Compounder Fund Investors' Letter: Third Quarter of 2020

COMPOUNDER FUND

GROWING YOUR WEALTH AND ENRICHING SOCIETY

Dear investor,

Together with my co-founder Jeremy Chia, I welcome you to Compounder Fund's first ever quarterly investors' letter.

In the third quarter of 2020 (do note that the start date is 13 July), Compounder Fund's overall net-of-fee return was 4.09%. Over the same period, the dividend-adjusted Singapore-dollar returns for the MSCI World Index and the S&P 500 were 3.73% and 5.19%, respectively. The table below shows the monthly returns for Compounder Fund, the MSCI World Index, and the S&P 500, for 2020's third-quarter.

Total Return	Jul 2020*	Aug 2020	Sep 2020	2020 Q3**	Since inception**
Compounder Fund (after fees)	1.26%	6.56%	-3.54%	4.09%	4.09%
MSCI World Index***	1.38%	5.54%	-3.06%	3.73%	3.73%
S&P 500***	2.78%	6.00%	-3.44%	5.19%	5.19%

**Performance calculated from 13 July 2020 to 31 July 2020*
***Since inception date of 13 July 2020*
****MSCI World Index and S&P 500 returns are in Singapore-dollar terms, with dividends reinvested*

Jeremy and I are comparing Compounder Fund's performance with that of the MSCI World Index and the S&P 500 to provide an indication of how the fund is faring against a broad group of stocks that are listed across the world and in the US.

As you know, Compounder Fund's investment mandate is global in nature. This means the fund can invest in any listed stock in the world; it also makes the MSCI World Index a sensible index to use for context about Compounder Fund's performance. But since most of Compounder Fund's holdings are currently US-listed stocks, it's also important to Jeremy and me that we compare the fund's performance with a prominent US stock market index, in this case, the S&P 500. If Compounder Fund is doing better than the MSCI World Index, comparing the fund's return with the S&P 500 helps the both of us to see if the outperformance is due simply to a rising tide in US stocks.

What can be gleaned from Compounder Fund's return so far? Nothing really. The time frame is way too short for any useful observations to be made. With your strong support, we are playing the long game here at Compounder Fund.

Judging our performance

As this is Compounder Fund's first quarterly investors' letter, Jeremy and I think it is a great opportunity to provide a gentle reminder on how we intend to judge Compounder Fund's performance. Our target is an annual return of 12% or more over the long run (a five- to seven-year period, or longer) for Compounder Fund's investors, net of all fees. When Warren Buffett was running an investment fund in the 1950s and 1960s, he discussed what's a suitable time frame to assess the performance of an investment manager:

> "While I much prefer a five-year test, I feel three years is an absolute minimum for judging performance. It is a certainty that we will have years when the partnership performance is poorer, perhaps substantially so, than the [market]. If any three-year or longer period produces poor results, we all should start looking around for other places to have our money. An exception to the latter would be three years covering a speculative explosion in a bull market."

Jeremy and I fully agree with Buffett. We hope that you, as an investor in Compounder Fund, will judge its performance over a three-year period at the minimum.

It will be very disappointing for the both of us too, if Compounder Fund fails to beat the MSCI World Index and S&P 500 over a five- to seven-year timeframe. Jeremy and I believe that having a thoughtful investment framework to find Compounders, and the willingness and ability to hold the shares of Compounders for years, will likely lead us to market-beating returns. The willingness comes from our ingrained long-term view towards the market. The ability, though, comes from *your* keen understanding of our investment approach - so thank you for taking the time to understand how we're running Compounder Fund and for seeing the logic of our ways.

Some caution is needed here: The stock market **is *volatile***. The returns of Compounder Fund will very likely *not* be smooth - this is just how stocks work. If the market falls, you should expect Compounder Fund to decline by a similar magnitude or more. But this will likely only be short-term pain. Jeremy and I believe in the long-term potential of the stock market, and especially in the underlying businesses of the stocks in Compounder Fund's portfolio (more on the businesses later).

