

# Dear Partner,

## Investment Results

IN 2016, THE AQUAMARINE FUND RETURNED 8.5% VS 11.9% FOR THE S&P 500. SINCE THE FUND'S INCEPTION IN SEPTEMBER 1997, OUR INVESTORS' CAPITAL HAS COMPOUNDED AT A RATE OF 8.9% ANNUALLY, VERSUS 6.5% FOR THE S&P 500. THE AQUAMARINE FUND'S TOTAL RETURN FROM INCEPTION IS 417%, VERSUS 238% FOR THE S&P 500.

These figures are net of all management expenses and fees, so these are actual returns. The figures for the S&P 500 include dividends, making this an apples-to-apples comparison.

### Commentary

In September 2017, the Aquamarine Fund will celebrate its 20th birthday, so it's a fitting time to pause for a moment and reflect on our long-term returns. Since the fund's inception in September 1997, we've outperformed the market by an average of 2.4 percentage points annually.

That might not sound like much. But the extraordinary power of compounding is such that this solid outperformance over two decades has generated considerable rewards for our shareholders. The Aquamarine Fund's total return of 417% since inception (versus 238% for the S&P 500) represents an outperformance of 179 percentage points.

What does that mean in dollar terms? If you had invested \$1 million in the Aquamarine Fund when it opened in 1997, your stake would now be worth \$5.17 million. By comparison, if you had invested \$1 million in the S&P 500, your stake would now be worth \$3.38 million. In other words, your investment in Aquamarine would now be worth about 50% more than if you had simply invested in an index fund that tracked the S&P 500.

As we all know, indexing is a powerful strategy. But our adherence to the time-tested principles of value investing has served us well over two decades. I'll do everything in my power to widen the fund's outperformance over the next 20 years, building on everything I've learned from my successes and my mistakes. I'm enormously grateful to you, the fund's shareholders, for partnering with me in this pursuit.

LONG-TERM  
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A year ago, when I wrote my last Letter to Partners, the investment environment was strikingly different than it is today. Back then, in early 2016, investors were getting buffeted by intense market volatility, and the financial news was filled with ominous stories about everything from falling oil prices to a Chinese economic slowdown to the threat of rising interest rates. Amid the market turbulence, the Aquamarine Fund dropped 14.9% in January 2016.

As I wrote to you back then: “It’s important to remember that our long-term success depends on our ability to remain calm, rational and value-focused in these periods of extreme irrationality.” I also noted: “The current turmoil is certainly uncomfortable, but it creates precisely the type of mispricings that we depend upon in our search for undervalued assets.”

A year later, I’m pleased to report how we’ve benefited from that determination to stay calm amid the storm. The Aquamarine Fund rebounded strongly after that tumultuous start to 2016; and, as I write this, the fund is up 9% in the first two months of 2017, driven in part by a re-rating of our automobile and bank holdings in the wake of the November presidential election. I also used the market volatility in early 2016 to buy two new stocks, Moody’s and Seritage Growth Properties. These are high-quality companies that I hope to own for many years to come.

I’m not writing this in a spirit of triumph or self-congratulation. The point is that long-term investment success requires the emotional fortitude, discipline and patience to stick with

the program during good times and bad. The past year provided a perfect illustration of why it’s so important not to get rattled by volatility, which leads many investors to make irrational decisions that doom them to lousy returns.

By contrast, the Aquamarine Fund seeks to exploit those periods of intense volatility and uncertainty to pick up undervalued stocks. It’s not easy psychologically, but we try to seize these fleeting opportunities to upgrade our portfolio. In retrospect, I probably should have bought more aggressively in early 2016, but the valuations weren’t sufficiently attractive.

Over the last 20 years, we’ve certainly experienced plenty of extreme market turmoil, including the “Asian Contagion” of 1997, the bursting of the tech bubble in 2000, and the global financial crisis of 2008-2009. Yet the fund’s original investors have quintupled their money over those two decades.

We’re certain to face periods of market turmoil in the future, too — and none of us can predict *when* they might occur or how extreme they might be. We can also be certain that I’ll make my fair share of investing mistakes. Still, our approach of investing patiently in a relatively concentrated portfolio of superior companies at attractive valuations should continue to work well in the long run, despite the potholes we’ll inevitably encounter along the way.

It’s worth adding that one of the greatest contributors to our success is that we have a remarkably steadfast group of shareholders who understand the importance of holding firm through thick and thin.

Paradoxically, today's euphoric market environment is, in some ways, more challenging for us than the panic-stricken market we faced a year ago. With equity markets at all-time highs, it's extremely difficult for value investors like us to find enticing bargains. But the alternatives to stocks aren't great either. Bond yields offer little joy for fixed-income investors; and I don't think it makes sense to hold large quantities of cash, which would represent an attempt to time the market. In my experience, market timing is a futile pursuit.

