

PRE - LAUNCH ANNUAL LETTER

January 06, 2022

To: All Clients and Limited partners of AR Capital
From: AR Capital - Managing Principal

Dear Partner,

As we approach the end of the first year of managed client accounts operations prior to launching the AR Capital Fund I, LP (ARCF I, LP) - we are committed to providing you with the information we would have sought if our positions were reversed.

Our managed client accounts operations have achieved a return of 20.88% IRR (after all expenses but before pay-for-performance advisory fees) as of 31st December 2021 in its first year before the official launch. For more information regarding this - please refer to the section 'Our Investment Activities and Probably Biased Opinions' in this letter.

ARCF I, LP is the first and only global value-oriented hedge fund operating in Bangladesh which will invest in countries with high economic growth yet historically overlooked by other investors - starting with Bangladesh. The minimum investment to join ARCF I, LP as a new partner is \$35,000 for individuals. We might consider waiving the minimum requirement for a limited time only. If you identify yourself as an accredited investor - you can join the waitlist by visiting www.ar.capital/join-the-waitlist and submit an expression of interest (Eoi) in just two minutes or, call / WhatsApp: +1 (917) 336 4502 us.

AR Capital is also looking to obtain a Merchant Banking or asset management company (AMC) license in Bangladesh to provide separately managed accounts (SMA) advisory services for Bangladeshi high net worth individuals (HNWI) and other corporate entities by prioritizing each client's asset-liability circumstances and choosing a strategy that caters to their individual needs the best possible way. For current investors in our advised accounts, the minimum addition to their existing capital account can be consulted with us. For new HNW clients and other institutions registered in Bangladesh, we are not interested in getting more than 10% of your equity invested with us in any given year (unless we have a special arrangement). To get more info - please contact ir@ar.capital or call us at +1 (917) 336-4502.

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*"If you give me six lines written by the hand of the most honest of men,
I will find something in them which will hang him."*

- Cardinal Richelieu

Our letter is going to be obviously more than six lines, and there is quite a chance that your analytical ability would obviously be better than Cardinal Richelieu, but please do not hang us. And before we even start our mambo-jumbo for the year, let us thank you for deciding to give us your benefit of doubt in managing your wealth. Today, most of our clients are friends and family. And this year for the first time, we will open our doors to selective individual and institutional clients and bring some structural order into our existing client accounts, turning AR Capital into an investment management company in a proper sense. While we are excited to start this new journey where we will get the opportunity to actually create some meaningful difference (in financial terms) to many families and probably institutional causes (that are subjectively important) around the world, we also share the concern of potential dilution of our culture within the firm that naturally comes with the growth of any kind. With time, we hope that AR Capital will evolve and learn to accommodate such changes but most importantly, keep you well informed so you can take your capital out from the partnership and decide the best course of action - if we happen to go da da with our minds, especially with our characters.

But first, let's try to wrap our heads around the simple concept of compounding. Albert Einstein once remarked, "Compound interest is the eighth wonder of the world. He (or She) who understands it, earns it. He (or She) who doesn't - pay it." Well, that sounded quite simple, but if so, then why do so many humans end up paying for it than earning it?

To make things really easy-peasy-cheesy - let's get ourselves a round trip of history's one of the most sensational missed opportunities of all time. Are you ready? Now, imagine Mr. Syed Mir Jafar Ali Khan Bahadur (more famously known as Mir Jafar), a military general who changed the history of the world as we know it - by betraying Nawab Siraj-ud-Daulah in the war against the British East India Company which was the major first step for the expansion and get the ultimate control over the entire Indian subcontinent by the British. Instead of taking the bribe from the East India Company, only if he had taken a compensation package from the last real nawab of Bengal - Nawab Siraj-ud-Daulah and helped him win the Battle of Plassey (23rd June 1757), who knows how would the culture, innovation, morals, arts, politics, and laws be shaped today? In that case, he would not even have the need to pay bribes left, right, and center just to keep his position on the throne. But let's continue with our imaginative version of alternative history anyway.

So, this yo-yo traitor Mr. Mir Jafar gets the compensation (which was in the north of 17 mn rupees) and after the war he leaves the town. Deep down what Mir Jafar really wanted was to acquire as much wealth as possible. He didn't really care as much about who from his gene pool would finally get to see the mission being successful as he did about the compounding and the protection of the wealth. Now, Mir Jafar wanted to have fun in his limited amount of time on earth as well. So, he kept the better half to himself for fun and enjoyment and only kept 70 Lac (1 lac equals 100,000) rupees to serve his ultimate purpose. He wanted to fully enjoy his time on planet earth, so him looking after this wealth was practically impossible. All he wanted was to eat, sleep, rinse, and repeat and still end up extremely wealthy. So he opened up a family trust and went on to find a wealth manager. And all of these would naturally take some time. But then he managed to finally hire a wealth manager, who started the compounding engine (i.e. growing the trust wealth) from January the 1st, 1758. For the sake of this example, let's imagine this wealth management firm has achieved a meager 6% net CAGR (compounded annual growth rate) over the years. Well, at this point you might be thinking, where am I going with all these thoughts? As you guessed, the 7 Mm rupees that he left aside and put in his trust brokerage account in 1758 would have turned into a grand sum of 31.6 trillion rupees (approximately north of \$400 bn) at the end of 2021. To put things in perspective, Bangladesh's GDP for the year 2020 was \$324 bn.

Okay, just hang on a second right there. Are we saying that - for the year 2020 in Bangladesh, the total spending by every man, woman, and child, the total of all public and private spending and investments plus the net export revenue would be less than what Mr. yo-yo Mir Jafar would have in his family trust account?

Yes, that is absolutely right. Even more interesting fact is that in 1970, before the independence of Bangladesh, Mr. yo-yo Mir Jafar's family trust's net worth would be more than East and West Pakistan's GDP combined. He could have his cake and eat it too - only if he had not bunked the school on the elementary compounding mathematics class! But such is life! On 19th August 1757, the very first coin was minted by the East India Company in Kolkata (then Calcutta). Warren Buffett did what Mr. Jafar failed to do. A small amount of capital - compounded over a long time, builds enormous sums of wealth.

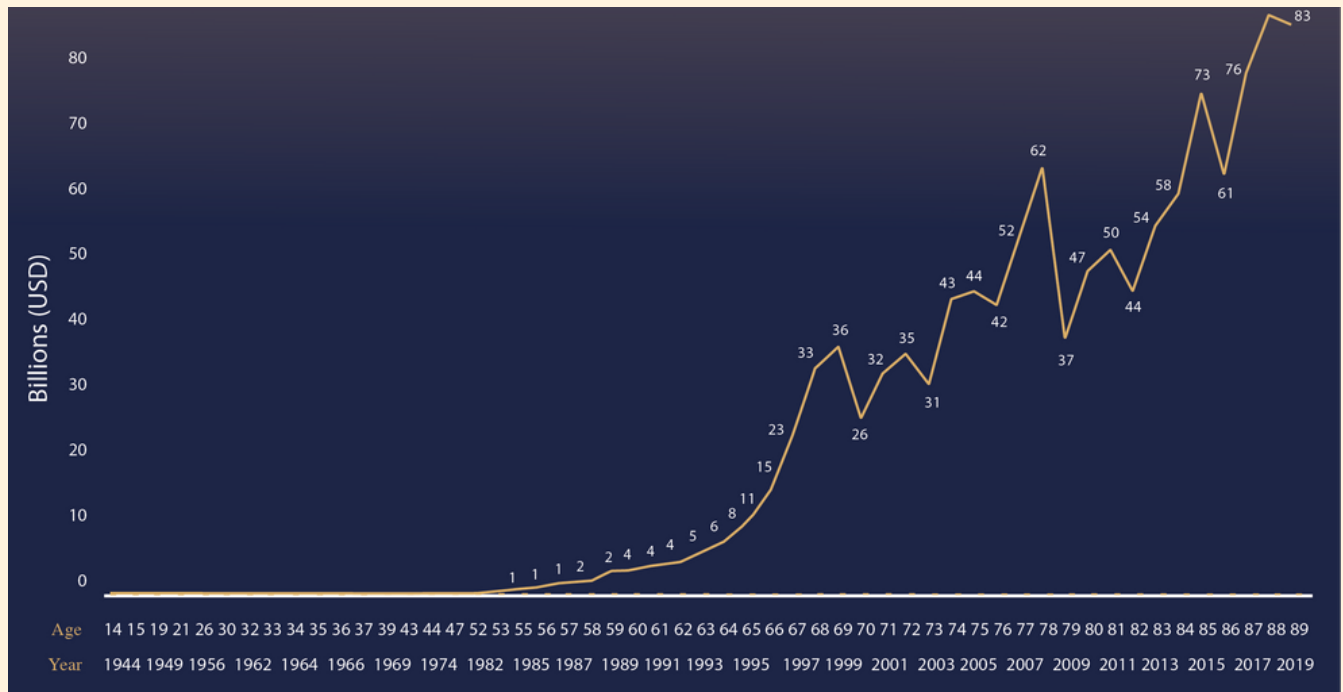


Photo: Warren Buffett's net worth over time.

Again, skeptics would say that Buffett could do it because it's only possible in western civilizations. For you, Mr (or Miss) Skeptic, Raamdeo Agrawal did the same in India in the last 30 years.

