Bolingbroke Capital

To the Partners of Bolingbroke Capital,

Over the course of 2024, the value of our portfolio increased 15%. As ever, our performance alone means little; we aim to outperform the market therefore some of our best years may have the smallest returns. Whilst we attempt to prevent losses, this is often out of our control within any single year. Should our returns exceed a measly market performance, this is as much a win as significant absolute gains. This year, the FTSE-100 increased by 14%.

In this letter, we will highlight up front and in bold, our mistakes, followed by some notable points of the year. We highlight in our supplement where we currently have interests and wish to draw your attention herein to how you – as *owners* of these businesses – ought to benefit from our shared interests in their success. This, of course, does not mean that this success will (a) be imminent; or (b) *even* materialise.

Should you have any questions, please contact me directly any time of the day or night, 365 days a year.

Bloopers

Shakespeare noted[1]*, the nature of bad news infects the teller.*

Rest assured; the following was written by ~~someone else~~ ***me!***

Our bloopers: mistakes made this year, and mistakes made in previous years that have only recently come to light. We describe our mistakes as: (a) not owning companies we knew enough about to own; or (b) owning companies we should have left untouched. Our mistakes are not limited to positions where we lose money. In fact, many may *make* us money. This does not exempt us from highlighting them, up front, herein.

This year, our biggest mistake, was that we did not turn over enough rocks. Every year, I print over 2,000 pages of stocks and look at every single one, twice. This year, I failed to truly act on that of which I found. Despite finding over 50 interesting companies, I did not truly look at them long enough. This, in my opinion, is a failure as a steward of your wealth. Whilst it is anyone's guess as to what we would have subsequently bought (or, ultimately missed out on) it is my mission to build more rigorous processes to ensure that I waste less time on potentials and focus on stocks which seem like no-brainers.

Ultimately, these stocks are supposed to be good enough to replace the great stocks we currently have in the portfolio. None of them, on the outset, passed this test. However, there is a huge psychological bias towards inactivity. That is, just because we have 10% of our portfolio in a stock, we tend to believe that it is better than a stock we do not own. This is called the endowment effect. Which can basically be translated as: *"my identical watch is worth more than yours, simply because it is mine."* Moreso than ever, I will continue to delve deeper into these stocks and constantly hold a spotlight up to our current positions to ensure we are not being lazy; whilst also not being **too** active.

[1] Antony and Cleopatra: Act 1 Scene 2

Finally, I'd be remiss not to use this as another opportunity to rub my nose in previous mistakes; once again. Looking back at what we should *not have* sold and comparing it to the things we *should* have sold. Three stocks went completely bananas (after we had sold); that is, we could have made over 5x our money, on those positions, on average. However, I noted last year that there was a lot of uncertainty surrounding one of the stocks. Thus, whilst I believe I could have done more work on the stock, at the time. I'm not so certain that the conclusion to sell would be any different. It may appear obvious that we should have held when a stock goes from \$9 → \$200+ but **only** if I could give a reason as to why it's likely to do so. It's very easy to look back and say it was obvious. If it was, we wouldn't have sold. If, having done more work, it would have *become* obvious, then that truly is a mistake.

That said, there is one company, I'm almost certain I knew more about even though it was not a stock where we had an edge. It was merely a tactical buy given that it was held in the minds of investors in a completely irrational way and the market dislocation was unfounded. This company was worth hundreds of billions and was a legacy holding from our old IICM portfolio where we intended to emulate what we believe Charlie Munger and Warren Buffett would deem a suitable investment. Upon revising our strategy (to bring all partners together into what WE believe is OUR edge) we sold. We focus on companies worth less than \$400 **million**, not \$400 **billion!** Since, the stock is up almost 4x. If we did not sell this stock, we would be 7% richer, today. Consider that an I O U.

This compares to a win, for us, which was ensuring we <u>did not</u> stay invested in a stock which went on to fall over 50%. By avoiding this, our portfolio is 3% higher, today. This shows that we can 'make' money by avoiding falling things just as much as we can by catching rising stars. Both are equally important.

Successes

Our successes – once materialised – will speak for themselves.

MMXXIV

This year, we sold 2 stocks and bought 3. The two we sold, have fallen 7% and 55%. Given our position sizes, if we had held on, our returns would be 4% lower. Instead, we pivoted into 3 other stocks which are up 0%, 6%, and 11%.

Nicolai Tangen, who manages $1.4 trillion (‘tr’, not ‘b’), says investment managers should judge themselves using inertia analysis. That is, if you did nothing all year, what would you have made? If, on the 7th of December 2023, I took a 1yr holiday, we would have made 8.5% this year. My time in the office, buying and selling, has made us an additional 6.5%. However, these buys, may cause us to be down next year. Hold the applause.

Another thought: If we had simply invested 10% into each position at the start of the year, ignoring any subsequent transactions, we would be **DOWN 4%.** Instead, we made 15%, driven entirely by investing *more* in the better performers and ensuring we are not too exposed to the more volatile positions. Ultimately, this means we made 19% through actively concentrating in the higher conviction companies and not just taking a Noah’s ark approach to our investments.

