

LONGRIVER PARTNERS FUND

4TH QUARTER 2023

15th January, 2024

Dear Partners,

Net returns for the Longriver Partners Fund (“the Fund”) were 9.3% over the quarter, bringing its gains for the year and since inception to 10.8%. Over the same time, our benchmark, the MSCI AC World USD Index, returned 11.0% and 22.2%, respectively.

Our strategy is to ride the long-term value created by our companies, so I encourage you to take a similarly long-term view of your investment in the Fund. Consider it as you would an investment in real estate or a private company – assets for which you wouldn’t receive a volatile quarterly valuation.

REFLECTIONS ON OUR FIRST YEAR:

We close our first full year with acceptable absolute results but a disappointing performance compared to our benchmark. Our investments in AMD, BFF Banking Group, Amazon and TSMC delivered but their contribution was detracted by Evolution, HDFC Bank and Tencent. Other investments have yet to recover from their drawdown in the third quarter and so close the year flat.

Our portfolio bears little resemblance to the index, so we shouldn’t expect its performance to be correlated in the short term. But in hindsight, I could have played my hand better. I was too cautious at the start of the year. I shied away from some (now) obvious ideas, though they were square in my wheelhouse. And I could have let our winners run more.

It certainly was a bumper year for American stocks, which comprise almost two-thirds of the index. The US seems to have achieved an impossible soft landing, taming inflation without a technical recession (so far). A rush to roll out artificial intelligence applications re-ignited animal spirits and sparked a wave of corporate investment and hiring. Government-backed investment in onshoring and infrastructure kept construction activity high. And the American consumer was cushioned by savings accumulated during COVID and low mortgage rates locked in when rates were at record lows.

In contrast, the nascent recovery in China following the end of its COVID lockdowns sputtered out early in the year. The central government stopped short of massive stimulus, disappointing the market. Even though it is making many incremental moves to support the economy, help private businesses and repair foreign relations, confidence is shot. Three difficult years of isolation and sagging real estate prices are taking their toll. Perhaps Chinese deflation lent America and the world a hand. Chinese companies like Miniso and Temu are, in fact, making a business out of it.

A year into launching the Fund, I feel like I am hitting my stride. I’ve outlined the tenets of our strategy in my previous letters, as well as how I go about finding investments and maximising my return on time (an entrepreneur’s most precious resource). I have a good workbench of companies to research and follow, a wonderful network with whom to share and test ideas, and excellent support at home. We are fully invested now and I’m excited about the portfolio (see the factsheet overleaf).

THE YEAR OF EFFICIENCY:

Recency bias is the tendency to extrapolate the present. When times are good, we tend to think that they will last forever. When times are bad, we fear the opposite. But good times don’t last forever, nor has the world ended nearly as often as we say

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it will. We are actually pretty good at just muddling through. People change; we get out of the way of danger; we compromise; we learn and do better; we innovate; we adapt. This is the *essence* of human progress.

We experience economic cycles because businesses are run by people who make forecasts with the same biases. Companies over-hire and over-invest during good times, raising fixed costs which weigh heavily on profits when the tide turns. Retrenchment usually happens slowly because it's hard to fire people; harder still to close factories or dispose of excess inventory; and hardest of all to change a culture. The biggest impediment to progress is psychological: no one likes to take the pain. Maintaining the status quo is easier, especially when responsibility is taken collectively.

2023 was remarkable because of how decisively some corporate leaders confronted their bloat. The poster child is surely Mark Zuckerberg, Founder and CEO of Meta, who launched his 'Year of Efficiency' in late 2022 ([link](#)). Its goal was to remake the company into a flatter, leaner and faster organisation better able to execute his long-term vision. From 3Q22 to 3Q23, Zuck reduced headcount by almost a quarter and operating expenses by fifteen per cent. Margins have since exploded as revenue growth has re-accelerated. Most importantly, Meta has its mojo back.

Other worthy mentions include Elon Musk for shrinking X's headcount by a reported 90%; Tobi Lutke for letting go of Shopify's strategic ambitions in logistics; Reed Hastings and team for introducing a heretofore verboten advertising tier to Netflix; and even Jack Dorsey for empowering Block's CFO to introduce financial discipline and proper accounting.