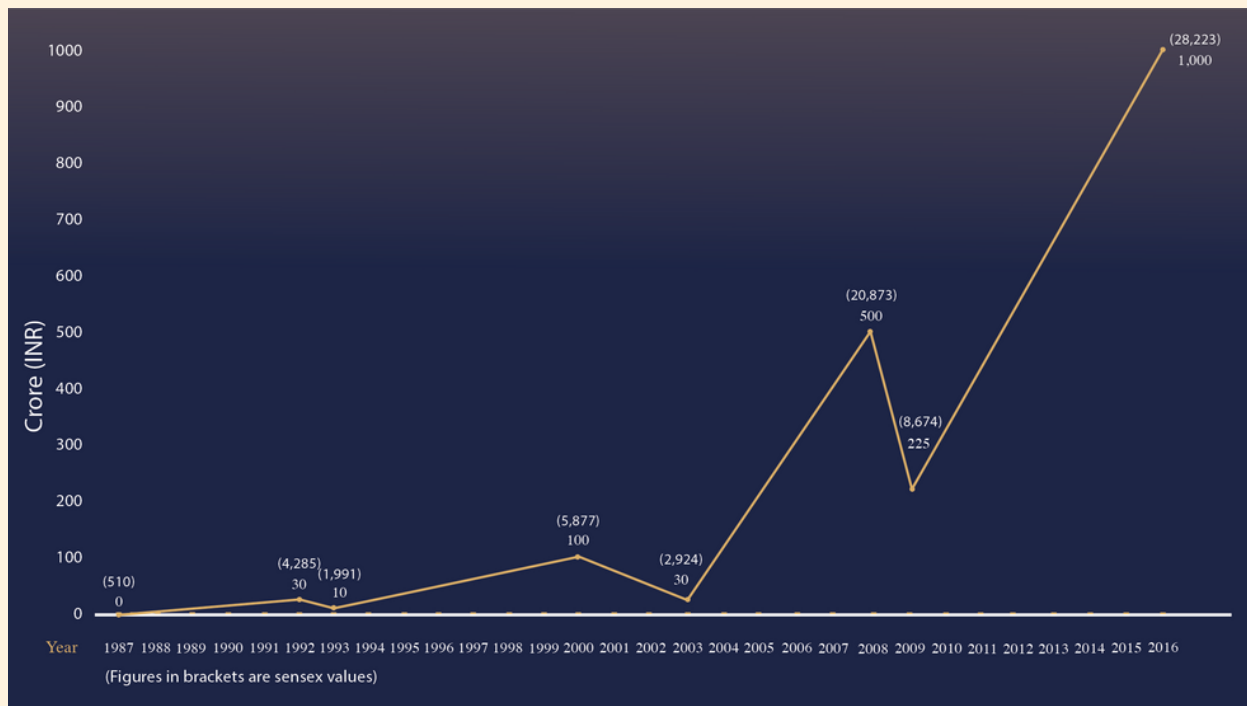


Photo: Raamedo Agrawal's net worth over time.

Just as the power of compounding can make a disciplined person the king or queen of the world, it can take the ignorant to destruction. For most people in the world, compounding is working but - sadly, in reverse. Simply think what happens when one spends wealth in 'not-so-necessary' or unproductive areas of life and pays heavy interest on them. Let's say one pays about 15% interest per annum on his / her purchases. If the thing that's been bought doesn't generate as much increase in earnings - it destroys that person's net equity. Similarly, when the return on capital (ROC) and the cost of capital (R) are the same, growth (no matter how fast or slow) adds no value to the company. Think about this for a second - the central bank in a particular jurisdiction sends powerful signals through the rate at which they buy and sell the 'subjectively' risk-free instruments. That then sets the tone for the minimum rate of return the entrepreneurs in the country aim to achieve - although not exactly like this - but at least in parts. And since their charters don't allow them to distribute the cash directly they print (which would have been complicated due to the lack of proper infrastructure and some political dynamics) - they allowed other banks to do it on their behalf (in many ways, they are just their agents who are allowed to add on the top and make something out of it because of their large volume) - with central banks having the absolute ultimate control over these agents and also get to set, modify and discard the ground rules of playing the game. But going back to our previous point that it's only when the return on capital (ROC) is more than the Cost of Capital (R) - growth creates some value. Likewise, when the ROC of a business is less than the R - it destroys business value. Any additional growth only makes things worse for those businesses.

Treating any and all businesses as a critical network-based 'winner-takes-all' type enterprise, such as - Facebook, Netflix, Google, Microsoft, and Amazon, has been at the center core of the venture capital world. But of course, they are playing a different game - of which we understand the 'why' but don't understand the 'how'. We are not condemning the industry as a whole, but only some characters who are demeaning the gods' work of capitalism by giving mediocre businesses the benefit of the doubt of becoming the next big thing. It seems like most of the poor performers and their clients in that world still like to be in it rather than changing their strategy. Buffett once said, "You don't have to make it back the way you lost it." But the tendency that we see is what John Milton writes in his epic 'Paradise Lost, "Better to reign in hell than to serve in heaven". We don't want the throne in hell, others can have it - that's absolutely alright with us. And that's not to say that we value investors don't make mistakes. We are humans as well, and we do make mistakes - sometimes large ones. But the simple idea of buying a business for less than what it's worth is a principle for producing sound investment results that transcend over time and ages. Legendary investor John Templeton once said that even the best investors would be wrong every one out of three times. Now just for a second - think about the uncertainty that most early non-venture-back enterprises possess. Those are some really difficult areas to operate in as an investment manager. So we deliberately keep ourselves at a 'sixty seconds' worth of distance run' from that part of the world. The idea of 100X growth in 5 years is a great sellable pitch by the VC world to the clients they manage the wealth for (and more often than not - they take advantage of our core human fallacy - 'greed' - to get to manage the wealth for them). That's what we find really distasteful about the industry, especially in Bangladesh.

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We ask ourselves how this could be labeled as 'prudent' to 'any' investor? A dollar lost is still a loss. There's no point viewing the same dollars through some different lenses. When one loses 50% on the capital - one has to make not 50% but 100% to just get to the previous level of wealth. Nassim Nicholas Taleb writes in his famous book Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets -

"\$10 million earned through Russian roulette does not have the same value as \$10 million earned through the diligent and artful practice of dentistry. They are the same, can buy the same goods, except that one's dependence on randomness is greater than the other. To your accountant, though, they would be identical..... Yet, deep down, I cannot help but consider them as qualitatively different."

At the same time, we are grateful that nature has allowed a few great firms like Sequoia, Andreessen Horowitz to operate and evolve well in this environment (for now), who are doing the hard work in sorting and bringing out some early-stage companies into existence that are producing real value to the civilization.

There are only three variables that can be tweaked in harnessing the compounding - the starting capital, the compounding rate, and the length of the runway (i.e. how long the capital has been compounded). The last one is not in our control, but the first two are. So, the magic formula is to start early (no matter the size of the capital) and either compound it through his / her own endeavors or to find someone who can reliably do it for him / her.

Since we talked about history, it won't be fair if we didn't talk some history about the stock market. In our humble opinion, the stock market is one of the greatest innovations of human civilization. It mobilizes money and credit to the hands that (by and large) can produce wealth and distribute it to the people who risked the capital in order to produce it. Here, an investor with the right frame of mind can participate in the wealth creation journey of entrepreneurs (who took their company public) by simply buying into the company at any point in the arch of a business's lifetime. Different investors with different risk appetites can approach it as it fits. They have the liberty to make their own rules in terms of what, where, and how they would like to be invested and call their own shots. Investors also get the leverage of 'not on their payroll' workforce (i.e. regulators) protecting their interests. Why would an investor look somewhere else if one gets to participate in it with extremely low frictional costs? Well, it turns out that people always liked 'get rich quick' schemes over long-term sustained gains.

The history of the stock market goes back to as early as the 13th century, when a courtyard of the Van der Beurse family Inn was used by commodity traders in the city of Bruges. Soon the idea spread around, and other cities followed the same suit (ever wondered why almost all major European market is called Borsa, Borse, etc?). Then the market in Italy started trading government securities. The idea was simple. The government needed money (that would fund mostly the wars and expansion of power) and people saved money that could be put to use. This would go on for quite a long time and then be changed by something revolutionary called the 'joint-stock-company' in Amsterdam.

The world's first joint-stock company, The Dutch East India Company, was formed in 1602 and was granted a 21-year monopoly to trade spices. Since they needed the capital to fund the war against the profitable spice routes to Mughal India (then claimed by the British East India Company), they invented easy access to money which would also take the risk of permanent loss of the entire capital base of the promoters and reap the reward if the voyager was successful.

The Dutch East India Company imported mostly silks and textiles from Bengal Subah (which modern Bangladesh is a part of and was one of the most prosperous places at the time in terms of the standard of living). They also exported species at 15X prices across Europe and the Mughal Empire. The spices were generally imported from Indonesia (Imagine the shareholder's reaction while reading about these types of margins in the annual report!).

The stock exchange on which the Dutch East India Company was traded is now known as Euronext Amsterdam. Stocks, as Ben Graham said in the 'Intelligent Investor' are not just pieces of paper. They are ownership of real businesses with underlying value. Now, whether an investor has the knowledge and ability to value a particular company that's debatable. But those who can and also stick to their circle of competence can heavily take advantage of the swings of the markets and own (part of) businesses that are mispriced and undervalued.

By holding these assets, investors can now take part in the journey of wealth creation by the entrepreneurs and/or the management of the company, go drink some orange juices on some island, check the status every couple of months - and reap its benefit like any other assets.

As one of the few (ever existed) value investing firms in Bangladesh, we feel a lot like the 'Maytag Repairman' (an iconic character metaphor for a professional whose services are rarely needed). What we have seen so far in the country is that there is a pervasive mentality of speculative activity in the market (which in many ways is an added advantage for us as we can quite frequently grab large quantities of shares of some great companies that are undervalued and offer large enough margin of safety). But the issue is even worse than that because most people here don't even know that they don't know. And to take things far, most 'accredited' asset management license holders also make speculations and pursue gullible investors to give them money to manage. One whom we had conversations with recently said, "this is a gamblers' market, and we only believe in technical analysis" (you can guess what kind of returns their clients are getting and the myth they have been told).

