GREENHAVEN ROAD
PARTNERS FUND

February 2023

Dear Fellow Investors,

The Partners Fund returned approximately +4% in the fourth quarter and -36% for the full year.[1] 2022 was a year in which many investors with terrific long-term track records significantly underperformed the overall market. Quite a few managers had drawdowns in excess of -40%, including four of the managers in our Partners Fund. This raises several questions, including how this happened, why this happened, and what the implications are going forward. Can a manager be both talented and have a severe drawdown?

There can be many drivers of outperformance and underperformance. Drawing large conclusions from a 12-month period is difficult at best, but I believe there are three causes/drivers worth mentioning. The first is concentration. Just as it would not be surprising to see a single company diverge from a market average, divergence (both positive and negative) is to be expected from managers that own just a handful of companies. The second driver is exposures (industry, geography, thematic, etc.) provided by the underlying investment holdings. In 2022, Oil and Gas was effectively the only industry that saw share price appreciation and managers without exposure to this type of company faced a stiff headwind. In addition, smaller companies and longer duration assets where profitability is further out fared particularly poorly in the rising rate environment. The third factor would be company-level performance, which can weigh heavily on a portfolio based on a combination of poor operating results and/or multiple compression. Many companies that experienced greater multiple expansion in 2021 saw greater contraction in 2022.

Value manager William Smead has a 70-20-10 rule. Now, I have not seen supportive empirical data, but, in a period like 2022 where macro sentiment trumped micro company fundamentals, his framework feels relevant. The rule posits that in any 12-month period, 70% of returns are determined by the market, 20% by the industry, and 10% by company-specific performance. However, over a 10-year period, the numbers flip: 70% of returns are driven by individual companies (stock picking), 20% by the industry, and just 10% by the overall market. The Partners Fund invests in managers who I have come to respect as astute investors. In 2022, macro dominated micro but that will not be the case forever.

The other framework that I have cited in previous letters is from Joel Greenblatt's Barron's study.

> "The statistics for the top-quartile managers for that decade were stunning: 97% of them spent at least three of those 10 years in the bottom half of performance, 79% spent at least three years in the bottom quartile, and 47% spent at least three years in the bottom decile." (link)

In effect, a year of bottom decile returns does not relegate a manager to the waste bin. Zigging when others zag and investing with conviction does not work all of the time, even for managers that are successful over a decade or longer. Stock picking is not dead, but in 2022, when everybody was talking about the Fed's dot plots and if rates

[1] Performance: (i) is representative of a "Day 1" investor in the Partnership, (ii) represents returns earned by Class B investors assuming a 0.75% annual management fee and no incentive allocation, and (iii) is stated net of expenses, including commissions, legal, audit, administration, and other. Year-to-date performance for an individual investor may vary from the performance stated herein as a result of, among other things, the timing of their investment and the timing of any additional subscription and withdrawals.

were going to be hiked 25 or 50 basis points, small misunderstood companies were a painful neighborhood to invest in. Fortunately, 2023 has gotten off to a better start so far. As usual, only time will tell.

In November, the Partners Fund and the Royce family hosted an event for approximately two dozen managers (Partners Fund managers + other respected managers) who shared ideas over the course of three days. I wish you could have seen the talent in the room, the quality of the ideas, and the quality of the research. Asymmetric risk reward is out there, and in many ways more pronounced given last year's broad and undiscriminating sell-off in smaller less profitable companies.

I'm pleased to share that we will be hosting another event, our first Greenhaven Road Investing Olympics, around the Berkshire Hathaway annual meeting in Omaha. This event will be more multi-disciplinary as opposed to idea sharing, but it should be a fun way to convene many of the Partners Fund managers and like-minded investors. While this will be limited to in-person only (at least this time), any of our limited partners who are going to be in Omaha are invited to participate or spectate. We would love to have you. Many of you know our excellent analyst, Kyle Campbell, who is organizing the event. Get in touch with him (kyle@greenhavenroad.com) for more information.

As I have said at the end of every letter, our fund of funds is going to be different. It will be smaller, the underlying holdings will be more esoteric, and I hope the managers will continue to collaborate more over time. I believe that it will be "good different," but only time will tell. Thank you for joining me on this journey. I will work hard to grow your family capital alongside mine.

Sincerely,

Scott

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