Of our top 10 positions, 6 ended the year higher than they started. This compares with 5 out of 10 of stocks doing the same within the FTSE-100. This shows that our ability to ‘select stocks which go up’ was slightly above average (this year). That said, where we truly differentiate is how much we have in the stocks that go up. As Warren would say, when opportunity rains down upon you, make sure you put out the bucket, and not the thimble.

Our average position size in the stocks that performed well was 14%. This compares to an average position size of just 3% in the stocks which were down this year. Moreover, because of their subsequent decline, our portfolio automatically de-risks itself as these positions get smaller. Should we deem the stock decline *irrational*, we can focus on whether we ought to add to this position whilst the stocks are on sale for us to exploit. Alternatively, if the story changes, we swiftly change our mind and revert to cash.

Ultimately, we must invest in things that the big players are not (or cannot) look at. Typically, this means we must look at small companies. Right now, the largest 500 companies in the US account for over 75% of the entire US stock market. This should be closer to 60%.[2] Since 1965, **this has only happened once!** That time was the year 2000. Remember that? This is bad news for investors in the S&P500. Or those with the burden of billions to invest. But it is great news for us. Whilst people are over-hyping the big players of today, they are not paying attention to what we are looking at.

If we look at what happened in the following 7 years after this historic high was achieved, the S&P500 returned just 8%, in 7 years! Yet, smaller 'value' stocks **returned over 185%** over the exact same timeframe.[3] We are now at that point again. Value will soon return. But what does this mean for us? We look at small companies. Today, small cap companies in the United States, currently represent just 4% of the total market. We have not seen this level since 1935; **we are currently experiencing an almost 100-year low.** What's more, this isn't just in the US – there is a complete tectonic shift in investor psychology. Small companies are being totally ignored. So, we must look very carefully, and find the best, whilst no one else is looking.

But *where* do we look? A good place – as detailed above – is where no one else can. But, a second place, is where no one else wants to. China, today, is a place where investors *really* do not want to invest. This means, the stocks are very cheap. If you are comfortable, and relatively well informed, you may make a lot of money. For me, I'm neither comfortable, nor do I intend to undergo the arduous task to make myself relatively well informed. As a result, I am almost certain, **we will miss out.** That is ok.

[2] Median % of S&P500 to total US stock market – Miller Value, Investor Call
[3] Proxy = Russell 2000 Value

How do I know we will miss out? It is very simple: look at how stocks have traded since 1990 and see how expensive they are today, relative to this timeframe. The US, for example, has traded between 11–25x earnings over the last 35 years, with an average of ~16x. Today, they are trading close to that higher end.[4] That is, they are more expensive than they have been, on average, in the last 35 years. In comparison, China has traded in a range of 8–34x, with an average of ~13x. Today, they are trading at ~11x; nearer the bottom of their 35-year range. You can open any newspaper and see why.

However, **there is** something I am comfortable with, and it just so happens to be the island I found myself on this morning. The UK has traded between 8–23x earnings with an average of 14x. Despite it being a much less treacherous place to invest than China (*in my 'umble opinion*), it is currently trading below it's average at roughly 12x. That is almost half it's high, and just 50% higher than it's all time low. More explicitly, the UK market is currently trading at approximately the same level as it's Chinese counterparts, relative to their averages. Now, I may be biased, but I don't think we're all that bad. Therefore, to me, this is an opportunity.

"It's no easy business to be simple"

Gustave Flaubert

As 19th Century author, Gustave Flaubert wrote to his lover, Louise Colet, whilst writing Madame Bovary: *"It's no easy business to be simple".* Especially in investing, where we tend to put up all forms of intellectual blockades to prop up the façade that no one else can do what we do. In fact, the opposite holds true. It *can be* simple, but it is very difficult. Especially when human psychology is involved. Our primary edge is therefore patience and simplicity. We like our businesses and the people

[4] Using Global forward P/E ratios, as a proxy. Research from JP Morgan.

running them; it is no easy task running a business and change doesn't occur overnight. What does, however, is price. We do not, and cannot, let price impact our rational, fact-based, decision making.

You, reading this, already know that. As a partner of Bolingbroke Capital, who is likely happy given you are now 15% richer, understands that these gains did not come from something we bought last night. In fact, the <u>exact</u> stocks which caused a 20%+ decline in 2022, is the reason we have outperformed for the last two years. This is not skill, it is simply picking good companies and not playing hot potato with them as their share price gyrates. We did not make a mistake in Q3 2022 (where we saw a huge portfolio decline) and we did not make any smart decisions this year. Rather, we bought good companies in 2021/22 and at the end of one year people disliked them; and at the end of this year people like them.

People dislike stocks because of all types of phantom theories and, when the price declines, they come up with even more theories. They do the same when the stock shoots up; even if it had nothing to do with why they bought the stock in the first instance. We buy a stock for set reasons, and should those reasons change, we may (or may not) change our mind. Like all lawyers seem to say: "it depends". However, just because a price wiggles more than we like in either direction makes us neither dumb nor smart – unless the primary reasons appear incorrect… then we really are dumb. Should they appear correct, however, we're a little smart, and a lot lucky.

