



April 14, 2021

To Our Clients & Friends:

We had a good first quarter of 2021 and a terrific first year in business, which is awkward to write given the ongoing health and social crises in the wider world but is nonetheless true. We launched our Giverny Capital Asset Management portfolio on April 1, 2020, very near the bottom of what turned out to be a severe but short-lived market contraction. In our first 12 months, we generated a return of 59.35%, net of fees,¹ vs. a 56.35% return for the S&P 500 Index.² For the first quarter of 2021, the GCAM model portfolio, which is a Poppe family account, generated an 8.68% return, net of fees, vs. a 6.17% return for the Index.

We don't expect to see another 59% return over a 12-month period any time soon. In fact, we would not be shocked if years passed before we earn the next 59%. We're not pessimists and we quite like our portfolio, but stock prices today incorporate a lot of optimism about corporate earnings growth over the next few years. We hope the optimists are right!

On a relative basis, a choppy or negative environment might be good for us. We own high quality businesses that generate better returns on capital and faster earnings growth than the S&P Index as a whole. Historically, market leaders outperform during challenging times. But on an absolute basis, we won't keep compounding like this. While our launch date creates strange comparisons, if we pull back to a longer view, the S&P Index rose over 30% in 2019, another 18% last year and 6% in the first quarter. That's a 64% return over nine quarters. Against that, the Wall Street consensus earnings forecast calls for 2021 Index component earnings to be roughly 10% higher in 2021 (\$175) than in 2018 (\$158.60).

The chasm between sluggish earnings growth hindered by Covid-19 and ebullient stock returns fueled by optimism about recovery (and perhaps also by the enormous amount of federal relief pumped into the economy), leads some wags to warn of a bubble for asset prices. When I look at the billions of dollars being poured into speculative investments, from low-quality stocks to alternative currencies to blind pools, I'm reminded of the old Steve Martin routine about coming into sudden riches. "I love money!"

¹ The family account does not pay a management fee. The returns presented herein assume the deduction of an annual management fee of 1% to show what a client account's performance would have been if it had been invested the same as the family account during the period. Past performance is not necessarily indicative of future results.

² The S&P 500 Index returns include the reinvestment of dividends and other earnings. The Index is an unmanaged, capitalization-weighted index of the common stocks of 500 major US corporations. The Index does not incur expenses and is not available for investment.

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cried the comic, boasting that he spent his windfall on an electric dog polisher, a gasoline powered turtleneck sweater and a fur sink. “Of course, I bought some dumb stuff, too.”

When bubbles pop, everyone tends to get splattered. I can confidently predict the current mania for the investing equivalent of fur sinks will not end well for the buyers, and probably not for the markets, either. But I also believe our GCAM portfolio should generate positive returns in coming years as our companies’ earnings grow. Tolerating short-term volatility is how we get to enjoy long-term gains.

Similarly, we caution clients not to put too much emphasis on a single quarter, or even a single year. We underperformed the Index during our first two quarters as technology stocks led the market, and outperformed over the next two, as higher interest rates helped our financial stocks. Comparing us to the benchmark on a quarterly basis can feel a bit like a coin flip. A year is more meaningful, but only by a little. We’re satisfied that we outperformed a high-flying market in our first four quarters, but the margin is modest and the time frame is short. We remain focused on the long-term.

In our initial letter announcing the launch of GCAM a year ago, we laid out our basic investment philosophy. “Businesses with extreme competitive advantages will find ways to outperform their peers, maybe now more than ever,” I wrote as lockdowns were just beginning. “I believe a long-term bias to disruptive and profitable businesses with engaged ownership and the ability to reinvest capital should yield satisfactory performance over time.”

No kidding, you might say, but we repeat ourselves because few people seem to follow this philosophy. CNBC reported recently that stock trading volumes in US markets were up 92% in January compared to the prior year, with 14.7 billion shares per day changing hands. This compares to 7 billion shares changing hands daily as recently as 2019. The firm Statista reports that the total dollar volume of equity trading globally rose from \$89 trillion in 2019 to \$137 trillion last year. The total value of all global equity markets is about \$100 trillion, suggesting the average holding period for stocks is down to about nine months.

