Bonsai Partners

February 19, 2024

Dear investor,

For the three months ended December 31, 2023, Bonsai Partners Fund, LP, appreciated 12.3% net of fees and expenses. The S&P 500 Total Return Index appreciated 11.7% during this period.

Bonsai Partners Historical Returns Summary

	2023	2022	2021	2020	2019	2018*	Since Inception*	Annualized *Since Inception*
Bonsai Gross Return	**22.7%**	**-26.5%**	**-13.9%**	**277.9%**	**60.3%**	**-17.6%**	**253.7%**	**29.8%**
Bonsai Net Return**	**21.5%**	**-27.3%**	**-14.8%**	**247.9%**	**56.1%**	**-17.7%**	**207.1%**	**26.3%**
S&P 500 Return	26.3%	-15.8%	25.1%	18.4%	31.5%	-8.6%	89.3%	13.1%

The performance data shown represents past performance. Past performance is not indicative of future results. 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 Bonsai Partners, LLC or Bonsai Partners Fund, LP will fluctuate so that an investment, when redeemed, may be worth more or less than its original cost.

The period October 22, 2018, to April 30, 2021, presents time-weighted returns of a representative Bonsai Partners managed account with the same strategy and risk profile as Bonsai Partners Fund, LP, which launched on May 1, 2021. Results from May 1, 2021, reflect the time-weighted returns of Class A shares of Bonsai Partners Fund, LP.

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. 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 individual mandates.

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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2023 In Review

On the surface, 2023 was an ordinary year. However, from my perspective, it was anything but. It pains me to say this, but 2023 was the first time our end-of-year portfolio looked even remotely close to our beginning-of-year portfolio. In 2023, our portfolio changed significantly less than in the past.

Throughout our initial years, a combination of uncovering new ideas, fixing past mistakes, managing unpredictable macro environments, and improving as investors resulted in multiple rounds of portfolio changes. As the quality of our investments increased, so did our opportunity cost, which in turn set the bar incrementally higher for each position added or replaced. Higher hurdle rates are helpful because they also sharpen our focus and slow the rate of change imposed on our portfolio.

I expect our portfolio will continue to change less than our first four years would suggest, and overall turnover will converge with our objective of long-term investing. That said, if the opportunity set changes dramatically or we recognize the need to change, you should expect us to act decisively to build the best portfolio we can.

After multiple years of change, it is gratifying to recognize that 2023 was a period of relative stability and gradual improvement. If you recall, one of Bonsai's core goals for 2023 was fixing our "leaky bucket" problem, whereby significant effort was spent running in place. We made substantial progress against this goal, and with less weighing us down now, we are free to invest significantly more in our systems, processes, and decisions.

Although 2023 was notable for less change, we remained busy. During the past year, we spent considerable time creating new tools and frameworks that magnify the impact of our work. For example, we built a more sophisticated watchlist system that actively monitors investment ideas we find interesting but cannot justify at prevailing prices. Rebuilding this tool was on our to-do list for some time, but we didn't have enough capacity due to our intense focus on redeploying capital into new ideas–the "leaky bucket" problem at work.

Our updated watchlist now uses market data feeds and JavaScript to track and automatically alert us if any of our ~100 watchlist companies meet internal return thresholds and merit a closer look. Previously, if we wanted to track our watchlist, we either had to remember to manually check ticker symbols of interest periodically and hope we caught them at the right time or build watchlists within outside systems (such as Bloomberg) and deal with the distraction of stock prices constantly flashing at us. Our simple system meets our needs better.

You would be surprised how distracting it is to monitor ~100 stocks. Instead, our tool does not require human intervention and frees up our time and mental capacity to do more valuable work. The more we can offload low-value or distracting tasks to a computer (such as watching stock prices), the more time we can spend learning and improving. Our watchlist is not designed to tell us when to mechanistically buy. Instead, it allows us to work on other tasks and alerts us when it might be time to revisit something we already like. We will continue to build out the watchlist in 2024.