I believe the best option is to remain invested in stocks, even though the valuations don't represent the sort of bargains we've found in the past. The truth is, none of us knows how this era of low interest rates will end. Sooner or later, rates have to go up, which implies a decline in asset prices. But if that rise is accompanied by sufficient inflation, then stocks won't necessarily decline. Even if interest rates rise substantially, it's possible that inflation — or merely the expectation of inflation — could result in a very strong bull market.

Needless to say, I'd never claim to have any gift at all for making macroeconomic predictions of this sort. But it's worth acknowledging that these macro risks and uncertainties exist. In any case, I believe that one key to preserving and growing our wealth is to stay committed to equities over the long term and to ensure that we're protected from the ravages of inflation.

That said, in today's bullish environment, it makes sense to tread carefully. Companies like

Facebook, Apple, Amazon, Netflix, Google, Airbnb, SpaceX, Tesla and Uber have performed particularly well, and it's easy to feel foolish for not owning them. These are extraordinary businesses that are transforming the world, but they also tend to have nosebleed valuations.

For what it's worth, I'm struck by the fact that my three children (who are aged nine to 12) have been clamoring for me to open brokerage accounts for them. Their main motivation: to bet on Facebook, Apple and Tesla. For those of you who weren't around for the last bubble, welcome to what it feels like.

I'm not saying that we're in bubble territory with these stocks. But it's worth reiterating that bubbles are mighty hard to detect while you're in them, however obvious the symptoms of irrational exuberance might seem in retrospect.

My focus, as always, is not on making market predictions but on finding superior businesses at compelling valuations. I'm not seeing many opportunities right now in the environments that I know best — the U.S. and Western Europe. But I'm not prepared to overreach by buying overvalued stocks. In the meantime, I'm also actively hunting for opportunities in other overseas markets.

Approximately 7% of our assets are currently in cash. That's not a reflection of any macroeconomic view on my part. Our cash position is relatively low for the simple reason that I'm happy with the businesses in our portfolio and haven't wanted to sell any of them.

### Post-Mortems: Two Stocks We Never Bought — Amazon And Valeant

Every year, I like to provide you with a post-mortem of two stocks that Aquamarine has sold. It's a useful way of explaining the fund's investment process while also rubbing my nose in my mistakes. But I thought it might be more revealing this year to look at two stocks that I *considered* buying and then, after extensive analysis, *didn't* buy: Amazon.com and Valeant Pharmaceuticals International.

In Amazon's case, this decision proved to be an expensive sin of omission. In Valeant's case, we dodged a deadly bullet. Let's start with Valeant.

There are times when a stock seems to scream "Buy me!" This was certainly the case with Valeant at various points over the last few years. In those heady days when Valeant was flying high, some of the world's smartest investors

were enormously bullish about the company's prospects. For example, famed hedge fund manager Bill Ackman — a friend whom I've long admired as a brilliant analyst — gave a 300-slide presentation on why Valeant was great and declared that it was "tremendously undervalued."

Another major shareholder in Valeant was Jeffrey Ubben, a San Francisco-based activist investor whom I also respect enormously. For good measure, Bob Goldfarb, then at Ruane Cunniff & Goldfarb, had also acquired a massive position in Valeant. Having followed Goldfarb closely for two decades, I revered him as one of the most gifted investors of our era.

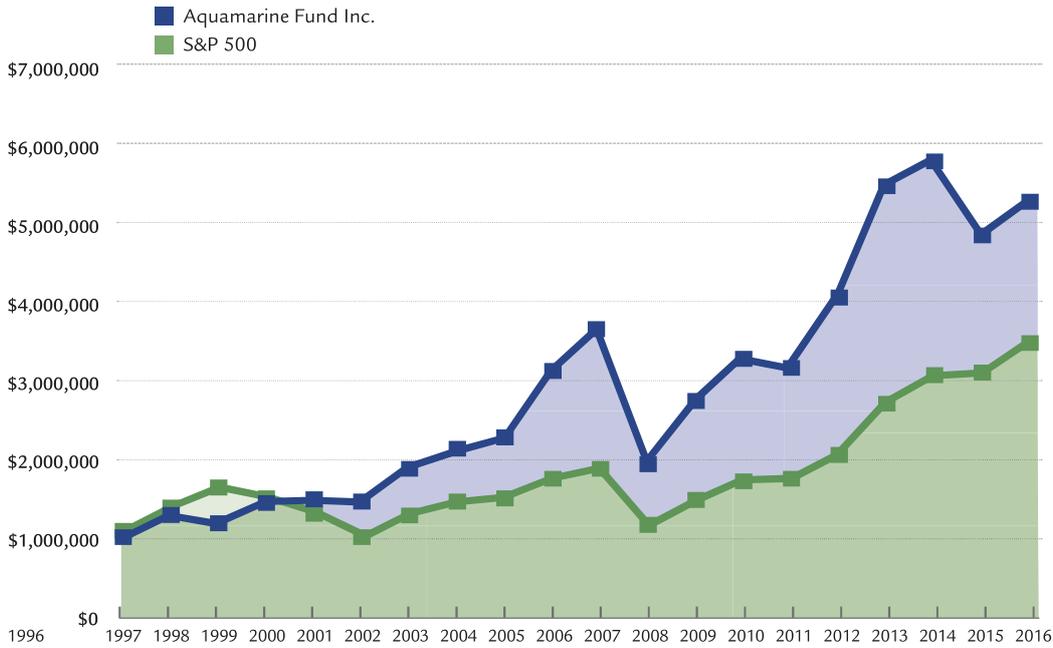
As part of my investment process, I routinely study the portfolios of the best investors I know. My goal isn't to copy them. It's to reverse-engineer their thought process and

