JANUARY 3, 2023

## TAPASYA INVESTMENT FUND I

# ANNUAL PARTNER LETTER 2022

# INTRODUCTION

Let me start with wishing you and your families a very happy new year. My attempt through this document is to communicate the performance of the fund, portfolio construct and sizing, provide some context across events through the year that impacted my investment decisions and also comment on what we could expect in the coming year(s).

One of the other goals I have through these letters is to provide enough information to you as partners, in the same manner as I would have liked it had our roles been reversed.

You can expect to have an annual letter and an interim letter each year. This is our inaugural annual letter. I will continue to share the "Global Investment Review" letters throughout the year.

As always, please reach out if you have any questions.

# PERFORMANCE

Tapasya Investment Fund I gross results for the year 2022 since inception is shown below alongside the S&P 500 Index performance.

| Date/Timeframe | Fund Returns | LP Returns | S&P 500 |
|---|---|---|---|
| **2022 - Since Inception** | **-6.8%** | **-6.8%** | **-11.0'%** |

The fund started mid-august; though we have a lead over the S&P, in the context of the timeframe these results are not that meaningful given we are just about 4+ months in the making. It is perhaps a reasonable start compared to the alternatives presented by the main indices. At the end, the focus is on the absolute returns.

The individual results for each investor will be sent separately. They could differ from what has been stated here due to the time of entry into the fund.

Some insights into our performance can be gleaned through the early Buffett Partnership letters, in 1960 this is what he wrote

*"I have pointed out that any superior record which we might accomplish should not be expected to be evidenced by a relatively constant advantage in performance compared to the Average. Rather it is likely that if such an advantage is achieved, it will be through better-than-average performance in stable or declining markets and average, or perhaps even poorer-than-average performance in rising markets"*

It's quite axiomatic that results for value investors during boom periods will be poorer than average and the results after boom, better than average. TIFI's performance since inception is in line with this phenomenon. You should therefore expect us to do well now that the bubble has burst.

# 2022 - A LOOK BACK

Now more about what occurred through this year since the launch. As luck would have it, I timed the “peak” of the bear market rally perfectly. Hence if there is any mis-conception on my ability to time the market, it's best to correct that now.

Though we have beaten the S&P through this short timeframe, there were times when we lagged behind as well. In my view anything less than 3 years is too short a term to take credit or otherwise of beating the market.

Few have seen markets like 2022 in our *own* investing journeys. Such drawdowns have occurred in the Dotcom bubble and the Great Recession of 2008. At that time, at-least in my case, I did not have much capital and was certainly not managing other people’s money. Hence 2022, as exciting as it may have been due to the fund launch , etc., also delivered more than it’s fair share of pain and angst.

This year the S&P was down 19%. This probably masks some of the pain individual investors and institutions faced. Individual stocks especially in Tech, have fallen over 50%, masked by the outperformance of Energy and the relative outperformance of Healthcare and Utilities.

The euphoria of 2021 with the market peaking in November 2021, died very soon starting with the invasion of Ukraine. To add to this, high inflation, significant tightening of money supply and raising of interest rates unparalleled in our recent history. To top this off, we had China continuing there Covid lockdowns causing supply chain scares as well as challenges for domestic companies here, as some of them have a sizable portion of their revenues from China.

With this backdrop, and my bottoms up investment style, I had the task of investing capital. I don’t pay too much attention to macro-conditions to base my investment decisions. Not to say, it's not important, it is. The outcomes are very hard to predict if at all possible. Coupled with those predictions is the required conviction to make an investment decision. Your fund manager for one certainly does not possess these skills nor do I know of anyone who does.

Years like we have had, come few and far in between. In my view if we can stomach short term volatility and paper-losses, this actually is a great time to deploy capital. Ideally one should take advantage of it. Bear markets make one rich, we just don't know at the time.

In my view, by investing in this fund and hopefully on your own as well, each of you have taken advantage of the situation presented to us i.e. deploying capital. The question then being how strong is the portfolio and should we expect to continue to extend our lead over the indices (in plural as I would make comparisons to other broad based indices as well).

I feel very good about the strength of our portfolio. There are 11 sectors in the S&P, the only sector that was up this year was Energy (58%). Despite not investing in energy stocks we were not only able to beat the index but were also positive for quite some time till there was a significant drawdown in December.

| ETF | Description | 1 Year |
|---|---|---|
| SPY | SPDR S&P 500 ETF | -19.48% |
| XLB | Materials Select Sector SPDR ETF | -14.26% |
| XLC | Communication Services Select Sector SPDR ETF | -38.22% |
| XLE | Energy Select Sector SPDR ETF | 57.60% |
| XLF | Financial Select Sector SPDR ETF | -12.41% |
| XLI | Industrial Select Sector SPDR ETF | -7.23% |
| XLK | Technology Select Sector SPDR ETF | -28.42% |
| XLP | Consumer Staples Select Sector SPDR ETF | -3.31% |
| XLRE | Real Estate Select Sector SPDR ETF | -28.72% |
| XLU | Utilities Select Sector SPDR ETF | -1.50% |
| XLV | Healthcare Select Sector SPDR ETF | -3.57% |
| XLY | Consumer Discretionary Select Sector SPDR ETF | -36.82% |