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The story that Warren Buffett mentions in his article 'The Super-Investors of Graham and Doddsville' is about a coin-flipping tournament that would probably sound analogous to our readers. Buffett writes -

"Before we begin this examination, I would like you to imagine a national coin-flipping contest. Let's assume we get 225 million Americans up tomorrow morning and we ask them all to wager a dollar. They go out in the morning at sunrise, and they all call the flip of a coin. If they call correctly, they win a dollar from those who called wrong. Each day the losers drop out, and on the subsequent day the stakes build as all previous winnings are put on the line. After ten flips on ten mornings, there will be approximately 220,000 people in the United States who have correctly called ten flips in a row. They each will have won a little over \$1,000.

Now this group will probably start getting a little puffed up about this, human nature being what it is. They may try to be modest, but at cocktail parties they will occasionally admit to attractive members of the opposite sex what their technique is, and what marvelous insights they bring to the field of flipping.

Assuming that the winners are getting the appropriate rewards from the losers, in another ten days we will have 215 people who have successfully called their coin flips 20 times in a row and who, by this exercise, each have turned one dollar into a little over \$1 million. \$225 million would have been lost, \$225 million would have been won.

By then, this group will really lose their heads. They will probably write books on "How I turned a Dollar into a Million in Twenty Days Working Thirty Seconds a Morning." Worse yet, they'll probably start jetting around the country attending seminars on efficient coin-flipping and tackling skeptical professors with, "If it can't be done, why are there 215 of us?"

Then Buffett goes into describing the performance achieved by other value investors and how the rest of the world - despite their great performances - is still skeptical about the philosophy. Buffett then writes at the end of the article -

"In conclusion, some of the more commercially minded among you may wonder why I am writing this article. Adding many converts to the value approach will perforce narrow the spreads between price and value. I can only tell you that the secret has been out for 50 years, ever since Ben Graham and Dave Dodd wrote Security Analysis, yet I have seen no trend toward value investing in the 35 years that I've practiced it. There seems to be some perverse human characteristic that likes to make easy things difficult. The academic world, if anything, has actually backed away from the teaching of value investing over the last 30 years. It's likely to continue that way. Ships will sail around the world but the Flat Earth Society will flourish. There will continue to be wide discrepancies between price and value in the marketplace, and those who read their Graham & Dodd will continue to prosper."

Some Introuction to AR Capital:

AR Capital is a global value-oriented hedge fund that invests wealth in historically overlooked markets. Since both Ahmed and I were born and raised in Bangladesh, we decided to give it a go before moving to other (by and large) historically overlooked investment destinations. We invest in simple, predictable, cash-flow generative businesses. Also, we are not willing to invest in tobacco, liquor, gambling, and other businesses even if it means giving up a percentage or two in the fund's overall performance. In our humble opinion, these businesses produce a net negative impact on society (by and large). The word 'risk' to us - just as in other businesses - is the probability of permanent loss of capital and not some quotation of short-term volatility. And our fiduciary duty as your wealth manager is to handicap as much risk as possible by not allowing us to investigate capital allocation opportunities outside our circle of competence. It is very important for our current and potential investors to understand that AR Capital is quite peculiar in many ways than a traditional hedge fund. While the world of investment management walks in lines with 'do whatever to bring the first foot of the client through the door' and telling them a gazillion greek letters that make things fancy - our reply to this whole situation could be best described through a cartoon conversation by E. B. White in 'The New Yorker' in the early 20th century. It goes something like -

Mother: "It's broccoli, dear."

Daughter: "I say it's spinach, and I say the hell with it."

Well, it is not to say that we don't care about getting clients; this is just to say that we care about our investment results, in the long run, more than everything else and we do everything that's possible to get ourselves to the promised land. But, if we objectively see ourselves not achieving the goal every rolling five years, we all ought to find someone who can do that for us. Our sentiment toward this issue is best described by Mao Zedong when he said, "I don't care if the cat is black or white, so long as it catches mice." To put this gibberish in perspective - we don't care about ultimately who is making money for all of us, whether it's us or someone else - doesn't matter. What matters is that at the end of the day, we all get to drink the Pina Colada in the financial promised land - which is to say - we would be satisfied to attain an absolute above-average compounded return on our capital over a long period of time.

We are a performance-fee-only investment management firm. Meaning we only make money when YOU as a client make money. The framing for the partners who are managing the wealth has to be as if you are hiring an employee. You as an employer have to pay us ZERO salaries, we only make a percentage when we make a return on your capital. Whereas almost all of the industry participants (specifically in Bangladesh) range between 1% to 2% on the AUM, in other words - the fee is charged based on the size of the assets they would manage on behalf of you regardless of their making or losing money for you (the AUM fee range varies for funds internationally). Now, how many managers had asked you for no salaries?

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We are able to do this because we have a healthy conviction in our bottom-up, fundamentally driven investment process, coupled with the fact that the markets we will be investing in are historically overlooked. These dynamics provide us some room to tolerate and accommodate for our ignorance of the greater world and the psychological blindspots we might have in our investments. Decisions made in a system with an alignment of interest would usually be vastly different from those where there is no alignment. We invest our and our family's wealth into the same fund along with you. How could our interests be more aligned than such arrangements?

The other important element that is absolutely critical for our existing and potential partners is to know that AR Capital can only produce a reasonable return on the capital over the long run. We possess no ability to invest for the short term. Therefore, we are only willing to take capital from partners to the extent that the amount invested in the fund will not be needed in the next 3 to 5 years (unless there is an unforeseeable event). In a nutshell, we are looking to partner up with families and institutions that understand - just like other things, that there is no shortcut to anything in life. They are coming to AR Capital to grow their wealth sustainability through a few intelligently made decisions and mostly patience. No legal constraints would stop you from taking the capital back after the first year of lock-up. This lock-up clause is there only to ensure that the flexibility of getting in and out of the fund does not invite pervasive activity and to form a solid business ownership mentality while investing in the fund (no matter the size of the capital that's been invested). Therefore, we humbly urge you - that anytime you decide to make additions to your capital account, you should call us at least two weeks before the first day of the following months - January, April, July, and October. The same applies to withdrawals as well (which can be done once every year at the year-end - unless your contract mentions otherwise). The two weeks notice is important for us to make sure all your paperwork is ready to go, and also we can have sufficient time to reshuffle / liquidate your portfolio based on the decision that's been made.

Now, the next thing to remember is that we are not a firm looking to get consulting or research revenue. Although these are all part of the process of achieving a good investment return, we are strictly an investment firm, and our purpose is to deliver investment results. Therefore, the time that we would have otherwise spent on activities would go on to look for the next best idea. We are not willing to share any research, portfolio positions, or market commentary. Those who believe these to be an important part of investment results - should not be in the partnership. But we, from time to time, would be sharing our thoughts and ideas through our writings and curated resources on the website; we can't present or do specific research to win your capital in the firm.

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AR Capital can not guarantee you any investment performance, but we can promise you this: our full effort and energy towards achieving above-average investment results over a long period of time. We hunt for value, so wherever we see value, we go there. In reality, there aren't that many businesses on the planet that can survive for more than a few decades. This naturally forces us to concentrate and own pieces of great businesses and do the intelligent thing with the capital at hand. This 'I know one when I see one' process to investing might mean - you are just betting on our characters and (seeing from outside, somewhat vague) ability to allocate capital. Naturally, you should never be investing above an amount that would take away your goodnight's sleep from you. What financial freedom really means if you can't sleep well at night anyway?

Just like Buffett (and sorry if you are getting bored reading him over and over throughout the letter. Both Charlie Munger and Warren Buffett have been the heroes of our lives. We just can't simply have enough of them), we have a '*price is my due diligence*' mentality. This might mean significant periods of doing nothing if we find nothing intelligent to do with your capital. And this also means that we might return the capital back to you (the academia might not have suggested the same, but anyway). Speaking of academia, we looked at what was available on one of the most important topics for investments and life in general - 'inversion'. Charlie Munger often likes to say, "*Invert. Always invert*". The concept of inversion is really simple - what he really means is - it's easier to start with the result and work backward to figure out what it would take to achieve them. The inversion system works a lot better than to drive for things from a blank piece of paper. For instance, to get a happy and fulfilling life, we ought to ask what it would take to have really had an unsuccessful and painful life and just avoid doing those actions.

We looked at the Wikipedia page for 'Reverse Engineering'. It describes - "*Reverse engineering is applicable in the fields of computer engineering, mechanical engineering, design, electronic engineering, software engineering, chemical engineering, and systems biology*". But it doesn't mention investing at all. The 'Factor of Safety' did not have 'investment' as an applicable field either (although we found a separate page for 'Margin of Safety Finance'). Our point is - academia also has these blind spots, and that's especially even more true for finance and psychology. But, we just need to accept them and deal with them just like we deal with any other challenges in life.

Being absolutely honest with you, I must confess that I have spent quite a few hours looking at Heidelberg Belt that came in the Sears magazine in circa 1902. According to some sources, this Heidelberg Electric Belt was claimed to reduce anxiety by sending electric shocks to - the genitals (Ouch!).

