

Management's Letter to Partners

Dear Partner,

Investment Results

In 2014, the Aquamarine Fund returned 5.5%, versus 13.7% for the S&P 500.

From the fund's inception in September 1997 to the end of 2014, our investors' capital has compounded at a rate of 10.6% annually, versus 6.5% annually for the S&P 500. These figures are calculated net of all expenses and fees, so these are actual returns.

Commentary On These Results

I'm always happier when I can report to you that we've had a year of strong outperformance. But this wasn't the case in 2014. On the contrary, we lagged the S&P 500 by 8.2 percentage points — a significant margin of underperformance.

It's important to understand that it is inevitable that we will underperform the market from time to time. This is simply part of the game if your goal is to compound money at high rates over many years and to achieve long-term outperformance.

After all, to beat the index, you cannot own the index. In the short term, our divergence from the index sometimes works to our disadvantage. But in the long term, this divergence has proven to be a considerable advantage. By owning a portfolio that doesn't mirror the index, we've achieved a 5.6-fold gain since the fund's inception, versus a 2.8-fold gain for the S&P 500.

Broadly speaking, my strategy is to own a relatively concentrated portfolio of the very best ideas I can find — essentially, the cheapest stocks with the greatest upside. I can't predict whether these stocks will soar in 2015 — or, for that matter, in 2016 or 2017. But I'm confident that this strategy works — and will continue to work — over time. One reason why most investors do so badly over the long term is that it requires psychological discipline to stick with the

program. Thankfully (for us), the nature of the stock market is ultimately to shift money from impatient investors to patient investors.

There will certainly be times in the future when we underperform. To my knowledge, every investor with a great long-term record has had periods of underperformance. Indeed, some of the most revered investors have endured multiple years of underperformance in which they were widely criticized for losing their touch or failing to understand some “new paradigm” or other. This was particularly common during the late ‘90s tech bubble when value investors like Warren Buffett, Jean-Marie Eveillard and Donald Yacktman, fell out of favor for a time.

My own focus will never be on short-term results, but on following the principles and process that have brought us success over the past 18 years.

As partners in the fund, it’s important to make sure that you’re truly comfortable with our investment approach, which is spelled out in the “Investing Principles” section of this annual report on page 27. I’ve also explained these precepts at much greater length in my book, *The Education of a Value Investor*. I’m not trying to convince you to buy it as a way of driving up sales! But, if you’re invested in the fund, I do think it’s worth

understanding the principles I try to adhere to in managing your money.

In assessing the fund, partners should ask themselves some fundamental questions: do these principles make good sense to you, and have they proven to be successful in the past? And does the manager operate in an environment that makes it possible for him to adhere to these principles in the broadest way, so that he’s likely to be successful in the future?

As I discuss in my book, a central focus for me in recent years has been to create a peaceful environment in which I can invest in a calm and patient manner. I’ve also focused heavily on improving my process over the years — for example, by developing a very detailed investment checklist to see what I might be missing.

Equally important, the fund is structured in a way that my financial interests are completely aligned with your interests as partners in the fund. Roughly half of the money in the fund belongs to my family. Other investors include many very close friends. My goal is not to run a closet index fund or to gather assets in order to earn higher fees for myself. It’s to compound money with my family, friends and partners over the long term by investing patiently together.

This path to wealth doesn’t involve doing whatever is popular today. It

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doesn't involve grabbing all of those bright, shiny objects that tend to attract short-term investors. It involves buying great companies at highly attractive prices and sticking with them. To do this, I need the discipline and detachment to sit quietly to one side, far from the noise of Wall Street. Operating independently of the crowd requires a particular type of temperament — both for the manager and the partners in the fund. I feel very fortunate to have you as my partners, and I will do everything I can do to deserve your trust.

