Compounder Fund Investors' Letter: Third Quarter of 2022

COMPOUNDER FUND
GROWING YOUR WEALTH AND ENRICHING SOCIETY

Dear investors,

Together with my co-founder Jeremy Chia, I welcome you to Compounder Fund's 2022 third-quarter investors' letter.

During the quarter, Compounder Fund's overall net-of-fee return for the earliest series of its Class A and Class B shares were both -0.8%. Over the same period, the dividend-adjusted Singapore-dollar returns for the MSCI World Index and the S&P 500 were -2.9% and -1.7%, respectively. Tables 1 and 2 below show the returns for Compounder Fund's two share classes (the earliest series for each share class), the MSCI World Index, and the S&P 500, since the birth of the fund.

Table 1

Time period	Compounder Fund Class A (after fees)	MSCI World**	S&P 500**
2020*	11.2%	14.6%	14.2%
2021	0.9%	24.8%	31.2%
Q1 2022	-18.9%	-4.6%	-4.1%
Q2 2022	-27.0%	-13.9%	-14.0%
Jul 2022	10.4%	7.4%	8.7%
Aug 2022	-2.4%	-3.2%	-3.1%
Sep 2022	-7.9%	-6.7%	-6.7%
Q3 2022	-0.8%	-2.9%	-1.7%
Year-to-date 2022	-41.3%	-20.2%	-18.9%
Total return since inception*	-34.2%	14.1%	21.5%
Annualised return since inception*	-17.2%	6.1%	9.2%

**Inception date: 13 July 2020*
***MSCI World Index and S&P 500 returns are in Singapore-dollar terms, with dividends reinvested*

Table 2

Time period	Compounder Fund Class B (after fees)	MSCI World**	S&P 500**
2020*	6.8%	10.4%	8.6%
2021	0.9%	24.8%	31.2%
Q1 2022	-18.9%	-4.6%	-4.1%
Q2 2022	-27.0%	-13.9%	-14.0%
Jul 2022	10.4%	7.4%	8.7%
Aug 2022	-2.4%	-3.2%	-3.1%
Sep 2022	-7.9%	-6.7%	-6.7%
Q3 2022	-0.8%	-2.9%	-1.7%
Year-to-date 2022	-41.3%	-20.2%	-18.9%
Total return since inception*	-36.8%	9.9%	15.5%
Annualised return since inception*	-20.5%	4.9%	7.5%

**Inception date: 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 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 USA.

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 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 us see if the outperformance is simply due to a rising tide in US stocks.

It's been more than two years since we started investing Compounder Fund's capital on 13 July 2020 and it has been disappointing. The fund's return has not only been negative since its inception, but it has also substantially underperformed both market indices. Compounder Fund's underlying businesses continue to do well, but their stock prices have not. This has been an ongoing theme since 2021 and it's something I've discussed in a number of past letters (the **2021 fourth-quarter letter**; the **Solidarity** letter sent on 27 January 2022; the **2022 first-quarter letter**; and the **2022 second-quarter letter**); I will have more to say on this topic in the "*Wonderful businesses"* section of this letter.

Compounder Fund's poor return since inception is painful to experience. **Jeremy and I are clear that the fund exists to ultimately produce a positive *and* healthy return over the long run for all of you, and not merely to invest in stocks with growing businesses**. But I have repeatedly emphasised, in our past letters, how our stocks' underlying *businesses* have been doing because what ultimately drives a stock's price over the long run is its business performance. Over the short run, stock prices and business fundamentals can diverge wildly, but they tend to converge with the passing of time. I will discuss this further in the "*An unfortunate but necessary disconnect"* section of this letter.

With your strong support, Jeremy and I are taking the long-term approach here at Compounder Fund, where the fund's return will come from the underlying business performances of its holdings. **And please never underestimate the importance of your role in shaping Compounder Fund's long-term return**. In the "*Investing thoughts: What's our edge?*" section of our **2020 fourth-quarter letter**, I discussed the three sources of investing edge that exist in the stock market and how all of you - Compounder Fund's investors - **play a critical role in helping Jeremy and me produce the behavioural edge**. Jeremy and I are thankful that, in what has been a rough period for Compounder Fund over the past two-plus years, **you have helped us produce the behavioural edge.** You have provided us with gentle patience and the space to engage in long-term thinking about stocks. **Most importantly, you did not panic. So, *thank you* - Jeremy and I are incredibly fortunate to assemble each of you as investors in Compounder Fund**.

Judging our performance

In all our **previous quarterly investors' letters**, I've provided a discussion on how Jeremy and I intend to judge Compounder Fund's performance. If this is the first investor's letter from us that you're seeing, *please* read this section. If this is not your first letter, please read through this section too because there are additions to it (although most of it will be familiar).

Our target for Compounder Fund is to generate an annual return of 12% or more over the long run (a five- to seven-year period, or longer) for the fund's investors, net of all fees. When Warren Buffett was running an investment fund in the 1950s and 1960s, he shared his thoughts on 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 the 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. Do note, however, that we harbour *no* illusion that we're able to beat the indices each month, each quarter, or each year. The willingness comes from our ingrained long-term view towards the market. The ability, though, comes from *your* keen understanding of our investment approach.

Some caution is needed here: **The stock market is volatile**. The returns of Compounder Fund in the future will very likely *not* be smooth - this is just how stocks work. And indeed, we've already experienced significant volatility in the results of Compounder Fund since its inception. If the market falls in the future, 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.

Speaking of volatility, I want to discuss the important concept of 'the destination'. I first heard about it from a friend - an incredibly impressive young investor and person - who in turn learnt about it from Nicholas Sleep, one of the best investors I've read about. After retiring in the mid-2010s and initially wanting to be outside the public eye, Sleep published a collection of his investment letters in 2021 on the **website** of his charitable foundation, I.G.Y (do check out his letters - they're a fantastic read). To illustrate the concept, I will need you to first think about two sequences of returns over a five year period, shown in Table 3:

Table 3

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Sequence A return	+50%	+28%	+3%	+15%	+5%	**139%**
Sequence B return	+5%	+15%	+3%	+28%	+50%	**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 compared to Sequence A's, since the former improved over time while the latter deteriorated. As humans, we 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. This 'great degree of control' comes from our careful selection of the companies that Compounder Fund owns shares in. And I say 'a great degree of control' and not 'full control' because luck *will* play some role in Compounder Fund's eventual gain. So you should expect Compounder Fund's return - and indeed, that of all stocks - to bounce around wildly in the short term. We've already seen such a bounce happen in an unwanted direction (downwards) but over the long run, Compounder Fund's return should gravitate toward the long term business performances of the companies it owns partial stakes in. There's no guarantee that this gravity will be a strong upward pull though. The direction of the gravitational force will depend on whether our insights - on the abilities of Compounder Fund's companies to grow their businesses at high rates over the long run - turn out to be correct. **In this regard, it's been so far, so good, as I'll discuss in the "*Wonderful businesses*" section of this letter**.

We're fast approaching the three-year mark at Compounder Fund and as I mentioned in the introductory section of this letter, the performance of the fund in terms of stock prices has been nothing but disappointing. The journey so far has been rough on all of us at Compounder Fund, to say the least. But Jeremy and I find solace in the business performances of the fund's holdings and this is what gives us confidence that when Compounder Fund's *stock price* performance is eventually weighed in the fullness of time, a favourable judgement is likely to result.

Portfolio changes

On 31 August 2022, I **published an update** on Compounder Fund's portfolio on the fund's website and also notified all of you via email. In the update, I mentioned a few things: (a) all 50 holdings in the fund's portfolio; (b) our full sale of Teladoc shares from the fund; (c) the partial sale of the fund's stakes in Tencent and Sea; and (d) an investment in a new company, namely, Medpace. As of the date of this letter, the portfolio contains the same 50 holdings although some involuntary removals could happen in the near future.