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# Performance Relative to the S&P 500 Index

Comparison of changes to \$1 million invested

## Aquamarine Fund Inc.



## Aquamarine Value Fund L.P.

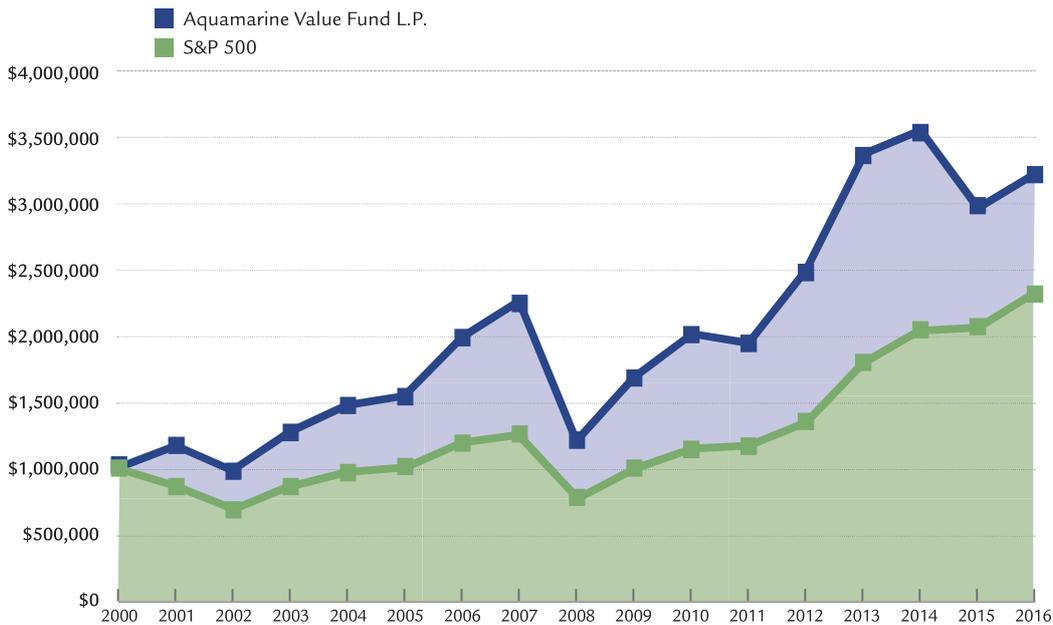


figure out why they own particular holdings. It's a useful way to search for potential investment ideas that might be worth analyzing in greater depth. The fact that Valeant had attracted these celebrated stock-pickers was intriguing, partly because they have such distinct personalities and their minds work so differently. I wanted to know why Valeant had captivated them.

As I read up on the company, it soon became clear that Valeant had a simple and seemingly effective business model: acquire traditional wet-pharma companies; cut R&D; raise prices; consolidate costs; rinse and repeat. Some investors came to regard Valeant as a platform company like Berkshire Hathaway with endless growth ahead of it.

But the truth is, I didn't even come close to buying Valeant. Why not? Much has been said lately about the company's aggressive accounting and the moral issue of raising drug prices. But for me, there was another fundamental obstacle that was simply insuperable: I just couldn't see that the stock was cheap. Valeant's fans liked to say it was cheap if you took into account the incredible acquisitions it would make in the future. In other words, the key was to look at this stock dynamically, understanding what it would (or might) do going forward.

The trouble was, this would have required me to "reach" in a way that I wasn't willing to do. One item on my investment checklist specifically requires me to flag stocks that are cheap only because of what the business is *expected* to deliver, instead of based on what it's

doing today. This is one of the great benefits of using a "pre-flight" checklist: it forces me not to overlook or gloss over warning signs like this.