Subscriptions, Redemptions, and Net New Capital

In 2014, we received a total of \$15.5 million from 27 new partners. We also met \$9 million in redemption requests from 11 of our investors. Of those, five were full redemptions and six were partial redemptions. In all, that represents \$6.5 million in net new

capital. We began the year with 75 investors and \$170 million in assets; we ended the year with 92 investors and \$187 million in assets.

I'm always pleased to see the fund's assets growing and our investor base broadening. But it's not an ambition of mine to amass vast assets or build a huge fund complex that I could one day sell. It's tempting for money managers to gather assets so that they can maximize their fees. But the fact that my family is such a large investor in the fund makes it significantly easier to resist those temptations.

If, at some point, the fund grows dramatically — for example, to \$500 million — I intend to lower the fees so that the partners share in these economies of scale. My intention is not to make money *off* my investors, but *with* my investors.

Stock Purchases, Sales and Portfolio Composition

In last year's annual report, I provided a post mortem of two investments I had sold in 2013: Crosstex Energy and Potash of Saskatchewan. As you know, I like to give you a thorough analysis in these shareholder letters of two stocks we've exited in the previous calendar year. It's a useful way of illustrating the fund's approach while also speaking candidly about any mistakes I may have made and important lessons I've learned.

However, in 2014, I didn't sell a single stock. I did sell two stocks in early 2015, but I'll wait until next year's annual report to provide a post mortem of those two investments. For now, the

key point to make is that I sold both of these stocks for a healthy profit because I wanted to raise cash in order to invest more money in three companies that we already owned.

These three investments struck me as much more attractive opportunities than the two stocks we sold. All three of these holdings seem extraordinarily cheap and have great growth prospects over the coming years. I believe that each of them could potentially triple or quadruple over the next few years.

I'm confident that these are my best ideas — and, if I were a more aggressive investor, I might put all of the fund's assets in these three positions. The



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IT'S ALSO THE RIGHT PLACE
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trouble is, I can't guarantee that I'm right. However sure I am of my analysis and however many times I go over my checklist, there's always a possibility that something unexpected will happen. In each case, there are also specific risks that prevent me from concluding that these investments are truly "inevitables." As Buffett has said, diversification is an insurance policy against ignorance. I'm not worried about what I know that I don't know, since I can guard against that. I'm worried about what I don't know that I don't know — and diversification is a protection against that.

As my parents can attest, I had an active imagination as a child and would conjure up all sorts of scary scenarios — especially at night. I would often end up falling asleep in mortal fear of crocodiles lurking under the bed. Temperamentally, I'm still inclined to be slightly fearful. My fear of "unknown unknowns" prevents me from making massive investments in the way that Buffett did when he invested more than 25% of his portfolio in American Express in 1963 during the "Salad Oil Scandal."

Still, as I write this report in April 2015, approximately 30% of Aquamarine's assets are invested in these three holdings. This strikes me as a reasonable balance between risk and opportunity. As Bill Sahlman, my professor of

entrepreneurial finance at Harvard Business School, used to tell our class: investing is "a horse trade between fear and greed."

I won't name those three holdings here because, as you know, my policy is to try to avoid commenting publicly on currently-held positions. As Robert Cialdini has explained, humans like to behave consistently with commitments they have made in the past. With this in mind, I prefer not to make pronouncements that might make it harder for me to reappraise our investments if the situation changes or if I realize that I've made a mistake. Also, the more I speak publicly about our holdings, the more likely it is that I will invest with one eye over my shoulder, thinking about how I will write to you about my portfolio moves, instead of keeping my focus on calmly and dispassionately doing what I believe is right.

Mohnish Pabrai has previously said that investing is a bit like making sausages: the result tastes excellent, but the process can be more than a little unappetizing. In my experience, the best way to invest is to sit quietly in a room and ask myself if this is where I would like my own family's money to be invested. If so, I'm comfortable that it's also the right place to invest my partners' money.

