Memo

From: Gregory, May 2023

Subject: Further explanation on 2022’s fund performance

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1) If we have a strong conviction about a toppish market in late 2021, why didn’t we liquidate most if not all our holdings and buy them back later at cheaper prices?

2022 was characterized with high volatility resulting from Russia Ukraine conflict, record pace of Fed interest rates hike and broad-based declines in nearly every asset classes. Our fund’s objective is to maximize the growth in long term NAV/Share over 20 – 30 years if not longer. To do that we spend a decent amount of our time understanding and thinking about the characteristics of enduring companies’ competitive advantages. Once we have invested in companies that possess such qualities at a reasonable price, we are very reluctant to sell them, even though we may believe there is a high probability of short-term price weaknesses. This could be due to 1) Temporary overvaluation 2) Short-term earnings disappointment 3) Short term industry headwinds etc.). As long as we think that their long-term business potential remains attractive, we tend not to sell them easily. We limit trading in our core holdings for several reasons.

To be successful as a short-term trader on our core holdings (that we intend to hold for infinite period), we would have to successfully estimate how much a stock will decline and then accurately predict what price and time would we be willing to repurchase. Such “dancing” in and out of our core positions strikes us as particularly speculative and the likely result are unsettled minds. A short-term trading policy may help us avoid temporary quotational losses but at a much larger cost of missing out on substantial share price gains in future. As such we usually do not trade around long-term holdings but generally make minor adjustments in size of position to manage portfolio’s concentration risks.

2) Was the outperformance mostly a result of luck?

We are not macro forecasters and do not make investing/trading purely based on macro views. Since we cannot predict the future, we would rather deal with probabilities. As such we tend to simply keep our heads down while others are losing theirs (as seen in periods during 2021). We are mentally well prepared for any significant declines that so often follow a period of exuberances and excesses. In early 2022, we sold off deep cyclicals and other mediocre quality businesses. The sales proceeds were either kept in cash and/or channeled into short-term trading activities. These trades, specifically shorts, also serve as hedging purposes for the overall portfolio. In 2022, most of the trading gains have been subsequently redeployed in adding existing or purchasing new positions at prices generally lower than they were in end 2021. In nearly all cases, these purchases have then increased in value by early 2023, further amplifying the benefits of our short-term trading/hedging strategy. Certainly, luck plays a part in almost everything we do, however our prepared minds and prudent attitudes have also protected investors’ interests and made significant contributions.

3) How did our core holdings perform in 2022 in terms of business performance?

Most of our long-term investments are high quality, simple to understand businesses. We also own several fine businesses that are trading at cheap valuations due to a one-time difficult period/problem. As a group they largely have minimal net gearing and predictable recurring cash flows. While most of our holdings experienced share prices declines in 2022, as a group, they continued to generate strong business performances, increase earnings, and healthy free cash flows per share. Their long-term prospects continue to look very attractive and accordingly we only made minor adjustments to our core holdings.

4) Where do we see opportunities currently, if any?

Based on the current situation, it seems the most glaring market excesses were cleared in 2022.

Broad market consensus on central banks' interest rates seems to be solidly anchored on "high for longer". The era of easy money has clearly ended, and speculation activities were no longer rampant. Bitcoin, one of the most glaring signs of investors' greed in 2020-2021, has corrected almost 75% from its peak in Nov 2021 to trough in Nov 2022. Sea Limited, once promoted as the next Amazon of Southeast Asia, has likewise corrected almost 90%, alongside many other flashy, losses making growth stocks. IPOs and SPACs activities have all but grounded to a halt. Now we no longer read about FOMO (Fear of missing out) but instead recessionary concerns, US regional banks crisis and falling US commercial real estate values dominate investing news headlines. After an almost 20% decline in the S&P 500, valuations have also reached more palatable levels. As such the investing environment has once again shift favorably towards the patient, long term buyer of values.

Many semiconductor equipment companies that we have been following closely for a long time (and have been shareholders before) are relatively well capitalized. They seem to be priced at bargain prices relative to their long-term earnings prospects. This type of pricing seems to occur frequently at times when the immediate earnings outlook is poor. We have carefully chosen and invested in a few of them. Though it may take some time to materialize, our analysis is that for quite a number of these companies, the next peak in earnings will likely be well above historic peaks, and valuations should likewise recover then.

We continue to focus our minds on managing your portfolio wisely and at the same time keep fund expenses low. Thank you for your support and patience.