GIVERNY CAPITAL

ASSET MANAGEMENT LLC

January 19, 2021

To Our Clients and Friends:

It is unseemly to say it, but for investors 2020 was the best recession ever. Just as the family dog loved the pandemic – you and me, together forever! – so did public company investors. The government flooded a wobbly economy with money, a good deal of which flowed into stocks. Super low interest rates acted like rocket fuel propelling asset values skyward. And, importantly, an extraordinary level of innovation continued to excite investors and attract capital to technology leaders, both proven and unproven.

Time will tell whether the rocket can permanently escape the gravity of the price-to-earnings multiple and how the Robinhood crowd will respond if it doesn't. But for now, this upstairs/downstairs recession has been both tragic for the country and embarrassingly good for public company investors. For the most aggressive risk-takers, it has been life changing.

For the fourth quarter of 2020, Giverny Capital Asset Management's model portfolio, which is a Poppe family account, rose 15.39%, net of fees[1], vs. 12.15% for the Standard & Poors 500 Index.[2] Our firm is now nine months old and our model account for that period is up 46.94% vs. 47.26% for the Index, net of fees.

We'll say what we always do, which is that results in any one quarter don't mean very much. We're not in business to match the Index but are satisfied with our return relative to the Index since inception, not to mention stunned by the absolute return. We don't wish to be repetitive in these letters, but it continues to be a weird stock market. Given the weirdness, we're doing fine. While we are not materially underweight the internet and technology, we have less of our money invested in both the hugely profitable giants and the unprofitable hyper growers. These two classes of businesses have helped lead the market this year. In October, the investor Joel Greenblatt observed that there were 261 US companies with a market capitalization above $1 billion that were unprofitable in 2019. On an equal-

[1] The family account does not pay a management fee. The returns presented herein assume the deduction of an annual management fee of 1% to show what a client account's performance would have been if it had been invested the same as the family account during the period. Past performance is not necessarily indicative of future results.

[2] The S&P 500 Index returns include the reinvestment of dividends and other earnings. The Index is an unmanaged, capitalization-weighted index of the common stocks of 500 major US corporations. The Index does not incur expenses and is not available for investment.

weighted basis, a basket of those stocks rose 65% through autumn. They rose even more in the fourth quarter. We own none of them in our model.

Another way to recognize the disparity in the market is that the Dow Jones Industrial Average, which consists of 30 household name companies representing a cross section of American industry, rose 7% for the full year. The S&P 500 rose 18%. And the Nasdaq composite index, filled with those unprofitable technology growers, rose nearly 44%. Over the past two years, the Nasdaq has nearly doubled while the S&P is up about 50%. While both figures are remarkable, and seemingly well in excess of the outlook for earnings growth in coming years, the gap between technology and the rest of the market is very wide. To match the S&P with a portfolio that is overweight diversified financials – about one-third of our portfolio consists of banks, insurance companies, commodity and stock exchanges, subprime lenders and transaction processors versus 15% for the Index – feels okay.

We are not tech-averse and we very much like to own fast-growing companies. But we also prefer to own businesses whose profit trajectories make sense to us. I worry that in these letters when I talk about not owning the fastest growing portion of the market, I sound like a cranky old value investor. I am one, I suppose, but our firm owns stocks that I believe will grow steadily for many years.

Investing is a game of predicting the future, with the investor trying to identify businesses that will perform better over time than other people expect. In a market with tens of thousands of intelligent participants, that's not easy. It is even harder to find hidden value in a company that doesn't grow or have much chance to grow, because it is a straightforward math exercise to figure out the value of something that earns the same amount every year and can't reinvest its capital.