While I typically avoid talking in detail about our current holdings, I do want to point out that our portfolio is currently more concentrated than usual. We own about 22 holdings, but about 65% of our assets are in just six positions. In part, this reflects my unwillingness to prune our winners. I usually won't invest more than 10% of our assets in a new position. But holdings like Berkshire Hathaway and American Express have done so well over the years that they have both grown to be more than 10% of the fund. Berkshire has grown into a 15% position, having quadrupled since we first started buying it.

A key aspect of successful investing involves letting your winners run, since one or two great stocks can often account for much of your outperformance. If a stock is still an attractive investment, even after it has surged, I won't sell it merely to make our portfolio look less concentrated.

Berkshire Hathaway still trades at a significant discount to its intrinsic value, it has strong growth prospects, and I expect it to outperform the S&P 500 for years to come. It also adds ballast to our portfolio. It's an "antifragile" investment that is likely to do extraordinarily well if the world experiences another period of extreme tumult. For these reasons, I currently see no reason to trim our position.

Looking Ahead

After several years of strong market performance, people often ask me if stocks are overvalued and if it's time to take some money off the table. I have no gift at all for predicting the direction of the market or trying to time it. (I'm not convinced that anybody *else* has a gift for market predictions, either.) So I focus instead on valuing individual companies. Still, it's fair to say that stocks are generally much less cheap than they were in the aftermath of the financial crisis. That said, I don't think we should underestimate the level of fear that many investors feel even now due to their painful memories of the crisis. As a result, stocks don't seem to be either particularly expensive or particularly cheap.

In this environment, we can't expect the upside we saw in the years that followed the crisis. But I do like what we own, and I expect us to do well over time by holding these investments. It's also worth noting that inflation seems likely to accelerate at some point in the future, further eroding the value of cash — and equities are typically a good place to seek protection from inflation.

Given the investments we own, I expect to meet our goal of compounding capital at decent rates of return over the

long term. As a patient investor, I tend to think in terms of periods of five years or more. Over the shorter term, we will inevitably experience fluctuations. I'd be surprised to see another financial crisis for the next decade. But it's not hard to imagine other possible disruptions and dislocations, including wars, terrorism, commodity shocks, and disruptive technology. I'm quite certain that it will not be a smooth ride.

The key for us is to stay invested in better businesses that can weather such tempests and thrive even in difficult circumstances. We also need to preserve the flexibility to respond when opportunities are offered up, just as we did during the credit crisis, which provided us with the foundation for years of outstanding returns. For a fund like ours, turmoil is often a gift, since it creates extremely attractive mispricings.

How To Widen Aquamarine's Moat

In the meantime, I wanted to share with you a few of my thoughts on how we can meet our goal of continuing to compound capital at high rates over the long term. Buffett tells his managers not to worry too much about what profits will be this year or next year, but to keep working to widen the moat around their business. What does this entail for an investor?

My belief is that there is plenty that I can do to continue widening Aquamarine's moat. Much of this is described in the later chapters of my book. For example, I write at length about the importance of constructing the right environment in which to invest calmly and patiently. This includes choosing where to live, how to set up my office, and how to surround myself with the right people. It also involves



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adhering to well-considered rules on matters such as how to buy and sell stocks (for example, only buying when the market is closed). And it involves using a highly personalized investment checklist that helps to prevent me from repeating the same mistakes.

Writing the book was enormously helpful to me because it forced me to explain my principles and process much more clearly and explicitly than ever before. I also had to think carefully about the workarounds that I've developed to combat my flaws and idiosyncrasies. Equally important, writing a book was a very positive act of "commitment and consistency": having publicly exposed my thoughts on these topics to a broad audience, I'm more committed than ever to the path I've laid out for myself. Indeed, now that the book has sold more than 20,000 copies, it's far more difficult for me to stray from these principles. This should benefit the fund's investors significantly.

Another unexpected benefit of writing the book is that it's helped to strengthen and broaden my relationships with a wonderful range of exceptional people. As I've mentioned before, I found it counterproductive to work with in-house analysts at the fund. But it's been extraordinarily helpful to operate in an environment in which friends and peers whom I greatly respect informally

exchange investment insights and ideas.

