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Given my generally long-term focus when evaluating businesses and preference for investments that can compound earnings over time, I view the high level of turnover in the top five positions of the Fund to be uncharacteristic and unlikely to occur consistently. There are two reasons I prefer long-term compounders over short-term re-raters.

The first is that I view investing in long-term compounders as less risky than short term re-raters. Following the same business for a long time allows me to get more familiar with an asset than I could in situations with a shorter investment horizon. The benefit of following the same company for multi-year periods, having a history with a management team and analyzing the operating performance of a business in real time as it happens cannot be overstated.

On top of that, compounders tend to predictably grow their value at a steady pace, which leaves the Fund with a larger margin of safety with respect to the multiple I use in valuing the business.

To elaborate further, when looking one year out, investor perceptions of the near-term earnings power of a business don't tend to vary significantly, but opinions about the multiple that the business deserves do. However, when looking further out, the differences in estimates and valuation multiples become more pronounced as market participants' varying assumptions compound.

Because of this, the shorter one's time horizon, the more likely it is that they are betting on the multiple of earnings that a company deserves, and the less they are betting on the earnings themselves.

Est EPS growth	Year							
	0	1	2	3	4	5	10	
	EPS							
0%	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00
5%	\$ 1.00	\$ 1.05	\$ 1.10	\$ 1.16	\$ 1.22	\$ 1.28	\$ 1.63	\$ 1.63
10%	\$ 1.00	\$ 1.10	\$ 1.21	\$ 1.33	\$ 1.46	\$ 1.61	\$ 2.59	\$ 2.59
15%	\$ 1.00	\$ 1.15	\$ 1.32	\$ 1.52	\$ 1.75	\$ 2.01	\$ 4.05	\$ 4.05
20%	\$ 1.00	\$ 1.20	\$ 1.44	\$ 1.73	\$ 2.07	\$ 2.49	\$ 6.19	\$ 6.19
	Forward P/E (assuming buying at 20x to start)							
0%	20.0x	20.0x	20.0x	20.0x	20.0x	20.0x	20.0x	20.0x
5%	20.0x	19.0x	18.1x	17.3x	16.5x	15.7x	12.3x	12.3x
10%	20.0x	18.2x	16.5x	15.0x	13.7x	12.4x	7.7x	7.7x
15%	20.0x	17.4x	15.1x	13.2x	11.4x	9.9x	4.9x	4.9x
20%	20.0x	16.7x	13.9x	11.6x	9.6x	8.0x	3.2x	3.2x

Using the illustrative table above as an example, if the Fund pays 20x earnings for a 20% long-term compounder in year 0, the corresponding margin of safety on my assumed exit multiple in year 10 is materially higher; we will likely be satisfied with the outcome whether the business is valued at 10x, 15x or 20x earnings given the 3.2x effective forward purchase multiple on our investment. The same can't be said for a business with little to no growth.

As such, having confidence in the long-term earnings trajectory of a business is one of the strongest forms of edge an investor can have in the marketplace, and one of the hardest types of alpha for others to arbitrage away. Basically, if I am right about a compounder, which I define as a business that can sustainably grow its earnings at above average rates over long stretches of time, then the Fund is most likely buying the business at a very low multiple of future earnings.

The second and more obvious reason that I prefer long-term compounders over short-term re-raters is that long-term compounders are significantly more tax efficient than short term re-raters. Not only is the tax rate on long-term gains lower than on short-term gains, but the longer we hold a compounder, the longer we defer paying any tax at all and the more we can let our investment compound tax-free. As stated previously in this letter, a majority of my net worth is invested in the Fund. As your partner, my goal is to maximize our collective after-tax returns.

However, I want to make it clear that I will not hold onto a position that I no longer find attractive simply for tax deferral. It should also be clear that although I prefer compounders, I will continue to pursue special situations when I have a strong conviction and when the risk/reward appears favorable.