First, there's the acquisition of Activision Blizzard by Microsoft that I discussed in Compounder Fund's 2022 **first-quarter** and **second-quarter** letters. In September, Activision's CEO, Bobby Kotick, gave an update on the deal. A number of countries have already approved the transaction and the regulatory process is proceeding as the management teams of both Activision and Microsoft have expected. There's no change in the time-line for the acquisition and it is still expected to close before 30 June 2023. As first discussed in Compounder Fund's 2022 first-quarter letter, Jeremy and I intend for the fund to hold onto its Activision shares and receive the cash from Microsoft if and once the acquisition is completed (but our intention could change depending on developments at both companies and the stock market in general).

Next, there's the privatisation of Pushpay that I first mentioned in the 2022 second-quarter letter. Last month, there was speculation in the media that the privatisation may fall through; Pushpay acknowledged the existence of the media speculation in an official announcement but gave no update on the progress of its discussions with the potential buyers. Then earlier this week, there was new speculation that Pushpay had received a revised non-binding buyout offer from one of its existing shareholders. The shareholder, BGH Capital, was among the third parties that first broached the acquisition of Pushpay in late-May. This time, Pushpay acknowledged that it had indeed received an "indicative non-binding proposal" but no price, nor timing for any potential transaction, was mentioned. Our stance with Pushpay remains the same as what I communicated in the 2022 second-quarter letter:

> "Jeremy and I think Pushpay's long-term growth prospects are healthy and we intend for Compounder Fund to hold onto its Pushpay shares for now (our intention is, again, subject to change depending on developments at the company and stock market in general). We'll make new decisions as and when Pushpay releases information about the offers."

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 2022, Jeremy and I successfully closed Compounder Fund's eighth subscription window since its initial offering period (which ended on 13 July 2020) and raised a net amount of S$0.21 million. This new capital was deployed quickly in the days after the last subscription window's dealing date of 3 October 2022. Jeremy and I invested the new capital in four existing Compounder Fund holdings. They are (in alphabetical order): Adobe, Alphabet, Mastercard, and Visa.

As of this letter's publication, we have released our investment theses on all 50 companies that are currently in Compounder Fund's portfolio, including Medpace, and they can be **found here**. We will inform you once our sell-thesis for Teladoc is published on Compounder Fund's website in the coming months.

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 four existing holdings in the portfolio that we added capital to have seen their stock prices rise strongly after we initially invested in them. But all of them have executed well since our investments and they've produced solid business results as I'll soon touch on in the "*Wonderful businesses*" section of this letter. They are winners, according to our definition. Here's how Compounder Fund's portfolio looks like as of 9 October 2022:

Table 4

Company	Weighting	Country/Region of listing	Headquarters
MercadoLibre	5.1%	USA	Argentina
Amazon	4.6%	USA	USA
Tractor Supply	4.3%	USA	USA
Costco	4.1%	USA	USA
Microsoft	4.0%	USA	USA
Alphabet	3.8%	USA	USA
Meta Platforms	3.6%	USA	USA
Apple	3.6%	USA	USA
Chipotle	3.3%	USA	USA
The Trade Desk	3.2%	USA	USA
Tesla	2.9%	USA	USA
Mastercard	2.8%	USA	USA
Visa	2.8%	USA	USA
Netflix	2.8%	USA	USA
PayPal	2.7%	USA	USA
DataDog	2.6%	USA	USA
Etsy	2.4%	USA	USA
Markel	2.4%	USA	USA
Tencent	2.3%	Hong Kong	China
ASML	2.2%	USA	Netherlands
Intuitive Surgical	2.1%	USA	USA
Adobe	2.1%	USA	USA
Starbucks	2.0%	USA	USA
Activision Blizzard	2.0%	USA	USA
Veeva Systems	1.8%	USA	USA
Medistim	1.7%	Norway	Norway
Salesforce	1.6%	USA	USA
Illumina	1.5%	USA	USA
Shopify	1.5%	USA	Canada
Meituan Dianping	1.5%	Hong Kong	China
Medpace	1.2%	USA	USA
MongoDB	1.2%	USA	USA

Table 4 (continued from above)			
Company	**Weighting**	**Country/Region of listing**	**Headquarters**
Block	1.1%	USA	USA
Adyen	1.1%	Netherlands	Netherlands
Haidilao	1.0%	Hong Kong	China
TSMC	1.0%	USA	Taiwan
PushPay	1.0%	Australia	New Zealand
Wix	1.0%	USA	Israel
DocuSign	0.9%	USA	USA
Paycom Software	0.9%	USA	USA
Zoom Video	0.9%	USA	USA
Wise	0.9%	UK	UK
dLocal	0.9%	USA	Uruguay
Twilio	0.8%	USA	USA
Okta	0.8%	USA	USA
Sea	0.6%	USA	Singapore
Fiverr	0.4%	USA	Israel
Coupang	0.3%	USA	South Korea
Alteryx	0.3%	USA	USA
Upstart	0.2%	USA	USA
Cash	**0.4%**	**-**	**-**

**0.3% of the Block position comes from Block shares that are listed in Australia, but for all intents and purposes, we see the Australia-listed Block shares as being identical to the US-listed variety*

Our biggest additions in early-October 2022 were in Mastercard and Visa (we invested similar amounts in both companies). The two payment networks have demonstrated strong *and* consistent business growth since 2021 (both companies were affected in 2020 because of COVID-19), as Table 5 below illustrates. In "*The risks involved"* sections of our investment theses for both companies (see **here** and **here**), we highlighted the intense competition they face as one of the key risks we're watching. But since our initial investments in Mastercard and Visa in mid-July 2020, both companies have been fortifying their positions as key players in the digital payments ecosystem. Some examples:

- In the year-to-date alone, Mastercard has inked more than 20 crypto-card deals, where consumers who hold cryptocurrencies are able to spend with fiat currencies with Mastercard-powered cards. Similarly, Visa's management mentioned in a June 2022 investor conference that the company was working with around 70 organisations in the crypto ecosystem that are in various stages of issuing crypto-cards to allow consumers to spend their cryptocurrencies in the form of fiat money. In our view, these developments lower the risk that Mastercard and Visa's payment networks would be disrupted in the future if cryptocurrencies become more widely adopted by consumers.
- Fintechs (financial technology companies) have also been partnering with Mastercard and Visa for their own digital payment services. For example, Mastercard struck up more than 250 payments-related partnerships with fintechs in 2021. In another instance, Apple's buy-now-pay-later (BNPL) service, Apple Pay Later, which

was announced this June, is powered by Mastercard. Over at Visa, fintechs issuing Visa cards grew by 30% in the fiscal year ended 30 September 2021 while payment volumes from fintechs nearly doubled. Visa also reported more than 100 fintech partnerships in Europe alone, as of July this year. Fintechs have the potential to build their own payment rails and thus disrupt Mastercard and Visa. But the burgeoning of partnerships that Mastercard and Visa have with fintechs lowers this risk, in our opinion.