I've been very fortunate on this front. As I explained in the book, I gradually came to understand the importance of "compounding good will" — an idea that emerged from various conversations with my friend Ken Shubin Stein, a money manager who teaches investing at Columbia Business School. My life improved immeasurably when I began to make a more concerted effort to act more kindly towards others and to be a more giving person. This way of living made me happier, which has been a huge reward in its own right. But it also turned out to be very positive professionally, helping me to surround myself with fantastic people who are givers, not takers. As I discuss in the book, my friendship with Mohnish Pabrai is a perfect example of this, and his brilliant analytical skills continue to be an extraordinary boon for shareholders in the Aquamarine Fund.

It's hard to convey just how important this kind of network of great people can be. For one thing, it creates an environment in which good investment ideas are more likely to flow our way. It seems to me that all of the most successful investors — people like Warren Buffett, Charlie Munger, George Soros, and Bill Ackman — sit at a nexus of information and insights that are gushing in at them from all sorts

of different sources. Conversations with a diverse group of people from different industries and with different perspectives are far more valuable than subscriptions to most investment newsletters and the like. After all, there is so much information available out there that even the smartest and most diligent person can't see or digest it all. It's a huge advantage if you can also rely on insights from the people around you to help filter those ideas.

Perhaps I can illustrate this best with three brief examples of the sort of unexpected, value-adding interactions that I believe will contribute to our investment returns over time.

The first was a conversation I had a few years ago with Bryan H. Lawrence, the founder of Yorktown Partners and the former Chairman of Crosstex Energy. We just had a sandwich during a short lunch meeting in his office, but he helped me to understand some priceless lessons that had served him well over the years. The key takeaway for me was that I learned the importance of investing in businesses that have the opportunity to reinvest capital at high rates of return. It's a simple but powerful idea that I had somehow failed to grasp during my years as a management consultant, MBA student, and investment banker.

Crosstex, which is in the gas pipeline

industry, possesses this all-important capability of reinvesting at high rates of return. So do businesses like Mid-American Energy and Burlington Northern — a characteristic that Buffett clearly understood when he invested in them. Both of these Berkshire businesses have structural features that allow them, as incumbents, to reinvest capital at a substantially higher rate than the cost of capital. The great advantage of being in such businesses is that you don't have to be smart on a daily basis.

One important goal for me is to invest as much of our money as possible in such businesses without paying too much for them. Doing so will ensure that I don't have to be smart all of the time. This insight grew out of that one highly instructive meal.

In a second example, I recently traveled to the Google campus in Palo Alto to give a talk. I joked with my host, Saurabh Madaan, that what I really wanted was access to his personal Google login so that I could see what was really going on inside that fascinating corporation. Needless to say, there was nothing doing on that front. But in one of our conversations, Saurabh explained to me the importance of Facebook's social graph, which depicts the personal relations of internet users. Our conversation highlighted for me that the value in Facebook may not lie

so much in its own website as in what others would be willing to pay for access to their social graph.

For me, this was not an actionable insight. But such insights are rare and valuable, and they are not equally distributed amongst the population — even amongst the population of smart investment analysts. I might have studied Facebook for weeks without gaining that insight. That is one of the inestimable benefits of having the right conversations with the right people.

Another fascinating insight came from a brief email interaction with Alain de Botton, the writer and philosopher, who is one of the founders of The School of Life. He clarified for me the distinction between businesses that fulfill a basic human need and businesses that stimulate a desire which they subsequently meet. Luxury goods, tobacco and gambling are good examples of the latter type of business.

This idea set me thinking about the businesses that Berkshire owns. What struck me is that almost all of them fall into the "Meeting Basic Human Needs" category. And even those companies that may belong in the "Creating Desire" category — such as Netjets or Borsheims — have the advantage of being the low-cost producer in that niche. I don't believe this is by chance,

given how deeply Buffett has thought through his investments.