# VALUE OF PATIENCE

The key here is patience, we all want to get rich but most mistakes tend to be made when we want to get rich *quickly*. Let me explain the joys of compounding and how a small lead over the index can significantly alter the outcome. Again just as a reminder, beating the index is a goal and not a promise. I don't like wearing an orange suit!!

As you would see from the table below, a lead of 5% over the S&P over a 20 year period makes a very large difference. $100K invested, assuming a 10% return from S&P would be $672K in 20 years vs. $1.6M at a 15% return. Though a 5% lead does not seem much at the beginning, the power of compounding leads to very significant gains over time as shown.

My personal goal is to have a 10 point difference to the S&P 500, we will see how close I can get to it.

| | **Assumed S&P Returns @10%** | **15%** | **18%** | **20%** |
|---|---|---|---|---|
| **10 years** | $259,374 | $404,555 | $523,383 | $619,173 |
| **15 years** | $417,724 | $813,706 | $1,197,374 | $1,540,702 |
| **20 years** | $672,749 | $1,636,653 | $2,739,303 | $3,833,759 |
| **30 years** | $1,744,940 | $6,621,177 | $14,337,063 | $23,737,631 |

# PORTFOLIO CONSTRUCT AND SIZING

Let me explain how I think about the portfolio and dissect the performance a little. I will also use the soccer analogy as we had the soccer world cup going on and I think it will convey why I think we have a strong portfolio.

In soccer if we talk about key positions — we have **Defense** (goalkeeper + others), **Midfield and Offense**. For us, the current composition of the portfolio is as shown below

- DEFENSE: ~10% of total

- MID-FIELD: ~75% of total

- OFFENSE: ~15% of total (inclusive of cash)

**Defense** plays a role in protecting on the downside when there are large drawdowns. In other words I expect them to outperform the S&P during drawdowns and at par (or potentially underperform) during bull markets.

**Mid-Field** will be our largest position collectively. The goal here, no pun intended, is to identify steady compounders that can deliver long term growth. The typical sizing here is based on the probability of upside coupled with likelihood of downside. The larger the expected upside and lower the potential downside, the larger the investment made. From time to time It's possible that one of the mid-field companies turns offensive.

**Offense** are companies that I expect asymmetric returns, while having higher risk for downside. Cash is also part of this, used as dry powder. This is because at times the market could throw some opportunities to make a quick-buck; this could be arbitrage opportunities, M&A , etc. This is why some cash is required to take advantage of the same.

The allocation here is as it exists today and on a cost basis. As you would know, I prefer to run a concentrated portfolio. I love picking stocks and that's my expertise, hence do not expect me to be a closet indexer (basically diversified above 50+ stocks and getting returns close to the index). I think the partners here, and investors outside are better off investing directly into an Index ETF rather than investing with closet indexers and avoiding paying exorbitant fees.

In terms of performance, Defense did exactly what they were supposed to do. We have 2 stocks here and both of them outperformed the S&P and have collectively delivered positive returns to us for the year. Given Mid-Fielders are long term compounders, it's a little unfair to look at them in such a short duration; they did deliver in line with the S&P. Our offense did not fire up as yet, I would expect them to do well as we move into a bull market.

I will refrain from going into individual companies where investments have been made since they are covered in the "Global Investment Review" letters. The other reason is these letters will be published on my website for all to see. In our annual meeting we will certainly go through each of the companies invested in and answer any questions you may have.

One of the other aspects of the portfolio that has helped and I believe will continue to provide alpha (basically beat the market) is our Geo-diversification. We have about 56% of our portfolio in the US (inclusive of cash), with the rest divided between China and Europe. Across these 3 regions European and Chinese stocks have out-performed, with a combination of individual stock performance and some currency tailwinds (forex trades).

**REGION ALLOCATION**

| | Weight |
|---|---|
| Asia | 16.28% |
| Europe | 27.83% |
| North America | 55.89% |
| **Total** | **100.00%** |

**SECTOR ALLOCATION**

| | Weight |
|---|---|
| Broad | 3.09% |
| Consumer Cyclicals | 22.97% |
| Consumer Non-Cyclicals | 5.63% |
| Technology | 46.08% |
| Telecommunications Services | 20.40% |
| Cash | 1.82% |
| **Total** | **100.00%** |

# A LOOK FORWARD - 2023 AND BEYOND

Let me start with saying with confidence that I do not have the faintest of ideas. My ability to look at the crystal ball, predicting the *near* future and being right is as likely to be true as me beating Tiger Woods in a game of golf. With this preamble let me add my thoughts below - I guess with that preamble I may have killed your motivation to read any further.