Table 5

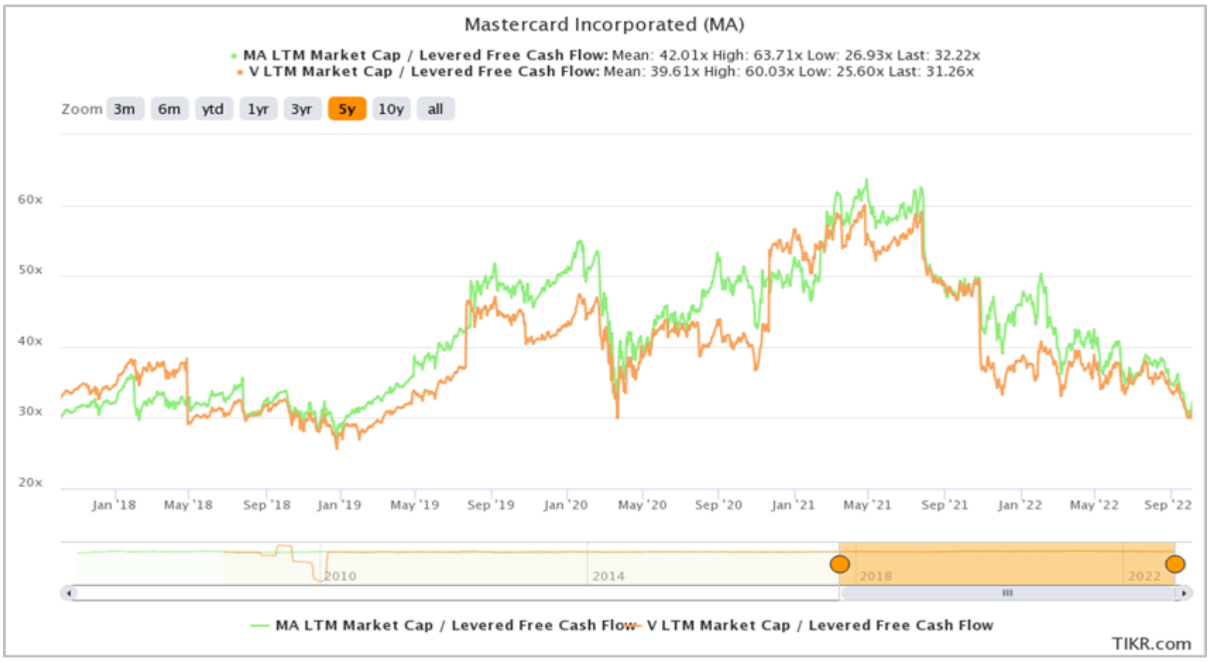
Quarter	Mastercard year-on-year revenue per share growth	Mastercard year-on-year free cash flow per share growth	Mastercard FCF margin	Visa year-on-year revenue growth per share	Visa year-on-year free cash flow growth per share	Visa FCF margin
Q1 2020	5.3%	32.3%	37.8%	9.0%	-32.9%	21.4%
Q2 2020	-17.5%	32.4%	37.8%	-15.3%	-8.9%	58.7%
Q3 2020	-12.9%	-30.7%	37.9%	-15.2%	-48.1%	37.8%
Q4 2020	-5.5%	-22.9%	50.3%	-4.4%	-7.3%	59.0%
Q1 2021	4.9%	-14.7%	30.7%	-0.6%	157.5%	55.3%
Q2 2021	37.7%	63.4%	44.8%	28.5%	51.5%	69.2%
Q3 2021	31.9%	53.5%	44.2%	30.5%	98.1%	57.4%
Q4 2021	28.5%	42.7%	55.8%	26.5%	23.4%	57.5%
Q1 2022	26.5%	16.6%	28.3%	28.5%	4.0%	44.8%
Q2 2022	23.9%	13.2%	40.9%	21.7%	21.2%	69.0%

Source: Company filings

There are two other key factors that influenced our decision to add to Mastercard and Visa:

- Both companies have experienced robust growth in their businesses over the past decade (see our investment theses for more details), when inflation was mostly low in the USA and other parts of the world. One of the big risks confronting the global economy today is inflation remaining high for a prolonged period of time. If this risk does manifest, both Mastercard and Visa could stand to benefit. During Visa's 2022 first-quarter earnings conference call, management said that inflation has historically been a net-positive for the company.
- The two payment networks have price-to-free cash flow (P/FCF) ratios that are near five-year lows, as illustrated in Figure 1. As of 30 September 2022, Mastercard and Visa have P/FCF ratios of 31 and 24, respectively.

Figure 1 (Green is for Mastercard; Orange is for Visa)



Source: Tikr

Here's a quick high-level geographical breakdown of Compounder Fund's portfolio as of 9 October 2022:

Table 6

Country/Region	% of Compounder Fund's capital based on country of listing	% of Compounder Fund's capital based on location of headquarters
Argentina	-	5.1%
Australia	1.0%	-
Canada	-	1.5%
China	-	4.8%
Hong Kong	4.8%	-
Israel	-	1.4%
Netherlands	1.1%	3.3%
New Zealand	-	1.0%
Norway	1.7%	1.7%
Singapore	-	0.6%
South Korea	-	0.3%
Taiwan	-	1.0%
UK	0.9%	0.9%
Uruguay	-	0.9%
USA	90.2%	77.3%

Wonderful businesses

Jeremy and I are pleased to report that the companies in Compounder Fund's portfolio have, in aggregate, continued to deliver healthy revenue growth in the second quarter of 2022. Table 7 below shows the year-on-year revenue growth rates for all the 50 companies that are currently in Compounder Fund's portfolio (the ones in table 4) for a few time periods: The whole of 2020 and 2021, and the first and second quarters of 2022:

Table 7

Company	2020 revenue growth	2021 revenue growth	Q1 2022 revenue growth	Q2 2022 revenue growth
Activision Blizzard	24.6%	8.9%	-22.3%	**-28.4%**
Adobe	17.3%	18.0%	14.4%	**12.7%**
Adyen	28.1%	46.4%	36.7%	**36.7%**
Alphabet	12.8%	41.2%	23.0%	**12.6%**
Alteryx	18.5%	8.2%	33.0%	**50.4%**
Amazon	37.6%	21.7%	7.3%	**7.2%**
Apple	9.9%	28.6%	8.6%	**1.9%**
ASML	18.3%	33.1%	-19.0%	**35.1%**
Block	101.5%	86.0%	-21.7%	**-5.9%**
Chipotle Mexican Grill	7.1%	26.1%	16.0%	**17.0%**
Costco	12.8%	17.7%	16.2%	**15.0%**
Coupang	90.8%	53.8%	21.6%	**12.5%**
Datadog	66.3%	70.5%	82.8%	**73.9%**
dLocal	88.4%	134.4%	117.2%	**71.6%**
DocuSign	49.2%	45.0%	25.5%	**21.6%**
Etsy	110.9%	35.0%	5.2%	**10.6%**
Fiverr	77.0%	57.1%	26.9%	**13.0%**
Haidilao	7.8%	43.7%	-16.6%	**-16.6%**
Illumina	-8.6%	39.7%	11.9%	**3.2%**
Intuitive Surgical	-2.7%	31.0%	15.1%	**4.0%**
Markel	17.0%	20.0%	27.0%	**19.2%**
Mastercard	-9.4%	23.4%	24.4%	**21.4%**
Medistim	-0.2%	17.7%	13.2%	**7.0%**
Medpace	7.5%	23.4%	27.3%	**26.2%**
Meituan Dianping	17.7%	56.0%	25.0%	**16.4%**
MercadoLibre	73.0%	77.9%	63.1%	**52.5%**
Meta (Facebook)	21.6%	37.2%	6.6%	**-0.9%**
Microsoft	14.7%	20.6%	18.4%	**12.4%**
MongoDB	40.0%	48.0%	57.1%	**52.8%**
Netflix	24.0%	18.8%	9.8%	**8.6%**
Okta	42.5%	55.6%	65.3%	**43.2%**
Paycom Software	14.1%	25.4%	29.9%	**30.9%**

Table 7 (continued from above)

Company	2020 revenue growth	2021 revenue growth	Q1 2022 revenue growth	Q2 2022 revenue growth
PayPal	20.7%	18.3%	7.5%	**9.1%**
PushPay	41.7%	16.0%	17.0%	**-**
Salesforce.com	24.3%	24.7%	24.3%	**21.8%**
Sea	101.1%	127.5%	64.4%	**29.0%**
Shopify	85.6%	57.4%	21.7%	**15.7%**
Starbucks	-14.1%	31.0%	14.5%	**8.7%**
Tencent Holdings	27.8%	16.2%	0.1%	**-3.1%**
Tesla	28.3%	70.7%	80.5%	**41.6%**
The Trade Desk	26.5%	43.1%	43.5%	**34.6%**
Tractor Supply	27.2%	19.9%	8.3%	**8.4%**
TSMC	25.2%	18.5%	35.5%	**43.5%**
Twilio	55.3%	61.3%	48.4%	**41.0%**
Upstart	42.0%	263.6%	155.6%	**17.6%**
Veeva Systems	32.7%	26.3%	16.5%	**17.3%**
Visa	-8.7%	18.6%	25.5%	**18.7%**
Wise	43.9%	32.3%	31.6%	**50.5%**
Wix.com	29.9%	29.0%	13.6%	**9.4%**
Zoom	325.8%	54.6%	12.3%	**7.6%**