There's nothing wrong with making money by selling Ferraris, Patek Philippe watches, and other products that are desirable rather than necessary. And there's nothing illegal about operating a licensed gambling facility or selling cigarettes in accordance with the law. But, in my view, it's more likely that a lasting, successful enterprise will be built out of meeting basic human needs. My thanks go to Alain de Botton for helping me understand this distinction. This is a fine example of Robert Hagstrom's idea that investing is truly the last liberal art.

Publishing a book has certainly placed me in a far broader and denser set of relationships than I could have imagined. This makes my life infinitely more enjoyable. And, in addition to the sheer pleasure I derive from our conversations, there will also be the odd occasion when they will result in an investment insight that I would not otherwise have had. Combined with intense research, this should benefit the fund considerably.

Another way we have continued to expand the fund's moat is by increasing the quality of our shareholder base. Five years ago, I initiated a share class in which investors can choose to pay no annual management fee; instead, Aquamarine receives 25% of the

shareholder's profits over a 6% annual hurdle. Investors in this share class can redeem their investment only once a year.

There are multiple benefits to this share class, including the fact that it creates a much better alignment of our financial interests: if I don't perform well, I don't get paid. But it's also a great advantage that this share class encourages investors to think about their capital once a year, instead of each quarter. This is a structural way of helping shareholders to think in a long-term way.

In retrospect, I should have created this share class from the very beginning of the fund. Thankfully, the proportion of investors opting for this share class has risen steadily over the last five years, and this should continue in the years to come. My belief is that this has already enhanced the quality of our shareholder base, helping to attract an excellent group of patient, thoughtful, and sophisticated investors.

This share class also gives me more flexibility to invest for the long term, since it reduces the likelihood that I might need to meet quarterly redemption requests. Most of the time, the value of this additional flexibility remains dormant; it only truly comes into play from time to time when the markets go through some kind of convulsion. The key in those moments

is to have the financial firepower to snap up fantastic bargains, rather than wasting that firepower to meet redemption requests from investors who get rattled or face a sudden need for liquidity. Having the majority of our partners think about their investment only once a year helps us enormously to take advantage of such opportunities and to stay the course.

True nirvana would be a structure that gives Aquamarine the benefits of permanent capital. This is what Buffett has at Berkshire Hathaway: when markets go haywire, he doesn't need to worry about meeting a slew of redemption requests, since he's not running a fund. Combined with his extraordinary temperament, this allows him to act decisively at moments when mispriced investments are most readily available.

As I discussed in my book, we often think that we can trump our environment with our intellect, but it is almost always the other way around: our environment usually trumps our intellect. Berkshire's structure provides Buffett with the ideal environment, helping him to invest boldly when markets are in turmoil and many money managers are contending with redemption requests.

With this in mind, I will continue to look for ways to move Aquamarine closer to having permanent capital. One



example of how to do this is the path taken by two of my friends: Mohnish Pabrai has launched Dhandho Holdings as a permanent capital vehicle and Ken Shubin Stein oversees Spencer Capital Holdings.

These vehicles have the additional advantage that they are insurance holding companies. In this, they take another page out of Buffett's playbook in that much of the investable capital that they generate is not necessarily shareholder funds but insurance float. These are assets held by their insurance businesses, which may be called on to pay future insurance liabilities, but can be invested today for the benefit of their shareholders. From an investor's perspective, one great thing about insurance liabilities is that they are not necessarily correlated to the whims of the stock market.

It's not clear to me exactly how I will move us in this direction. But I've always been surprised by the nature of serendipity. Some time ago, I read a book entitled *Write It Down, Make it Happen*. Now that I've written down this aspiration in our annual report, I'm intrigued to see what transpires! Please feel free to email me at gspier@aquamarinefund.com if you see something along these lines that you think is an opportunity for Aquamarine. I'll do my best to reply promptly to you.

