"The big money is not in the buying and selling, but in the waiting." -Charlie Munger

15th of July 2022

Dear Clients & Friends,

The first half of 2022 was a difficult period for the major stock indices with the S&P 500, Russell 2000, and NASDAQ Composite indices declining 20%, 23.4%, and 29.2%, respectively. The broad-based declines were largely the result of growing concerns about persistent inflation and rising interest rates. Rising costs can curtail spending, hiring and capital investment, denting consumer confidence and economic growth. The good news is that poor S&P 500 performance periods have historically been followed by impressive rebounds. According to Ned Davis Research, the S&P 500 has experienced a quarterly drop of 15% or more eight different times since 1946. In the 12-months following those declines, the S&P 500 gained an average return of 26.1% and recorded a positive gain in all eight of those periods.

Our managed portfolios were generally down more than the S&P 500 through the first half of 2022 due to our lack of exposure to energy and traditionally defensive securities as well as experiencing some punitive declines in specific companies after their not meeting short-term market expectations. Due to strong fundamentals and now even more attractive prices, our portfolios could perform well should we see a sharp market recovery.

We own a diversified portfolio of dominant and profitable companies with wide competitive moats, strong management, and durable business models. These companies are blessed with leading brands, innovative technology, and some of the best and brightest employees in their respective industries. Historically, businesses that deliver immense and unique value to customers have been a good hedge against inflation. When a business sells something essential, or uniquely valuable, customers are less likely to replace it or go without it. Should we experience persistent inflation, we believe that the companies that we own will be able to pass on higher prices and in some cases, take market share from competitors. With current valuations of our portfolio companies at very attractive levels, we see a long runway for our holdings to increase their market value.

KNOW WHAT YOU OWN

As long-term bottoms-up investors, most of our time is devoted to researching individual companies and industries. While changing macroeconomic variables such as interest rates, inflation, and employment can move stock prices in the short-term, over the long-term, the strength of each individual company's business model, and durability of each company's profit stream, will be the key long-term drivers of individual stock performance. We believe that the best return on our time is to deeply research individual companies, seeking to identify the businesses and management teams that are built for long term success, *whatever* may come.

Focusing on individual company fundamentals can provide a key strategic advantage when markets sell off; it gives us the confidence to hold our investments through difficult periods and mitigate selling at the wrong times. When markets are rising, investors can become complacent, piling into hot stocks or sectors and chasing trends. When prices keep rising, these choices seem validated, complacency can metastasize, and the cycle continues.

Eventually, this cycle ends and investors who do not know what they own or why they own it will have an instinct to react emotionally to falling market prices. Selling during periods of fear and failing to hold through the tough times can be damaging to long-term returns. Through our research process, we become intimately familiar with the companies that we own, allowing us to develop the conviction to hold through tough times. Below are a few core holdings whose stock prices declined in the first half of 2022, but the underlying business fundamentals are strong, and the future return potential is high.

Disney

Disney ("DIS") declined ~40% in the first of half of 2022 due to investor worries about a slow-down in consumer travel and saturation of the global streaming market.

Disney remains one of the world's most loved brands with global multi-generation appeal and an iconic catalog of intellectual property and theme parks. Over the next few years, we believe that Disney's streaming business will establish itself as a long-term winner in internet entertainment with revenue and profits higher than the market expects. We see a multi-year demand tailwind for Disney family vacations and growing theme park revenue. We estimate that a sustained rebound in consumer travel and growing scale in streaming will allow Disney to earn $7/share in 2024. At a 20x multiple, the stock would be valued at $140, 40% upside. Long-term, we believe that Disney's brands and streaming scale could drive sustained double-digit profit growth for many years.

Netflix

Netflix ("NFLX") declined ~70% in the first half of 2022 due to worries that increasing competition will erode its market share and pinched consumer budgets will cause customers to cancel the service.

This is the third time in NFLX's public company history that the stock has declined over 60%. Each time, the business has bounced back stronger and more profitable. This is due to a world-class management team and core consumer value proposition that improves each year with a greater variety and quality of content. We believe this time will not be different and over the next several years, NFLX's revenue and profit growth will meaningfully exceed current market expectations. By 2024, we estimate that NFLX could earn $14/share and be valued at $280, nearly 55% upside. Long-term, we believe that NFLX could have over 300 million subscribers, revenue of $54B and long-term earnings power of $35/share, with the stock valued at $700/share, approximately 4x the current price.

Ally

Ally Financial ("ALLY") declined ~30% in the first half of 2022 due to concerns about a slow-down in the used car market, a key end market for Ally's consumer lending business.