The story behind this mind-boggling innovation starts in the latter half of the 19th century. When a neurologist named George M. Beard coined the term “neurasthenia”, a disease whose symptoms ranged from - nervous dyspepsia, insomnia, hysteria, hypochondria, asthma, sick headache, skin rashes, hayfever, premature baldness, inebriety, hot and cold flashes, nervous exhaustion, brain-collapse, or forms of elementary insanity. This Heidelberg Belt, which was sold by Sears at the time claimed to have a solution for all of those situations just for \$18.00 (which by the way would be worth approximately \$580 in today’s dollars).

Before we move ahead at all, one doesn’t need to pay a consultant to come and verify its merits - you can absolutely sense that it is just bonkers! It’s like getting hit by a baseball bat. The world of academic finance and investment management, in general, is not really far from it. The most recent addition to the asininity bucket is the ‘coin-and-crypto-mania’. While we think that the technology ‘Blockchain’ that’s backing them up is a great innovation and might offer humanity some real tangible benefits, we find the ‘currency-on-the-blockchain’ story utterly disgusting. People usually want to hear dreams and shun reality. And we see all these standard stupidities happening over and over again. We might go on to say that perhaps - it is about time - for investors all over the world (and especially in Bangladesh) to practice some delayed gratification. There is a famous quote by one of the best historians ever historian William Durant “*A nation is born stoic, and dies epicurean*” - and we have nothing to add.

Our general ‘thumb-sucking activity’ and ‘not so important for you to know’ opinions:

The purpose of this section is to make some space in the letter to provide some idea about our thought process and the activities that took place during the year. This is absolutely not essential for you to spend your time on. We would rather have some partners with bored faces than to have a few with some unclarity in terms of how we think and the principles we conduct our businesses on.

A French saying goes ‘*plus ça change, plus c’est la même chose*’ (please don’t bite your tongue. Having a tongue is important). The saying means - that the more things change, the more they stay the same. No matter which planet from the universe we humans decide to go and live, how much ‘driverlessness’ we build in our cars, or choose a world that does not exist - the basic necessities remain exactly the same (so do the core investment principles). If we look around - it’s at the core only food, shelter, sex, safety, and companionship that the world offers to us in one way or the other. It doesn’t even provide us with our owner’s manual nor give us a purpose to live for.

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What are we really trying to convey through this? There isn't usually a 'this-time-it's-different' in the world of investment, and in reality, the world doesn't change as much as we anticipate. There are only seven deadly sins - pride, greed, wrath, envy, lust, gluttony, and sloth - that get us all every now and then. And as Charlie Munger says - amongst them envy isn't even fun to have! (To be very honest, we like the last one a lot).

Speaking of envy (which god knows why, people even try! - hopefully that didn't rhyme), this girl named from the latter half of the nineteenth century named Helen Josephine Mansfield - 'Josie' - got famous when two rational and wealthy individuals tossed their rationality in the garbage can to kill each other in order to get her. Warren Buffett once remarked, "It's not greed that drives the world, but envy". Let's look at what happened with both of those wealthy idiots. By the way, this is the woman who would later appear on the \$1,000 silver certificate (the highest denominated United States dollars in 1891).

Josie's father was a news reporter who joined the gold rush and later got murdered by his business rivals. Her mother Sarah, married her late husband's brother (Josie's uncle) - Charles - right after. Young Josie had a really hard childhood. She was also said to have been sexually molested by her step-father for a couple of years in her childhood but could not express this to anyone. Growing up, she had seen her mother dressing up and going to the town to party hard. Although Josie's mother had gotten quite old by then, but still got admirers coming from left, right, and center. Charles, her husband, later found the secret letters from the admirers of her mom and eventually filed for a divorce. Well, as humans, we only learn from examples as children. No matter how many times we are told to behave otherwise. We, as adults, would do what we have seen our parents doing. Growing up, she became famous in her school because of her short hemlines, which are often rumored to have revealed her petticoat (hopefully, you are not reading out loud beside your wife in the bed - surely she would not believe that you are reading your investment manager's year-end updates!).

Later Josie was proposed to by a guy named James, who would fund her studies and send her to Notre Dame (San Jose) in the hopes of finally marrying her. You know what usually happens with these kinds of capital allocations (Dear James, my friend, you might have just missed the footnotes of the statements). In the meantime, her mother was bored and alone. So she decided to get married once again. Even this time around, poor Josie was taken advantage of by her new stepfather. A lot of things happened in between but finally, to escape her father - she decided to get married to Frank Lawlor. That marriage lasted for only a few months (well, Ben Franklin had already said, "*where there's marriage without love, there will be love without marriage*" - but that's a separate topic which is too sensational to get in on an investment letter, so let's not go there before our first year of negative performance).

Anyways, since there used to be no Bloomberg terminals for people in investments and finance to spend their useless time on, a local wealthy financier James Fisk (who might have just forgotten to check the price of his stocks only to figure out years later that he has gotten exceptionally wealthy - but on a more serious note - he's our idiot no. 01) decided that the best way to spend his time was to hand out \$100 bills to women who caught his eyes. Josie refused the hundred dollar bills from Fisk a few times but later allowed him to pay for her overdue rents and then finally moved in with him. Eventually, Fisk bought her a condo and filled it with everything she wished for. He spent enormous sums of money on buying her emeralds and dresses. Josie always seemed to have a special interest in perfecting her looks to the outside world. She would spend most of her time taking bismuth treatment to keep her skin white and smooth and do all other stuff.

Then at a new years eve party, Fisk introduced Josie to (Guess who? You are absolutely right, our idiot no. 02) Edward Stiles Stokes. Actually, both of these gentlemen were business partners, and Fisk used to give Stokes special discounted freight rates for his oil refinery business. Stokes later became a frequent visitor to Josie (let's not investigate - why). Sensing this, Fisk urged Stokes to stop seeing her. Stokes left the ultimate decision to Josie regarding whom she wanted to see. She declined to decide and wondered why they could not be all 'just friends' (Yeah-yeah, we all know 'I see you as my brother' feeling). Fisk wrote back in his letter, "*You can't run two engines on one track in contrary directions at the same time*" (C'mon Josie! That's such a no-brainer!). And that was the beginning of the fight between our two wealthy idiots.

Actually, our referee (Josie) wanted to get involved in the fight as well (too good of a thing to miss! Especially right after the great gold crash of 1969 in the US, where the entire securities market crashed when Fisk and Gould tried to corner the market for the gold). So the referee blew her match whistle by sending Fisk the love letters Stokes had written to her (who knows what the contents were!). Fisk retaliated by having Stokes arrested for fund embezzlement from the refinery (Bishum!). Stokes punched back with force and blackmailed to publish incriminating letters from Fisk (Bishum!). Stokes was later awarded \$10,000 by the court, but he wanted to get more out of Fisk so he kept blackmailing him. Stokes would soon figure out that Fisk had indicted him for attempted blackmail with the Grand Jury (Bish!). As our referee sat on the sidelines with a big bucket of butter popcorn and watched the game - the final fly kick was performed. Guess from who? Well, it was Stokes (Bishumaik!). Knowing that Fisk always entered The Grand Central Hotel by the ladies' entrance - he went in and waited until Fisk showed up. As soon as Fisk showed up. Stokes shot Fisk twice and the next day Fisk died of gun wounds. By the way, the bishum-bishum-bish-bishumaik must have been a little unfamiliar to our readers. They are the background sound effects used in the 1990s for fight scenes in Dhallywood movies (the Bangladeshi cinema industry is known as Dhallywood). Our readers can search on YouTube for Bengali movie fight scenes at their own risk! Stokes was later caught and prisoned. He died a couple of years down the road.

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Enough of all this; what's the moral of the story? There are a few great lessons. Lesson no. 01 - never have a Bloomberg terminal at your desk - if you want to become exceptionally wealthy, and lesson no. 02 when you become one, please do not go on handing out \$100 bills to the lovely-looking women (kidding!). But seriously, we asked ourselves, how come one who has faced tremendous headwinds in life ends up on every \$1,000 silver certificate? How does one make just a few great decisions and those take care of everything else? If we look carefully enough, Josie can also teach us some great lessons - particularly for business strategy.

Josie understood very early in her life that her competitive advantage was her beauty and short hemline skirts (skeptics would say - the beauty was hereditary. We agree, but the underlying principle still remains the same). So she always doubled down her efforts in perfecting those grounds. Remember? that amongst every choice she had in front of her, she really focused deeply on keeping her skin white and smooth and the dresses she wore? It is no different from Jeff Bezos trying to ask 'what will never change ten years from now?' It's a great advantage in a world where everyone is investigating what's going to change in the next decade. The former is relatively straightforward to identify, but most importantly, it's a little easier to stick to. Josie knew that ten years from now, the possibility of a man coming and saying, "Oh Josie, I wish you had worn something longer!" or, "I wish your skin were not soft and smooth!" - no chance! Therefore, every unit of energy and focus she spent on her core competitive advantage continued to pay her dividends for a long-long time. In our business, there are only two rules; as Buffett says, rule no. 01 never lose money and rule no. 02 never forget rule number one. So if we take care of the performance of the capital you entrusted us with to achieve long-term outsized financial returns, we believe all else will take care of itself.

So as we navigate through this pandemic that is dubbed a 'once in a lifetime event' (which in reality happened many times in many different places around the world before us) - our highest priority goes into identifying, understanding, and - not necessarily - (but sometimes) acting upon things that still remain the same and continue to hold their position at the center of the truth. We obviously would like to tell you that we knew what would happen and could see what was there, but that would not be true. The journey is to gradually position ourselves in the center of the universal truths and be grounded in reality so that we can proudly refer to Alfred Housman's poem the next time around -

"The thoughts of others were light and fleeting,
Of lovers meeting, or luck or fame.
Mine were of trouble, and mine were steady;
So I was ready when trouble came."