ISTOCK

Custodian Update

In 2014, I experienced some frustration on the custodial side of the fund. This mostly related to our investment in a Brazilian education company that was acquired by a competitor in a share-for-share swap. The way it worked out, we were charged an unexpected and punitive tax, even though Brazil's tax law on this point is, at best, unclear. I was later advised by our Brazilian counsel that most, if not all, Brazilian investors intended not to pay the tax; if challenged by the finance ministry, they would take it to an independent court where they were expected to win.

By contrast, Citibank, our sub-custodian in Brazil, calculated the tax in a way that was most unfavorable to us and agreed with the view of the Brazilian finance ministry. Moreover, Citibank, with the help of Credit Suisse, our custodian, paid that tax without warning us or allowing us to provide input. It seemed to me that Credit Suisse and Citibank lost sight of our interests, possibly because they also felt the need to protect their own relationships with the finance ministry.

After Credit Suisse paid the tax and deducted the relevant amounts from our account, I made various attempts to enlist their help in reclaiming the overpaid tax. Instead, they sent us a long document prepared by the Credit Suisse

legal department, which gave a closely-argued legal opinion offering reasons why the bank was within its rights to summarily deduct the tax. The subtext seemed loud and clear: we don't think we have made a mistake; if we *did* make a mistake, we don't plan to admit it; and if you confront us, we will fight you tooth and nail.

At the end of the day, the tax hit cost us only 0.3% of our assets under management. Up to 0.2% would likely have been payable in any case. In the grand scheme of things, this was hardly fatal. But, over time, frictional costs add up and cause an unnecessary drag on our rate of long-term compounding. Equally important, I don't want to put us in a position where a custodian can overpay taxes on our behalf without any redress. As a result, I decided that it was time to seek out a new custodial relationship.

This is no reflection on the individuals who worked on our account. I'm deeply grateful to Thomas Lauber, Raphael Huber, Taylor-Ann Messmer and others at Credit Suisse who were caught between a rock and a hard place through no fault of their own. In the past, Credit Suisse had done a consistently excellent job on our account. I should also mention that I've been enormously impressed with the hard work, trustworthiness

and reliability that I've again and again encountered among people in Switzerland — precisely the kind of Buffettesque values that drew me to live and work there in the first place.

In any case, I don't harbor any ill will toward these banks, despite my disappointment over this one experience. I understand that organizations like Credit Suisse and, for that matter, UBS must contend with various stresses and pressures that don't make life easy. For example, they are caught up in the challenges of meeting new minimum capital requirements from Basel III and the like, while also confronting their history as havens for tax evaders and other less-than-pristine participants in the global financial system. By using them as custodians, we may have unwittingly risked being tainted by the same brush.

Aquamarine is a law-abiding, transparent financial institution that intends always to remain in regulatory compliance. So we have no need to tie our fate to institutions that must contend with such issues. With this in mind, I was determined to find a different custodian.

I talked to several institutions in the U.S. and Europe, including Bank of New York Mellon, Northern Trust, UBS and Banque Pictet. But I quickly settled on Northern Trust. I had originally met

with representatives of Northern Trust at a Campden conference and had heard positive evaluations from my friend Nick Sleep and other investors. I also liked the non-promotional way they talked to me about their services.

At the time, I let them know that I was happy with my existing service providers, but would get in touch if something changed. After my experience in Brazil, I reached out to Northern Trust. Thanks to the efforts of Iain Carey and Keith Bradley — and in spite of our being on the small side as a prospective client — they agreed to take us on. They will service us out of their Dublin office.

Based in Chicago, Northern Trust is more than 125 years old. It has about \$110 billion in banking assets and acts as a custodian for more than \$6 trillion in assets. I would describe it as a custodial bank in that it specializes in servicing assets for institutional investors rather than “doing deals.” It has a business model that emphasizes stable fee income instead of taking principal risk. It doesn’t have an investment banking arm or an OTC derivatives desk. It stands at the more boring end of the spectrum of financial institutions. I like this. The bulk our assets will end up being serviced by Northern Trust, and I’m confident that they will do a great job.