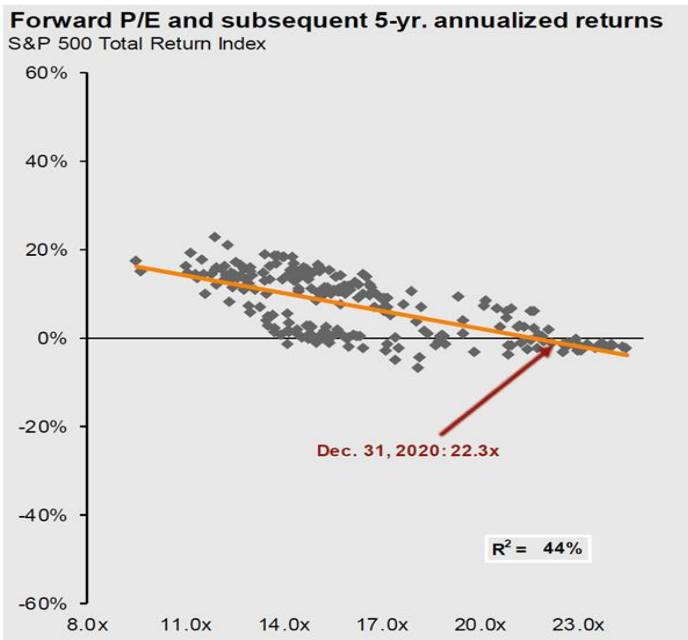
Good investors buy businesses that are inexpensive relative to their future cash flows. Because the market is smart but highly focused on the present, the likeliest way one will find something that is cheap relative to its future cash flows is if those cash flows can grow for a long time. A business like that may occasionally be mispriced at moments when people are focused on short-term misfortunes. We view investments in long duration growth companies as the best way to maximize our chance to outperform. Not incidentally, it helps if few other investors agree with your view.

Right now, many investors seem to see 30%-40% growth from a large group of software and Internet businesses as likely to continue for years. The math behind 30% sales growth is daunting. To grow 30% for seven years, a business would need to increase its revenue by more than six times. The rise of Amazon taught investors not to worry about profit in the early years so long as the business captured share and made steady progress toward profit. That was the correct analysis. But 260 money losing companies will not become Amazon, nor will many of them grow their revenue six-fold by 2027. I wonder how many Nasdaq stocks suffer from artificially low expectations?

After such an enormous nine-month run, it seems reasonable to worry that the market is overpriced. At minimum, it seems fragile and overly dependent on low interest rates to justify high price-to-earnings ratios. The US is absolutely chock full of fine businesses, but if they had to pay, say, 6% for loans instead of 3%, their opportunity set would shrink dramatically. And if savers and investors could receive even a

2% return risk-free on a 10-year Treasury, their appetite for speculative investments that remain years away from profitability might wane.

JP Morgan published an excellent report in early January that included scores of charts on market valuation. This one caught my eye:



Source: FactSet, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Returns are 60-month annualized total returns, measured monthly beginning November 30, 1995.

Historically, when the forward price-to-earnings multiple on the S&P 500 is above 20x, the expected rate of return for the next *five* years is negative. The S&P multiple on 2021 earnings estimates at year-end was 22.3x. Now, these are unusual times and the market is probably correct to discount at least the portion of the forecasted earnings shortfall for 2021 that is driven by pandemic. Even if the pandemic recedes in a few months as more people get vaccinated, 2021 earnings will not represent a normal environment.

It is also true that the S&P Index is lopsided. JP Morgan says the 10 most valuable components of the Index, which include the technology giants Alphabet, Amazon, Apple, Facebook, Microsoft and Netflix, trade for 33x their forward earnings estimate. The other 490 S&P components trade for 19.7x. Not only are the giants expensive, but they are enormous, accounting for 28% of the value of the Index. GCAM has a bit less than 14% of the model portfolio allocated to tech giants Alphabet, Facebook and Amazon, with Alphabet constituting a majority of that exposure.

The giants are great companies and may be worth their lofty multiples. But among the other 490, plus the rest of the stock universe, valuations are not so extreme. We're finding enough ideas to keep us busy.

We don't build portfolios this way, but if you looked at our tracking error – which measures the composition of our portfolio versus the Index and handicaps the likelihood that we will track the S&P 500 over time – it is high. That means we are unlikely to track the Index closely over time. With more than half the portfolio in our top 10 holdings, and with 26 total holdings at year-end, we've made fairly concentrated allocations of capital to a group of businesses we perceive as competitively advantaged – very much including through their use of technology – and reasonably priced. But our portfolio is underweight the most popular part of the market and if investors continue to favor fast-growing firms that may not produce earnings for some years, we will be fortunate to keep up with the Index.