Now, what did we do in 2021? Just as we watched markets all around the world riding the roller coaster, we just sat back with loads of popcorn and listened to Bachman Turner Overdrive's 'You Ain't Seen Nothin' Yet'. Such fun in life should never be missed! But all this was possible because of YOU. Because of your understanding that the only way to create a massive amount of wealth is by having a long-term business ownership mindset and being patient (surely no one can compete with you in that!). On top of all that - the conviction and trust you have shown in our character and also in our ability to protect and grow your wealth by gifting us with ample amount time (to read, think, contemplate and sharpen our investment process). We are truly grateful to you.

Our Investment Activities and Probably Biased Opinions:

If you have been with us for the last couple of years, you might already know that we do not write or talk about our current holdings and investment positions to avoid commitment and consistency biases. This psychological bias can have a meaningful impact on a subconscious level on the decisions we might want to take. We only talk about our past investments (if we ever decide to do so). Since we very rarely sell our positions completely, you probably would not see much in here.

One ground rule is that we never spell out the names of the companies we have invested in. Our partners should know it is not to keep some secrecy. It is there to protect the interest of other partners who are also invested with us. Also, companies that we usually invest in are in many ways - mispriced and / trading at a significant discount to our conservatively measured intrinsic value. These opportunities are rare and quite short-lived. So when we finally decide to move the needle, we generally overload our trucks. We also do not compare our fund performance with other funds operating in Bangladesh due to the difference in the nature of their incentive structure (AUM based fees vs performance-based-fees).

We provide services to NRBs (Non-resident Bangladeshis), foreign individuals, family offices and institutions, and selective Bangladeshi clients. Now that we know - that you would definitely have the right kind of expectations from us, we feel extremely lucky not to be worried about other menial stuff and can focus on the right thing to build wealth for you in the long run.

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Our sentiment around how we try to position ourselves and our investment style at AR Capital closely resembles Howard Marks memos presented below in italics.

Published on September 5, 2003 -*What's Your Game Plan?* he says -

"Clearly, if we can keep up in good times and outperform in bad times, we'll have above-average results over full cycles with below-average volatility, and our clients will enjoy outperformance when others are suffering."

In his memo *The Avarity*, published on May 16, 2008, Howard says -

"Because ensuring the ability to survive under adverse circumstances is incompatible with maximizing returns in the good times, investors must choose between the two."

We have had quite a similar feeling for our portfolio this year. When Buffett sold his airline stocks in his entirety during the first half of 2020, it sent a strong message to the entire investment community. The signal was less about the airline industry but the severity of the situation at hand and how things might unfold in the future. It could not have been clearer and stronger. We also took a hard look at our own portfolio businesses in an effort to understand what the pandemic would mean for us.

It seemed like the portfolio required a few major shifts. So we did. Again, the decision was from a business owner's standpoint and not from where the price of those securities would be some months down the road. It was quite painful to fight through the emotions to get a new canvas and start the painting from scratch - but at the same time - it was quite liberating. We just knew we did the right thing for our client's and families' wealth. Today a great majority of our portfolio is sitting in companies that possess a combination of two factors - (A) a small percentage of interest-bearing debts relative to their net worth, and the debt-service coverage is extremely high through a normalized level of margins, and the sales volume slightly lower than the pre-pandemic levels, and (B) very little room for working capital squeeze for the next 36 months (unless something devastating happens - which always have a probability of happening). To give you some context, the lowest growth in operating profit we have seen from our portfolio of businesses is north of 2%, and just between us girls (don't tell this to your neighbors), the condition is so severe that it perfectly matches with a song by Aerosmith, that goes -

I was cryin' when I met you
Now I'm tryin' to forget you
Your love is sweet misery.

I was cryin' just to get you
Now I'm dyin' 'cause I let you
Do what you do down on me.

And we have nothing to add in that regard. The businesses in our portfolio grew between 2% to 39% and represent north of 23.25% weighted-average growth for the overall portfolio from the same period last year. The weighted average trailing PE Ratio of our portfolio is a little less than 15, which translates into a PEG Ratio of 0.63. Motilal Oswal's 23rd wealth-creation study mentioned - *"Our theme study this year has almost conclusively established that stocks with PEG less than 1x tend to significantly outperform the market."* The study was conducted on all available public equities in India. On page number 45 of the study, they shared one of their extraordinary findings. You can find a part of Motilal Oswal's observation about the PEG Ratio in the table below.

Exhibit 4 PEG < 1x is a solid formula for high returns

PEG Range in 2013 (x)	No. of Cos.	WC (INR b)	% Share of WC	CAGR (%)		RoE (%)	
				Price	PAT	2018	2013
<0.5	23	7,427	17	38	34	19	10
0.5-1	26	17,803	40	28	17	15	14
1-1.5	11	5,093	11	20	13	18	18
1.5-2	11	4,952	11	16	13	25	26
2-3	9	2,091	5	22	10	11	16
>3	14	5,365	12	20	6	18	23
L to P	3	682	2	24	L to P	13	-20
PAT decline	3	1,470	3	19	-17	3	16
Total	100	44,883	100	24	19	16	14

Note: PEG here is calculated as P/E of March 2013 divided by 2013-18 PAT CAGR

Photo: Excerpts from Motilal Oswal's 23rd wealth creation study.

Our back-tested research shows similar patterns for Bangladeshi public equities, where a portfolio constructed with PEG < 1X consistently produces outperformance in every rolling five years period (which we are not attaching here in this letter). This leaves us with the thought of whether the portfolio is overlooking the other investment categories that usually hold it from bleeding in the drawdown?

Generally, these positions add a little drag to the portfolio in the rising market environment. One of the best possible ways to bring that balance is to have controlling positions where the ultimate business result becomes the only parameter, and the investor can pretty much ignore what the market is really doing. We are not activists in the real sense. However, we tend to promote changes in businesses in which we invest. We hope that our involvement in those businesses would meaningfully benefit most stakeholders and the ecosystem. Even there, we tend not to bother the management unless they ask for it themselves. But to actually answer the question - we have no ability to predict how the securities in our portfolio would behave relative to the market in the future.

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What we know and rather focus on is how the portfolio is positioned on the basis of where we are on the economic cycle. With a reasonable degree of confidence (and a great amount of doubt), we feel that our portfolio is quite tilted towards slight defense than offense. Normally, this would change as we get more credible information as we go. Again, we are not short-term investors - we are buying ownership share of real businesses to grow wealth with a long-term horizon.

When we say that we are growing wealth - what we all are essentially trying to do is that we are changing the form of the assets that we hold to be valued more based on the return it can generate relative to the risk-free rate of return. Meaning the change in form from cash to any kind of fixed assets only is justified when the fixed assets in exchange for every dollar can produce more dollars than the cash form itself. Therefore, entrepreneurs in reality, are transforming their cash (asset) into fixed and current assets, effectively creating a 'bond-like' security that is 'hoped-to-possess' a coupon rate greater than that of generally available in the market at the time. That 'bond-like' instrument is what we humans call 'business'. Humans do like to complicate things a lot. But a business is just that. It is only just as valuable as the coupons (distributed or otherwise) it can produce. No coupon equals no value - as Buffett said that a company should only retain a dollar that will be valued at least a dollar or more.

Let's say you put your \$100 in a savings account or buy a T-bill that pays 5% interest per annum (which is an extinct animal in the west - for now). So you get a \$5 cheque every year for your \$100. To produce another \$5 dollar of income, you would need to invest \$100 more. In other words, to double the income, you would need to double your capital employed (CE) - be it in the savings account, T-bills, or whichever form you chose to save in. Your return on capital employed (ROCE) would still be the same unless the risk-free rate (i.e. the gravity in the financial world) changes. Now, if we can have a security that can produce 5X interest (\$25) a year, how much would an investor pay to own that asset? It is quite straightforward mathematically (although not that much in reality). It should be 5 times the capital employed by the business (or \$500) when the risk-free rate is at 5% (in reality, it would be less than that to accommodate for the risk premium). Now, if we just add the excess cash and minus the interest-bearing-debt from that figure, we can go very close to the intrinsic value of the business.

Why compare equity with fixed-coupon security like a bond? Because that is the way to go in valuing businesses. A business is nothing but a cash-producing machine from an investor's point of view. Now looking into the reality of the world, there are only a handful of businesses that can produce more income with next to no incremental capital employed. Meaning the receivables and inventories attributable to growth (if any) are offset by the 'interest-free-loans' by the company's vendors and others (in other words - trade and other payables). These businesses can generate enormous sums of wealth for their investors due to the nature of their operations. At the end of the day, the return on incremental capital employed (ROICE) multiplied by the re-investment rate is going to dictate the long-term growth of the intrinsic value for any given company, and that ultimately is going to dictate the returns for investors for the contribution of their capital in any given business.

On the other hand, the general practice of most industrialists in Bangladesh is to retain as much capital in the business as possible. No matter if there is a mediocre or (often) no return on that capital. Whichever asset one may own - they tend to hoard more of it. For instance, the garment factory owners make additions to their factory lines, restaurateurs expand to unreasonable places, gold owners own more gold, land and apartment owners load up their trucks with more of it etc.

The allocation of family net-worth based on the liquidity spectrum is almost nonexistent in the country. Although, there are different reasons specific to the country's history that shaped this behavior - (which we would not get into details now) most business owners can not simply conceive the idea of diversification of their assets. Most of them happily accept the 'mental-security' of tangibly owning something (which really is only a mirage - since assets, no matter in what condition or type that destroys wealth, is worse than having no assets) at the cost of acceptance of mediocrity. Dan Burke, who is known as one of the architects of the modern television industry once remarked, *"Avoid getting into the business of manufacturing trombone oil. You may become the greatest trombone-oil manufacturer in the world, but in the end, the world only consumes a few quarts of oil a year!"*. People who only own one type of asset or business and constantly acquire more of it without the justification of a reasonable return might own the best business in their particular category in Bangladesh or even in the world - but eventually go nowhere in amassing wealth. Winning in the intense game of business, they lose in building and preserving the wealth in the end. Who would even want to play a game like that?