The truth is, people trade a lot because trading a lot is fun, at least when the market is rising. I play tennis at a club that occasionally arranges matches for me. Not long ago, I was playing a highly educated fellow who asked what I did for a living. I told him. We chatted for a minute before he blurted out, “I never understood the point of paying someone not to trade for me.”

The reason to pay someone not to trade for you is because you’re paying them to do something else entirely, which is to curate. I am as guilty as the next person of overusing sports analogies, but from my vantage point, investing is a bit like pro sports: for all the commentary on tactics and human drama, most games are won by the team with better players. The portfolio manager’s job is to identify the best players, acquire them on reasonable terms, and retain them while they’re in their prime.

Most great American fortunes were earned via ownership of a single wonderful business for many years. Getting wealthy is much harder if you’re regularly trading your best businesses, thanks in part to the tax consequences but more so because the more decisions the manager makes the less conviction he probably has in each succeeding one. A portfolio manager should spend most of his time trying to find the next great company while also making companies on the current roster are still robust. Once done, get up the next day and do it again.

As a client, you don't have the familiarity with the portfolio that I do. So how can you tell that our roster is truly filled with superior players, other than taking my word for it?

Answer: it's not easy, but there are some pretty good clues. We are bottoms up stock pickers, looking for individual businesses that we would own in their entirety if we had enough money to buy them. There is some subjectivity in our assessment of what "great" looks like. But once the roster is assembled, simple analytics tell us a lot.

FactSet Research says the S&P 500 Index overall earned a return on equity last year of just over 13%. While 2020 was an unusually bad year for earnings, the five-year average return on equity for the Index was 15%. These are very respectable numbers and speak to the capital efficiency of corporate America. Most people would be happy to invest \$100 in widget shop and receive \$13 in returns – in a bad year.

FactSet reports the S&P Index grew its earnings per share by a bit less than 7% annually from 2014 through 2019. This is not a great compound given much of the growth came from the big corporate tax cut in 2017. Looking ahead, for the four-year period 2019 through 2023, Wall Street analyst consensus calls for 8% earnings growth for the Index, from \$160 to \$220.

The S&P 500 Index at the end of 2020 traded for 23x the consensus estimate of 2021 earnings.

By comparison, our GCAM portfolio generated a weighted average return on equity of 22% in 2020, per FactSet. Again, if you deployed \$100 into our conglomerate, the underlying businesses generated \$22 of profit. A subtle factor that makes this gap in returns more meaningful (at least to me) is the S&P 500 Index in aggregate employs more debt as a percentage of capital than GCAM. We earn a higher return on equity despite being more conservatively financed.

A less subtle factor is that our portfolio companies grow their earnings faster than the Index. This portfolio did not exist prior to 2020, though I owned many of the stocks personally. It would be pretty easy to build a portfolio with the benefit of hindsight that showed rapid earnings growth. In fact, this one did. But if you look forward, Wall Street analyst consensus is that our portfolio should grow earnings per share by 12% over the haul from 2019 through 2023, on a weighted average basis.

Our portfolio is a bit more expensive than the S&P, trading for 25x expected 2021 earnings.

Past performance does not predict future results. Strange things happen in markets and yesterday's winners may not be tomorrow's. But we think the math of much higher returns on equity, lower levels of debt, and stronger earnings growth at a slightly higher price than the Index should work out well.

There is a qualitative aspect, too. We believe in our companies, but so does every manager. What may be different about us is that 15 of our 26 holdings on March 31 have a founder involved as chairman or CEO. And a 16th, Alphabet, has founders Larry Page and Sergey Brin on the board of directors and with extra voting rights. I like the idea of partnering with owners who are tending to their life's work. People like Mark Leonard at Constellation Software, Jeff Sprecher at Intercontinental Exchange or Laurans Mendelson at Heico, not to mention Jeff Bezos, John Malone and Chuck Schwab, have built extraordinary companies. We love being in business with them.