We had our normal frenetic quarter of trading. Meaning, yes, we actually did a couple of trades affecting about 2% of our portfolio. We trimmed Berkshire Hathaway, Charles Schwab and Heico, all fractionally, and used the proceeds to establish a position in Autohome, a Chinese advertising and listings business for new and used cars. We are not fans of the Chinese stock market – we like audited financial statements, for one thing. And reading recently about Alibaba's and Ant Financial's problems with the Chinese government, we're even less inclined to want to own shares of businesses that could be confiscated by the government at any time.

Nevertheless, our partners at Giverny Capital Inc. in Montreal have owned Autohome for some time and we're persuaded they've identified a terrific business. Autohome operates the leading auto information and listings website in China. The Chinese new car market is considerably larger than the US market in terms of units. Plus, there are more car brands in China than in the West and consumers are less familiar with them, as many households are just now buying their first car. That creates great demand for unbiased information about cars. Autohome has 39 million average daily users, and more 90 carmakers pay to advertise on its sites.

While the primary business is information about new cars, the used car market could become very important over time. In the US, roughly 2.5 used cars are sold each year for every new car. In China, the ratio is the opposite. As more people own cars in China, and as the country gets wealthier, the used car market should grow rapidly. Bloomberg estimates the used car market in China should double in size over the next five years. We think Autohome should be the leader there, too.

Finally, Autohome is majority-owned and managed by the Ping An insurance company. We view Ping An as one of the best companies in China and among the most reliable fiduciaries we could choose there. Autohome grew earnings by 26% per year from 2016-2019. The business is growing a bit slower during the pandemic, but earnings should rise about 12% in 2021, per Wall Street consensus. The company earns high returns on capital and has roughly $2 billion in net cash, or one-sixth of its market capitalization. We paid a high-teens multiple of 2021 earnings estimates for our shares.

As for the trims, both our Heico Class A shares and Charles Schwab have appreciated a lot recently. We like both companies and they remain among our top 10 holdings. We sold a little Berkshire Hathaway because we believe Autohome will generate higher returns over time. We're encouraged that Berkshire is using some of its prodigious cash balance to buy back stock at reasonable prices, but this is a recession where the economy is flooded with cash. We believe it will be hard for Berkshire to find productive uses for its capital, other than stock repurchase, at the scale required to make a difference for shareholders.

Perhaps one day cash will become dear again and Berkshire's stockpile will look like a competitive weapon, but for now we believe we're better off with smaller compounding machines like Autohome.

When a portfolio rises in value by 15% in one quarter or 47% in nine months, a lot has to go right. While we build our portfolio from the bottom up, trying to identify superior companies that trade for reasonable prices, we certainly benefitted in the quarter from a modest uptick in interest rates. Among our top performers during the quarter were Charles Schwab, up 46%, First Republic Bank, up 35%, and JP Morgan, up 32%. These three may be benefitting from rising interest rates in the short-term, but they're also exceptional franchises with advantages in technology, reputation and customer service.

Among our best non-financial holdings, Arista Networks rose 40%; the youth retailer Five Below rose 38%; and Heico Class A shares rose 32%. Our largest holding is Alphabet, and its Class A shares rose just under 20%.

Arista makes crucial networking equipment for cloud computing hubs and large corporate data centers. During much of the past year, skeptics have asserted that cloud giants like Microsoft and Facebook would reduce their orders with Arista in favor of so-called white boxes, or unbranded routers and switches that cost less. This has not come to pass. Arista packages networking equipment with operating software that makes it easier for customers to operate and scale their networks, and to diagnose and repair problems. As there is no end in sight to the growth of hyperscale data centers, managing the performance of these sprawling networks is vital. Arista offers a superior solution to a fast-growing customer segment.

