Compounder Fund Investors' Letter: Solidarity

Dear investors,

Jeremy and I typically send you a letter once a quarter describing Compounder Fund's investment activities and our thoughts on investing topics we deem to be important for the fund's long-term return. Accordingly, the last letter, which was sent just three weeks ago, was for the **fourth quarter of 2021**. We've decided to write to all of you again given the significant declines seen in the *stock prices* for many of Compounder Fund's holdings in the month of January 2022. This volatility, which is shown in Table 1 below, is in addition to the poor 2021 that many of these companies have experienced in their *stock prices* (again shown in Table 1).

Compounder Fund's mission is to "Grow Your Wealth and Enrich Society." To accomplish the first part of the mission, Jeremy and I need to do two things. First, we need to invest well by finding Compounders, buying their shares, and holding these shares over the long run. Compounders, as you all are aware, are companies that we think can compound their intrinsic business values at high rates for a long time. Second, we need to ensure that all of Compounder Fund's investors - that's you! - understand the investing game that Jeremy and I are playing and are aligned with it.

Our investing game is one that focuses on the long-term performance of a company's business. It relies on the idea - borne out of observations about the behaviour of stocks for long periods of time - that stock prices and business growth converge over the long run, even though stock prices can be volatile in the short run. I discussed the investing game that Jeremy and I are playing in greater detail in the "*Investing thoughts: Playing the right game*" section of Compounder Fund's **2021 second-quarter investors' letter**. As for alignment, recall that in Compounder Fund's **Owner's Manual**, Jeremy and I implored all of you, with your best interests at heart, to "Please DO NOT invest in Compounder Fund using money that you require for the next five years, at least." Investing with long-term capital helps you *stay* invested for the long haul and be aligned with the investing game Jeremy and I are playing.

This understanding and alignment is critical because **investors can lose money if they're not in-sync with the investing game their fund managers are playing, even if they're invested with the best fund managers**. The *Wall Street Journal* **reported** in December 2009 that the CGM Focus Fund, which invests in US-listed stocks, had gained 18% annually over the past decade. The fund was the USA's best-performing diversified stock mutual fund for the period. But the average investor in the fund *lost* 11% per year in the same time frame. The key problem was that investors chased the CGM Focus Fund when it was doing well, but bailed when there were temporary declines. Investors in Peter Lynch's legendary Magellan Fund also made similar mistakes, as Jeremy and I described in the Owner's Manual. Despite Lynch producing a 29% annual return for Magellan Fund from 1977 to 1990, the average investor in his fund only made a gain of 7% per year.

To grow your wealth, Jeremy and I need your help to understand Compounder Fund's investing game and be aligned with it. We know that our investing game is not easy to play - because it hurts when stock prices decline - **but it is a game worth playing**. This is why we're writing to you outside of our typical schedule. We want to express our gratitude for your understanding of our investing game and to let all of you know that we're in this together. Most importantly, we want to let you know that **this too, shall pass**.

Table 1

Company	Stock price change from 31 Dec 2020 to 31 Dec 2021	Stock price from 31 Dec 2021 to 23 January 2022	Stock price change from 31 Dec 2020 to 23 January 2022
a2 Milk	-52.3%	-6.2%	-55.3%
Activision Blizzard	-28.3%	22.3%	-12.4%
Adobe	13.4%	-11.8%	0.0%
Afterpay Touch	-29.7%	-19.9%	-43.7%
Alphabet	65.3%	-10.0%	48.7%
Alteryx	-50.3%	-12.2%	-56.4%
Amazon	2.4%	-14.4%	-12.4%
Apple	33.8%	-8.5%	22.4%
ASML	63.2%	-12.7%	42.4%
Block (formerly Square)	-25.8%	-26.9%	-45.7%
Chipotle Mexican Grill	26.1%	-21.2%	-0.6%
Costco	50.7%	-15.2%	27.8%
Coupang	-	-38.4%	-
Datadog	80.9%	-29.5%	27.5%
dLocal	-	-28.7%	-
DocuSign	-31.5%	-23.8%	-47.8%

Table 1 (continued from above)