Among the other 10 companies we own, most have unique cultures and business models. Markel Corp. is a 90-year old company, but a Markel family member still serves as chairman of the board. Progressive

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and Carmax have unusually good corporate cultures. Overall, we think the math says a lot about the quality of our portfolio. But it is the people in charge of our businesses who give us confidence that the math is sustainable.

While I think of myself as a value investor, our Morningstar reporting system labels GCAM as an aggressive growth portfolio. Every good investor is a value investor, because we are all trying to pay less for assets than they are truly worth. But clients should understand that GCAM owns growing businesses, few of which are cheap.

However, we are not speculators. Our portfolio tends toward proven business models. For better or worse, we didn't own any of the fast-growing, unprofitable tech stocks that led the market last year. The chart below shows our top five performing stocks for the year ended March 31, 2021.

Average portfolio <u>Weight</u>	Return for year <u>ended 3/31/2021</u>	<u>Security</u>
4.05%	170.67%	Five Below
7.47%	152.33%	CarMax
2.05%	105.62%	First Republic Bank
3.29%	100.94%	Eurofins Scientific
4.38%	96.07%	Charles Schwab

Our five best performing stocks in our first year represent a diverse group of companies: an extreme value store, a no-haggle used-car retailer, a bank catering to the affluent, a French laboratory testing company and the leading discount broker.

While these five led the way in performance, our leading contributors in year one were slightly different. Measuring the total contribution to the portfolio multiplies security performance by its average weight in the portfolio. The manager's allocation decisions will have a big influence on the top contributors.

Average portfolio <u>weight</u>	Return for year <u>ended 3/31/2021</u>	<u>Security</u>	<u>Contribution Impact</u>
7.47%	152.33%	CarMax	8.35%
8.11%	77.32%	Alphabet A&C	5.88%
4.05%	170.67%	Five Below	4.74%
4.85%	79.84%	Heico Corp. Class A	3.65%
4.38%	96.07%	Charles Schwab	3.59%

Again, our top contributors represent a diverse group of businesses. Our two largest positions at inception, Alphabet and Carmax, were our two leading contributors for the year. Compare this to the top five contributors to the S&P 500 for the year ended March 31, 2021:³

³ For these charts, we used FactSet software to calculate the attributions and the SPDR S&P 500 ETF to approximate the performance of the S&P 500 Index.

Average portfolio weight	Return for year ended 3/31/2021	<u>Security</u>	<u>Contribution Impact</u>
6.15%	93.63%	Apple Inc	4.92%
5.60%	51.02%	Microsoft	3.00%
4.43%	56.70%	Amazon.com	2.62%
3.39%	77.90%	Alphabet A&C	2.36%
2.13%	72.66%	Facebook Class A	1.45%

These are outstanding companies but they don't represent a diverse array of industries.⁴ GCAM's results came from a far more eclectic group of companies.

We're pretty happy with the current portfolio and so were not very active during the quarter. Our only consequential decision in the first quarter was to exit the off-price retailer The TJX Companies in January. My prior firm owned TJX for most of the past 20 years and enjoyed appreciation on the order of 20 times the original purchase price.

TJX is a great company, but the growth rate has slowed in recent years and the operating margin has been under pressure, mainly from rising wages for store workers. When the pandemic hit, I bought the stock for GCAM in the belief that if the US fell into a prolonged recession, TJX would be a winner because of its extreme value position.

The US didn't fall into a prolonged recession. Rather, many consumers are flush with cash thanks to government relief programs. But brick-and-mortar stores are losing out to online competitors for reasons of safety and convenience. TJX has fared much better than most of its competitors during this time and should continue to do so, thanks to its model of buying inventory close to need and reacting to what is happening in the marketplace rather than trying to create hot product. But the stock rose about 50% in the few months we owned it and that increase seemed to price in a complete recovery and more. We sold in early January.