Heico has a large business selling private label aftermarket parts to airlines. Obviously, with commercial jets flying fewer hours the airlines aren't buying many spare parts. But Heico's parts tend to cost a lot less than the authorized parts produced by original equipment manufacturers, and as debt-laden airlines will need to mind their pennies in the future, Heico should gain market share for years. It has a second unit selling sophisticated electrical components to the defense, aviation, space and electronics industries. This segment never missed a beat, growing income by 14% in the fourth quarter ended October 31.

Five Below is an extreme-value retailer offering a mix of items both fun and essential to a young customer, with nearly everything in the store priced at $5 or less. Recent performance can accurately be described as stellar, with comparable store sales up 10% during the holiday season and overall sales growth up more than 20%. Teens and tweens may live their lives online, but they like to find bargains on school supplies, tech accessories, games and room décor at Five Below. We believe the company can triple the store base over time, at high returns on invested capital, while also growing sales per store. Five Below has been rolling out small selections of higher priced items, priced up to $15, and has met little resistance. That bodes very well for the future – young people are willing to spend an increasing portion of their pocket money in the store. The stock has tripled from our first purchases in the spring, reflecting a robust recovery from pandemic and the long growth runway the business enjoys.

Alphabet is our largest holding. We're biased, but we'd argue that Alphabet is reasonably priced. It earns significant profit from travel related searches, which are way down this year. Travel spending figures to roar back at some point, possibly soon. Alphabet also spends extravagant amounts on R&D and capital spending as it finances younger ventures. Those other businesses, which include YouTube, Waymo self-driving cars and cloud computing centers, plus research in artificial intelligence, should eventually generate meaningful returns for shareholders. Or at worst, they will consume less investment over time. If Alphabet simply exercises discipline over investment spending for a few years as travel advertising rebounds and the core search business grows, the resulting free cash flow should generate satisfactory returns for owners.

While we enjoy a victory lap as much as anyone, and we hope you get a sense of how much we like our portfolio, we confess that our recent returns are not sustainable and, indeed, are unlikely to recur any time soon. Broadly speaking, for the past two years stock market returns have been driven by PE multiple expansion, not earnings growth. The forward PE multiple for the S&P is now at a level that historically corresponds to negative five-year returns. And the multiple for the Nasdaq is far higher than S&P multiple. Over long stretches of time, stock prices are driven by earnings growth. So, either earnings need to grow mightily this year and next to support the optimism reflected by stock prices or the market will correct to reflect the reality of a less robust earnings environment.

For the pessimists among us, I would note that even throughout this horrible pandemic and dismal political environment, the US continues to have a dynamic private sector that leads the world in technological innovation. Our country benefits from both the rule of law and a healthy dose of animal spirits. I suspect that even if returns from stocks are subdued for a few years, over the balance of my investing career stocks will outperform other asset classes and US companies will continue to attract capital and talent from around the world.

A few months ago, a client recommended a book to me called “100 to 1 in the Stock Market.” Written in 1972 by Thomas W. Phelps, a former Wall Street Journal and Barron’s editor whose career following the markets began shortly before the 1929 crash, the book is a manifesto for buy-and-hold investing and for common sense optimism. I haven’t been a big reader of investment books for many years. Charlie Munger once said there are two kinds of people who make money at a bass fishing tournament: people selling tackle and advice on catching fish and people who know how to catch fish. I didn’t think I needed any more fishing poles, so it took me some time to pick up this book.

I’m glad I did. Phelps marvels that over the course of his career in finance some 365 different US stocks had appreciated by at least 100 times their value. While the early 1930s represent a profound bottom for the stock market, and the early 1970s a top, he wasn’t really cherry picking. For a stock to rise 100-fold over 40 years requires an annual compound above 12%, which is hard to maintain no matter how you choose your start and end points. Further, many of the stocks he cites rose 100-fold from their initial public offerings, not from some multi-year low.

If we just looked at the decade of the 1950s, a surprising number of companies that went public then had risen 100-fold by 1971: Diebold, McDonnell Aircraft, GEICO, Henry Holt & Co., Texas Instruments, Georgia Pacific, Walt Disney, Avon, Emery Air Freight, Baxter Labs, Occidental Petroleum, Xerox and Monroe Auto, to name some of the more recognizable ones. The alert reader will note that a number of these continued doing well for decades after 1971.