Company	Stock price change from 31 Dec 2020 to 31 Dec 2021	Stock price from 31 Dec 2021 to 23 January 2022	Stock price change from 31 Dec 2020 to 23 January 2022
Etsy	23.1%	-32.0%	-16.3%
Fiverr	-41.7%	-28.6%	-58.4%
Haidilao	-70.3%	9.4%	-
Illumina	2.8%	-3.8%	-1.1%
Intuitive Surgical	31.8%	-25.0%	-1.2%
Markel	19.4%	-1.3%	17.9%
Mastercard	0.7%	-1.2%	-0.5%
Medistim	48.7%	-15.0%	26.5%
Meituan	-23.3%	3.3%	-20.8%
MercadoLibre	-19.5%	-21.9%	-37.2%
Meta Platforms (formerly Facebook)	23.1%	-9.9%	11.0%
Microsoft	51.2%	-12.0%	33.1%
MongoDB	47.4%	-29.1%	4.6%
Netflix	11.4%	-34.0%	-26.5%
Okta	-11.8%	-16.0%	-26.0%
Paycom Software	-8.2%	-25.3%	-31.5%
PayPal	-19.5%	-13.3%	-30.2%
PushPay	-29.8%	-10.4%	-37.1%
Salesforce	14.2%	-14.0%	-1.8%
Sea	12.4%	-31.0%	-22.4%
Shopify	21.7%	-36.0%	-22.1%
Starbucks	9.3%	-17.7%	-10.0%
Teladoc (Livongo)	-54.1%	-20.6%	-63.5%
Tencent Holdings	-19.1%	3.9%	-15.9%
Tesla	49.8%	-10.7%	33.8%
The Trade Desk	14.4%	-35.1%	-25.8%
Tractor Supply	69.7%	-12.4%	48.7%

Table 1 (continued from above)			
Company	**Stock price change from 31 Dec 2020 to 31 Dec 2021**	**Stock price from 31 Dec 2021 to 23 January 2022**	**Stock price change from 31 Dec 2020 to 23 January 2022**
Twilio	-22.2%	-27.1%	-43.3%
Upstart	271.3%	-38.7%	127.5%
Veeva Systems	-6.2%	-13.1%	-18.4%
Visa	-0.9%	-5.0%	-5.9%
Wise	-	-13.4%	-
Wix	-36.9%	-18.5%	-48.6%
Zoom	-45.5%	-19.7%	-56.2%

Source: Yahoo Finance
(Coupang was listed on 11 March 2021; dLocal was listed on 3 June 2021; Wise was listed on 7 July 2021)

Earlier in the first paragraph of this letter, I emphasised the phrase "stock prices." I did this to distinguish the stock price movements of Compounder Fund's companies from the performance of their underlying businesses. This distinction is important. What will drive Compounder Fund's return over a multi-year period is the business performance of the fund's companies (remember, business performance and stock prices converge in the long run!). Over the short run, however, what drives Compounder Fund's return is the change in the collective *feelings* market participants have about the growth prospects of the fund's businesses. **And importantly, changes in these feelings, which are represented by changes in valuation ratios, sometimes do not reflect the underlying reality of a business's growth**. In the 2021 fourth-quarter letter, I shared a striking example. Netflix's stock price collapsed by 60.6% in 2011, from US$25 at the start to less than US$10 at the end, despite achieving excellent revenue growth of 48%. **But this too, did pass**. Netflix's revenue continued growing at a healthy double-digit clip in the years ahead. The result? Netflix's stock price was US$398 as of 23 January 2022, around 1,500% *higher* than at the start of 2011.

At Compounder Fund, Jeremy and I are making our investment decisions based on the underlying reality of business performances. **The good news is Compounder Fund's companies have been performing really well business-wise - much better than the market (as represented by the S&P 500) - and they continue to have bright long-term growth prospects**. Table 2 below, which was first displayed in the 2021 fourth-quarter letter, gives a useful perspective on the far-superior growth rates for Compounder Fund's businesses compared to the S&P 500.