And so I passed on Valeant. In doing so, I had to endure a look in some of my professional friends' eyes that said: "This guy just doesn't get it. He's too dumb. What a shame. He could be making all this money with me, but he isn't." This kind of subtle peer pressure can be surprisingly difficult to resist. But making the right decision will often require me to be willing to look stupid in front of my peers — and also to endure that unpleasant feeling in my gut that says: "You idiot! Why don't you just go ahead and buy it? Otherwise, you'll be kicking yourself when all these other fund managers make a killing."

In the case of Valeant, my cautious approach saved us a lot of pain. The stock has plunged from \$257 in 2015 to \$11. Bill Ackman recently revealed that he has sold all of his Valeant shares, taking a reported loss of about \$4 billion. And Bob Goldfarb has now retired after a 45-year career in which he helped guide the Sequoia Fund to a spectacular long-term record.

It's a useful reminder of how humbling and hard this business can be and that even the best investors make costly mistakes. My painful experience of investing in Horsehead Holdings, which ultimately went bankrupt, has reinforced my own determination to do everything I can to avoid these permanent losses of capital — even at the risk of sometimes being overly conservative.

Let's now move on to Amazon.com — another company that didn't make it into our portfolio.

A few years ago, around 2012, I was visiting my friend Nick Sleep, a superb investor based in London. I had originally met Nick when we were both invested in Weetabix, and it's been a great pleasure to spend time with him over the years.

Nick had previously written a memo about Costco that was widely shared within the investment community. As he explained, Costco has a remarkable business model. It adheres to a strict policy of never charging more than a 13% gross markup on its products, and it provides great service and quality to its customers. As a result, it's become a dynamo with a tremendously loyal client base — people who regard themselves as members of a club, not just consumers. Rather than make an extra buck, Costco keeps reinvesting its profits to provide less expensive products. Without any advertising or promotions, they keep coming back for this raft of ever-improving deals. A good phrase to describe this powerful model is “scale economies shared.”

While Costco has constantly looked expensive on an earnings basis, Nick argued that this wasn't really the case. As he saw it, you needed to make the adjustment for steady state — in other words, you should figure out how much the company could raise its prices before it would stop growing. To put this another way, you have to ask: what could a reasonable owner extract from the business on an annual basis while leaving the company's earnings power unchanged? Viewed from this perspective, you might conclude that Costco wasn't expensive.

As Nick saw it, Amazon was like Costco on

steroids. He and his partner, Qais Zakaria, explained this thesis while we ate delicious Cornish pasties on the King's Road. In their view, Amazon was the ultimate example of “scale economies shared.” Best of all, as an online company, it didn't have the same capex requirements as Costco, and it didn't have to contend with the complicated challenges of running those massive retail stores.

Nick was as close to banging the table as an Englishman can get. In his view, this was the slammiest slam dunk of any investment idea ever. I then returned home to Zurich and reviewed his thinking from the quiet of my own office. In addition to Nick's reasoning, it wasn't lost on me that Amazon's annual reports were very similar to Costco's annual reports, and their CEOs talked about their businesses in the same way.

There was just one problem. As far as I could tell, Amazon's CEO, Jeff Bezos, seemed determined never to make any money for his shareholders. He priced his traditional products at close to below cost and was reinvesting in the cloud and other seemingly unrelated services at a loss. I couldn't tell if this was genius or madness. I wrote in my investment diary that Amazon might go through its entire competitive life-cycle without ever earning a dime for its shareholders. At the time, Steve Ballmer, Microsoft's former CEO, said of Amazon: “At some point, you do have to make some money.” That resonated with me.

In some ways, Amazon presented me with the same issue I faced with Valeant: the only way in which I could consider these stocks a bargain was if I made some key assumptions about

## MY CAUTIOUS AND RETICENT APPROACH TO INVESTING PREVENTED US FROM OWNING AMAZON, BUT IT ALSO PREVENTED US FROM OWNING VALEANT.

what these businesses would achieve in the future. I would have to bank these assumptions as a given, then buy into a very high current valuation, hold my nose, and hope that the future lived up to these aggressive expectations.

In Amazon's case, I would have to make some dramatic accounting adjustments to remove the company's growth capex and replace its ultra-low gross margins with the more reasonable margins it would make if it ever stopped underpricing its products. In other words, I would have to torture the income and cash flow statements to develop a picture of what Amazon would look like if Bezos decided to run the business in steady state, milking it as a cash cow instead of endlessly growing it at a loss.

To do this, I would have to make enormous assumptions that I didn't believe I could bank on. And if I didn't make sufficiently aggressive

assumptions, the stock would continue to be wildly expensive.

For intelligent and astute fund managers, there can be something strangely seductive about paying up to invest in a superior business. It can appeal to the manager's vanity and narcissism. Here's how the internal monologue might go: "I can safely pay up for this stock because I'm smart enough to figure out what a phenomenal business model this is. Pity the poor fools who *can't* figure this out and who aren't willing to buy this amazing stock at these high prices and make all this wonderful money!"