Source: Companies' earnings updates

Here's a table showing the simple averages of the year-on-year revenue growth rates for the fund's holdings for each quarter going back to the first quarter of 2020 (**note the high revenue growth rates for every quarter**):

Table 8

Simple averages for revenue growth from year ago	Compounder Fund current portfolio	Compounder Fund current portfolio (exclude Medpace, include Teladoc)
Q1 2020	35.3%	37.3%
Q2 2020	32.4%	35.0%
Q3 2020	43.3%	45.3%
Q4 2020	44.5%	47.1%
2020	38.9%	40.7%
Q1 2021	54.8%	57.5%
Q2 2021	77.2%	78.7%
Q3 2021	38.8%	39.9%
Q4 2021	34.7%	35.2%
2021	44.0%	45.2%
Q1 2022	27.4%	27.3%
Q2 2022	**20.6%**	**20.4%**

Source: Companies' earnings updates

As I mentioned in the "*Judging our performance"* section of this letter, it's been 'so far, so good' for the business results of Compounder Fund. **The fund's current crop of portfolio companies produced healthy year-on-year revenue growth of 20.6% (this is a simple average) in the second-quarter of 2022**, **and this continues from the impressive revenue growth rates seen in prior quarters going back to 2020**. Table 9 below gives perspective on the far-superior growth rates for Compounder Fund's holdings compared to the S&P 500.

Table 9

Simple averages for revenue growth from year ago in a certain quarter	S&P 500	Compounder Fund current portfolio	Compounder Fund current portfolio (no Medpace, include Teladoc)
Q1 2020	Around -2%	35.3%	37.3%
Q2 2020	Around -10%	32.4%	35.0%
Q3 2020	Around -2%	43.3%	45.3%
Q4 2020	Around -0.5%	44.5%	47.1%
Q1 2021	Around 10%	54.8%	57.5%
Q2 2021	Around 25%	77.2%	78.7%
Q3 2021	16.6%	38.8%	39.9%
Q4 2021	16.1%	34.7%	35.2%
Q1 2022	13.4%	27.4%	27.3%
Q2 2022	**11.9%**	**20.6%**	**20.4%**

Source: ***Yardeni Research*** *for S&P 500 data (data for S&P 500 is as of 20 September 2022; revenue growth rate for Compounder Fund is a simple average of the revenue growth from the fund's holdings)*

In Compounder Fund's 2022 second-quarter letter, I mentioned:

> "We're excited to see what the future brings. Although, we do note that the second quarter of 2022 - and perhaps for the next few quarters too - could see the fund's companies produce slightly weaker revenue growth because of tough comparisons."

This indeed came to pass. During the second quarter of 2022, Compounder Fund's portfolio companies produced an average revenue growth rate of 20.6%. This is a healthy growth rate and was nearly double the S&P 500's corresponding revenue growth of 11.9% (great), but it's a significant deceleration from what was achieved in each quarter in 2021 (not great). 2021 is providing tough comparisons for the 2022 growth-rates of some of our companies as they had enjoyed a COVID-induced bump in their business fortunes. But we're not worried. We invested in the companies that are currently in Compounder Fund's portfolio because their businesses are riding on - or creating - durable and lasting long-term trends. This means they still have massive market opportunities to grow into over the long run (you can read about this in detail in our investment theses for each company).

Compounder Fund's holdings may continue to post *relatively*-slower revenue growth in the next few quarters. But consistent with what I've been sharing in our past quarterly letters, Jeremy and I continue to think there's a high chance that the fund's portfolio companies will, in aggregate, carry on producing pleasing year-on-year revenue growth in the years ahead. **And if these companies can sustain average annual revenue growth of around 25% in aggregate for the next five to seven years, *while producing healthy free cash flow* (an important requisite!), we believe it will be exceedingly difficult for Compounder Fund's**

portfolio to *not* do well over the same timeframe and when measured from the fund's inception. We're excited to see what the future brings.

Speaking of free cash flow, Compounder Fund's holdings did not manage to strengthen their cash flow muscles in the second quarter of 2022. Table 10 below shows the revenue growth for each company that's currently in the portfolio (the 50 companies in Table 4) for the quarter as well as the change in their free cash flow margins for the period. **During the second quarter of 2022, the simple-average free cash flow margin for all the fund's current holdings was 12.5%, down from 16.8% a year ago**. It has been a string of quarters where the free cash flow margin has declined on a year-on-year basis (the margin also fell in the second, third, and fourth quarters of 2021, and the first quarter of 2022), so we're watching this carefully. But there are signs for optimism as some of the fund's holdings have:

- Been improving their cost structures of late (examples include Amazon, MercadoLibre, Meta Platforms, Sea, Shopify, Twilio, and Wix)
- Seen strong growth in their free cash flow margin in the latest quarter (some examples are dLocal, Haidilao, MercadoLibre, and Trade Desk)
- Experienced a positive inflection in their revenue growth as in the case of PayPal (4% growth in April, 10% in May, 12% in June, and 14% in July)
- Projected near-term expansion in their free cash flow margins compared to the first half of 2022, with Wix and Okta being two examples.

Given the nature and track records of the companies in Compounder Fund's portfolio, we continue to think that the long-term average free cash flow margin for the current crop of portfolio companies can grow to around 25% eventually and be maintained at that level.

Table 10

Company	Revenue growth in Q2 2022 from a year ago	Free cash flow margin in Q2 2022	Free cash flow margin in Q2 2021
Activision Blizzard	-28.4%	9.8%	16.3%
Adobe	12.7%	35.4%	33.3%
Adyen	36.7%	52.0%	56.4%
Alphabet	12.6%	16.5%	26.0%
Alteryx	50.4%	-39.9%	-13.2%
Amazon	7.2%	-5.6%	-1.4%
Apple	1.9%	25.1%	23.3%
ASML	35.1%	42.6%	82.6%
Block	-5.9%	-3.6%	5.2%
Chipotle Mexican Grill	17.0%	8.4%	6.9%
Costco	15.0%	1.7%	2.9%
Coupang	12.5%	-4.0%	-3.1%
Datadog	73.9%	14.8%	18.1%
dLocal	71.6%	30.5%	-7.7%
DocuSign	21.6%	17.0%	31.6%
Etsy	10.6%	20.1%	22.0%
Fiverr	13.0%	7.1%	19.9%

Table 10 (continued from above)			
Company	**Revenue growth in Q2 2022 from a year ago**	**Free cash flow margin in Q2 2022**	**Free cash flow margin in Q2 2021**
Haidilao	-16.6%	12.2%	-5.6%
Illumina	3.2%	4.6%	18.6%
Intuitive Surgical	4.0%	20.0%	31.9%
Markel	19.2%	-	-
Mastercard	21.4%	40.9%	44.8%
Medistim	7.0%	22.4%	18.2%
Medpace	26.2%	24.3%	20.4%
Meituan Dianping	16.4%	-5.4%	-8.8%
MercadoLibre	52.5%	31.1%	6.0%
Meta Platforms	-0.9%	14.8%	28.7%
Microsoft	12.4%	31.8%	34.1%
MongoDB	52.8%	-15.6%	-10.8%
Netflix	8.6%	0.2%	-2.4%
Okta	43.2%	-5.7%	-1.2%
Paycom Software	30.9%	5.8%	8.1%
PayPal	9.1%	19.0%	17.0%
PushPay	-	-	-
Salesforce	21.8%	1.7%	2.7%
Sea	29.0%	-	-
Shopify	15.7%	-10.6%	5.2%
Starbucks	8.7%	10.3%	18.8%
Tencent Holdings	-3.1%	16.8%	12.5%
Tesla	41.6%	3.7%	5.1%
The Trade Desk	34.6%	22.8%	1.2%
Tractor Supply	8.4%	10.6%	14.3%
TSMC	43.5%	22.7%	5.5%
Twilio	41.0%	-8.3%	0.5%
Upstart	17.6%	-26.6%	46.0%
Veeva Systems	17.3%	17.2%	25.0%
Visa	18.7%	69.0%	69.1%
Wise	50.5%	-	-
Wix	9.4%	-4.6%	4.7%
Zoom	7.6%	20.9%	44.5%
Simple average	**20.6%**	**12.5%**	**16.8%**

Source: Companies' earnings updates

(As of the publication of this letter, there's no quarterly free cash flow data available for Pushpay, Sea, and Wise for the second quarter of 2022. We did not include free cash flow data for Markel because we don't think it's as important for the company - it is predominantly an **insurer and investment holding company**, so we think the book value holds more meaning.)

