

## 4<sup>th</sup> Quarter 2022 Letter

January 25, 2023

The Springview partnership’s Master Fund gross and net returns by quarter and for the full year ended December 31, 2022 are shown below together with comparable returns for the S&P 500 Index (which we believe is our most appropriate benchmark), and our results relative to the index:

	<u>Springview</u> <u>Gross</u>	<u>Springview</u> <u>Net</u>	<u>S&amp;P 500</u> <u>Index</u>	<u>Springview Net</u> <u>Relative</u>
1Q 2022	+1.9%	+1.3%	-4.6%	+5.9%
2Q 2022	-8.4%	-8.4%	-16.1%	+7.7%
3Q 2022	-3.7%	-4.0%	-4.9%	+0.8%
4Q 2022	+7.6%	+7.2%	+7.5%	-0.4%
<b>CY 2022</b>	<b>-3.2%</b>	<b>-4.6%</b>	<b>-18.1%</b>	<b>+13.5%</b>

Dear Partners,

Your investment in the Springview partnership returned a negative -4.6%, net of fees, last year, which compares favorably to total returns (including dividends) of -18.1% for the S&P 500 and -32.5% for the Nasdaq Composite. Last year was a tough year for risk assets. Cash and commodities were the best performing asset classes by far, as even bonds – including risk-free US Treasuries – suffered double-digit annual declines.

In this context, the partnership’s performance was satisfactory, although far from heroic. While the market prices for many of our investments pulled back, the aggregate value of our portfolio fell considerably less than the market.

We believe this reflects three underlying factors: (i) the quality and durability of our portfolio businesses; (ii) outstanding execution by their management teams; and (iii) our ability to purchase their shares at sensible prices. The last factor is the only one for which your fund manager can take any credit and it is at this intersection of quality, management, and price that we hope to separate ourselves from the herd.

As we wrote in our inaugural 1Q22 letter:

*“Our conservatism may cause the partnership to outperform (relative to the main indexes) in weak markets and to just keep up or modestly underperform in strong ones.”*

This is essentially how 2022 played out. Dividing the year into two halves shows how our conservative yet steadfast approach navigated two distinct market backdrops:

Between January and June, when the S&P 500 fell -20.0% (including dividends), Springview held its losses to a comparatively small -6.6% decline (before fees), absorbing just 33% of the market drawdown. Then, between July and December, when the stock market staged a recovery and the S&P 500 rose +2.3% (including dividends), Springview gained +3.6% (before fees), capturing 158% of the market's upward trajectory.

In a recently published memo titled "*What Really Matters?*", Oaktree Co-Chairman Howard Marks delves into the concept of asymmetry in investing. It is a good memo and I encourage you to read it. The thrust of Mr. Marks' insight is that alpha generation ultimately shows up as asymmetrical returns. The passage in the memo that really struck a chord was:

*"To determine whether [investors] have alpha and produce asymmetry, we have to consider whether the aggressive investor is able to avoid the full loss that his aggressiveness alone would produce in a bad market and **whether the defensive investor can avoid missing out on too much of the gain when the market does well** [emphasis added]."*

- "*What Really Matters?*", Howard Marks, November 22, 2022

As unabashed risk-averse investors, we were not surprised that our defensive posture beat the market during a time as challenging as the first half of last year. It was no mean feat. Featuring mostly boring steady Eddie businesses, we felt our portfolio should keep chugging along with relatively muted correlation to investor sentiment swings and macro gyrations. And it mostly did.

We were less confident about whether our defensive, less-cyclical holdings, burdened by the fund's unusually large cash holdings, would be able to keep up when animal spirits returned.

In that regard, the second half performance was gratifying, in that we were able to exhibit a modicum of asymmetry (outperforming the downside while avoiding missing out on the upside).

Zooming back out to the full year, our 15-point outperformance (before fees) versus the S&P 500 is a fine outcome but one which will probably be tough to replicate consistently. Even a result half as good – say, seven points of outperformance annually (no easy feat, either) – would produce exceptional wealth creation over many years.

It is not lost on us that the above analysis of two six-month stretches is largely meaningless against our long-term objectives. Randomness and luck can easily overpower investment skill over brief measurement periods. Mr. Marks is looking for asymmetry over not months or quarters, but years and even decades. As are we.