Speaking of volatility, I want to introduce you to the important concept of “the destination”. It was first described to me by a friend, who’s an incredibly impressive young investor and person. He in turn first came across the concept from one of the best investors I’ve read about. This particular investor has been retired for a few years and prefers to be outside the public eye, hence my reluctance to name him. To illustrate the concept, I will need you to first think about two sequences of returns over a five year period:

Time	Sequence A return	Sequence B return
Year 1	+50%	+5%
Year 2	+28%	+15%
Year 3	+3%	+3%
Year 4	+15%	+28%
Year 5	+5%	+50%
Total	**139%**	**139%**

Both sequences result in the same total return - the journey is different, but the destination is the same. Interestingly, even though the end results are identical, we humans tend to prefer Sequence B over Sequence A. This is because Sequence B’s return looks better to us since it improved over time compared to Sequence A’s return, which deteriorated. We humans exhibit natural psychological biases that cause us to favour more recent data.

This is important to note because when investing in stocks, it’s often much easier to know the destination than it is to know the journey. Jeremy and I have absolutely *no* control over the journey of returns for Compounder Fund - what we have is a great degree of control over the destination. I say ‘a great degree of control’ and not ‘full control’ because luck *will* play some role in Compounder Fund’s eventual return. So you should expect Compounder Fund’s return - and indeed, that of all stocks - to bounce around all over the place in the short term. Over the long run, Compounder Fund’s return should gravitate toward the long term business performances of the companies it owns partial stakes in.

Portfolio changes

Compounder Fund closed its initial offering period (IOP) on 13 July 2020. On 5 August 2020, I wrote an investors’ letter for the fund titled ***Compounder Fund Investors’ Letter: First Portfolio Update***. In it, I shared all 40 holdings in Compounder Fund’s initial portfolio. There have been no changes in terms of the companies in the portfolio - as of the date of this letter, the portfolio contains the same 40 holdings.

What has changed though, are the weightings of the 40 holdings. The changes in the weightings happened because of: (1) The stock price movements of the holdings since we made the investments; and (2) the deployment of new capital.

As you know, Compounder Fund is able to accept new subscriptions once every quarter with a dealing date that falls on the first business day of each calendar quarter. In the middle of September 2020, Jeremy and I successfully closed Compounder Fund's first subscription window since its IOP. We raised an additional S$1.358 million.

This new capital was deployed quickly in the days after 1 October 2020, which is the last subscription window's dealing date. Jeremy and I invested the new capital across 11 of Compounder Fund's existing holdings. They are (in alphabetical order): Amazon.com; DocuSign; MercadoLibre; Netflix; Okta; PayPal; Shopify; Tencent; Tractor Supply; Wix.com; and Zoom.

In Compounder Fund's **Owner's Manual**, we mentioned that "if Compounder Fund receives new capital from investors, our preference when deploying the capital is to add to our winners and/or invest in new ideas." Not all of the 11 stocks we added capital to have seen their stock prices rise strongly after we initially invested in them. But all 11 of them have executed brilliantly in recent times and produced wonderful results as you'll soon see. They are winners, according to our definition. Here's how Compounder Fund's portfolio looks like as of 13 October 2020:

Company	Weighting	Country/Region of listing	Headquarters
Mercadolibre	4.8%	USA	Argentina
Amazon.com	4.6%	USA	USA
PayPal	4.5%	USA	USA
Netflix	4.4%	USA	USA
Tencent	4.3%	Hong Kong	China
Facebook	3.6%	USA	USA
Microsoft	3.3%	USA	USA
Shopify	3.2%	USA	Canada
Tractor Supply	3.1%	USA	USA
Okta	2.9%	USA	USA
Zoom	2.9%	USA	USA
DocuSign	2.8%	USA	USA
The Trade Desk	2.8%	USA	USA
Salesforce.com	2.7%	USA	USA
Wix.com	2.7%	USA	Israel
Haidilao	2.6%	Hong Kong	China
Apple	2.4%	USA	USA
PushPay	2.3%	Australia	New Zealand
Veeva Systems	2.3%	USA	USA
Square	2.2%	USA	USA
Meituan Dianping	2.2%	Hong Kong	China