We believe that Ally has the balance sheet, underwriting discipline, and management team to successfully and profitably navigate the current environment. Additionally, Ally's management has built one of the most sophisticated online banking operations in the financial industry, creating a key new market for growth. Ally is currently valued at 5x E2022 earnings and 85% of tangible book value, a very cheap price for a competitively advantaged financial services company. With no multiple expansion, we estimate that the stock return could approximate the company's 19% return on tangible equity (ROTE) annualized through 2024, which would result in a $50/stock, a ~40% return.

Lennar B

Lennar ("LEN-B") declined ~30% due to concerns that rising mortgage rates will chill demand for new residential homes, causing a broad-sell-off in homebuilder stocks.

For over 30 years, Lennar has deftly navigated economic cycles, financial crises, and changing consumer preferences to remain one of the U.S.'s most successful home builders. We believe that the U.S. is structurally undersupplied with new homes, creating a multi-year demand tailwind that should allow Lennar to grow it earnings for several years, even with higher mortgage rates. Lennar B shares are currently valued at 4.3x this past year's earnings and 1x tangible book value, a roughly 30% discount to its 10-year average valuation. We believe that Lennar can benefit from continued strong earnings and multiple expansion as earnings prove less cyclical than market expectations. If LEN-B shares just continue to trade at a depressed 1x tangible book, the stock return should equate to its tangible return on equity which consensus analyst forecasts to be between 15%-25% for the next few years.

The company snapshots above provide a glimpse into why we remain upbeat: we own a diverse collection of high-quality, durable businesses at attractive valuations. The one-two punch of a great business at a great price can drive strong forward returns. While it has certainly not been fun to see the value of our holdings decline this year, we know what we own, and we believe that the future remains bright for our companies. The market sell-off provided us with an opportunity to make two new investments during the quarter, discussed below.

NEW PURCHASES

Activision Blizzard

Activision ("ATVI") is a special situation investment that should have low correlation to the overall market and a favorable risk/reward with the potential for a 20% return by July 2023.

ATVI publishes and owns a broad catalog of globally popular videogames, including well-known titles Candy Crush, Call of Duty, and World of Warcraft. Three billion people around the world play videogames, a number that is growing as new technologies make gaming more immersive and social. ATVI has a long-history of profitability and deep expertise producing and distributing high-quality games.

On Jan. 18. 2022, Microsoft ("MSFT") announced its intent to acquire ATVI for $95/share in cash. With its ownership of the XBOX, Minecraft, and other videogame assets, MSFT is one of the largest global gaming companies. MSFT's management believes ATVI's gaming portfolio and talented employee base would strengthen its competitive position in the videogame industry.

ATVI currently trades at $78/share, a 17% discount price to MSFT's all-cash offer of $95/share. With the deal set to close in July 2023, the stock market is concerned that the deal could be blocked given heightened regulatory scrutiny of large technology companies and a less hospitable regulatory environment for large M&A.

We believe that there is a higher probability that the deal will close than the market is pricing in, given that a combined MSFT/AVTI would not consolidate enough videogame market share to warrant blocking the merger based on traditional antitrust analysis. If the deal closes at $95 in July 2023, our return on the stock would be 20%. If the deal is blocked, we are happy to own ATVI standalone because we like the economics of the business, are bullish on the global growth of

videogaming, and see a clear path for ATVI to grow its earnings. In 2024, we estimate that ATVI could earn $4.00 per share. A 20x multiple plus net balance sheet cash of $10/share would result in a stock price of $90.

J.P. Morgan

J.P. Morgan ("JPM") is the largest financial services company in the world with ~$4 trillion in assets. JPM's business spans multiple areas of finance, including commercial banking, wealth management, capital markets, and consumer credit. The unifying thread across each of these disparate businesses is J.P. Morgan's brand name, which stands for wonderful customer service, indomitable financial health, and some of the most talented financial professionals in the industry. With a business that dates back to 1799, one is hard-pressed to find many companies with the business durability of JPM.

Broader worries about a global economic slow-down weighed on JPM's stock in the first half of 2022, sending the stock down ~28%. The stock is currently valued at 10x E2022 earnings and 1.6x tangible book value, an attractive valuation for a best-in-class global financial services company with superb management. With no multiple expansion, we estimate that the stock return could approximate the company's 16% return on tangible equity (ROTE) annualized through 2024, which would result in a $162/stock, a ~40% return.

If you have any questions, please don't hesitate to contact us.

Sincerely,

Ben Weiss, JD
Chief Investment Officer

Tom Eidelman, CFA
President

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