Our advantage is going to lie in the fund manager's analytical ability and making few but key investment decisions along with the long term view of our partners (you).

Though there are a lot of uncertainties in 2023 which include interest rates environment, geo-political/war situation, energy crisis especially in Europe and China re-opening; what gives me confidence is the world has seen worse in the past and has always figured out a way over time to address the issues at hand.

My #1, #2 and #3 priority for 2023 is to continue to deliver market-beating performance, and I don't believe this prioritization would ever change. To achieve this I will be on the lookout for great value opportunities that have the ability to deliver long term gains.

At the same time, what you would also notice is that I continually evaluate the portfolio and should a particular thesis for investment change considerably, I would revisit the stock and potentially sell.

At any time, I do not expect the stock portfolio to have more than 15 stocks. At the same time I do think there would be some short term debt and credit spread opportunities to show up in 2023 which if they do I would like to take advantage of.

I was asked about the reason for not investing in India. It's driven from the fact that it is more complex in transacting in India as a hedge fund based in the US vs. other countries. That said, I am looking into this and as and when I am able to enable it, we could potentially make some investments if they meet our standards. I have a watchlist of companies that I have been tracking for years waiting for the right price, this also includes Indian companies.

Let me repeat the **DESTINATION** section of the Welcome letter that I had sent out in Sept. It's just a reminder of my vision for this fund and the journey we are on.

## THE DESTINATION

The goal of the fund is to beat the S&P index over the long term. But that's not necessarily the destination. The destination for me is to turn every $1 invested in the fund to $16 in about 20 years. That said, assuming I can turn $1 to $16 the question that arises is whether it matters reaching the destination in 18 or 22 years? There is a difference in the annual compound rate of about 3% per annum (don't want to make light of that!), but securing the destination is also very important. Traveling comfortably dominates most people's thinking when they should be thinking about the destination.

The reason I am stating this here, the ride or journey could be bumpy especially with the fact that the portfolio would be concentrated on our best ideas. What good habits and techniques ensure, is that the destination is secure, even if the ride is bumpy and that the $16 will be realized.

## PARTNER COMMUNICATION

This was our first annual letter. You can expect an interim and an annual letter about every 6 months (July and Jan). You would also get the Global Investment Review about 6 times a year.

NAV Consulting is our fund administrator. One of the questions that I had for the partners was on Reporting. NAV consulting provides reporting by month for each investor to me. They could also send that directly to the investor. At this time I have not enabled the same. I plan to report on a quarterly basis. I have enabled access to each of the investors via the NAV portal. You should receive your login credentials soon.

Given the orientation of the fund is genuinely long term, reporting more regularly like daily, weekly and in my view even monthly feels counterproductive to me.

I don't believe it's very beneficial especially with the long term view we have.

**I am looking at increasing the Assets Under Management (AUM); I would appreciate it if you have any referrals that would consider investing in this partnership.**

**OPERATIONS & INCENTIVE STRUCTURE**

Our unique fee structure is based on the original Buffett partnership, placing incentives on performance to align interests. This is why my family is the largest partner in the fund and your capital is invested alongside our own.

- Zero Management Fee
- Annual Hurdle Rate of 6%
- Performance incentive of 25% earned only on profIt's after the hurdle rate
- High Water-mark (incentive provision only after reaching new all-time highs)

**FUTURE COMMITMENTS**

Our minimum commitment is $50K and as little as $10K can be added to existing accounts.

- Accepting capital from new and existing partners monthly
- Subscription document and capital required prior to close date

# APPENDIX & APPRECIATION

In this section I will describe some of the sources I used to assist me with the letter here. I claim no originality. But firstly I would like to Thank Arun Singh who has assisted me in creating my website and also helped review the document here. Also, I want to thank

Rishabh Pincha who is pursuing his MBA in Finance at Babson. He has helped with me with several analysis.

**Sources of information:**

1) Nomad Investment Partners Investment Letters

- As you may already know I am highly influenced by the investing style and achievements of Nick Sleep and Qais Zakaria. The letters they wrote to their partners are in the link below. I have read it a few times now and would encourage you to read it if time permIt's.

- Link: Nomad Investment Partners - Letters

2) Buffett Partnership Letters

3) Other Investors

- Investors like Mohnish Pabrai, Matt Peterson, Guy Spiers and Howard Marks. I am sure there are portions of this document that they have said or mentioned in their communication in the past

**Thank you for your confidence, value your support and welcome any questions.**

Yours sincerely,

Pratik Kodial

1/3/2023