Costco	2.2%	USA	USA
Adobe	2.2%	USA	USA
Mastercard	2.2%	USA	USA
Chipotle Mexican Grill	2.2%	USA	USA
Intuitive Surgical	2.2%	USA	USA
Alphabet	2.0%	USA	USA
Visa	2.0%	USA	USA
Markel	2.0%	USA	USA
Twilio	2.0%	USA	USA
Medistim	1.9%	Norway	Norway
Starbucks	1.8%	USA	USA
Illumina	1.8%	USA	USA
Activision Blizzard	1.5%	USA	USA
a2 Milk	1.5%	Australia	New Zealand
Livongo	1.0%	USA	USA
DataDog	1.0%	USA	USA
MongoDB	1.0%	USA	USA
Paycom Software	1.0%	USA	USA
Alteryx	0.7%	USA	USA
Cash	**1.6%**	-	-

The standout change will be video conferencing app provider Zoom. In Compounder Fund's initial portfolio that was shared in ***Compounder Fund Investors' Letter: First Portfolio Update***, Zoom's weighting was just 1.0%. Today, it's nearly 3%. In roughly equal measures, the increase in Zoom's weighting has been due to an increase in its stock price since we first invested as well as the addition of new capital. Of the S$1.358 million we raised in the last subscription window, around S$170,000 was invested in Zoom shares.

When we first invested in Zoom, the only results the company had reported for FY2021 (fiscal year ending late-January 2021) was for the first quarter. It was *really* good, with a 169% jump in revenue from a year ago and a huge 1,541% spike in free cash flow. But amazingly, Zoom's business performance in the second quarter of FY2021 was even better, because of COVID-19-related tailwinds. The table below shows Zoom's revenue, operating cash flow, and free cash flow in the first and second quarters of FY2021. Zoom's excellent performance in the second quarter gave us even more confidence in the long-term growth of the company's business in the future and so we decided to significantly increase its allocation within Compounder Fund's portfolio.

	Zoom: First quarter of FY2021	Zoom: Second quarter of FY2021
Revenue	US$328.2 million	US$663.5 million
Change in revenue from a year ago	169%	355%
Operating cash flow	US$259.0 million	US$401.3 million
Change in operating cash flow from a year ago	1,065%	1,188%
Free cash flow	US$251.7 million	US$372.0 million
Change in free cash flow from a year ago	1,541%	2,072%

Source: Zoom earnings updates

In our **investment thesis for Zoom**, we wrote the following:

> "We completed our purchases of Zoom shares with Compounder Fund's initial capital in late July 2020. Our average purchase price was US$258 per Zoom share. At our average price and on the day we completed our purchases, Zoom shares had trailing price-to-sales (P/S) and price-to-free cash flow (P/FCF) ratios of around 92 and 217, respectively...
>
> …For perspective, Zoom carried P/S and P/FCF ratios of 103 and 197, respectively, at the 21 September 2020 share price of US$468."

Notice that Zoom's share price had increased significantly in around two months from late July to 21 September. But crucially, its valuation - measured by the P/S and P/FCF ratios - were similar. This is an effect of the company's jaw-dropping growth in the second quarter of FY2021. In our view, the best time to add to a company's shares is when its valuation (and not its share price) declines even when its business grows strongly. The next best time to add is when the valuation stays roughly the same even in the face of excellent growth - this is the case with Zoom.

Here's a quick high-level geographical breakdown of Compounder Fund's portfolio as of 13 October 2020:

Country/Region	% of Compounder Fund's capital based on country of listing	% of Compounder Fund's capital based on location of headquarters
Argentina	-	4.8%
Australia	3.8%	-
Canada	-	3.2%
China	-	9.1%
Hong Kong	9.1%	-

Israel	-	2.7%
New Zealand	-	3.8%
Norway	1.9%	1.9%
USA	84.0%	73.3%

Wonderful businesses

Jeremy and I are pleased to report that the companies in Compounder Fund's portfolio have, in aggregate, delivered strong growth in the first half of 2020. As of the date of this letter, we have the 2020 first-half financial results for all of Compounder Fund's holdings except for PushPay (PushPay reports once every six months, and the results for the six months ended 30 September 2020 will only be released in early November).