That said, we will continue to work closely with Ajay Desai and his excellent team at UBS Wealth Management in Chicago to execute our trades in the U.S. and elsewhere. They will also act as a back-up custodian for us. They have done an extraordinary job for us and I am deeply grateful to them.

Working with Northern Trust should also have the added benefit of making it easier for us to invest in India. As it happens, we have a long history in India. Fifteen years ago, I was searching for overseas investments that were similar to investments that had worked for us in the U.S. In an interview with me for *Value Investor Insight*, Whitney Tilson and John Heins described this as “reasoning by analogy.” One area of focus was the credit rating industry. Thanks to my friend Girish Bhakoo, I heard about CRISIL India, which would later become Aquamarine’s biggest-ever winner in percentage terms.

Among its attractions, CRISIL had an important feature: it had two large shareholders, ICICI Bank and Standard and Poors. With those shareholders owning the same share classes as me, I was pretty confident that my interests were well protected. Still, I allocated only a very small proportion of the fund to the investment, so it had far less impact than it should have had.

Since then, I've come across other enticing opportunities in India. But my inclination has been not to invest. However, the advent of the Modi government reinforces my conviction that this is an attractive hunting ground for us. With developed markets not particularly cheap, I also believe that many of our best opportunities in the next few years may lie in developing countries like India and Brazil.

We will be working with Northern Trust to open up our access to the Indian market, and I have my eye on a number of Indian businesses. Straightforward and transparent access to a market like this is difficult for the average investor to achieve. So it's useful to add this capability to our investment toolbox.

Regulatory and Organizational Update

Since last year, we have successfully registered with the U.S. Securities and Exchange Commission (SEC) as an investment advisor. Orly Hindi, whom many of you know, has taken on the role of compliance officer. One slight disadvantage of registering with the SEC is that we had to start filing 13F reports in 2015. This means our U.S. investments can be followed by curious outsiders. To my dismay, this led to me receiving various messages from people who had picked over my portfolio.

It was less distracting when we could operate below the radar, without people tracking our investments. But it's now obligatory to register with the SEC if you manage more than \$100 million in U.S. assets. On the positive side, I've found that registration enhances our credibility and also requires us to do a thorough review of our operations and structure on a regular basis.

Meanwhile, in Switzerland, we have filed our application to FINMA on behalf of our Swiss Advisor, Aquamarine (Zurich) A.G. This application was the first step towards the ultimate goal of registering as an asset manager in Switzerland, which will be a necessity if we are to remain based in the country. This application process itself required enormous effort, including a financial audit of our Swiss management company.

In the process, we adopted a new structure in Zurich. One aspect of this is that Mark Chapman, who used to be a Partner at Deloitte, joined us as a director both of Aquamarine Fund Inc (our offshore feeder) and Aquamarine (Zurich) AG. We have been working closely with Mark both to ensure that we are compliant in the U.S. with the SEC and on risk management policies and procedures in Switzerland.

As we worked through the Swiss FINMA application, I felt at times as if we were

I'VE FOUND THAT SEC REGISTRATION ENHANCES OUR CREDIBILITY AND ALSO REQUIRES US TO DO A THOROUGH REVIEW OF OUR OPERATIONS AND STRUCTURE ON A REGULAR BASIS.



in the theatre of the absurd. In all, I must have met with more than 15 people in our Swiss office as part of this process. I demonstrated to them over and over again the simplicity of our operation: Guy Spier sits alone in a room and picks undervalued stocks. He makes a very small number of trades and holds a small number of investments. Period. End of story.

Over time, as more and more people got involved with the process, I believe they started to understand how the current Swiss legislation, as applied to Aquamarine, is a bit like using a sledgehammer to crack open a peanut. In any case, anyone who reads our application – which extended to more than 80 separate documents and filings – will see that we have worked hard to meet the requirements of the letter of the law in a way that makes sense for our small operation.