You can even convince yourself that the more you pay up for the stock, the more intelligent and astute you must be. Needless to say, this is a dangerous mental habit if you're serious about preserving a big margin of safety in your portfolio.

With all this in mind, I didn't invest in Amazon, despite Nick Sleep's compelling thesis. And, of course, he was absolutely right and I was wrong. As we now know, Bezos wasn't crazy. The people who invested in Amazon back then now look like geniuses, while those who invested in Valeant look hopelessly misguided.

When you look back on it now, it's easy to say that there was a stark and clear-cut contrast between Valeant and Amazon. After all, Valeant grew by acquiring new businesses; by cutting employees, R&D and other non-core expenses; and then by jacking up prices on customers who often had no choice but to grin and bear it. By contrast, Amazon grew more like Costco by constantly charging far less than it could

and thereby developing a loyal customer base, while also successfully investing huge sums in adjacent or semi-adjacent businesses.

But here's the rub: at the time, I was unable to make this clear distinction. Indeed, the one person I know of who foresaw Valeant's fall from grace is Charlie Munger, who accused the firm of "price gouging" and acting immorally. Yet for all his brilliance, even Charlie Munger wasn't able to figure out Amazon — despite the fact that he sits on Costco's board and was well-placed to spot the similarities. Part of what Nick Sleep saw in Amazon and Costco was the power of their corporate culture. I saw these cultural similarities, but not as clearly as he did.

So what's the moral? As I see it, the real point for Aquamarine's partners is this: my cautious and reticent approach to investing prevented us from owning Amazon, but it also prevented us from owning Valeant. I certainly wish that

I'd bought Amazon. But my firm belief is that, over a lifetime of investing, we'll benefit greatly from a conservative approach in which I simply refuse to overpay for stocks and also refuse to invest on the basis of blue-sky visions of the future. There are so many ways that we can make money safely without stretching to justify an investment in a company like Amazon.

As Charlie Munger has said, a key component of successful investing is to focus consistently on avoiding dumb stuff, instead of trying to be brilliant. Over time, this skeptical, cautious mindset should keep us out of a lot of trouble.

#### **Improvements To My Investment Process**

Over the last year or so, I've thought a lot about aspects of the investment process I discussed in my book, *The Education of a Value Investor*. To put it bluntly, there are a couple of things I wrote that I now consider asinine and over-

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simplistic. That's not surprising, given that I'm a work in progress and my education is on-going. But I thought it might be helpful to reflect briefly on what I've learned (or unlearned) since then.

Perhaps the best way to explain this is by way of a reflection from Girish Bhakoo at my VALUEx conference in Klosters. I met Girish about 20 years ago when he was a young analyst working for Bill Strong. I've learned an enormous amount from Bill and his two analysts, Girish and Sean Fieler, and they also led me to two of my most successful investments of that period: Duff & Phelps and Crisil. Girish later joined Ruane Cunniff, where he's worked closely with the renowned investor Greg Alexander.

At VALUEx, Girish posed this question: "In order to get the best investment returns, is it better to be passive or aggressive?" This question gave rise to a fascinating discussion about these two very different mindsets. Here's how the debate played out:

When it comes to investment research, you need to have an aggressive mentality, unleashing your inner hunter as you search for the very best investment ideas. You need to hunt down the facts. Go meet the players. Attend conferences. Perform channel checks. Interview competitors. No nugget of information or insight is too insignificant to be energetically pursued. It all goes into building up a holistic, multi-dimensional picture of the company or industry you're analyzing.

But later in the process, when it's time to select your investments and manage your portfolio,

this aggressive hunter mode would be a liability. At *this* stage of the game, you need to operate in the opposite manner — to be lackadaisical and laid back. Instead of letting the money burn a hole in your pocket, you want to feel like you have all the time in the world to make carefully considered decisions. If the insight and conviction doesn't hit you over the head, then you're probably reaching.

This discussion revealed to me two distinct and contradictory aspects of good investment management that could be called the "yin" and "yang" of investing. As I listened to Girish, it instantly became obvious that we need both mindsets. More important, we need to operate in the right mode at the right time — using the aggressive hunter mindset during the research process, then shifting to a more passive mindset when we're making decisions about the portfolio.

If you're too passive during the research process, you'll miss a lot of opportunities; if you're too aggressive during the decision-making process, you're likely to end up with too many high-risk stocks like Valeant in your portfolio.

In my book, I described a set of behavioral rules designed to help me achieve a calm mind, so I could make good investment decisions. I wrote about settling in Zurich and shutting myself away in my library there, so I could think in peace. In other words, this was all about getting my mind into the passive mode that's best suited to measured decision-making. In truth, I was overly influenced by my image of Warren Buffett sitting in a dark room in Omaha, quietly reading the paper and thinking great thoughts.