In summary, we are pleased with the aggregate business performance of Compounder Fund's portfolio holdings.

Near the beginning of this letter, I mentioned that I will have more to share on the stark differences between the business performances of Compounder Fund's holdings and their declining stock prices. Table 11 below shows a few things for the period from 30 June 2022 to 30 September 2022 for the fund's current crop of 50 companies: The change in their trailing revenues-per-share; the change in their trailing P/S (price-to-sales) ratios; and the change in their stock prices. I'm using revenue instead of earnings or cash flow because some of Compounder Fund's holdings are still heavily reinvesting in their businesses for future growth. As a result, they currently are deliberately loss-making, have negative free cash flow, or have low profit and/or free cash flow margins.

Table 11

Company	Trailing revenue per share on 30 Jun 2022	Trailing revenue per share on 30 Sep 2022	P/S ratio on 30 Jun 2022	P/S ratio on 30 Sep 2022	Trailing revenue per share change from 30 Jun 2022 to 30 Sep 2022	P/S ratio change from 30 Jun 2022 to 30 Sep 2022	Stock price change from 30 Jun 2022 to 30 Sep 2022
Activision Blizzard	US$ 10.56	US$ 9.71	7.4	7.7	-8.0%	3.8%	-4.5%
Adobe	US$ 35.29	US$ 36.34	10.4	7.6	3.0%	-27.0%	-24.8%
Adyen	€ 32.65	€ 37.53	42.5	34.7	14.9%	-18.4%	-6.2%
Alphabet	US$ 20.25	US$ 20.92	5.4	4.6	3.3%	-15.0%	-12.2%
Alteryx	US$ 8.48	US$ 9.34	5.7	6.0	10.1%	4.7%	15.3%
Amazon	US$ 46.93	US$ 47.76	2.3	2.4	1.8%	4.5%	6.4%
Apple	US$ 23.53	US$ 23.64	5.8	5.8	0.5%	0.6%	1.1%
ASML	€ 44.29	€ 46.36	10.3	9.1	4.7%	-10.9%	-12.7%
Block	US$ 30.59	US$ 29.01	2.0	1.9	-5.2%	-5.6%	-10.5%
Chipotle	US$ 276.53	US$ 288.94	4.7	5.2	4.5%	10.0%	15.0%
Costco	US$ 488.97	US$ 510.29	1.0	0.9	4.4%	-5.6%	-1.5%
Coupang	US$ 11.00	US$ 11.29	1.2	1.5	2.6%	27.3%	30.7%
Datadog	US$ 3.45	US$ 3.95	27.6	22.5	14.5%	-18.6%	-6.8%
dLocal	US$ 0.93	US$ 1.07	28.2	19.2	15.1%	-31.8%	-21.8%
DocuSign	US$ 11.15	US$ 11.68	5.1	4.6	4.8%	-11.0%	-6.8%
Etsy	US$ 16.07	US$ 16.49	4.6	6.1	2.6%	33.3%	36.8%
Fiverr	US$ 8.58	US$ 8.84	4.0	3.5	3.0%	-13.7%	-11.0%
Haidilao	RMB 7.74	RMB 6.98	2.0	2.0	-9.8%	-0.8%	-15.8%
Illumina	US$ 29.28	US$ 29.88	6.3	6.4	2.0%	1.4%	3.5%
Intuitive Surgical	US$ 16.10	US$ 16.33	12.5	11.5	1.4%	-7.9%	-6.6%
Markel	US$ 813.69	US$ 853.28	1.6	1.3	4.9%	-20.1%	-16.2%
Mastercard	US$ 20.28	US$ 21.36	15.6	13.3	5.3%	-14.4%	-9.9%

Table 11 (continued from above)							
Company	**Trailing revenue per share on 30 Jun 2022**	**Trailing revenue per share on 30 Sep 2022**	**P/S ratio on 30 Jun 2022**	**P/S ratio on 30 Sep 2022**	**Trailing revenue per share change from 30 Jun 2022 to 30 Sep 2022**	**P/S ratio change from 30 Jun 2022 to 30 Sep 2022**	**Stock price change from 30 Jun 2022 to 30 Sep 2022**
Medistim	NOK 23.84	NOK 24.54	11.9	8.5	2.9%	-28.7%	-26.5%
Medpace	US$ 33.37	US$ 36.71	4.5	4.3	10.0%	-4.6%	5.0%
Meituan	RMB 31.20	RMB 31.87	5.3	4.7	2.1%	-11.3%	-14.7%
Mercado Libre	US$ 157.49	US$ 175.31	4.0	4.7	11.3%	16.8%	30.0%
Meta Platforms	US$ 43.64	US$ 43.76	3.7	3.1	0.3%	-16.1%	-15.9%
Microsoft	US$ 25.50	US$ 26.30	10.1	8.9	3.1%	-12.1%	-9.3%
MongoDB	US$ 14.44	US$ 15.91	18.0	12.5	10.2%	-30.6%	-23.5%
Netflix	US$ 67.12	US$ 68.72	2.6	3.4	2.4%	31.5%	34.6%
Okta	US$ 9.39	US$ 10.22	9.6	5.6	8.8%	-42.2%	-37.1%
Paycom Software	US$ 19.53	US$ 20.82	14.3	15.8	6.6%	10.5%	17.8%
PayPal	US$ 22.03	US$ 22.63	3.2	3.8	2.7%	20.0%	23.2%
PushPay	US$ 0.18	US$ 0.18	4.2	2.9	0.0%	-30.5%	-14.2%
Salesforce	US$ 27.91	US$ 29.29	5.9	4.9	4.9%	-16.9%	-12.8%
Sea	US$ 19.94	US$ 21.08	3.4	2.7	5.7%	-20.7%	-16.2%
Shopify	US$ 3.83	US$ 3.97	8.2	6.8	3.7%	-16.7%	-13.8%
Starbucks	US$ 26.89	US$ 27.56	2.8	3.1	2.5%	7.6%	10.3%
Tencent Holdings	RMB 57.53	RMB 57.19	5.3	4.2	-0.6%	-19.7%	-24.8%
Tesla	US$ 17.92	US$ 19.38	12.5	13.7	8.1%	9.2%	18.2%
Trade Desk	US$ 2.67	US$ 2.86	15.7	20.9	7.1%	33.0%	42.6%
Tractor Supply	US$ 114.21	US$ 117.48	1.7	1.6	2.9%	-6.8%	-4.1%
TSMC	NT 330.96	NT 339.26	7.3	6.4	2.5%	-12.3%	-16.1%
Twilio	US$ 17.29	US$ 18.65	4.9	3.7	7.9%	-23.6%	-17.5%
Upstart	US$ 10.87	US$ 11.50	2.9	1.8	5.8%	-37.9%	-34.3%
Veeva	US$ 11.87	US$ 12.31	16.7	13.4	3.7%	-19.7%	-16.7%
Visa	US$ 12.58	US$ 13.19	15.7	13.5	4.8%	-14.0%	-9.8%
Wise	£ 0.54	£ 0.60	5.5	11.0	11.1%	99.9%	122.1%
Wix	US$ 22.74	US$ 23.15	2.9	3.4	1.8%	17.2%	19.3%
Zoom	US$ 13.75	US$ 14.00	7.8	5.3	1.8%	-33.0%	-31.8%
Simple average	-	-	**8.3**	**7.4**	**4.3%**	-	-

Source: Companies' earnings updates

What Table 11 highlights: **Compounder Fund's businesses have performed well over the past quarter (46 of them saw growth in their trailing revenues per share for 30**

September 2022 compared to 30 June 2022), but the stock prices of many of them fell because of a compression in their P/S ratios.