Table 2

Collection of stocks	Revenue growth in Q1 2020 from a year ago	Revenue growth in Q2 2020 from a year ago	Revenue growth in Q3 2020 from a year ago	Revenue growth in Q4 2020 from a year ago	Revenue growth in Q1 2021 from a year ago	Revenue growth in Q2 2021 from a year ago	Revenue growth in Q3 2021 from a year ago
S&P 500	Around -2%	Around -10%	Around -2%	Around -0.5%	Around 10%	Around 25%	16.6%
Compound -er Fund current portfolio	38.6%	36.5%	45.8%	47.7%	56.8%	77.9%	40.8%

*Source: **Yardeni Research** for S&P 500 data (data for S&P 500 is as of 22 December 2021; revenue growth rate for Compounder Fund's current portfolio is a simple average of the revenue growth from all the fund's current holdings)*

One of Compounder Fund's investors recently provided an excellent suggestion to me. He thought it would be a great idea to show changes in the earnings and P/E (price-to-earnings) ratios for Compounder Fund's companies in future quarterly letters. In this way, it's easier to see the disconnect, if any, between operating growth and stock price changes. I agree. So in Table 3 below, you can see the change in the trailing revenue-per-share for Compounder Fund's companies from the end of 2020 to 23 January 2022, as well as the change in their P/S (price-to-sales) ratios. The table also shows the same numbers for the S&P 500. I'm using revenue instead of earnings because some of Compounder Fund's holdings are still heavily reinvesting in their businesses for future growth. As a result, they are currently loss-making, have negative free cash flow, or currently have low profit and free cash flow margins.

Table 3

Company	Trailing revenue per share on 31 Dec 2020	Trailing revenue per share on 23 Jan 2022	P/S ratio on 31 Dec 2020	P/S ratio on 23 Jan 2022	Revenue per share change from 31 Dec 2020 to 23 Jan 2022	P/S ratio change from 31 Dec 2020 to 23 Jan 2022	Stock price change from 31 Dec 2020 to 23 January 2022
a2 Milk	NZ$2.34	NZ$1.62	5.3	3.4	-30.6%	-36.0%	-55.3%
Activision Blizzard	US$9.86	US$11.55	9.4	7.0	17.1%	-25.2%	-12.4%
Adobe	US$26.53	US$32.82	18.8	15.2	23.7%	-19.2%	0.0%
Afterpay Touch	A$1.95	A$3.22	60.5	20.7	64.8%	-65.8%	-43.7%
Alphabet	US$249.43	US$352.09	7.0	7.4	41.2%	5.4%	48.7%
Alteryx	US$7.45	US$7.79	16.3	6.8	4.5%	-58.3%	-56.4%
Amazon	US$683.59	US$890.98	4.8	3.2	30.3%	-32.8%	-12.4%
Apple	US$15.66	US$21.69	8.5	7.5	38.5%	-11.6%	22.4%
ASML	€32.79	€44.41	12.4	13.8	35.4%	11.2%	42.4%