The table below shows the year-on-year revenue growth in the first half of 2020 for all 40 companies that are in Compounder Fund's portfolio, except PushPay.

Company	Revenue growth in Q1 2020 from a year ago	Revenue growth in Q2 2020 from a year ago	Revenue growth in the first half of 2020 from a year ago
a2 Milk	34.2%	34.2%	34.2%
Activision Blizzard	-2.0%	38.4%	15.5%
Adobe	14.0%	13.8%	13.9%
Alphabet	13.3%	-1.7%	5.5%
Alteryx	43.2%	17.3%	29.7%
Amazon	26.4%	40.2%	33.5%
Apple	0.5%	10.9%	5.5%
Chipotle Mexican Grill	7.8%	-4.8%	1.2%
Costco	7.3%	12.4%	10.2%
Datadog	87.4%	68.2%	77.0%
DocuSign	38.8%	45.2%	42.2%
Facebook	17.6%	10.7%	14.0%
Haidilao	-16.5%	-16.5%	-16.5%
Illumina	1.5%	-24.5%	-11.4%
Intuitive Surgical	12.9%	-22.5%	-5.8%
Livongo	114.6%	124.7%	120.3%
Markel	10.5%	11.8%	11.1%
Mastercard	3.1%	-18.9%	-8.2%
Medistim	16.2%	-12.1%	1.7%
Meituan Dianping	-12.6%	8.9%	-1.0%
MercadoLibre	37.6%	61.1%	50.3%

Microsoft	14.6%	12.8%	13.6%
MongoDB	45.8%	39.2%	42.3%
Netflix	27.6%	24.9%	26.2%
Okta	46.0%	42.7%	44.3%
Paycom Software	21.2%	7.2%	14.8%
PayPal	11.9%	22.2%	17.1%
PushPay	-	-	-
Salesforce.com	30.2%	28.9%	29.5%
Shopify	46.7%	97.3%	73.5%
Square	44.0%	63.8%	54.9%
Starbucks	-4.9%	-38.1%	-22.2%
Tencent Holdings	26.4%	29.3%	27.9%
The Trade Desk	32.8%	-12.8%	6.8%
Tractor Supply	7.5%	34.9%	23.0%
Twilio	56.5%	45.7%	50.7%
Veeva Systems	37.7%	32.5%	35.0%
Visa	6.6%	-17.2%	-5.7%
Wix.com	23.9%	27.3%	25.7%
Zoom	169.0%	355.0%	270.3%

Source: Companies' earnings updates

Despite the current COVID-19 pandemic and big drops in GDP for many major economies around the world in the second quarter of 2020 (this includes a painful 9.0% fall in US GDP for the period compared to a year ago), only seven of the 39 companies in the table above experienced a decline in revenue. The simple-average of the revenue growth rate in the first half of 2020 for the 39 companies is an impressive 29.5%. Some of them even saw their revenue growth accelerate from the first quarter to the second quarter.

We chose to display just revenue growth simply because some of our companies are still loss-making and/or generating negative free cash flow (for healthy reasons!). Besides, strong revenue growth is the best starting ingredient for a company to produce growing free cash flow.

Only time can tell if the 32 companies in Compounder Fund's portfolio that grew their revenues in the first half of 2020 will continue producing great business results over the long run. But they're off to a good start. Of the seven that experienced revenue declines, we believe that their troubles are short-term in nature and growth will resume once COVID-19 stops becoming a serious global health threat. But again, only time can tell if we're right

Portfolio management thoughts: Guiding light

Some of you reading this letter may have heard me mention this before. A guiding light for the way I think about investing and the construction of Compounder Fund's portfolio is a quote from David Gardner, co-founder of The Motley Fool. David once said:

> "Make your portfolio reflect your best vision for our future."

This is a simple but profound statement. It focuses us on the future. And it's not just any future - David's statement guides us to think about a beautiful future, a better tomorrow. The benefit of doing so is that our portfolios will end up with companies that are likely to continue to be relevant in the years ahead. This is because these are the companies that are innovating to solve problems and improve the world.