We did a very minor amount of portfolio sculpting during the quarter. We sold fractional amounts of Carmax as it rose above an 8% portfolio weight, and we sold a sliver of Five Below in the model as it reached 5% after a meteoric rise. We rotated those funds into existing holdings Progressive, Credit Acceptance Corp. and Facebook, which struck us as better bargains than the stocks we sold. Trading around positions in a portfolio generally doesn't add value, but in the first quarter the three we bought outperformed the three we sold.

As far as the additions go, at \$87 we should have filled up a wheelbarrow with Progressive shares rather than just adding a scoop with our garden trowel. PGR is a large position for us, 5.5% at the end of the

⁴ The returns for Alphabet stock shown in both charts are for the C shares. The average weighting shown for both GCAM and the Index are for A&C shares. The A&C shares did not earn an identical return in 2020. GCAM's performance result for Alphabet C shares held in our model differed from the Index's return from C shares because we had transactions in the stock during the year, effecting our time-weighted return calculation.

quarter. Progressive underperformed the overall GCAM portfolio in our first year, but this is partly because it did not suffer the plunge in February and March 2020 that many other stocks did.

I laid out our basic thesis on Progressive in our initial letter a year ago, but it's worth repeating: the risk profile of every US driver is a bit different, and Progressive has done more than any other company to use telematics to learn more about how we drive. Most insurers correlate your driving risk to your profession, the value of your home, the number of speeding tickets you've accumulated, or maybe your credit score. Many factors have some correlation to your driving tendencies, but none is better than the way you actually drive. Progressive has been using telematics longer than any insurer, so it has years of data on driving patterns that it uses to set rates appropriately.

Progressive today has the highest underwriting margins and the fastest revenue growth rate of any large auto insurer. Because it underwrites risk so well, it needs to hold less capital in reserve to pay potential claims. So it grows faster while consuming less capital than peers. Shareholders benefit from this capital efficiency when Progressive pays periodic special dividends of capital it does not need to backstop potential claims. The stock trades for a significant discount to the S&P 500 PE multiple despite being the technological leader in its industry.

Credit Acceptance and Facebook are both under regulatory pressure. We added to each position in the belief that the regulatory and legal issues they face are challenging but resolvable, while their stock prices reflect excess pessimism about their futures.

Another addition to the portfolio was a small dollop of Topicus shares that were distributed to us by our holding Constellation Software. This is a tiny position that we view as part of Constellation, which remains the controlling shareholder. Constellation distributed these shares as a way to create a vehicle for the European-based management of Topicus to be measured and rewarded solely by the performance of the business they control, rather than by the performance of the much larger parent. We like this arrangement and believe there is plenty of opportunity to buy niche software businesses in Europe, meaning Topicus should be a good grower. However, Topicus is not a very liquid security, and the price has soared in the first weeks of trading. We've opted to keep what we have but are not adding more. We encourage you to think of the combination of Topicus and Constellation as one holding amounting to roughly 5.5% of the portfolio.

In his annual client letter, my business partner Francois Rochon lists his three biggest mistakes of the past year. It's a good exercise in humility and, in a spirit of partnership, I thought I would finish this update on our first year in business with a recounting of my most consequential mistake.

I could recount a few errors of omission. Stock prices bottomed out at a very low level last March, and while I'll pat myself on the back for initiating positions in Five Below and Heico, among others, last March at what turned out to be wonderful prices, I passed on a few ideas that performed similarly well. Paraphrasing Warren Buffett, investors can let an unlimited number of fat pitches go by, so long as we hit the ones we swing at.

The result of letting too many pitches go by last year, however, was an error of commission that hurt performance. GCAM carried too much cash all year. This is a hard one to explain away because I've done it before, vowed to stop doing it and ... kept on doing it. I recognize it is a tic in my own investing

personality. I like flexibility. I don't like the idea of forced selling; that is, having to sell a good security to buy one that I think will perform better.

Ultimately, however, holding cash is a market timing decision. It is a bet that prices will fall sometime soon and provide us with more attractive entry points. Yet timing the market seldom works.

We returned 59% in our first year despite holding an average cash weighting of about 6%. Had we invested all the cash pro rata in our existing portfolio, we'd have generated more than three percentage points of additional outperformance.