The world and stock markets in general in 2021:

We must communicate with our current and potential investors that we are not in the business of predicting how the market, economy, or business (in general) would do the next or the year after. These are some important variables but are simply not knowable. We highly recommend that our investors watch weather news to satiate the need to hear some solid ones. Then why writing a section like this one? We are writing this to share our thoughts and views about markets. And just by the virtue of discussing this with you - we are helping ourselves to build the ark and not just predict the storm.

With the Shiller CAPE at historically high levels, we might be gradually rolling towards the end of the big debt cycle that started back in 1945, right after World War II at the Bretton Woods. To put things in perspective, we had only seen the CAPE reaching this level two times in the modern history of human civilization - in 1929 and 2000. And you already know how that period turned out ultimately.

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The combination of negative real rates globally from fixed income instruments coupled with the execution of monetary policy three (it is also called 'free money' by some but let's not dial our telephones to Mr. Karl Marx just yet) - for understandable reasons - reflatd the price of almost all financial asset classes in all major economies. However, it might not seem like one, but the world is going through three critical wars: technological, capital, and ideological. Perhaps we are entering into a world where ideological polarity becomes a force for destruction in productivity and bad financing for assets (that require more spending than the income produced by them to service that debt) - and in rare cases, often generate only suboptimal returns for the shareholders who put up the capital together.

This domino effect might fundamentally shake up capitalism as we know it today until we come to a common ground on how the wealth should be redistributed and opportunity gaps be neutralized. Please do not get us wrong; we are card-carrying capitalists and are big believers in capitalism as an idea that has created the world we live in today. It is our opinion that it needs a critical reformation to make it work and have it synch with the reality we have around us in today's world.

A part of the US market looks quite frothy. We have observed a significant speculative environment and participation by retail investors this year. Businesses that lost money as a group pre-covid are up more than 100%, and on the other hand, we see some companies with incredible MOATs available at reasonable prices. We also see similar trends in Australia, Japan, Germany, Brazil, and India.

On the other hand, markets in Bangladesh, South Korea, New Zealand, and South Africa are constantly throwing low ball pitches to investors who are willing to dive into those markets. In many ways, we are playing a game that's somewhat partial to us. So we don't deserve the claps and celebrations as much as other investors who are working their way through the overvalued and euphoric market conditions but yet managed to get a respectable rate of return. Buffett always says that we only discover who's been swimming naked when the tide goes out. In that regard, we believe that our underwears are still in good shape.

Historically, the motivation to invest in any fixed-income securities has been governed by only two principles - the real positive interest rate and the price appreciation of those securities. So the payments to the IOU bearer are just as riskless as the currency in which the debt is denominated and paid back to its lender. It's also important to realize that any form of currency is just a claim on an economy's real goods, services, and assets. Therefore producing more of it creates inflation which we are observing in many parts of the economy. Inflation in turn, rewards people with the reflatd price of assets that either saves people time and/or money. The aggressive yet absolutely necessary monetary policies combined with targeted fiscal policies in fighting the economic recession caused (partly) by COVID-19 were essential to fill in the income and liability holes in the individual and corporate balance sheets, but this in and of itself might prove to become the self-reinforcing catalyst to the subsequent, financial drawdown.

We might look back at this period a few years from now and view the lockdown measures imposed by various governments around the world, effectively derailing the economy as over-reactive and not so wise. This is just a classic human fallacy - overvaluing the short-term results and undervaluing the long-term consequences. Progressive policies applied by the central banks (mainly in the west) who now have started owning pieces of private businesses synthetically through the ETFs change the dynamics of central banking, the role it would play in the economy, and the opinion it would reflect through their voting rights through the means of production. For instance, the Bank of Japan is the owner of approximately 7% of the TSE and more than a third of many major Japanese companies. We don't want ourselves to sound like the 'doomsday preachers' of finance but again, this is to retain some consciousness into ourselves (and let the people we care about know) by taking one step at a time towards the destination.

As we all see the inflation ticking up (also spreading to the major parts of the economy) and more and more investors seek shelter in inflation hedged assets, we account for the risk associated with owning equities outside of those categories in every step of the thought we give in constructing the portfolio. We also acknowledge that the road ahead for a long-only equity investor might be a bumpy ride. But at the same time, this might also present one of the biggest wealth creation opportunities to achieve an absolute return in the decade ahead.

Now, where are we going with all of these thoughts? On one end, we have our frailed economy by COVID, which in many ways is intensifying the polarity in people. Then 'the have's are getting richer through reflation of the assets that they own - all at when 'the have nots' are losing on basic human needs like housing, healthcare, and education. We all know how primates react to inequality from the lab experiment which has been captured in a video named 'Two Monkeys Were Paid Unequally' by Frans de Waal. Lay that on top of the rise of China as a globally competitive power and what it means for the global ground rules for technological advancements, capital flow, and ideological differences. This might start to feel overwhelming.

It is also becoming increasingly clear that the economic concepts that the economists and policymakers rely on have to be defined well in the new 'technology-based-deflationary' environment. The way we perceive GDP numbers and the consequent decision makings need to be re-evaluated to fit today's reality. The Winchester Mystery House in California has something to teach us about the perception of the GDP. The house used to be the primary residence of Sarah Winchester, who was the widow of the firearms business magnate William Wirt Winchester. Sarah, who at the death of her husband in 1881, received close to 50% of the Winchester Repeating Arms Company (which was rumored to have earned around \$1,000 a day for her - more than \$27,000 in today's dollar) and got another \$20 mn (equivalent to \$550 mn) for the rest of the company.

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Just to take a little avenue in our lane of thoughts, we would also like to assume that - at 30% approximate dividend payout ratio and no preferred shares or debts on the balance sheet (which probably was not true), the company probably was making around \$2.43 mn/year after-tax and sold off at north of 16 times trailing earnings at a time when the 10-years-treasury interest rate was near 5% and the US just returned to the gold standard 2 years back (the US abandoned the gold standard and printed fiat money between 1862 to 1878). The company's financials on December 31, 1924 reveal some interesting facts about the company at the time. The Winchester company had sales of \$12.7 mn (equivalent to \$207 mn) with a gross margin of 19.5%. The total assets of the company were \$39.5 mn (equivalent to \$642 mn), and their operational loss was \$598,000 (equivalent to \$9.7 mn). The company was approximately 54% funded by a combination of 7% cumulative and 6% non-cumulative preferred stocks). By the way, without much concrete data on our hands and because of the space it would take for us to go deeper into the company than the space we are willing to spare in this letter - we should stop ourselves right there.

Now back to the story once again. Sometime after her husband's death, Sarah's daughter died of marasmus. This disease usually kicks in because of a severe deficiency of nutrients and is usually found in children. The body gradually wastes away with this disease. She consulted with a medium who suggested that the soul of her husband wants her to move to the western part of the country and continually build a house to accommodate the souls of people who have been the victims of Winchester rifles (well, we can surely attest that the situation with business consultants are still the same. But who knows? Perhaps, the medium was sent to her by some Californian construction company). Sarah then decided to move to California. She bought a huge property spanning 162 acres, where she started building the house. From then on, this woman continuously built 'perceived-assets' around the house.

Sarah continuously built rooms, ballrooms, and fireplaces all around the house. So, there are peculiarities found everywhere in it. From chambers that have been built for no reason to doors and stairs leading nowhere. Sarah hired one of the Tiffany family members to design a special window with prismatic crystals to cast rainbows across the room. There were three elevators in the house. One of them was made by Otis (glad to see them going public, one more company to put in our watchlist), which had a rare horizontal hydraulic elevator piston. Fortunately, the building was built on a floating foundation (invented by John Wellborn Root, where the foundation volume - when filled with soil, would be equal in weight to the total weight of the structure, reflecting Archimedes' principle in practice). This clever system protected the building from a total collapse during the great earthquake of 1906 in California (with an estimated moment magnitude of 7.9). Since then, it's a 4-storeyed building, down from 7 storeys pre-earthquake.

Let's focus on the cheese now. Just like the money spent on the passages and stairs that lead to nowhere adds to the house, but creates no value to the whole. We have a ton of public and private spending that doesn't really contribute to the economy much, or even worse, gets wasted eventually. We still count that into the GDP number. That's just a classic human misjudgment. Economists prefer to see the economy through the quantity demanded and supplied lenses. Whereas it is more important to look at the spending (who is spending on what and so forth) to actually understand the dynamics of how the economy functions in reality.

So, just as the amount spent on building the 'perceived-assets' in the Winchester Mystery House doesn't mean they increase the value of the asset. Likewise, just because the bridges are appearing here and there and that spending is eventually being added to the GDP figure does not mean a thing. So the holy-grail of economic progress is not so much of progress after all. The idea is simple (although the execution is not - at least at the national level) - it is to know who is spending what in order to get what. And knowing how much of that is really ultimately creating/destroying the intrinsic value. And by how much? And then to allocate capital well which would create progress. Just like Josie in our previous example, just a handful of variables - taken seriously and pursued voraciously can have an enormous impact of magnitude on the end result and that's the way to go.