This said, the decline in the P/S ratio (from an average of 8.3 to 7.4) is a welcome change from prior quarters when Compounder Fund's holdings experienced even sharper P/S-ratio contractions. **We think Compounder Fund's holdings now have more-than-reasonable valuations (something which we also saw when I wrote the 2022 first-quarter letter, but did not mention) and this bodes well for the fund's future return**. As of 30 September 2022, the companies currently in Compounder Fund's portfolio **have an average trailing P/S ratio of 7.4, and an average trailing free cash flow margin of 16.7%, which equates to an average P/FCF ratio of 44**. If Compounder Fund's companies had an average free cash flow margin of 25% today - around the level we think they could achieve, eventually - **the implied P/FCF ratio would be even lower at 30**. For perspective, the implied P/FCF ratio of 30 comes from a group of companies - Compounder Fund's current portfolio - that produced impressive average revenue growth rates of 44.0%, 27.4%, and 20.6% for the whole of 2021 and the first and second quarters of 2022, respectively.

An unfortunate but necessary disconnect

One of the most frustrating aspects of investing in stocks - and something Jeremy and I have unfortunately led all of you in Compounder Fund to experience so far - is that business-success can sometimes be divorced violently from stock price movements.

For example, let's look at two groups of real-life companies. If you could go back in time to the start of this year, which group would you be interested to invest in? Table 12 below shows the historical revenue and free cash flow - both on a per-share basis to account for dilution - for the two companies in Group 1, namely, Company A and Company B. Company A did not grow its revenue per share much over the past four-and-a-half years, its free cash flow per share has not been steady, and its free cash flow margin was only in the low-teens range at best. Meanwhile, Company B's revenue per share barely budged and although its free cash flow per share doubled, the free cash flow margin has already hit a high level. There's only so much juice left that can be squeezed from improving the free cash flow margin.

Table 12

Metric	2017	2018	2019	2020	2021	12 months ended 30 June 2022
Company A revenue per share in US$	36.70	38.84	39.60	39.96	41.27	42.63
Company A free cash flow per share in US$	-0.28	2.75	1.72	4.30	3.34	3.80
Company A free cash flow margin	-0.8%	7.1%	4.3%	10.8%	8.1%	8.9%
Company B revenue per share in US$	8.37	7.98	8.64	7.64	8.91	9.49
Company B free cash flow per share in US$	1.22	1.41	1.95	2.00	2.59	2.35
Company B free cash flow margin	14.6%	17.7%	22.6%	26.3%	29.1%	24.8%

Source: Companies' annual reports and earnings reports

Next we have Table 13 below, which shows the historical revenue and free cash flow - again on a per-share basis - for the two companies in Group 2, Company C and Company D. Both companies produced excellent revenue growth, with Company C quadrupling its revenue per share and Company D increasing its per-share topline around five times. Both companies also produced consistent and impressive growth in free cash flow per share over the period while exhibiting excellent free cash flow margins for most of, or the entire, time frame.

Table 13 (revenue and free cash flow are per-share numbers)

Metric	2017	2018	2019	2020	2021	12 months ended 30 June 2022
Company C revenue per share in US$	0.70	1.04	1.38	1.71	2.40	2.86
Company C free cash flow per share in US$	0.04	0.13	0.04	0.66	0.64	0.98
Company C free cash flow margin	5.9%	12.9%	3.0%	38.9%	26.6%	34.3%
Company D revenue per share in €	7.14	11.40	17.50	22.31	32.65	37.53
Company D free cash flow per share in €	2.89	5.49	9.40	12.10	18.47	20.27
Company D free cash flow margin	40.5%	48.2%	53.7%	54.2%	56.6%	54.0%

Source: Companies' annual reports and earnings reports

So would you prefer to invest in Group 1 or Group 2 if you could travel back in time to the start of this year? It's clear that Group 2 contains the superior businesses - not only do they have fat free cash flow margins, their revenues have also been growing rapidly. If you're a business-focused investor - like Compounder Fund - you likely would have picked Group 2. **But if you did, you would be nursing a big loss for both companies in the group**. On the other hand, the Group 1 companies saw either a small increase or a moderate decline in their stock prices. Table 14 shows the identities of the companies in the two groups, and their stock price performances, including dividends, for the first nine months of this year.

Table 14

Company	Stock price performance, including dividends, from end of 2021 to 30 September 2022
Company A: Kellogg	10.9%
Company B: Coca-Cola	-3.3%
Company C: The Trade Desk	-34.8%
Company D: Adyen	-43.7%

Source: Yahoo Finance

But interestingly, over the five years ended 30 September 2022, Trade Desk's stock price is up by 871% whereas Kellogg's and Coca-Cola's returns were much poorer at 33% and 46%, respectively. Adyen was listed only on 13 June 2018 and from then to 30 September 2022, its stock price is up by 186%; in this time period, Trade Desk, Kellogg and Coca-Cola's respective returns are 563%, 23%, and 46%. What these show is that business fundamentals and stock prices can move in completely opposite directions in the short run, but over the long run, business fundamentals are what dominates stock prices.

The experience of Trade Desk and Adyen are not isolated cases, nor a modern phenomenon. **Even Berkshire Hathaway, the storied conglomerate of the investing legend and - our investing hero - Warren Buffett, has seen an extreme dislocation in its share price and business performance in the distant past**. Buffett assumed control of Berkshire in 1965 and Table 15 shows the five highest annualised growth rates in book value per share Berkshire has produced over rolling 10-year calendar-year periods from 1965 to 2021.

Table 15

List of Berkshire's top-five decades with highest annualised book value per share growth rates	Annualised growth rate in Berkshire's book value per share
1976-1985	33.0%
1975-1984	30.4%
1977-1986	29.9%
1974-1983	29.4%
1980-1989	29.0%

Source: Berkshire annual shareholder letters

In the 1974-1983 period, Berkshire produced one of its highest annualised book value per share growth rates at 29.4%. The destination was brilliant, but the journey was anything but smooth. **A dollar invested in Berkshire shares at the end of 1973 would be worth just 52.6 cents (a *decline* of 47.4%) by the end of 1975. Over the same years, the S&P 500 was *up* by 1.0% including dividends**. And it wasn't the case where Berkshire's book value per share experienced a traumatic decline - in fact, the book value per share *increased* by a total of 28.6% in that period. Moreover, prior to the decline in Berkshire's stock price, its book value per share was up by a healthy 16.0% per year from 1965 to 1973. **So in the first two years of one of the best decades of value-building Buffett has led Berkshire in, after a long period of excellent business growth, the company's stock price fell by nearly half and also dramatically underperformed the US stock market.**

But as an apt reflection of Ben Graham's timeless analogy of the stock market being a voting machine in the short run but a weighing machine in the long run, **Berkshire's book value per share and stock price compounded at highly similar annual rates of 29.4% and 32.6% over the 1974-1983 timeframe (the S&P 500's annualised return was just 10.5%)**. This is the unfortunate reality confronting investors who are focused on the long-term business destinations of the companies they're invested in: The end point has the potential to be incredibly well-rewarding, but the journey can also be blisteringly painful.

Jeremy and I had set out, and are continuing, to invest Compounder Fund's capital - which we are fully aware, consists of your hard-earned money you've entrusted to us - in high-quality businesses with outstanding growth potential and hold their shares for the long run. We are keenly focused on the destination of companies, knowing full well that the journey could be filled with the toughest obstacles and abysmal valleys (and we're in one of those valleys right now). Reading this, some of you may wonder: Why did we undertake such an investment operation whereby the interim experiences could be crushing? It's because this is the best way we know of to invest in the stock market, and the long-term gains could be more than pleasing. But it's not something that Jeremy and I can do alone - it's only possible with your gentle patience and thoughtful support. So *thank you, again*.

Recession, inflation, and interest rates

Peter Lynch, the legendary manager of the Fidelity Magellan Fund from 1977 to 1990, once said that "there is always something to worry about." In today's context, Jeremy and I think three of the biggest issues that currently occupy the thoughts of most stock market participants would be the possibility of a recession in the USA and the high inflation as well as rising interest rates seen there and in many other countries. How are we responding to these risks when managing Compounder Fund?

In the fund's **Owner's Manual** and **website**, Jeremy and I wrote:

> "In essence, we're investing based on the strengths of a stock's business. We will *not* be investing Compounder Fund's capital based on predictions about financial markets, stock prices, economies, and politics."