For a long time, the "best vision" I had was somewhat hazy. I knew I wanted a portfolio filled with companies that can help make the world a better place. But I couldn't define 'better' clearly. Recently, as I looked at Compounder Fund's portfolio as well as the portfolio I **used to help my family run in the past**, my thoughts crystallised. It's still a work in progress, but I can see with more clarity now that my best vision for our future is a world that can make us smarter, happier, richer, and healthier each day.

I think my vision is reflected clearly in Compounder Fund's holdings. For instance, MercadoLibre, Square, Shopify, and Wix.com are democratising economic opportunities, especially in the digital economy - this makes the world richer and happier. Facebook and Tencent are trying to connect the world - this makes us happier and healthier. Illumina, Intuitive Surgical, Livongo, and Medistim are improving healthcare through technology - the world is smarter and healthier as a result. Amazon and Costco are relentless about lowering costs for consumers, leading to richer and happier individuals. Activision Blizzard and Tencent, as massive video game developers, deliver endless joy for gamers. Alteryx, DataDog, and MongoDB provide software services that make their customers smarter. a2 Milk and Chipotle Mexican Grill think about nutrition differently from their peers - people are healthier (possibly!) and happier as a result. I could go on, but I think you get the point.

Some of you may find the phrase "smarter, happier, richer, and healthier" to be familiar. This is because The Motley Fool's purpose is to make the world smarter, happier, and richer. I worked for The Motley Fool's Singapore arm for nearly seven years from January 2013 to October 2019. I enjoyed my time at the company tremendously and I grew so much as a person and as an investor. I have deep admiration for and gratitude to the Fool, more so now that it is the Fool's purpose statement that helped me clear up the haziness I had about my best vision for our future.

Portfolio management thoughts: Diversification

Earlier in this letter, I mentioned my impressive young investor friend. Jeremy and I recently had lunch with this friend together with his colleague, who's a well-respected, highly successful fund manager and a wonderful person.

During lunch, the four of us talked about an excellent investor who has one of the investment industry's storied titans as an early backer. This excellent investor is known to run a highly concentrated portfolio. Interestingly, Jeremy and I learnt that this investor's level of concentration was one of the reasons why the investment industry titan favoured him. Upon hearing this, Jeremy then asked me: "If the same titan wants to invest in Compounder Fund on the condition that we can only invest in 10 companies, would we want to do it?"

I answered "No" very quickly. Having this legendary investor on board means we can tap on an invaluable source of knowledge from time to time. Moreover, from a practical point of view, the presence of this investor in Compounder Fund could be tremendously useful for the fund's marketing activities. But my consideration was this: If we're made to invest in a way that does not suit our psyche, Compounder Fund will definitely be doomed in the long run. We don't want this to happen.

I currently believe that the right level of diversification is different for each investor. Some investors have an investment process and psyche that suits a highly concentrated portfolio, say, of 10 companies or less. Jeremy and I do not belong in this group. Instead, we are well-suited for a portfolio that has significantly more companies. When I was investing for my family, the portfolio had slightly more than 50 companies by the time I liquidated most of its stocks so that the capital can be invested in Compounder Fund. I was comfortable managing around 50 companies and I could sleep soundly at night. This is why Compounder Fund was designed to have between 30 to 50 companies in its portfolio at any one time. Jeremy and I believe this is a suitable level of diversification for us that will also not dilute the fund's return.

Why do I say that the right level of diversification is different for each investor? Let's consider the case of three legendary US-based investors. Peter Lynch was the manager of the Fidelity Magellan Fund from 1977 to 1990. During his tenure, he produced a jaw-dropping annual return of 29%, nearly double what the S&P 500 did. Toward the end of Lynch's stint, the Magellan Fund owned more than 1,400 stocks in its portfolio. Walter Schloss produced an astonishing return of 15.3% per year from 1956 to 2000; in comparison, the S&P 500's annualised gain was a little below 11.5%. Schloss typically held around 100 stocks in his portfolio at any given time. Then we have Charlie Munger, who achieved an annual return of 13.7% per year when he was managing an investment fund from 1962 to 1975. Over the same period, the Dow was up by just 5.0% per year. At any point in time, Munger's portfolio would only have a handful of stocks.