Table 3 (continued from above)							
Company	**Trailing revenue per share on 31 Dec 2020**	**Trailing revenue per share on 23 Jan 2022**	**P/S ratio on 31 Dec 2020**	**P/S ratio on 23 Jan 2022**	**Revenue per share change from 31 Dec 2020 to 23 Jan 2022**	**P/S ratio change from 31 Dec 2020 to 23 Jan 2022**	**Stock price change from 31 Dec 2020 to 23 January 2022**
Block (formerly Square)	US$17.40	US$32.18	12.5	3.7	85.0%	-70.7%	-45.7%
Chipotle Mexican Grill	US$205.05	US$252.25	6.8	5.5	23.0%	-19.2%	-0.6%
Costco	US$389.14	US$456.78	1.0	1.1	17.4%	8.9%	27.8%
Coupang	US$5.87	US$9.81	-	1.8	67.1%	-	-
Datadog	US$1.78	US$2.86	55.2	44.0	60.2%	-20.4%	27.5%
dLocal	US$0.3	US$0.67	-	38.2	123.4%	-	-
DocuSign	US$7.02	US$9.99	31.7	11.6	42.3%	-63.3%	-47.8%
Etsy	US$10.26	US$15.28	17.3	9.7	49.0%	-43.9%	-16.3%
Fiverr	US$5.04	US$7.61	38.7	10.7	51.1%	-72.5%	-58.4%
Haidilao	RMB4.65	RMB7.35	10.8	2.1	58.2%	-80.3%	-
Illumina	US$21.89	US$28.72	16.9	12.7	31.3%	-24.6%	-1.1%
Intuitive Surgical	US$11.96	US$15.61	22.8	17.3	30.5%	-24.2%	-1.2%
Markel	US$599.04	US$726.68	1.7	1.7	21.3%	-2.8%	17.9%
Mastercard	US$15.47	US$17.9	23.1	19.8	15.7%	-14.0%	-0.5%
Medistim	NOK19.99	NOK22.11	12.4	14.1	10.6%	14.4%	26.5%
Meituan	RMB17.57	RMB28.12	14.1	6.7	60.0%	-52.3%	-20.8%
Mercado Libre	US$66.78	US$126.34	25.1	8.3	89.2%	-66.8%	-37.2%
Meta Platforms (formerly Facebook)	US$27.39	US$39.06	10.0	7.8	42.6%	-22.2%	11.0%
Microsoft	US$19.26	US$23.29	11.5	12.7	20.9%	10.1%	33.1%
MongoDB	US$9.28	US$12.21	38.7	30.8	31.5%	-20.5%	4.6%
Netflix	US$52.48	US$65.22	10.3	6.1	24.3%	-40.8%	-26.5%
Okta	US$6.08	US$7.9	41.8	23.8	29.9%	-43.0%	-26.0%
Paycom Software	US$13.96	US$17.04	32.4	18.2	22.1%	-43.8%	-31.5%
PayPal	US$17.12	US$20.7	13.7	7.9	20.9%	-42.3%	-30.2%
PushPay	US$0.14	US$0.17	9.5	4.8	17.4%	-50.0%	-37.1%
Salesforce	US$21.91	US$25.92	10.2	8.4	18.3%	-17.0%	-1.8%
Sea	US$7.61	US$15.79	26.2	9.8	107.5%	-62.6%	-22.4%

Table 3 (continued from above)							
Company	**Trailing revenue per share on 31 Dec 2020**	**Trailing revenue per share on 23 Jan 2022**	**P/S ratio on 31 Dec 2020**	**P/S ratio on 23 Jan 2022**	**Revenue per share change from 31 Dec 2020 to 23 Jan 2022**	**P/S ratio change from 31 Dec 2020 to 23 Jan 2022**	**Stock price change from 31 Dec 2020 to 23 January 2022**
Shopify	US$19.91	US$33.08	56.9	26.7	66.1%	-53.1%	-22.1%
Starbucks	US$19.9	US$24.51	5.4	3.9	23.2%	-26.9%	-10.0%
Teladoc (Livongo)	US$11.14	US$11.94	17.9	6.1	7.2%	-66.0%	-63.5%
Tencent Holdings	RMB46.71	RMB56.67	10.2	6.8	21.3%	-33.2%	-15.9%
Tesla	US$25.5	US$41.72	27.7	22.6	63.6%	-18.2%	33.8%
The Trade Desk	US$1.5	US$2.25	53.3	26.4	49.8%	-50.5%	-25.8%
Tractor Supply	US$84.66	US$105.79	1.7	2.0	25.0%	19.0%	48.7%
Twilio	US$10.82	US$14.75	31.3	13.0	36.4%	-58.4%	-43.3%
Upstart	US$2.89	US$6.35	14.1	14.6	120.0%	3.4%	127.5%
Veeva Systems	US$8.6	US$10.83	31.7	20.5	26.0%	-35.3%	-18.4%
Visa	US$9.83	US$11.02	22.3	18.7	12.1%	-16.0%	-5.9%
Wise	£0.36	£0.51	-	12.9	39.1%	-	-
Wix	US$18.13	US$22.68	13.8	5.7	25.1%	-58.9%	-48.6%
Zoom	US$6.58	US$12.79	51.3	11.5	94.5%	-77.5%	-56.2%

Source: Company filings; Yahoo Finance

What Table 3 shows: Compounder Fund's businesses have performed very well over the past year or so, but the stock prices of many of them have fared poorly because of large declines in their P/S ratios. In other words, while the underlying reality of Compounder Fund's businesses was that of healthy growth, market participants' *feelings* of their future prospects have turned for the worse. Can these feelings turn rosy again? We don't know. **But crucially, how market participants feel about the growth prospects of Compounder Fund's businesses *is not important for our investment process*. What's important is the underlying reality, the actual growth of the fund's businesses.** Let's use Twilio as an example.