This does *not* mean we ignore macro worries in our investing process. We're just not interested in making predictions about big-picture issues because it's so hard to get them right. Howard Marks, the co-founder of Oaktree Capital and an investor we deeply respect, wrote recently:

> "The problem, in short, is that I don't think there can be a process capable of consistently turning the large number of variables associated with economies and financial markets (the inputs) into a useful macro forecast (the output)."

Instead, **how Jeremy and I approach macro concerns in managing Compounder Fund's capital is to simply accept that bad scenarios *inevitably* happen from time to time, but we just don't know when**. So what we do is to invest in companies that we think have both bright growth prospects in peaceful conditions *and* a high likelihood of making it through a crisis either relatively unscathed or in even better shape than before.

To manage the risk of recessions and rising interest rates, we focus on investing in companies with strong balance sheets and/or resilient revenues and cash flows. To handle inflationary environments, we seek companies that are solving important problems and/or lowering costs for their customers (we think such companies are better-equipped to handle rising input costs without losing business); we also want companies that have a high chance of producing strong business growth (more on this later). To navigate an unpredictable and fast-changing world, we aim to partner with management teams that we find to possess integrity, innovative minds, and excellent execution capabilities. We're not trying to shift the portfolio into companies with different characteristics depending on the macro-worry-of-the-day (remember, we're not interested in making predictions on such matters) - we want to invest in companies that possess all or most of these characteristics. As a reminder, we seek companies with the following traits for Compounder Fund:

1. Revenues that are small in relation to a large and/or growing market, or revenues that are large in a fast-growing market (I want to highlight that we're not interested in faddish markets - in order to not be considered a fad, a service or product needs to be solving important problems for its users)
2. Strong balance sheets with minimal or reasonable levels of debt
3. Management teams with integrity, capability, and an innovative mindset
4. Revenue streams that are recurring in nature, either through contracts or customer-behaviour
5. A proven ability to grow

6. A high likelihood of generating a strong and growing stream of free cash flow in the future

We think companies with these traits have the best chance of being able to grow their business values - and thus their stock prices - over the long run, come rain or shine. In our **investment theses for each company** that's currently in Compounder Fund's portfolio, we describe in detail how the company exhibits all or most of these six characteristics. **Coming back to the question on how Jeremy and I are responding to the prominent risks of today - recession, inflation, and higher interest rates - simply put, there's no change in how we're investing**. As I mentioned earlier, we operate with the idea that bad scenarios *will* happen from time to time, we just don't know when - what this means is we're aware that there are always risks lurking around the corner and we have been, and continue to, invest with this in mind.

Lest you think jumping in and out of stocks depending on whether a recession or a rise in interest rates is on the cards is a good idea, it's not. Here's why:

- **It's not a given that stocks will definitely fall during a recession**. **According** to Ben Carlson, Director of Institutional Asset Management at Ritholtz Wealth Management, there have been 12 recessions in the USA since World War II (WWII). The average return for the S&P 500 when all these recessions took place was 1.4%. There were some horrible returns within the average. For example, the recession that stretched from December 2007 to June 2009 saw the S&P 500 fall by 35.5%. But there were also decent returns. For the recession between July 1981 and November 1982, the S&P 500 gained 14.7%.
- **Holding onto stocks in the lead up to, through, and in the years after a recession, has mostly produced good returns**. Carlson also showed that if you had invested in the S&P 500 six months prior to all of the 12 recessions since WWII and held on for 10 years after each of them, you would have earned a positive return on every occasion. Furthermore, the returns were largely rewarding. The worst return was a total gain of 9.4% for the recession that lasted from March 2001 to November 2001. The best was the first post-WWII recession that happened from November 1948 to October 1949, a staggering return of 555.7%. After taking away the best and worst returns, the average was 257.2%.
- **Avoiding recessions flawlessly would have caused your return to drop significantly**. **Data** from Michael Batnick, Carlson's colleague, showed that a dollar invested in US stocks at the start of 1980 would be worth north of $78 around the end of 2018 if you had simply held the stocks and did nothing. But if you invested the same dollar in US stocks at the start of 1980 and expertly side-stepped the ensuing recessions to perfection, you would have less than $32 at the same endpoint.
- **Stocks tend to bottom *before* the economy does**. The three most recent recessions in the USA prior to COVID-19 would be the recessions that lasted from July 1990 to March 1991, from March 2001 to November 2001, and from December 2007 to June 2009. During the first recession in this sample, **data on the S&P 500** from Yale economist Robert Shiller showed that the S&P 500 bottomed in October 1990. In the second episode, the S&P 500 found its low 15 months after the end of the recession, in February 2003. This phenomenon was caused by the aftermath of the dotcom bubble's bursting. For the third recession, the S&P 500 reached a trough in March 2009, three months before the recession ended. Even if we are right today that the economy would be in worse shape in the months ahead, stocks may already have bottomed or be near one - only time can tell.

- **Stocks have climbed in rising interest rate environments**. Carlson has **shown** that the S&P 500 climbed by 21% annually from 1954 to 1964 even when the yield on 3-month Treasury bills (a good proxy for the Fed Funds rate, which is the key interest rate set by the USA's central bank, the Federal Reserve) surged from around 1.2% to 4.4% in the same period. In the 1960s, the yield on the 3-month Treasury bill doubled from just over 4% to 8%, but US stocks still rose by 7.7% per year. And then in the 1970s, rates climbed from 8% to 12% and the S&P 500 still produced an annual return of nearly 6%.

Earlier in this section, I mentioned that we look for companies with a high chance for producing strong business growth as a way to handle the risk of inflation should it flare up. The experience of Walmart, the US-based retailing giant, is an illustrative example. In the post-WWII years, the 1970s was the worst decade for inflation in the USA, with the rate of inflation averaging at 7.1% according to data from the Federal Reserve Bank of St. Louis (see Table 16). During the decade, inflation ranged from 2.9% (in August 1972) to 13.9% (in December 1979). Inflation remained high in the early 1980s too, coming in between 3.8% (December 1982) and 14.6% (March and April 1980) in the first two years of the decade.

Table 16

Decades	Average inflation rate in the USA
1950s	2.1%
1960s	2.3%
1970s	7.1%
1980s	5.6%
1990s	3.0%
2000s	2.6%
2010s	1.8%

Source: Federal Reserve Bank of St. Louis

As inflation was raging in the USA in the 1970s, Walmart produced breath-taking business growth from 1971 to 1980. Table 17 shows the near 30x increase in Walmart's revenue and the 1,600% jump in earnings per share in that period. This exceptional growth did not help with Walmart's short-term return (remember the Berkshire episode?). Based on the earliest data I could find, Walmart's stock price *fell* by *three-quarters* from less than US$0.04 in late-August 1972 to around US$0.01 by December 1974 - in comparison, the S&P 500 was down by 'only' 40%. But by the end of 1979 (when inflation in the USA peaked during the 1970s), Walmart's stock price was above US$0.08, more than double what it was in late-August 1972 (when inflation was at a low in the 1970s). Still, the 2x-plus increase in Walmart's stock price was far below the huge increase in earnings per share the company generated. **This is where the passage of time helped - as more years passed, the weighing machine clicked into gear. At the end of 1989, Walmart's stock price was around US$3.70, representing an annualised growth rate in the region of 32% from August 1972; from 1971 to 1989, Walmart's revenue and earnings per share grew by 41% and 38% per year**.