The markets continually keep us absorbed in the present. It, therefore, becomes challenging to delay gratification when one is unsure how long it will be delayed. However, the term markets typically consist of topics that win the popularity contest at any given time. Thus, we must heed the advice provided by Johann Wolfgang von Goethe:

> *If you haven't been reading newspapers for a few months and then read them all together, you realise how much time is wasted on these sheets of paper […] and whenever there is a situation of uncertainty, the journalist baits either one party or the other, either more or less, and boosts*

our inner preference or dislike from one day to the next until, in the end, there is a decision and then, what has happened is an object of wonder, as though it were an act of God. [5]

Overall, our performance depends on how we position ourselves during market fluctuations. We frequently find ourselves in a diverse set of companies, including great compounders (where we focus on long-term future growth) to liquidation plays (where – if the clock were to stop – we expect to see a significant return on our investment still). Regardless, at Bolingbroke, we think in two ways: (1) we have little respect for what happens in any given year – it is the long-term that counts; and (2) we **always** think like business owners.

[5] Maxims and Reflections. Note 970. Page 126.

Current Portfolio

As of writing, we own 11 businesses[6], with our top 5 equating to 84% of our overall portfolio. We currently have 3% in cash waiting to be deployed.

[6] Which exceed 1% of current portfolio assets under management.

Final Remarks

In investing, you're allowed to state how much you think you'll make, or when you expect to make it, but never both. Over 65% of our money is in stocks with catalysts that we expected to materialise in the back half of 2024 / first half of 2025. We are starting to see these play out in 3 of 4 companies (58% of the portfolio). If they fully materialise, we expect to see our first big portfolio moves come to light (as opposed to the more general stock market appreciation we've seen in previous years). The nature of our portfolio composition means *when* they move, **they really move** the needle for us.

Now, whilst still returning double-digits and beating the UK market, I believe our performance remains lacklustre. The Bank of England interest rate peaked at 5.25% this year. Assuming it stayed this way all year, investors could have made "an easy 5%". We made triple this amount and outperformed the FTSE100. Whilst proud, it was hard-earned. We expect next year to be much more of a headline for us. I personally believe the current portfolio is trading at below half its intrinsic value. This is why **I have almost 90% of my entire net worth invested alongside you.** This year, I increased how much I've invested, alongside you, by over 60%. In 2025, I aim to increase my investment by another 60%, at least. As always, we're on a journey together; I hope it is a long and prosperous one.

As for my requests to St. Nick, please provide me with book, article, interview, podcast, video, or any other helpful recommendations. Books I have read this year are detailed below for you to scrutinise and improve; financial literature is certainly not necessary. Expanding upon my list will only increase my ability to think, and it is in all our interests that my time be spent **thinking** and not trading.

See you between the lines.

Merry Christmas,

Aiden C. Patterson

// 14.12.24 //

Readings

Below is a list of readings from this year, excluding periodicals, snippets, annual letters, financial statements, reports, podcasts, videos, transcripts, interviews, journals, blogs, tweets etc. Each aims to enhance my mental latticework, thus improving upon the ideas I can draw from when investing. If you believe something is missing, please make a recommendation.

1. How to read a book. Adler.
2. Don Quixote. Cervantes.
3. Meditations. Descartes.
4. Pensees. Pascal.
5. Paradise Lost. Milton.
6. Leviathan. Hobbes.
7. Theologico-Political Treatise. Spinoza.
8. Second Treatise of Government. Locke.
9. Discourse on the Origin of Inequality. Rousseau.
10. Gulliver's Travels. Swift.
11. New System of Nature. Leibniz.
12. Of correspondence with de Volder. Leibniz.
13. On Nature Itself. Leibniz.
14. Principles of Nature and Grace. Leibniz.
15. Monadology. Leibniz.
16. Enquiry concerning human understanding. Hume.
17. Enquiry concerning Principles of Morals. Hume.
18. Ergodicity. Luca Dellanna.
19. The Basic Laws of Human Stupidity. Cipolla.
20. Risk Savvy. Gigerenzer.
21. Poor Charlie's Almanack. Kaufman.
22. Alchemy. Sutherland.

23. Confessions of an Advertising Man. Ogilvy.
24. The Deals of Warren Buffett. Arnold.
25. Selected Poems. Byron.
26. The Origins of Creativity. Wilson.
27. Heal. Grow. Love. Jeanty.
28. Power. Robert Greene.
29. Not Fade Away. Shames & Barton.
30. This is Water. David Foster Wallace.
31. Excellent Advice for Living. Kelly.
32. A manual for Living. Epictetus.
33. The Concise Laws of human Nature. Greene.
34. The Journey of Leadership. Maor et al.
35. The Alchemist. Paolo Coelho.
36. Find Your 9others. Lewis & Stafford.
37. The Power of Now. Tolle.
38. God from the stone. Sissay.
39. Fooled by Randomness. Taleb.
40. The Eve of St Agnes.
41. How to Win Friends and Influence People. Carnegie.
42. The Sayings of Disreali. Blake.
43. The Philosophy of Benjamin Disreali. Graham.
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As you can see, I missed my goal… *again!*