We have written in the past that we will grade ourselves over rolling five-year periods, and this remains the case. If anything, the past year is a decent start. But it is just a start.

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### **PORTFOLIO CHARACTERISTICS**

During the year, the fund averaged daily gross long exposure of 60.7%, daily gross short exposure of 6.4% and daily net long exposure of 54.2%. These same numbers as of the last day of the year were 82.2% gross long, 3.3% gross short, and 78.9% net long.

Our cash position, which averaged 39.3% during the year, has been whittled down to 17.8% by the end of the year and further still to about 11% as of this writing. We are now close to being fully

invested, although we would not shy away from increasing our exposure further if a juicy investment opportunity came along.

If numbers can tell a story, the story here is that we deployed substantial capital in the fourth quarter. We added to existing longs and made several new investments. At the same time, we reined in our short exposure. The market's plunge during the summer and early fall pummeled many securities, including most of our favorite shorts, leaving them oversold and washed out.

Our shorts contributed just 1.5% to our full year returns. In hindsight, I was much too cautious about staying with – and pressing – shorts as prices fell. Ultimately, my decision to play overly defensive on the short side, and to de-risk the short book in the fourth quarter, subdued the fund's overall returns somewhat.

I should once again reiterate my belief that shorting in the normal course as a feature of the hedge fund business model is a loser's game in the long run. The accepted practice of carrying a substantial short book to “hedge” the portfolio, “fund” longs, or “target” a certain exposure level is, in our view, incompatible with maximizing returns over the long term.

At best, investors may view short selling as useful for dampening volatility in a bad market like last year. At worst, investors lean on short selling to justify a fee structure or fit an institutional style box. Did I also mention that short selling is tax inefficient?

Allow me now to share some important details about the portfolio as it stood as of December 31, 2022 (with one notable exception – a large new investment in Fairfax Financial, discussed briefly below – the portfolio is largely the same today).

Our ten largest holdings as of year-end are as follows:

Berkshire Hathaway	11.5% of fund assets
W.R. Berkley	9.9%
White Mountains	9.7%
Markel	7.4%
Hilton	5.8%
Union Pacific	4.7%
Visa	4.3%
Mastercard	3.5%
Alphabet	3.5%
Copart	<u>3.3%</u>
Top ten	63.5%

Our portfolio companies operate in seven broadly defined GIC sectors, as follows: financials at 48% of fund assets, industrials at 10%, information technology at 8%, communication services at 6%, consumer discretionary at 6%, materials at 3% and energy at 1%.

Since the fund's early days, we have had a notable concentration in the property/casualty (p/c) insurance sector. This continues to be the case. The main features of the p/c business – consistent cash generation, a nondiscretionary and inevitable product, and sticky low-cost insurance reserves (“float”) – combined with reasonable stock prices and highly competent managements (p/c is not an industry that suffers fools for long) has made this industry an irresistible and profitable area of focus for the fund over the past year. We estimate that the fund's economic exposure to the p/c insurance sector, after adjusting for large non-insurance businesses at Berkshire Hathaway and White Mountains, was approximately 27% of assets at year-end.

Constructing our portfolio from scratch on January 3<sup>rd</sup>, 2022, we initiated forty-two long investments over the course of the year and ended it with twenty-one holdings. Portfolio turnover, as defined in our 1Q22 investor letter (calculated as [total number of positions initiated minus ending number of positions] / total number of positions initiated), was 50% during the year, implying a two-year holding period.

*“The big money is not in the buying and the selling, but in the waiting.”*  
- commonly attributed to Charlie Munger

We agree with Munger. Patience is a key ingredient to compounding and fifty percent annual turnover smacks of short-term thinking. Perhaps this suggests that (gasp!) we overtraded.

However, under the surface our turnover looks more in line with our objectives. Confining the analysis only to positions sized at 2% of capital or more – our core holdings – the comparable turnover statistic is 22%, implying a 4.5-year holding period. Different methodologies exist for measuring turnover and we do not dwell too much on the exact number so much as on whether the portfolio output is consistent with our original intent of patient, long-term investing. In this respect, we believe they are.

Our long investments detracted approximately -4.7% from performance during the year. On an average daily exposure of 60.7%, our average return on capital on longs works out to -7.7%, about 10 points ahead of the overall market. The largest contributors to performance were our investments in W.R. Berkley and White Mountains, while the largest losses were incurred in Alphabet and Netflix.