Lynch, Schloss, and Munger are all stock market investors with incredible long-term track records (and I consider all of them as my investment heroes!). But their levels of

diversification are so different. I think this is the best example of how there's no magic number when it comes to diversification.

What's next?

As you know, Compounder Fund's mission is to "Grow *Your* Wealth & Enrich Society." One of the key pillars of the mission involves Compounder Fund being a source for investor education. To this end, Jeremy and I are running Compounder Fund transparently. As of this letter's publication, we have released detailed investment theses for 18 of Compounder Fund's holdings. They can all be found in the "**Performance & Portfolio**" section of Compounder Fund's website. The investment theses for the remaining 22 companies in Compounder Fund's portfolio will be steadily released in the coming months and they will also be on the same webpage. Once a month, we will send out a quick email to let you know what has been published.

Compounder Fund's next subscription window will close in the middle of December 2020 and it will have a dealing date on the first business day of January 2021 (which should be 4 January). If you will like to top up your investment in the fund, please submit the relevant paperwork by the middle of December 2020. Jeremy and I are happy to help you with any queries you may have.

Optimism

We're aware that the world currently seems more divided and uncertain. There are a myriad of important political, social, economic, and healthcare issues that are plaguing our globe. But this is how it works. Over the long arc of history, there are things breaking all the time. But crucially, this does not stop progress from happening. It took us only 66 years to go from the first demonstration of manned flight by the Wright brothers at Kitty Hawk in 1903 to putting a man on the moon in 1969. But in between was World War II, a brutal battle across the globe from 1939 to 1945 that killed an estimated 66 million. Morgan Housel **writes** (emphasis is mine):

> "A real optimist wakes up every morning knowing lots of stuff is broken, and more stuff is about to break.
>
> Big stuff. Important stuff. Stuff that will make his life miserable. He's 100% sure of it.
>
> He starts his day knowing a chain of disappointments awaits him at work. Doomed projects. Products that will lose money. Coworkers quitting. He knows that he lives in an economy due for a recession, unemployment surely to rise. He invests his money in a stock market that will crash. Maybe soon. Maybe by a lot. This is his base case.
>
> He reads the news with angst. It's a fragile world. Every generation has been hit with a defining shock. Wars, recessions, political crises. He knows his generation is no different.

> *This is a real optimist. He's an optimist because he knows all this stuff does not preclude eventual growth and improvement. The bad stuff is a necessary and normal path that things getting better over time rides on. Progress happens when people learn something new. And they learn the most, as a group, when stuff breaks. It's essential.*
>
> *So he expects the world around him to break all the time. But he knows – as a matter of faith – that if he can survive the day-to-day fractures, he'll capture the up-and-to-the-right arc that learning and hard work produces over time."*

Jeremy and I are still long-term optimistic on the stock market. This is because we still see so much potential in humanity. There are 7.8 billion individuals in our globe today, and the vast majority of people will wake up every morning wanting to improve the world and their own lot in life. *This* is ultimately what fuels the global economy and financial markets. Miscreants and Mother Nature will occasionally wreak havoc (and what havoc COVID-19 has caused!), but we have faith that humanity can clean it up. To us, investing in stocks is ultimately the same as having faith in the long-term positivity of humanity. And we will remain long-term optimistic on stocks so long as we continue to have this faith. The only exception is when stocks become wildly overpriced and we don't think this is the case today.

Final word

If you have any questions related to Compounder Fund's administrative matters or our general investment thinking, please know that our email inboxes are always open to you. Thank you again for trusting Jeremy and myself with your hard-earned capital. We deeply appreciate your trust and support, and your belief in Compounder Fund's mission to "Grow *Your* Wealth & Enrich Society". You can expect to see Compounder Fund's 2020 Q4 Investors' Letter in mid-January 2021. Till then, stay safe and have a wonderful end to 2020!

Excelsior,
Chong Ser Jing
Co-founder and Portfolio Manager, Compounder Fund
15 October 2020

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