Maggie Mahar talks about the 17-year cycle phenomena of booms and busts in markets in her famous book, *Bull: A History of the Boom and Bust, 1982-2004*. There is rather a simple explanation behind this. A generation never experiences the same 'lost-my-pants' type of bubble with the same amount of exposure in a lifetime on average. Therefore, when the next generation has made some savings and is ready to invest in the market, the optimism feels very real. The blood is warmed up by all the 'get-rich-quick' to 'would-punch-my-boss-and-resign' type of dreams. The last recession, which was not the result of the credit crunch, rather a reflection of the euphoria of the human spirit was the dot-com bubble of 2000s.

How come we haven't seen one in the last two decades then? We don't have the answer to that. Who knows what and when we will have the next one? But with these impressive technologies coming left, right and center - it can be sensed with somewhat conviction that the boat might go over another waterfall. But let's stick to our job of never trying to predict the unpredictables. Hallelujah!

How the three-point-line changed the basketball game and how that's relevant to investing in today's world:

Historically, basketball has been a game of close contact and brutal competition. The 2 point scoring in the game was usually made through dunks, layups, and only a handful of mid-range shots. The shots from far out of the court seemed to offer only unnecessary risk with no commensurate level of rewards. These 2 pointers even made more sense for a team that had players like Kareem Abdul-Jabbar who is 7.2 feet tall (such competitive advantage in business is always warranted!).

2 points shots used to carry a very high probability of success from a player's vantage point who is 5 feet away from the rim and, on top of that, had players like Jabbar to support the strike.

Then in 1979, the NBA introduced 3 point line in order to give opportunities to the trailing team to catch up faster. This in turn, was supposed to make the game more interesting. Whatever the reason, the 3 points line did not produce the effect that the NBA wanted. The stats speak for themselves. Between the 1979-1980 NBA seasons, only 3 percent of the shots were attempted for the 3s. From that point, it would take another 10 years for the 3-point shots to finally gain some traction. The NBA in the 1990s decided to tinker around the line and bring it closer to make it easier for the players to score some 3s. In the end, that also failed to produce the intended results (in the short term); what happened next changed the history of the game for good.

As the players got some taste of hitting the 3s, experienced the dopamine that followed them, and observed other players creating a solid edge that soon take their careers to the top, more and more players got interested in honing the skill. In 1997, the NBA took a good hard look at the results the new line had produced. Neither the overall score did improve significantly, nor did the gate revenue see the bonanza. Ignoring what was building beneath, they decided to move the line back to where it had been in the past. But dopamine had already taken over, and unlike one of the early Amazon warehouse employees who had furnished an escape home within the warehouse and furnished it with TV, sofa, and snacks - all for free - it did its job well. And right at the beginning of the new century, the number of 3-point shots attempted relative to all shots jumped to 16.7%. That number for the year 2018-2019 was 35.8%. The theory of natural evolution was at play, and lo and behold, we have the Houston Rockets shooting more 3s (~ 51%) than 2s (~ 49%) in the 2019 season.

The strategy of attempting for less risky 2s than 25 feet 3s made absolute sense and perhaps still makes a ton of sense - until Daryl Morey came into the scene. He is often credited with figuring out the strategy behind the gradual move towards shooting for the riskier 3-pointers than the relatively easier 2s. The math is simple, 1 out of 3 shots being successful in getting 3s is as good as 1 out of 2 being successful in getting 2s. Therefore, more shots allocated in attempting 3s and specializing in making these kinds of shots to - raise the success rate a little more than the average team in the NBA - provides an extraordinary edge for the team that can execute the plan successfully (this is such a no-brainer as the energy and effort spent in perfecting the 3 pointer techniques have greater probability in presenting the team with nonlinear reward until the defense evolve well to tackle the new sets of game challenges). Then the team only needed to have a good enough portfolio management strategy of the right mix of 2s and 3s to produce an extraordinary result. Back to Daryl Morey again, his team Rio Grande Valley Vipers in 2013-2014, attempted north of 48% of their total shots for 3 points, whereas the NBA average was just about 22.5%. This made the Rio Grande Valley Vipers become number one in the offense that year and reinforced the clarity of how the competition might turn out in basketball in the future. Once again, the same old principle of nature - all great ideas are simple. It's just that they are pursued ferociously.

Enough of basketball stats; what am I exactly trying to convey through all of these examples? Well, investing broadly might also follow the basketball trend in the future. Why do we say that? In the era between the 1930s - 1950s, value investing, as preached by Ben Graham and David Dodd meant buying companies with a market cap of less than the company's net-working capital. Then in the 50s, when Warren Buffett started investing for his partners in the Buffett Partnerships, these types of anomalies in the market were still there. And then started the bull run through the 60s, and by the early 70s, those types of market offerings were almost extinct.

We value investors generally divide the available universe for investments into two camps. There are (A) discounted pies and (B) growing pies. An investment thesis can be labeled as discounted pie, growing pie, or a combination of both. A discounted pie is the one where an investor is buying an asset by usually paying 50% or less than the replacement cost of the asset i.e. buying a dollar for 50 cents or less. Here the intrinsic value of the asset in question might just remain the same or decrease during the holding period. The expectation is generally just to buy and sit out on our assets (you have heard that last word right!) until the value gets recognized by the market within a reasonable timeframe. We might choose to simply liquidate the balance sheet by wearing an activist's hat to realize value from the company if the market seemed not to have recognized it within some reasonable time. The timeframe varies between 18 to 36 months and accommodates a wide range of investment activities starting from special situations (general arbitrage events) to macro-economic commodity crunch to distressed balance sheet recovery type of situations. An investor buying into these assets are usually waiting to collect up to 80% - 90% of the conservatively calculated intrinsic value, approximately doubling their money, and then rinse and repeat. But in the cases when the value does not get recognized within a reasonable time - we conclude that the consensus might have been right and the investor's analysis went haywire somewhere in the process of making that decision.

One might argue that one needs to be a clairvoyant or a visionary to understand and invest in the growing pies. But in reality, it is a form of art. Understanding of which requires the mastery of not only the elements of finance (which, in our humble opinion, doesn't play much of a role beyond a certain point) but also philosophy, history, psychology, biology, physics, chemistry, mathematics, music, language, etc. A sum that becomes greater than all of its parts is often called the 'Lollapalooza Effect' by Charlie Munger. Hunting for these growing pies is quite analogous to becoming a painter cum art collector who is constantly searching for a fine piece of art in this world to include in his / her collection. However, very rarely gets that piece that deserves a place in the museum that offers very limited space. Pablo Picasso once remarked, "*Learn the rules like a pro, so you can break them like an artist*". The feeling is exactly the same, but it's hard to describe it through the words that language has to offer to us. Unlike investments in the discounted pies, where investors are waiting to see the value gap close, the expectation behind growing pies is ideally never to sell them. The skills and abilities that enable an investor to identify, research and value these assets are vastly different from the skills and abilities that help one invest in the growing pies. While the discounted pie heavily tilts towards the quantitative analysis and then a set of qualitative metrics layered on top - it is absolutely the opposite for the growing pies.

The pre-tax dollars that go into funding a company's maintenance CapEx are massively different from the after-tax growth CapEx, M&As, and how it impacts the income statement for these great technology companies (just to sidetrack a little - it's really interesting to see companies that are trading on a very high earnings multiple - i.e. the ones that have enormous expectations built in their valuation by the consensus - generating more than a dollar of value for each dollar of earnings in the bottom line through the acquisition of other companies that are trading at much lower earning multiples on the market). To really distinguish between what part of the expenses should be accounted for as the maintenance CapEx and growth CapEx can not be explained by tearing down these statements like all the analysts have been doing in the past. The only way left to analyze these new-age technology companies boil down to customers' lifetime value, the valuation of the network itself, and other subjective elements, which varies significantly for different assets in question.

Please do not get us wrong. We are not saying that the growing pies are only made off of technology businesses. In fact, any and every company usually has a built-in growth element to it. However, as humanity and the world progresses toward the world of tomorrow - the best kind of businesses might prove to be the ones that have an extremely high return on incremental capital employed (ROICE) because of their next to no marginal cost of servicing a newly acquired consumer in the service network. As we see the metrics that bear the magnitude in one's judgment moving to the far right in the spectrum of vagueness and subjectivity, the decision gets harder and harder - prone to a lot more blind spots and biases - the potential reward size gets bigger and bigger.

With the growing speed and capabilities in processing information and computing power and the rise of adoption to the rule-based investment models in the value community such as Magic Formula by Joel Greenblatt, Free Lunch Portfolio by Mohnish Pabrai, The Acquirer's Multiple by Tobias E. Carlisle that significantly outperforms the market in the long run - money managers are at odds to actually producing some value on the table for the clients they manage the wealth for. We are therefore left with arguably only one variable which might offer some value and produce differences in investment results. It's the investor's own psychological edge and the discipline he/she incorporates in the process of decision-making. Other things that might help produce the outsized financial results include the improved information sorting process, a curated investment checklist produced through the comprehensive study of hundreds of failed investments made by great investors around the world, an understanding of financial history and the mechanics of how almost everything has a relationship with everything else in the real economy and how that eventually shows up through market systems, a process to take as much risk off the table as possible (i.e. the 'neutralization of the portfolio' in fancy terms) and also having next to no impact to the results as those risks are taken off or, just entirely sidetracking all of it by choosing the destinations where the number of intelligent, informed and knowledgeable investors are just few and far between.