While contributing only +1.5% to performance, our shorts did so on very little capital employed. On an average daily short exposure of 6.4%, our average return on capital works out to +23.0%, which is about five points better than the market’s decline. Our most profitable shorts were in cruise line operator Carnival and a basket of treasury and corporate bond exchange traded funds. We did not have any individually meaningful losers on the short side.

In summary, both longs and shorts generated alpha during the year. Our temporarily large cash holdings also contributed somewhat to the fund’s overall outperformance.

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### **TOP FIVE HOLDINGS**

**Berkshire Hathaway (BRK)** is our largest position and has been for much of the past year. So long as its share price continues to bear little relation to what we believe to be the immense value and bright prospects of the company, BRK should remain a mainstay in our portfolio. BRK appreciated +3% during 2022, putting on display the defensive qualities of a company with nearly 20% of its market value in cash and a collection of solid businesses generating copious free cash flow.

More to the point, we believe Berkshire represents a bargain at current levels and, despite Warren Buffett’s God-like status and media attention, is one of the most institutionally ignored stocks we have ever encountered.

It may sound puzzling that a near-\$700 billion market cap behemoth could be ignored and undervalued, so let’s review the numbers. BRK has two sources of value: its cash and marketable securities portfolio, and its wholly owned operating businesses. At year’s end, we estimate that cash and securities, net of holding company debt, totaled roughly \$430 billion, equivalent to about \$200 per class B share. The wholly owned operations, comprising juggernauts like BNSF Railway and MidAmerican Energy (leaders in their respective industries) and dozens of other businesses, should,

we believe, earn at least \$10 after tax per class B share this year. The arithmetic is straightforward: at the current BRK price of about \$310, the market is valuing the wholly owned operations at less than 11x earnings, a whopping discount from fair value (public peers of BNSF and MidAmerican trade at 18-19x and 20x, respectively).

It is true that such a disconnect has persisted for many long stretches over BRK's history. We are not uncovering some overlooked exotic arbitrage. What's different today is that BRK's massive size and Buffett's advancing age (92 years old) have collided to meaningfully diminish BRK's capacity to retain capital for internal reinvestment. As such, Buffett has begun returning bucketloads of cash to shareholders via his preferred method of share buybacks. Over the past three years BRK has repurchased a cumulative 10% of its shares and we believe this is just the beginning of a long-term capital return program.

**W.R. Berkley (WRB)** has been a top-five holding from day one and was our second-largest holding at year end. We previously shared our investment thesis on this family-owned-and-operated property/casualty specialty insurer in our interview in *Value Investor Insight* last January and discussed our bullishness on the property/casualty sector in our 2Q22 investor letter. Our views have not changed. WRB has been enjoying the concurrent tailwinds of a hard insurance market and rising short term interest rates.

The former is helping underwriting margins while the latter is fattening investment income on the company's large (and short duration) bond portfolio. The lollapalooza effect of rising insurance pricing *and* rising yields is manna from heaven for WRB's business model. While we do not expect this happy confluence to repeat in the same magnitude in 2023, we think WRB can continue its steady Eddie compounding of book value.

The stock had a truly exceptional 2022, finishing up +34% including dividends (our most profitable investment), and we remain confident and comfortable in father-and-son combo Bob and Rob Berkley's stewardship of this business, of which they are by far the largest shareholders.

**White Mountains Insurance (WTM)** popped up on our special situations screen last April and its attraction was immediately apparent after just a few hours of research. At the time, it was in the process of exiting a large and spectacularly successful investment in NSM, a managing general agent business. The discount to pro forma, cash-rich, net asset value got our attention and we made WTM a meaningful position.

Having discussed the idea in our 2Q22 investor letter, we will refrain from rehashing it here, except to say that we are pleased with how the investment has turned out so far. In August, WTM commenced a \$500 million common stock modified Dutch auction and ultimately repurchased 11.3% of its outstanding shares at a price of \$1,400 per share (the shares closed the year at \$1,414, up +40%). Pleasingly, even after the large tender, the company still has \$1.1 billion in excess, undeployed cash (equivalent to about 29% of its current market capitalization).