When we first invested in Twilio in July 2020 at a stock price of US$258, it had a P/S ratio of around 28. This is a high valuation and singalled the positive feelings that market participants had on the company's growth. As of 23 January 2022, Twilio's stock price and P/S ratio had both deflated to US$192 and 13, respectively. Market participants are thus a lot less positive on Twilio's growth prospects currently. Now let's make a few assumptions:

- Twilio is able to compound revenue at 45% annually from 2019's level till 2025 (for perspective, Twilio's revenue growth in 2020 and the first nine months of 2021 was 55% and 57%, respectively), thus ending 2025 with US$10.54 billion in revenue.
- Twilio's diluted share count grows at 10% annually from 130.1 million to 230.5 million over the same period - Twilio will thus have a revenue per share of around US$45 in 2025.
- Twilio's PS ratio further compresses to 10 at the end of 2025, resulting in a stock price of US$450.
- For a sanity check, if Twilio can achieve a 20% free cash flow margin in 2025 (we think a 20% free cash flow margin for Twilio in a steady state is reasonable), the P/S ratio of 10 translates to a P/FCF ratio of 50. For a company that's growing its revenue at north of 40%, this is a reasonable valuation ratio.
- The assumed future stock price of US$450 in 2025 equates to a healthy low-teens annual return from our initial point of investment in July 2020. A low-teens annual return is higher than what the S&P 500 has historically achieved over the long run (a 10% annualised return over the past 120 years from 1900 to 2021). It's worth keeping in mind that the projected return for Twilio assumes a significant deterioration in the feelings that market participants have on Twilio's future growth (the shrinking of the P/S ratio from 28 to 10).

Jeremy and I understand that it can be painful to stay invested when stocks are down. But you're not alone - we're in this together with you (our and our families' capital are invested in Compounder Fund), hence the title of this letter, "Solidarity". And to help you better deal with the struggle, here are a few ideas, some of which I've discussed in previous quarterly letters:

- Look at volatility in stock prices as the fee for admission for great long-term returns instead of as a fine for making mistakes (previously: **2021 first-quarter letter**)
- Recognise that even the best long-term winners in the stock market can make our stomachs churn in the short run; this is a *feature* of stocks and not a bug (previously: **2021 third-quarter letter** and fourth-quarter letter)
- Morgan Housel, who's a partner in the venture capital firm Collaborative Fund and one of my favourite finance writers, once **wrote** something ironically true about investor psychology: "Every past decline looks like an opportunity, every future decline is a risk." I believe the reason this quirky bit of investor psychology exists is because people *know with certainty* how past market declines have recovered, but they don't know what's going to happen when a future decline occurs. **This uncertainty is scary**. **But it doesn't have to be**. With the following in mind, Jeremy and I are able to keep an even keel despite having money on the line: The vast majority of the 7.9 billion individuals living in the world **today** will wake up each morning wanting to improve the world and their own lot in life and *this* is the fuel for propelling the global economy and financial markets higher over time.

As this letter nears its end, I want to share one of my favourite investing quotes that I've encountered recently. It's particularly apt for the discussions in this letter and it's **from** Josh Brown, market-commentator-extraordinaire and the CEO of Ritholtz Wealth Management:

> "Returns only come to those who are willing to bear that volatility when others won't. The volatility is the point."

With that, I wish all of you Happy Chinese New Year! May you and all your loved ones have a healthy and prosperous year - and *years* - ahead!

Excelsior,
Chong Ser Jing
Co-founder and Portfolio Manager, Compounder Fund
27 January 2022

P.S: You can expect to see Compounder Fund's 2022 first-quarter investors' letter in mid-April 2022.
P.P.S: You can find all of our **past investors' letters here**.

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