As always, the investment managers are left with a choice of mediocre performance in relative terms or to put enough risk deliberately to create investment outperformance with a ton of luck supporting him/her (By the way, it's important for us to tell you that we value investors do not believe in taking an additional risk to outperform the market. Rather the idea is to mitigate as much risk as possible to take the path toward the center of certainty and predictability). Just like the NBA athletes and their coaches in the 80's did not fully appreciate the role 3-point shots would play in the future and the mix that would be required just to protect their position in the game, the wealth managers - in our humble opinion - are quite short-sighted in this regard in preparing for possible future changes that the wealth management industry as a whole would experience in our lifetime. But as we say this, we also do want to be grounded in reality. Hitting these 2Xs (in other words, 'discounted pies') is still a challenging endeavor and needs a lot of focus, energy, and attention, among the other important things in an investor. But the game is gradually tilting towards managers who can strike out a balance between 2Xs and multi-bagger opportunities (in other words, 'growing pies').

The heaven for a value investor would be to create a portfolio of only potential multi-baggers and let it run for at least a couple of years, if not decades, and preferably to never come to a point to sell them. It's not that the wealth management industry previously did not focus enough on trying to invest their wealth in these potential multi-bagger opportunities. The fact is - this is not that straightforward. If it were that easy, we probably would not have allocated this time even to discuss the issue. The guessing game would have been taken to an end, and voila! humanity had solved the game of investing.

So, where does the real challenge lie? The real challenge lies in vision to see, courage to buy, and patience to hold these great stocks completely untouched in the portfolio for a long-long time as one of the greatest investors of our age - Raamdeo Agrawal said. It is not something new. This really is an age-old challenge in the global investment community.

All of these facts came together and hit our heads hard again with an eye-opening achievement by the former fund manager of Nomad Investment Partnership, Nick Sleep, who held only 3 stocks (Amazon, Costco, and Berkshire Hathaway) in his portfolio since 2013 and before that - in the partnership portfolio. He and his partner Qais Zakaria decided to wind up the fund as the UK regulators were concerned about the position concentration in their portfolio.

Here is someone who had presented his fortitude in having the patience to hold on to a few intelligently made decisions, kicked his bike across Europe, and still managed to beat most active managers in the world.

But we are getting ahead of ourselves. Let's go back to some basics.

At first, we must acknowledge the fact that - 'reversion to the mean' is always at play in the nature - whether we like it or not. Reversion to the mean refers to the idea that any extreme outcome gets normalized towards the mean (and the opposite direction in some instances) over a long time. It is there in any and almost all faculties of life. Be it in the profitability of a given industry, business survival, or let's just for instance, take the height of human offspring.

In 1886, Sir Francis Galton published his most famous paper called '*Regression towards Mediocrity in Hereditary Stature*'. Sir Galton for the first time in scientific history, discussed the concept of regression to the mean in heredity characteristics in human offsprings. He observed that the heights of the offspring are not usually passed down from the direct parents, rather they regress towards a mediocre point which has been identified as the new mean of that population. It simply means that the parents' deviation in height from the typical people in the population is proportional to the difference between the parents and their offspring. Therefore we see the parents who are taller than the average height of the population have offsprings who are shorter than their parents by a factor we know as one minus regression coefficient multiplied by the excess height above the mean for men and women in the population for the parents.

Trying to understand what reversion to the mean signifies and how it influences also leads us to see the blind sides of the argument - which, to some extent, is to understand the natural human misjudgment around that concept. Any outperformance or outlier event could be expressed as a combination of luck and skills. We can simply ask ourselves if we could fail purposefully in an activity to draw a line between the probable mix of luck and skill involved in that particular activity. Reversion to the mean only applies to the luck end of the spectrum, said Michael Mauboussin in his book '*The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing*'. Outcomes that are a direct byproduct of skills remain mostly intact. That's why every time we race with Usain Bolt, he is going to come out first unless something really unlucky happens to him or luck supports us to the moon.

Daniel Kahneman, who won the Nobel Memorial Prize in Economic Sciences in 2002 concluded that we often mistake 'reversion to the mean' for the 'incentive-caused-reinforcements'. Here again, the famous observation is that the performance improves with the rebukes and falls with praise. The recency bias in action. What really happens behind the complexity of the human mind is - when we rebuke someone for mediocrity, we are, in theory punishing them for letting others win. Exactly for the same reasons when we praise someone, it is because they have caused others to lose. Just because the praises and the rebukes were there right before the performance shifted its course to the opposite direction relative to the mean - does not necessarily make it the causality for the change in the performance itself. But aren't we expecting a lot from the mortal human-kind?

Now wrapping everything that we have discussed so far together - where exactly do we want to go? Just like the 3-point shooters in basketball, investors who are well equipped in terms of either a special understanding of value migration from one part of the economy to another or just simply investing in markets that are overlooked by the investment community generally are going to be able to worth the dollar on their paycheck. The other grounds seem quite dull. Because there is only a limited number of ways to outperform the market (since the economy only creates an amount of wealth that it can produce in a given year by prudently allocating the capital). It is only a matter of time for global investors to catch up with the tools and techniques to squeeze out the performance spread between a professional wealth manager and a well-informed and equipped investor. On top of that, we also have the 'reversion to the mean' into play i.e. whenever a particular industry sees a reasonable return beyond their actual cost of capital, the competitors are invited - like the rear-end baboon pads getting red and swollen during their cyclical estrus - to overshoot the target and bamboozle with overcapacity, taking the market shares away until there's no return left on the table for the new entrepreneur to start in the same industry without some sort of disruptive innovation. This, by the way, makes the job of an investor harder and yet more exciting.

That is the reason why even if some investor spots these multi-baggers, he/she can not logically stomach the volatility and the pain that comes with holding them throughout the years till the end. The 'Why?' part is quite understandable behind this behavior. The competitive nature and brutality of capitalism might not even let the shareholders who risked their capital take a commensurate level of treasure at the tail end of the journey anyway. In the future, we might see the investment puzzle only get harder and harder as the crowd figures out ways to squeeze both sides of the bell curve. We would not only stay put just right there but express our conviction in saying that it is about time - (no matter what the strategy might be) to gradually move towards more 3-pointers than the 2s - with a healthy balance that beats the market over time.

This is an important paragraph for you:

Your patience with your capital with us is what allows us to do the right thing to our investments in businesses that are playing a long-term game in their industries. We can not thank you enough for taking the ride on Peel P50 with us - and we can surely say that we are enjoying it to our fullest. A recent journal published in Research in International Business and Finance titled '*LEGO: The Toy of Smart Investors*' argues that between 1987 - 2015 small and huge 'seasonal and movie-based' lego sets have generated 11% nominal returns (on average) with a Sharpe ratio of 0.4 (sensational!). A first-edition LEGO 'Ultimate Collector's Series Millennium Falcon no. 10179' changed hands at \$15,000 at a Las Vegas auction in 2014. The original price for the set was \$500 at the time of its release in 2007. That's a whopping 62.56% CAGR in 7 years. Bottom line: there would almost always be something happening around us that would make us at AR Capital look like jokers. Let us cross our fingers and hope that you still keep your capital with us.

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The price doesn't always reflect the true value, so it is important for our partners to understand that permanent loss of capital is always possible. We run a very concentrated portfolio, perhaps more concentrated than many others in the industry, and therefore the volatility of the investment results would probably be more than the peers. This is a long-term investment firm, and we do not think it is suitable for investors with less than 5 years time frame. If you are uncomfortable at all, then we suspect AR Capital is not for you.

We do guarantee you that we are only humans, and we are going to make mistakes every now and then - so please check everything we say and forgive our errors. Although our intention is not to mislead, we can not guarantee you that the letter will not be interpreted in ways we do not intend. All writeups at AR Capital are produced in good faith and to inform and educate our partners about our actions and our thought process leading to those decisions. We hope that these letters will be read in the same spirit in which they have been written.

Partners should also know that only Ahmed and I are responsible for making all investment decisions at AR Capital. The destination is to have a good life, now whatever the definition of 'good life' may be. We would hate to do anything other than what we do and are not willing to do it with anyone other than the people we do it with. Ahmed and I tap-dance to work every day. The idea is to enjoy every bit of life like the person appearing at 6:24 in *Hey Jude* by The Beatles. The journey continues...

We wish you and your family a very happy new year!

- Riyan & Ahmed

Some Footnotes and Basic Housekeeping:

We can not believe you have not yet thrown out our letter in your garbage can (we might be dreaming, who knows?). The previous line might have just increased the possibility in your head, Yikes! But we are thankful that you tolerated us for so long, and gave this letter your attention and time. You will hear from us again in our year-end letter in January 2023.

For those of you who have not yet submitted your capital commitment for the year 2022 should know that there is no prize reserved for the person who does the last submission. You can only make additions to your capital account at the beginning of each quarter within a year. Any withdrawals up to 100% of your capital amount are possible with a 15 days notice before the end of the year (unless the individual contract with you says otherwise).

Your statements and all financial figures have been prepared in-house at AR Capital for now (this job might be passed down to an internationally accredited fund administrator soon - but in that case, you will obviously be notified). Please contact ir@ar.capital with your legal full name and 'Unique Investor ID' (this should be kept confidential) to collect information about the status of your capital contributions in the fund or any queries related to fund-specific information.

Our partners should also consider us on the other side of the phone (if required) at +1 (917) 336-4502. Ahmed (ahmed@ar.capital) and I (riyan@ar.capital) can be reached in the email directly. But we are afraid that you might find us saying nothing different than what is already mentioned in this letter. In the world of investment management and specifically the type your managers are - there aren't a lot of things happening every month. Building real long-term wealth through investing is like seeing the paint getting dry and we already know you are incomparable in your ability to see the paint getting dry.

Legal Footnotes:

In our letters, materials, website, and all other public disclosures, we refer to both limited partners in the Partnership, and common shareholders in the AR Capital as “partners”. We do this to convey a relationship we seek in which our investors are partners in a shared experience and destiny, in which they too have something to contribute. We do not mean to suggest that there is a partnership, in the strict legal sense of the word.

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