What I now realize with much greater clarity is that my quest for quiet and calm was only half the battle. It's not enough to seclude myself in Zurich, far away from the *sturm* and *drang* of New York City, and to listen carefully for the whispers. I also need to get out there and hunt aggressively for the best investment ideas. For me, this is also part of being true to who I am and playing to my strengths. Yet I had somehow shifted too far in the direction of being quietly contemplative.

My view of how to operate when I'm in hunter mode has also changed. For example, I explained in my book that I had a hard and fast rule of not speaking to the management of companies that I was researching. In retrospect, this rule was ridiculous, at least for me.

It's true that management is often promotional and that it can be difficult to resist a slick sales pitch. But that's a reason for approaching these interactions with care, not for avoiding them altogether. Of course I should speak to management, but only after I've armed myself with my own in-depth research and analysis. Once I've done this groundwork for myself, it's undoubtedly helpful to meet with management, so that I can deepen my knowledge of the business and the industry by talking to the key players themselves.

With this in mind, I've been spending a lot more time out in the field. For example, I recently traveled to Dusseldorf to visit a distribution facility for a company that I've been researching. I've also just returned from a trip to India with my friend Mohnish Pabrai to visit a slew of small-cap companies. This is

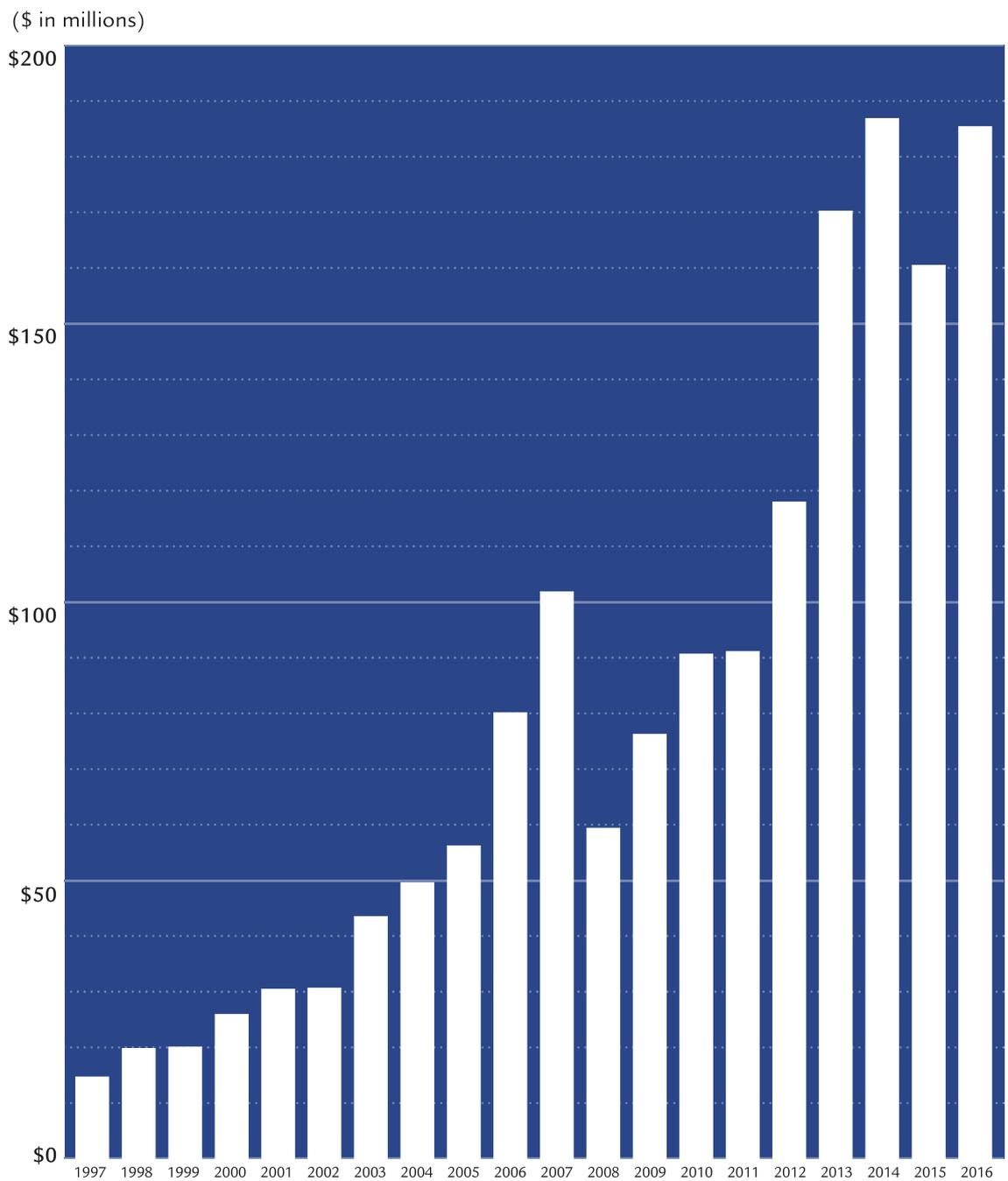
a recognition of the reality that I can't deliver the best returns by hanging back and reading endlessly about companies, even though this contemplative side of the process matters, too.