Table 17

Year	Walmart revenue (US$, million)	Walmart net income (US$, million)	Walmart earnings per share, stock-split adjusted (US cents)
1971	44.3	1.6	0.059
1972	78.0	2.8	0.094
1973	124.9	4.4	0.133
1974	167.6	6.0	0.172
1975	236.2	6.0	0.188
1976	340.3	11.1	0.313
1977	478.8	16.0	0.438
1978	678.5	21.2	0.563
1979	900.3	29.4	0.750
1980	1,248.2	41.2	1.000

Source: Walmart annual reports

In a recent *Wall Street Journal* article, the renowned financial journalist Jason Zweig shared the following passages, which further illustrate the merits of investing in fast-growing businesses during inflationary environments:

> "The single-best performing stock between early 1966 and late 1982, however, was Tandy Corp. (later known as RadioShack Corp.). According to the Center for Research in Security Prices, Tandy returned 14,175% over that period…
>
> …Tandy's TRS-80 desktop microcomputer was one of the first personal computers to hit the market. In a Wall Street Journal advertisement for the TRS-80 in 1978, Tandy emphasized its "affordability" at $599; by 1980, a far more powerful version cost just $699.
>
> Between 1976 and 1982, Tandy's earnings roughly quadrupled—not because it had pricing power, but because its business boomed in a stagnant economy."

Strong long-term business growth is a valuable trait for investors, be it in inflationary or non-inflationary times. In fact, it is a valuable trait in nearly all scenarios. This is why at Compounder Fund, Jeremy and I are focused on finding and investing in businesses with the potential for producing high rates of growth in the long run.

House-keeping matters and what's next

As a reminder, on 11 May 2022, we sent a digital copy of Compounder Fund's audited financial statements for 2021 to all of the fund's investors. If you did not receive it, or if you joined the fund as an investor after 11 May 2022 and would like a digital copy of the audited financial statements for 2021, please let Jeremy and me know.

As Jeremy and I have shared before, giving back to society is one of the four key pillars of Compounder Fund's mission to "Grow *Your* Wealth & Enrich Society." In the fund's website, we **mentioned** that "we are setting aside at least 10% of every dollar we earn from Compounder Fund in each year for charities of our choice" and that "we will audit our giving." The first audit for our giving covered the period from November 2019 (when we started building the fund) to December 2021; subsequent audits will be conducted on an annual basis. The first audit report is available on the fund's website **here**. If you are interested to know more, feel free to reach out!

Another of the key pillars of Compounder Fund's mission involves investor education. To this end, Jeremy and I are running Compounder Fund transparently. We have released the investment theses for all of Compounder Fund's 50 current holdings (for your convenience, all our theses can be **found here**). As already mentioned, our detailed thoughts on why we sold Teladoc will be published in the months ahead. We will inform you once it is ready. In the future, we will also be publishing our theses if and when we add new companies to the portfolio or completely exit an existing holding.

Compounder Fund's next subscription window will close in the middle of December 2022 and it will have a dealing date on the first business day of January 2023 (which should be 2nd January). If you would like to increase your investment in the fund, please submit the relevant paperwork by the middle of December 2022. Jeremy and I are happy to assist with any queries you may have.

Optimism (as always!)

There are a myriad of important political, social, economic, and healthcare issues that are plaguing our globe today (I mentioned some of them in the "*Recession, inflation, and interest rates*" section of this letter). But 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 nearly 8.0 billion individuals in the world **right now**, 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 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. We will remain long-term optimistic on stocks so long as we continue to have this faith.

History has shown that people rise to the occasion when tough times descend. On the surface, there's no obvious common thread that links iconic American companies such as IBM, Disney, Hewlett-Packard, Hyatt, FedEx, Microsoft, Apple, and Airbnb, given that they belong to a myriad of industries. What they all share is that they were founded in years when the American economy was in or near a recession, as Table 18 illustrates. They're not exceptions either. According to the Kaufman Foundation, over 50% of the companies in the 2009 Fortune 500 list (the Fortune 500 are the top 500 American companies by revenue) were founded during a recession or bear market. I don't know what the founding years are for the companies in the 2009 Fortune 500 list. But in the 100 years ended 2009, there were a total of 20 recessionary episodes that occurred over 285 months, meaning that the USA was in a recession in only 24% of the time; this gives perspective on the incredible amount of business value that people can create even - or perhaps, *especially* - in the face of adversity.

Table 18

Company	Founding year	Nearest recessionary episode in the USA to company's founding
IBM	1911	Jan 1910 - Jan 1912
Disney	1923	May 1923 - Jul 1924
Hewlett-Packard	1939	May 1937 - Jun 1938
Hyatt	1957	Aug 1957 - Apr 1958
FedEx	1971	Dec 1969 - Nov 1970
Microsoft	1975	Nov 1973 - Mar 1975
Apple	1976	Nov 1973 - Mar 1975
Airbnb	2008	Dec 2007 - Jun 2009

Source: Companies' data and National Bureau of Economic Research

The only time Jeremy and I will turn pessimistic on the long-term returns of stocks is when they become wildly overpriced - and we don't think this is the case today. This does *not* mean that stocks are cheap or that stocks won't fall in the months or next year or two ahead (remember, we don't know what the journey will look like!). It only means that we think valuations are somewhat reasonable and that investing now will likely lead to a satisfactory outcome, if we have a multi-year time horizon and we're invested in fast-growing companies. **With your support, we have both ingredients at Compounder Fund.**

Final words

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 me with your hard-earned capital. We deeply appreciate your trust and support, your belief in Compounder Fund's mission to "Grow *Your* Wealth & Enrich Society," and your understanding of the investing approach that we are taking.

Your deep understanding of our long-term-oriented investment style gives us the space we need to do our work (analysing businesses and their possible long-run futures) to the best of our abilities, for you. **So, thank you all again for being the wonderful investors that you all are. And please, *never* underestimate your importance in helping to shape Compounder Fund's long-run return.**

You can expect to see Compounder Fund's 2022 fourth-quarter investors' letter in mid-January next year. Till then, stay safe and take care.

Excelsior,
Chong Ser Jing
Co-founder and Portfolio Manager, Compounder Fund
12 October 2022

P.S.: You can find all of our **past investors' letters here**.

Disclaimer

The Information published herein is intended for “Accredited Investors” and/or “Institutional Investors” only as defined in the Singapore Securities & Futures Act (Cap. 289) of Singapore ("SFA"). This Information is provided for informational and discussion purposes only and is not, and may not be relied on in any manner (legal, tax or investment advice) as an offer to sell or a solicitation of an offer to buy or subscribe to any funds managed by Galilee Investment Management Pte. Ltd. ("Galilee"). An offering of interests in the Fund will only be made pursuant to a confidential offering memorandum or similar written material and the Fund’s subscription documents (collectively referred to as the “Material”), which will be furnished to accredited or institutional investors (and their employees and agents) on a confidential basis at their request for their consideration in connection with such offering. None of the information or analyses presented is intended to form the basis for any investment decision, and no specific recommendations are intended. No reliance may be placed for any purpose on the Information provided or the accuracy or completeness thereof and no responsibility can be accepted by Galilee, and/or any of their respective affiliated entities to anyone for any action taken on the basis of such information. Whilst Galilee shall use reasonable efforts to obtain information from sources which we believe to be reliable and up to date, Galilee gives no warranty as to the accuracy, completeness or reliability of any information, opinions or forecasts contained in the Information. No responsibility or liability can be accepted for any errors or omissions or for any loss resulting from the use of the Information. Past performance of the managers and the funds, and any forecasts on the economy, stock or bond market, or economic trends that are targeted by the funds, are not indicative of future performance. Investment in the Fund will involve significant risks, including loss of the entire investment. The Fund will be illiquid, as there is no secondary market for interests in the Fund and none is expected to develop. There will be restrictions on transferring interests in the Fund. Investments may be leveraged and the investment performance may be volatile. Whilst Galilee shall use reasonable efforts to obtain information from sources which we believe to be reliable and up to date, Galilee gives no warranty as to the accuracy, completeness or reliability of any information, opinions or forecasts contained in the Information. No responsibility or liability can be accepted for any errors or omissions or for any loss resulting from the use of the Information. Galilee may update, revise, delete or modify the content and information herein without notice. The material should only be considered current as of the time of initial publication or as otherwise stated in the Material without regard to the date on which you may access the Material. These exclusions of liability do not apply to the extent that such exclusions are invalid or ineffective under any law or regulation applicable to Galilee. Before deciding to invest in the Fund, prospective investors should read the Material and pay particular attention to the risk factors contained in the Material. Investors should have the financial ability and willingness to accept the risk characteristics of the Fund’s investments, including any risk factor, forward looking statements as set out in the Material. Holdings are subject to change at any time.