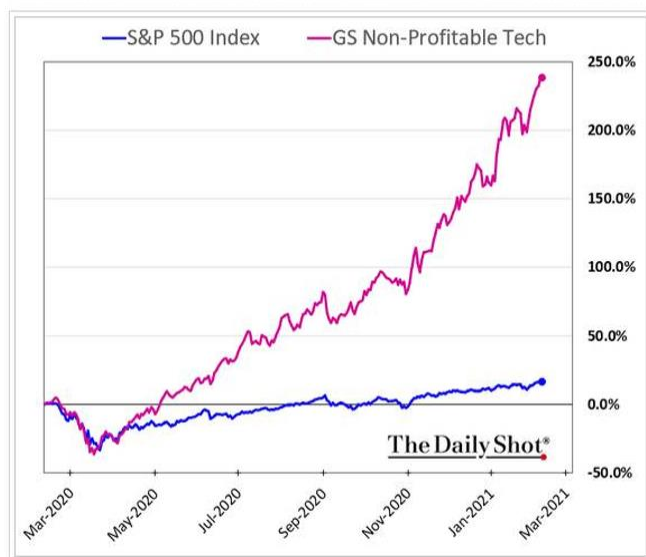
You might ask: Has David learned his lesson? It is no secret that stocks outperform other asset classes over time, right? Well, Suzanne Vega has a wonderful line in her song "Cracking:" "It's a one-time thing. It just happens a lot." After getting down to 3% cash at year end, we exited March with a 5% cash weighting after selling TJX and not making any significant purchases. In normal times, the impact of a 5% cash weighting hardly matters. In today's market, it leaves a bruise.

My wife is a former journalist and terrific editor. She is the first reader of these quarterly missives and catches most of my errors, which is like finding most of the pinecones the Adirondacks. After marking up one recent effort, she wrote in the margin: "you're not much of a marketer."

So before signing off, let me close with the sales pitch. We generated excellent performance in our first year in business while being substantially underweight the so-called FAANG+M (Facebook, Amazon, Apple, Netflix, Alphabet/Google and Microsoft), and without owning any unprofitable, hyper-growth tech stocks.

We outperformed while taking less risk, in the obvious form of holding some cash but also by owning a portfolio that employs less leverage than the Index, grows faster and generates higher returns on equity. And while the Index's 56% return is nothing to sneeze at, we'd remind you that the S&P Index did benefit from the performance of speculative stocks. Here is a visual reminder of what has led the market over the past year, courtesy of Goldman Sachs.

Goldman's non-profitable tech index is approaching 250% year-over-year performance



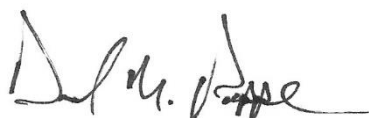
You read the slide correctly: as of a few weeks ago a basket made up only of unprofitable US tech stocks was up more than 200% over the past year.

Some members of the non-profitable tech index will morph into the leaders of tomorrow. Most won't. Our companies, on the other hand, are well managed, conservative about risk and grow faster in aggregate than the components of their benchmark. Valuations today are demanding, but we feel good about our conglomerate's future.

Looking at our own structure, my family remains the largest client of GCAM. I am 100% focused on compounding capital, mine and yours. To increase that likelihood, we are affiliated with a successful firm, Giverny Capital Inc., that supplies us with excellent research resources and back-office support, a similar attitude toward investing and a spirit of partnership.

It's been an invigorating first year. I am delighted with our growing roster of like-minded clients and am deeply grateful to all who have placed their trust in me, our operations head Al Munro, Jr., and our Giverny colleagues.

Sincerely,



David M. Poppe

Giverny Capital Asset Management portfolio

March 31, 2021

Top 10 holdings

Alphabet A&C	8.6%
Carmax	8.2%
Progressive Corp.	5.5%
Charles Schwab	5.3%
Constellation Software	5.1%
SS&C	4.8%
Heico Class A	4.6%
Five Below	4.6%
Facebook	4.5%
<u>Arista Networks</u>	<u>4.3%</u>
Total	55.5%

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