Another issue that I wrote about in my book was my deep ambivalence about the Bloomberg terminal. As I explained, part of the problem is that it's hard to invest calmly and patiently when you're barraged by a constant fire hose of information, which can easily serve as a call to action. This led me to switch off the Bloomberg for weeks on end, helping me to focus on the long term while keeping short-term noise at bay.

Lately, though, I've become more engaged with the Bloomberg monitor. What initially caused this was my growing awareness that so much of the information available for free on the internet is based on unverified rumors, ideological opinions, and thin (or non-existent) reporting. We've all heard about the prevalence and dangers of fake news in the world of politics. But the challenge of finding reliable information extends into other fields, too.

Quality publications like the *Wall Street Journal*, the *New York Times*, and the *Financial Times* probably have sufficient scale, reach and recognition to continue their in-depth reporting. These publications have their biases, too, but that's manageable if you read widely enough.

Still, this only covers a small sliver of the news and information that I need. When I'm researching a company, it's unlikely that I'll find much coverage of it in these publications. And



most of the free sources on less covered topics need to earn their keep, which can easily distort their coverage. Likewise, corporate websites can subtly set the agenda by emphasizing some things and hiding others.

Even without fake news, in a world of smaller newsrooms and tighter editorial budgets, so much of what's out there is recycled. I'm increasingly sensitive about what the source is for a particular insight. For example, much of my knowledge of Valeant's culture was recycled, based on the flawed judgement of others.

In short, I think we all have to wrestle more than ever with this challenge of finding reliable information. When it's free, you tend to get what you pay for. And an enormous amount of useful data now sits behind pay walls.

Used properly, the Bloomberg terminal can help me strip away much of the chatter, so I can focus on what matters. It also helps that it's become easier for the user to get rid of unnecessary distractions like blinking lights and second-by-second price changes, which used to be hallmarks of the monitor. Nowadays, I use the Bloomberg to standardize and structure the information and insights I'm seeking. I still don't keep the monitor open every day, but I use it whenever necessary. In one case, I recently found 15 years of annual reports for a company that doesn't even have its own website.

Of course, the underlying principle behind my aversion to the Bloomberg is still valid: I need to minimize short-term market noise, so I can focus on investing patiently in great companies

over many years. But my solution to this challenge has become more nuanced. In the same way, my views on visiting companies and meeting management have also become more nuanced. The underlying principle that I need to avoid getting duped by smooth-talking CEOs is still valid, but never meeting management is the wrong solution.

Thankfully, investing is a discipline in which it's possible to keep learning and improving over many decades. From the perspective of my partners in the fund, what matters is that I'm constantly looking to strengthen and refine my process.

Finally, some other beneficial changes to my investment process have grown out of Aquamarine's successful registration with the Swiss Financial Market Supervisory Authority (FINMA). For example, my pre-investment checklist and my in-flight checklist are now formally included in our regular management meetings, which are required by FINMA. Thanks to FINMA, my colleagues are also empowered to play a more critical role in the investment process: for example, we have structured conversations about risk management, and I'm obliged to send my checklist to our risk manager. FINMA also requires me to write down my thinking before making any investment decision.

Initially, I thought that the rigid structure imposed by FINMA might feel like a straitjacket. But these systematic changes have brought a heightened level of discipline and formality to the process that I believe will produce better results.

WE AVOID COMPLEXITY. OUR SIMPLE GOAL IS TO EARN GOOD LONG-TERM RETURNS BY PURCHASING A PART OWNERSHIP IN HIGH-QUALITY BUSINESSES, IDEALLY HOLDING THEM FOR MANY YEARS.

### **Looking Forward: Some Key Investing Themes I'm Exploring**

The fund is still heavily invested in autos, banks and financials. Going forward, I'll continue to upgrade the quality of the portfolio as opportunities arise, but without overpaying. There are several investment themes that I'm exploring, which should help us to uncover some multi-baggers of the future:

#### **i) Scale economies shared.**

Costco and Amazon are great examples of a business model in which scale economies are shared in ways that create an intensely loyal customer base. GEICO, Netjets, and IKEA also fit this description. I continue to research businesses that fall into this category. I've identified a few of them, but — so far — the valuations have been too high for us to invest.

