQ is the largest provider of alternative collision and mechanical automotive parts in the United States. In Europe, they are the leading distributor of general automotive maintenance parts and supplies. Its shares appreciated 27.1% during the quarter.

LKQ reported reasonably healthy third-quarter results, with revenues nearly flat year-over-year. This is quite remarkable considering ~9 months ago when we first considered buying LKQ, I didn't know if the company would potentially trip its debt covenants and run into liquidity issues due to steep revenue declines. These issues appear well behind us now.

Given the serious tail-risk concerns when we first acquired the position, we cheaply hedged with put options; the only time we've ever done so. These options recently expired worthless and it never felt so good to lose money.

The company seems back on track to execute its strategy of streamlining its operations, and management used COVID as a catalyst to rationalize the business and improve service levels. Fortunately, LKQ's business is counter-cyclical, so it stands to benefit from economic stresses if they are yet to come.

Taiwan Semiconductor (NYSE: TSM)

Taiwan Semiconductor is the world’s largest outsourced foundry of logic semiconductor chips. TSMC’s shares appreciated 34.5% during the quarter.

Taiwan Semiconductor continues to see unprecedented demand, albeit at a slightly less rapid growth rate than earlier in 2020. At the time of writing, TSMC announced strong fourth-quarter results and staggering growth in their expected capital expenditures for 2021 – growing from $17B in 2020 to $25B to $28B in 2021. Forward-looking capital expenditures are the key leading indicator of their medium-term growth rate expectations, and I expect TSMC management will continue to earn excellent returns on these colossal investments.

TSMC's capital expenditure growth is likely due to investment in their new U.S. manufacturing footprint, rapid investment in their cutting edge process technology, as well as generally high levels of customer demand. Lately, we've seen semiconductor shortages in some of their less advanced process technologies, emphasizing the current state of the semiconductor supply-demand imbalance.

Illumina: (Nasdaq: ILMN)

Illumina is the leading provider of genomic sequencing instruments and reagents. Illumina’s shares appreciated 19.7%.

The fourth quarter was pretty quiet for the company. Illumina released third-quarter results that showed good catch-up momentum as laboratories started to reopen. I continue to monitor the position.

Operations Update: Shifting to a Fund Structure

Bonsai is moving from managing separate accounts to a fund structure. Let me explain why.

Since Bonsai began in October 2018, we have used Interactive Brokers' managed accounts platform and it has served us well. In 2020 for example, administering the Bonsai strategy cost around 10 basis points (0.1%). Delivering my work at a reasonable cost to you remains one of my core values.

Despite the initial cost advantage that separately managed accounts offer, it was clear from the start that a fund structure eventually offers you the most value. At enough asset scale, a fund doesn't have nearly as much of a cost burden, meanwhile, it offers tax and operational benefits over managed accounts. Today we are at the point where the scale has tipped in favor of a fund structure.

Further, a recent change at Interactive Brokers post-Brexit has pulled forward this decision. As it stands today, I am facing uncertainty around whether I can continue to manage European client accounts. Converting to a fund structure solves this issue and lets me take back control of Bonsai's back-office. Now is the right time to make the switch.

I am excited about this change because it marks a new phase of Bonsai's development and it will increase the durability and quality of what I can offer you.

I will be in touch with you about these changes over the coming weeks and hope the process of rolling our managed accounts will be as painless as possible.

Concluding Thoughts

As always, if you have questions or comments don't hesitate to reach out to me directly.

Fondly,

Andrew

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Disclaimer:

Bonsai Partners, LLC ("Bonsai") is the investment manager of Bonsai Partners Fund, LP (the "Fund").

This letter has been updated from its original version. Disclaimers were revised to reflect current standards and clarifications for the intended audience. Certain visual elements, formatting and brand identifiers have been refreshed to align with our current branding. These changes do not alter the core message of the original letter.

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The S&P 500 Total Return index is a basket of 500 large U.S. stocks, weighted by market capitalization, and is the most widely followed index representing the U.S. stock market. The S&P Total Return Index includes the reinvestment of dividends. Benchmarks and financial indices are shown for illustrative purposes only. They provide general market data that serves as a point of reference to compare the performance of other securities that make up a particular market. Such benchmarks and indices are not actively managed and do not reflect the expenses associated with managing an actual portfolio, the cost of investing in the instruments that comprise it, or other fees. No representation is made that any benchmark or index is an appropriate measure for comparison.

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