WTM was our third-biggest holding at year end and our second most profitable investment for the year. It remains a top holding.

**Markel Corporation (MKL)** was our fourth-largest holding last year and completes our stable of property/casualty insurers specializing in non-standard "Excess-and-Surplus" (E&S) policies. Don't tell the FTC, but our trifecta of Berkshire, W.R. Berkley, and Markel in effect gives us a dominant share of the U.S. E&S market. Our recent purchase of Fairfax further adds to our commanding market share.

Lest we divert FTC Chair Lina Khan's attention away from her big-tech crusade, it is worth noting that E&S is and will remain a very fragmented and commoditized market: MKL is the third-largest

writer of E&S in the US but enjoys only about a 6% market share; Berkshire, the industry leader with a 7% share last year acquired the tenth largest (3% share in 2021) writer Alleghany.

MKL has been in the specialty insurance business for ninety-two years, has an enviable record of +14% annual shareholder returns since its 1986 IPO, and we believe enjoys a special corporate culture that is unusually long term in orientation. It helps that two board members, chairman included, go by the last name Markel. Underwriting income grew +20% year-over-year through the first nine months of last year, and the company's equities-heavy investment portfolio should drive book value growth as stock markets recover. MKL shares appreciated +7% last year, and we believe remain cheap at current levels.

**Hilton (HLT)** rounds out our top five positions. The company is the world's second largest franchisor of branded hotels with a portfolio of more than 1.1 million rooms across 7,000 hotels. HLT's trusted and ubiquitous hotel brands, 146 million member-strong loyalty program, and asset-light franchise-fee revenue streams make this company a formidable long-term compounding machine.

While demand for lodging is cyclical, HLT's geographic diversification, capital-light business model and high profit margins provide a margin of safety against normal-course cycles; to wit, HLT generated positive EBITDA consistently throughout the pandemic lockdowns. Led by all-star CEO (and one of the nicest people in the world) Chris Nassetta, HLT's free cash flow exploded last year (from \$30 million in all of 2021 to \$1.1 billion in just the first nine months of 2022) as both leisure and business travel recover. The stock declined -19% last year but is trading above our cost basis.

#### **NEW POSITION**

**Fairfax Financial (FFH CN)** was a small position when the curtain fell on 2022 but we continued to buy in the new year to the point where it is now a top holding. FFH owns majority stakes in six large and profitable world-class insurance and reinsurance companies and a few (much smaller) non-insurance businesses.

What attracted us to FFH in the first place was a set of facts and patterns that bore a striking resemblance to our White Mountains investment: a very cheap stock and a management proactively taking steps to crystallize the hidden value.

In October, FFH sold its pet insurance business for \$1.4 billion, a fancy price equivalent to 12x our estimate of the subsidiary's book value. Pro forma for this deal, we estimate FFH shares trade at less than 0.9x adjusted accounting book equity and less than 60% of our own conservative estimate of fair value. Controlling shareholder and CEO Prem Watsa is no patsy: he has been buying back stock hand over fist, reducing the share count by 9% in the past twelve months. With a cash-rich balance sheet and a cheap stock at his disposal, we think Mr. Watsa will continue to buy in shares aggressively, allowing us to increase our ownership interest in FFH without laying out another dollar.

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#### **HOUSEKEEPING**

The partnership's first year was eventful and exciting. We are immensely grateful to all our partners for your support, encouragement, and capital. As I have said before, you deserve credit for your stoic demeanor and steadfast focus on long term results. We are honored to manage your capital.

I would be remiss if I did not give proper recognition to Ian Malakoff, my indispensable analyst, friend, and partner, for his tireless work ethic and his hugely positive impact on the partnership. I would also like to congratulate Ian and his wife Kelsey on the birth of their son, Otto George Malakoff.

Anthony Lee left the firm during the quarter. We thank Anthony for his contributions and wish him success in his future endeavors.

KPMG is working on the fund's year-end audit and taxes. K-1s should go out to investors by the middle of March. Please feel free to reach out with any questions about your capital account.

My family and I are the single largest investor in the partnership and have nearly 90% of our liquid net worth invested in the fund. I again thank you for your capital, your patience, and your support.

Respectfully Yours,

A handwritten signature in black ink, appearing to read "Guy Baron", followed by a period.

Guy Baron

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