#### **ii) Bundling.**

One reason why a family might visit the mall is that so many different attractions are on

offer there, whether it's shopping for clothes, going out for coffee, or looking for jewelry. This bundling of multiple attractions in one location is an enticing proposition. I see the economics of bundling in many other areas, too. Netflix represents a bundling of entertainment, while the iPhone provides another form of bundling. In the past, OTC pharmaceuticals were available only in convenience stores and pharmacies; now, you can buy them on Amazon. TV networks like ABC and CBS built moats by bundling information and entertainment; then cable came along, bundling a different set of services, news and entertainment.

I find this idea of bundling to be a useful way of viewing the world — an organizing principle that helps me search for great businesses with emerging moats.

#### **iii) The gravitational force of information.**

It was Warren Buffett who said that

information and computing power are the new raw material of our era. What has also become clear to me is that, in the world of cloud computing, the more information you have, the more you can attract. Winners win. This is clearly demonstrated by Amazon Web Services, Dropbox, and others. I'm looking for companies with similar models.

#### iv) Friendly activism.

From time to time, decent businesses run into trouble that's not entirely of their own making and they have a temporary problem to solve. I'm on the lookout for opportunities to be part of the solution — in a friendly way, where management invites me in. This happened with EVCI Career Colleges when my friend Whitney Tilson and I helped the company to do a modest debt-for-equity swap. Once we had helped them remove that debt, the clouds hanging over the business parted and the stock soared.

Last year, I saw extraordinary opportunities for activism with Horsehead. It didn't work out in the end, but this experience reinforced my awareness that there are plenty of overlooked opportunities to help good companies that have temporarily stumbled. The key is to align with the right management teams.

### Assets Under Management, Subscriptions, And Redemptions

In 2016, we received \$3.9 million in new capital from six investors in the fund. We also received redemption requests for \$4.1 million, of which \$2.7 million was for complete withdrawals by five investors. I'm always sorry to see investors

go, but I'm delighted to see them meeting their life goals, thanks in part to the appreciation of their holdings in the Aquamarine Fund.

We ended 2016 with \$177 million in assets under management. This provides us with sufficient scale to run the business comfortably, while still giving us all of the trading flexibility that comes from being small and nimble.

### Share Classes

Aquamarine Fund Inc. launched a new share class, effective January 1, 2017 called Class D, which has received approval from HM Revenue and Customs in respect of UK Reporting Fund Status. This share class has the following characteristics:

- Zero management fees.
- Annual returns above 6% generate a 25% performance fee.
- One-year lock up periods.

Our UK resident Class D shareholders in Aquamarine Fund Inc. may be able to enjoy favorable income and capital gains tax treatment in the UK.

There are currently two share classes available to investors. The original class charges a 1% management fee and a 20% performance fee over a 4% annual hurdle. The newer class, which is modeled on the Buffett partnerships, charges no annual management fee and 25% of the profits above a 6% hurdle. This is a better deal for our investors and a better alignment of our interests, since I don't get paid at all unless I perform.

## Our Value Proposition

I continue to believe that the Aquamarine Fund offers an extraordinary value to its investors.

- **Low/no management fees.**

It's not uncommon in the fund management industry for investors to be charged exorbitant fees of 2% or more for the privilege of having their money managed. At Aquamarine, the maximum fixed fee you can pay is 1%, and many of our investors have opted for the zero-management-fee option.

- **Alignment of interests.**

My family is the largest investor in the Aquamarine Fund. My parents, my sister, my aunt and my uncle, and I are all invested in the same vehicle as the fund's other shareholders. Virtually all of my own money is in the fund. In other words, we eat our own cooking. Your money is pooled with my family's assets, and we get the same results as you do. This means that the fund is structured as a true partnership in which our incentives are powerfully aligned.

- **A conservative, long-term, value-oriented strategy.**

The Aquamarine Fund uses no leverage, no margin loans, and no short positions. We avoid complexity. Our simple goal is to earn good long-term returns by purchasing a part ownership in high-quality businesses, ideally holding them for many years. Businesses are the wealth creation engines of our society. We want to partner with the best of them, without overpaying for the privilege.

## Thanks

I feel extraordinarily fortunate to have such a phenomenal group of shareholders. The Aquamarine Fund's base of sophisticated and loyal partners has stood firm over many years, enabling us to take advantage of the great buying opportunities that arise during times of heightened uncertainty and volatility.

Most of the partners in our fund came to us through referrals from existing shareholders who were pleased with our performance. If you know of someone who might benefit from investing in the Aquamarine Fund, please don't be shy about introducing them. Feel free to contact me about referrals or anything else by calling +41 44 210 1900 or +1 212 716 1350 or via email at [investorservices@aquamarinefund.com](mailto:investorservices@aquamarinefund.com).

I'm happy with the current size of the fund and have no interest in marketing it in hopes of growing bigger. But I'm always pleased to partner with the right shareholders: that's to say, patient, value-oriented, long-term investors who'd like to join us in compounding wealth over many years without excessive risk.

Thank you for your confidence and your trust.

Warm regards,



*Guy Spier*