Could anyone but a Founder be so bold?

Our investment in Amazon is a bet that someone can. Andy Jassy took the reins of Jeff Bezos' sprawling empire in 2021 at a time when its profits were severely depressed. When I first heard Jassy speak, he sounded hesitant and diffident, giving rambling answers and hiding behind corporate jargon. But there is steel behind his soft demeanour. Bit by bit, he has chipped away at the excesses. He reduced headcount and laid down the law on working in the office. He shut down middling projects, reminding everyone that one of Amazon's greatest strengths is to experiment lots, fail quickly and move on.

Amazon under Jassy is focusing on a smaller number of big bets. I am most impressed with the creation of 'Amazon 3PL' ([link](#)) and 'Buy with Prime' ([link](#)). Rather than shutting down the excess logistics capacity built during COVID, Jassy leaned into it and flipped Amazon's retail business model on its head. Merchants don't have to sell through Amazon.com anymore. Now, anyone, anywhere, with a store online can avail themselves of Amazon's same-day and next-day fulfilment. And why wouldn't they, given consumers convert more and spend more frequently when their shopping arrives faster ([link](#))? Jassy's move has increased Amazon's TAM, given it more volume to operate efficiently and widened its moat.

Analyst Ben Thompson describes Jassy's vision as "Amazon as a Service" ([link](#)), which seems apt as higher-margin third-party sales are on the cusp of overtaking first-party sales. I suspect Jassy's 'year of efficiency' is only just beginning.

LET'S TALK ABOUT TRAUMA:

Another aspect of recency bias is anchoring on catastrophic but low-probability events from the past. A classic example is hearing about a plane crash and becoming afraid to fly, even when statistics prove that flying is far safer today than virtually any other mode of transport. Writ large, the media's constant barrage of negative headlines distracts us from the fact that the average person is wealthier, healthier and safer now than at any other time in history.

Recency bias colours investors' minds too because losing money can be so traumatic.

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One of the most vivid traumas is in the US Residential Housing sector, which was the epicentre of the Sub-prime Mortgage Crisis of 2007 that metastasised into the Global Financial Crisis of 2008. When financing dried up, the forced selling of homes began. The Case-Shiller US National Home Price Index fell almost thirty per cent from its peak in 2006 to its low in 2012. This was an economic tragedy for highly leveraged homeowners and a corporate near-death experience for highly leveraged banks and homebuilders.

How did homebuilders respond? The survivors spent more than a decade licking their wounds and repairing their balance sheets, during which time they massively underbuilt relative to underlying demand. In aggregate, the industry is still underbuilding. Single Unit Housing Starts peaked in 2005 at an average seasonally adjusted annualised rate of 2.1 million. Despite the US population growing by some 40 million people since then, there were ~660,000 fewer homes started in 2023 ([link](#)).

The result is an acute housing shortage and affordability crisis, particularly in regions enjoying inward migration. Much of the housing stock is not built to modern standards either. According to Home Depot, the average age of an American home is now more than forty years old.

The equity of American homebuilders has delivered phenomenal results since the lows of March 2009. The combination of profitable business, market consolidation, undervalued stock and dedicated share buybacks saw the SPDR S&P US Homebuilders ETF rise more than 9x since then. However, even though the fundamentals are materially better today for both homebuilders and homeowners, the ghosts of 2009 resurface each time there are fears of a slowdown. “Will it be another GFC?” they asked in 2018 and again in 2022 when rates rose. Why is that still our default base case? The facts have changed but our minds have not.

Investor Jeremy Hoskings coined ‘the capital cycle’ to describe how investors could profit when investment retreats and supply contracts. Perhaps trauma is a necessary condition for this process to occur. I made two investments this year in industries which fit the bill. The first is Ashtead, an equipment rental business that almost went bust in 2009. The second is Vistry, a homebuilder in Britain, where the housing crisis is arguably even more severe than America’s. Both companies enjoy secular tailwinds, earn high returns on capital and have low valuations matched with plans to buy back stock.