I started off this process with a slight sense of frustration, which has since dissipated for the following reason: all developed markets have decided that they want to have closer scrutiny and tighter regulation of financial institutions, including ones as small and simple as the Aquamarine Fund.

My goal is not to fight that or to have an adversarial relationship with any regulatory authorities, whether in Switzerland or elsewhere. In order to be in the investment business, I understand that we need to manage our regulatory reputation. Moreover, we no longer just have to do the right thing. We have to do the right thing in such a way that the various regulatory bodies that have jurisdiction over us can see that we are doing the right thing. This requires us to abide by their rulebook and to understand their way of viewing the world.

My basic standard, which I learned from studying Buffett, is to operate at all times on the assumption that what we do might be written up on the front page of a newspaper. At the same time, we behave as if the staff of the various regulatory bodies were sitting next to us and observing our every action. I've communicated these ideas on multiple occasions to our small staff and our counterparties.

The late Donald Keough, author of a book entitled *The Ten Commandments for Business Failure* and a former director at Berkshire Hathaway, taught me the importance of "playing center court." The idea is never to take the risk of venturing into grey areas. Today, more than ever, playing center court is both a smart business approach and the right thing to do in ethical terms.

The key instruction that I have repeated numerous times to Aquamarine's staff is that if they ever receive a call from the SEC, FINMA or other regulators, they should feel free to invite them into our office and give honest answers to their questions without having first to check in with me or our legal counsel.

Because Mark Chapman has orchestrated and so much of our regulatory work and organizational overhaul in the last six months, I have

invited him to write a note for you, which you can find on page 23.

Partnership Meetings in 2015

We will continue to have three annual partnership meetings in London, New York and Zurich. In the past, I've been liberal with my invitations. Sharing my experiences and mistakes with a broader public, including students and analysts, has been extremely gratifying and educational for me. To the extent that it helps others not to repeat my mistakes, I also see it as a kind of public service.

However, the SEC requires me not to engage in activities or communication with the general public that might be construed as a public offering of the fund. So I have made a change in our policy for 2015: our partnership meetings will now be for our existing shareholders and prospective accredited investors. When it comes to regulations, it's not enough to be governed by your "inner scorecard": doing the right thing also needs to be accompanied by *appearing* to do the right thing. The outer scorecard counts.

At these meetings, I will update you on our investment results, share some updates on our portfolio, and provide some post mortems. But I don't want to give up my engagement with a broader audience, which blossomed as a result of the book. So I will also host some book-related talks at around the same

time, which will give me an opportunity to discuss more general topics. These book-related meetings will not go into specifics about the fund because that might be construed as an offer to non-accredited investors to invest.

It remains for me to thank you for your support and your trust.

Warmly,



Guy Spier

PS: If you have noticed a marked improvement in the quality of my shareholder letters in the last couple of years, you are right — and it's not just because my book gave me the opportunity to practice my writing. It's also due to the involvement of William Green, a writer and editor who is a friend and classmate from Oxford. After collaborating with me on my book, William volunteered to edit my shareholder letters, too, starting last year. The process mirrors the way we worked together on my book: the thoughts originate with me, but William questions me deeply, pushing me to elaborate on and clarify

my ideas. He then takes my thoughts and words and edits them into something that is clearer, more readable, and a more accurate expression of my thinking. It also helps that he is a long-time investor in Aquamarine because he understands what his fellow shareholders would like to know about how their money is being managed.

*William's involvement is another example of the benefits of an expanding circle of goodwill that has compounded for me over the years. It's a wonderful asset to be able to work with talented friends. William did an extraordinary job on my book and has now written and edited a book entitled *The Great Minds of Investing*. Thankfully, he also introduced me to a remarkably gifted designer, Cecelia Wong, who designed the cover of my book and has now designed this year's annual report for Aquamarine. I hope that we can continue working together for years to come. ■*