We also created a portfolio monitoring tool using similar technology that alerts us if one of our positions experiences a material price change that might require our attention. Like our watchlist, this system reduces our need to constantly check our investments multiple times each day to "see if something happened." While these systems might sound insignificant, constant minor distractions like checking stock prices add up quickly because they break up windows of time reserved for intensely working on higher-value tasks.

Lastly, I share below a few additional projects we worked on in 2023 that should also be helpful:

1. **Goal / KPI Dashboard.** With the help of Airtable, we built a simple dashboard that links our daily and weekly tasks against our quarterly, annual, and longer-term objectives.

2. **Portfolio Management Frameworks**. In addition to our portfolio monitoring tool, we developed new underwriting frameworks, outlined additional exposure limits, and updated our thinking around the cadence of buying positions. These guardrails will help us make better decisions and keep us moving in the right direction.

3. **Decision Journal**. While implementation of this project is still a work in progress, we are now more rigorous about creating decision journal entries when we buy, sell, or pass on an idea.

> Journaling helps hold us accountable and amplifies fading feedback signals associated with long investing cycles.

To conclude, 2023 was a satisfactory year for our portfolio. I make this statement solely as an observation that most of our portfolio companies meaningfully improved during the year–much like we aspire to do. I remain optimistic about what lies ahead.

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Selling Elastic

Knowing when to sell is significantly harder than recognizing when to buy.

While I usually get stuck selling a position after it already took a turn for the worse, Elastic does not fall into this category. Instead, the company appears to be on a similar footing as when we initially invested. Instead, we are the ones who changed, and the position no longer serves our needs.

Before going further, please refer to our Q3 2023 letter, which outlines much of our thinking that underlies the decision to sell Elastic. This letter's discussion around "narrow and wide aperture ideas" highlights our concern regarding Elastic. Like many other software companies, Elastic's weakness lies in its inability to change despite operating in a rapidly changing industry. In other words, for an investment in Elastic to be successful, the future must look like today.

Although we understood this risk when we initially invested, I relied on pattern recognition that helped me rationalize the belief that Elastic would likely retain its current market position. For example, Elastic enjoys the same long-lived network effects as other leading open-source projects, and there are multiple historical precedents of enduring database software. However, now that I better understand the fragility associated with "narrow" path investments, the risk-reward for Elastic is no longer as attractive as I initially observed.

For example, the recent push into artificial intelligence (AI) is a stark reminder of how quickly the landscape for search technologies can change. Although Elastic presently stands to benefit from the shift to AI, it easily could have gone the other way. Will the next wave of search technology be more efficient than Elastic? It's hard to know, and I don't want to have to guess correctly for this investment to pan out.

As with our investment in Nagarro, some companies naturally adapt to whatever technologies win in the marketplace, while others, like Elastic, cannot. Elastic is less adaptable to whichever version of the future unfolds and, therefore, has a narrower pathway for the investment to work in our favor. Since our appetite for "narrow aperture" investments significantly declined, we removed Elastic from the portfolio.

The hardest thing to mentally process in this situation was moving forward with selling even though our original thesis remained intact and potentially looked stronger than when we first invested. However, given how our philosophy evolved, I knew I had to make this change regardless. I decided to opportunistically sell around one-third of our Elastic position early in the fourth quarter and sold the remainder when Elastic's shares appreciated after its quarterly results in early December.

Usually, when I realize I'm wrong, I pay a hefty price to fix the problem. However, in the case of Elastic, I was fortunate to encounter a positive outcome from an investment that no longer served us. Although I remain optimistic about Elastic's prospects, it is not the right fit for us anymore, and we are happy to deploy your capital elsewhere.

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Concluding Thoughts

As always, thank you for your partnership.

I will be attending the Berkshire Hathaway annual meeting in Omaha this year. If any of you expect to be there also, I would love to see you.

Please don't hesitate to contact me with questions or comments.

Fondly,

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