A YEAR INTO CHINA’S OPENING, THREE YEARS INTO ITS DEFLATION:

Talking about trauma is healthy, so this seems a good place to segue from the past to the present. Hong Kong’s Hang Seng Index has fallen fifty-one per cent from its 2018 high and stands even below its 1997 peak. It has been down every day this year, bar one. The fatigue is palpable. There is little reason to be optimistic. Everyone is leaving, either to shop at Sam’s Club in Shenzhen ([link](#)), to dine in Tokyo ([link](#)) or to migrate permanently ([link](#)). Friends make me feel like having kids is an act of courage. Housing transactions fell to a thirty-three-year low. I don’t dare think about the drawdown on the value of my home.

I didn’t experience the COVID years in mainland China but my travels there this year have been revealing. Shanghai is resilient and appears on the mend. Elsewhere, though, the central government’s decision in 2021 to deflate the real estate bubble is evidently taking its toll. I passed countless unfinished real estate developments on my inter-city train rides. In lower-tier cities, ‘ghost towns’ were conspicuous at night for their dark, unlit silhouettes. Shopping malls felt eerily quiet (a more light-hearted moment was when I inadvertently woke four salesmen sleeping in a demonstrator car at a leading EV maker’s showroom). ‘Consumption downgrade’ has replaced ‘consumption upgrade’ as the hallmark of an attractive investment. Tmall is out and Pinduoduo is in.

The US experienced technical bear markets – a twenty per cent decline in the index – in 2020 and 2022. But I think

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this is what a *proper* bear market feels like: a long, slow grind punctuated by grief, frustration, disappointment and now, resignation.

China will muddle through. The question is how long it will take to deleverage and restore confidence. As America proved after the GFC and Zuck proved last year, it's far better to be decisive and confront your problems head-on. This may not be an option in China, though, because of the risks to social stability.

A conversation with a Hong Kong developer with interests in the mainland was instructive. They recently completed a luxury residential project but won't sell units because market prices have fallen below what they think they're worth. The project sits at RMB 3 billion on their books but when pressed, they estimated they might get just RMB 600 million for it today, if there are any buyers at all. They argue that the market valuation is irrelevant, however, because they have liquidity and support from the banks. Why are the banks lending at these phantom valuations? Because they don't want to mark to market either. I'll leave you to consider for yourselves what that means for everyone's equity and solvency.

Nonetheless, the signs of progress are there if you look for them. According to broker CLSA, since 2021, thirty-eight of China's largest one hundred real estate developers have undergone restructuring. As I described earlier, Beijing has made a raft of incremental steps to stabilise the economy and restore confidence. These include injecting additional liquidity through the banks and providing funds to local governments to buy unsold homes for long term rental.

Optics matter too. When Secretary Xi Jinping told a full house of American businessmen in San Francisco that China needs them and is open for business, it was as much for their benefit as his audience at home. And when a proposal for harsh new restrictions on the gaming industry wiped out billions of dollars of market capitalisation, a retraction was made the next day and the head of the regulator was fired the next week.

I have an instinctive urge to lean into this, which is why we own several Chinese companies. These are high-quality businesses trading at cheap valuations, with growing earnings and net cash balance sheets. Furthermore, all are making strides to grow overseas, offering us a hedge on the domestic situation.

COMPANY WRITE-UPS:

I publish ad hoc write-ups on individual companies on the Longriver website. The benefit of sharing these publicly is that I get critical feedback from sharp-eyed readers, helping me test my assumptions. This quarter, I wrote about two of our companies:

– Vistry, the British homebuilder which has gone all in on the 'Partnership Model', in which it pre-sells large volumes of homes in exchange for a bulk discount. The proceeds free up capital, which Vistry plans to use to buy back GBP 1 billion of stock in the next three years, equal to a quarter of its current market cap ([link](#)).

– Kweichow Moutai, the ultra-premium Chinese baijiu distiller, which is taking back control of its distribution channels to capture more value for itself while – counterintuitively – increasing consumer surplus ([link](#)).