For the record, for a stock to rise in value by 100 times in a 20-year period, it must compound at 26% annually. To rise 100-fold in 15 years requires a 36% annual return.

Phelps makes two points: First, the way to really succeed in the stock market is to buy fine businesses and hold them. There are 100-to-1 opportunities all around us, but even at the end of his investing career Phelps knew surprisingly few people who had ever held a stock long enough to earn a 100x return. Most people are too impatient. They sell their winners, paying taxes, and move on to the next idea. Often, he notes, they sell simply because the stock has gone up so much that they fear looking foolish in a correction.

Second, and ultimately more profound: there is something unfortunate about Americans, or maybe about people, that render us distinctly afraid of the future. This despite the fact that the country, its people and its businesses, however imperfect, keep making progress.

In 1972, Phelps put it better than I ever could: "Year after year, mankind achieves the impossible but persists in underrating what it can and will do in the future. … Some bureaucrat advocated closing the patent office a hundred years ago because everything had been invented. Rodgers and Hammerstein put it to music 80 years later: 'Everything's up to date in Kansas City. They've gone about as far as they can go.' … Every day we crisscross the Atlantic Ocean with airplanes of greater tonnage than the Mayflower. We have proved and put to practical use Einstein's equation that energy equals mass times the velocity of light squared. We have turned the dread sonic barrier – the speed of sound – into a speedometer gauge. … Yet like birds making their first flight, the higher we rise the more terrified we seem to be that we shall surely fall."

I am not a Pollyanna. I watched the riot in Washington, D.C. on January 6th with feelings of anger and dread. "A Republic, if you can keep it," said Benjamin Franklin. We have suffered grievous harm as a society over the past few years and have much work to do to heal wounds and reestablish a reality-based narrative of government and, sadly, of life.

As for business, I will always remember the Walmart executive who said, only half-jokingly, that the retail colossus made progress like an 18-wheeler on a highway, steering from ditch to ditch. Running a business is hard work. Failure is always a possibility. And progress comes in fits and starts while people prefer predictability. But in fact, investors get paid for tolerating volatility. The highway takes us forward, not backward, so long as we retain the will to extract ourselves from the occasional ditch.

Before signing off, two small points to make on our performance. During the 4th quarter, we held about 3% of our model portfolio in cash. And for the prior two quarters, cash amounted to about 7% of our holdings. I felt it wise to keep a little dry powder in a volatile environment but with stocks rising 47% in nine months, our cash position created a little security blanket for me at the expense of our performance.

Second, our holding Constellation Software is set to distribute to shareholders a stake in a European business it owns called Topicus, on or about February 1st. Constellation went ex-dividend in December,

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with the share price declining roughly by the value of the Topicus business to be distributed. But shareholders have not received Topicus shares yet. We believe this caused our fourth quarter performance to be depressed by about 25 basis points. Our first quarter performance will benefit by a similar amount when we receive the Topicus shares. Essentially, we ended the year with a large dividend accrued but not paid.

Our goal as your investment manager is to own great businesses run by honest and energetic people who themselves have significant ownership in their companies. I am grateful for my partners at Giverny Capital Inc. in Montreal, who have been unfailingly supportive during this launch year and have brought a number of good companies to my attention. And I am thrilled to have the client group I have. I very much appreciate the confidence you've placed in our young firm and I am excited to have you invested alongside me.

We've gone nowhere near as far as we can go.

Sincerely,

David M. Poppe

Giverny Capital Asset Management, LLC	*Top 10 holdings*
December 31, 2020	
Alphabet A&C	*7.9%*
Carmax	*6.6%*
Progressive Corp.	*6.0%*
SS&C	*5.4%*
Constellation Software	*5.1%*
Heico Class A	*5.1%*
Five Below	*4.9%*
Charles Schwab	*4.7%*
Arista Networks	*4.5%*
Facebook	*4.1%*
Total	***54.3%***