I also recorded conversations with friends on Kinsale Capital, Evolution and the Chinese Electric Vehicle industry (my personal favourite). You can read these and more at <https://www.longriverinv.com/thought>

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PERSONNEL UPDATE:

I'm delighted to share the good news that baby Alexander Ulysses Rhodes was born on 28 December 2023. He is in great shape and was kind enough to arrive before results season (but not after my year-end audit). My wife Lizzie is doing well and assures me that not being pregnant is so so so much better than being pregnant. Rest assured that Alex's future investment money will be invested here, right alongside us.

CLOSING:

I can't thank you enough for being with me on this first year of our investment journey. Your support means everything. If you have any questions or concerns, I'm always available. The door is open for new investment. I am trying to grow Longriver, so truly appreciate your support and referrals.

I will be travelling for work this year so hope to see more of you. I have tentative plans to be in London in February and again in September; Stockholm in March; Atlanta and Omaha in late April and early May; Shanghai in July; and Tokyo in September. Do let me know if our paths cross and you would like to meet.

Best wishes and safe investing,

Graham F. Rhodes

Founder & Portfolio Manager

Longriver Investment Partners Limited

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ABOUT THE FUND:

- Business Owner's mindset to understand and manage investment risk
- Investing globally within our few, narrow areas of expertise, drawing on insights from our experience in Asia
- Prefer long-term investments in companies with predictable business models, ambitious management and good governance, which can re-invest on our behalf at high rates of return
- Concentrated portfolio of 10-20 securities to make the most of scarce ideas, diversified across duration, industry and geography

NET RETURNS:

Since Inception	Fund	Benchmark	Delta
Cumulative Return	10.8%	22.2%	(11.4%)
Per Annum Return	10.8%	22.2%	(11.4%)

	Q1	Q2	Q3	Q4	YTD	BMK	DELTA
2023	10.1%	3.1%	(10.7%)	9.3%	10.8%	22.2%	(11.4%)



ABOUT THE MANAGER:

- Boutique Hong Kong-based manager with deep roots in Asia
- Major investors in the fund, investing for clients as we do for ourselves
- Spirit of partnership with fair fees, expenses and disclosure
- Employee ownership permits independent judgement
- Focus is always on margin of safety
- Long-term mindset allows for contrarian thinking and accumulation of competitive advantage

TOP HOLDINGS & PORTFOLIO CHARACTERISTICS:

ASHTED | AMAZON | BFF BANK | EVOLUTION | BERKSHIRE HATHAWAY | GAMES WORKSHOP | META | NETEASE | TSMC VISTRY GROUP

Portfolio:

Holdings	14	Duration:	-%
Top 10 %	85%	Growth:	54%
24E PE:	20x	Income:	18%
24E ROE:	26%	Cyclical:	14%
24E EPSg:	16%	Cigar Butt:	9%
24E Yield:	3%	Fixed Income:	-%
LTM D/E:	4%	Cash:	5%

Duration:

Industry:

Digital:	24%	Geography:	
Consumer:	38%	Global:	37%
Financial Services:	22%	Asia:	11%
Industrial:	16%	Europe:	23%
		Americas:	28%

Geography:

Notes: Benchmark is the MSCI AC World USD Index. Longriver net performance figures are unaudited. Portfolio characteristics are as at 30 September 2023. Duration, Industry and Geography characteristics are as defined by the Manager. Duration represents the certainty and timing of returns, with cash at one end of the spectrum and companies which re-invest all or more of their earnings into hypergrowth at the other. Portfolio, Industry and Geography metrics exclude cash. Portfolio LTM D/E excludes Financial Services.

KEY INVESTMENT TERMS:

Manager:	Longriver Investment Partners Limited
Mandate:	Long-only, global, primarily equities
Launch:	January 3rd, 2023
Minimum:	USD100,000
Fees:	1.00% p.a. + 10% over 6% hurdle + High Water Mark
Liquidity:	Monthly subscriptions; quarterly redemptions with sixty days written notice

OPERATIONS:

Structure:	Hong Kong Open-ended Fund Company
Regulator:	Hong Kong Securities & Futures Commission
Admin.:	Sinopac Services & Solutions Limited
Custodian:	Interactive Brokers Hong Kong Limited
Auditor:	East Asia Sentinel Limited
Legal:	Charltons
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