KP7

October 23, 2023
Letter #11

Dear Investors:

KP7 was exactly flat for the third quarter of 2023 after all fees and expenses, versus the return of the S&P 500 of -3.3%. For the year, KP7 is up 18.4% after fees and expenses versus a return of +13.0% for the S&P 500.

A year ago, we described the inevitability of drawdowns in the asset management business, especially for relatively concentrated portfolios like ours. We were in one at the time. Our strategy during drawdowns is to: 1) reevaluate our theories and investments to make sure we are right and 2) add to our highest-conviction investments at lower prices in order to reduce our cost base. We told investors at the time that one way to add to dollar-weighted returns is to contribute more capital during those drawdowns. We told investors that we (the principals at KP7) were investing incremental capital. We invited investors to do the same.

I am happy to report that those of us that added to the fund a year ago are now up 41% on those incremental investments. The S&P 500 is up 21% over the same period. The index has done magnificently. We have nearly doubled the index.

Making incremental investments during drawdowns creates true value for investors. That value does not show in our results, however, because we report performance based on time-weighted returns. Our time-weighted return was +41%. Applying that +41% to a higher capital base allows us to create more absolute dollars for our investors as our performance recovers, as long as the capital contributions don't negatively affect the time-weighted return. We are small enough at the moment that the additional capital had zero effect on our returns.

Therein lies one of our true competitive advantages. We have a group of investors that understands what we do, trusts us, and has a level of conviction in our abilities to see through drawdowns. Our policy of transparency and alignment is designed specifically to build deep and enduring relationships with you, our clients. That allows you to have the trust and confidence in us, especially during the inevitable drawdowns, to behave in ways that increase dollar-weighted returns. We are proud of our investors. Our portfolio of clients is just as important as our portfolio of stocks.

Our biggest winner in the quarter was dLocal, which was up 57%. That increase was partially offset by Impinj, which was off 38%. We described each of these stocks in our last letter, so we won't go into detail here, except to say these are relatively short-term results for each. They are both among our top five holdings.

Our precious metals positions were also down in the quarter. We cluster our investments around certain big global themes. Our biggest theme in the portfolio today – by far – is a collection of stocks that will benefit from what we believe will be the negative long-term effects of the increase in central bank balance sheets that has occurred since the Global Financial Crisis. Since we think inflation is the ultimate result, we like companies that will benefit from an inflationary environment, including the producers of precious metals and companies with royalties on precious metal production. We took the opportunity after the close of the quarter to add incrementally to some of these positions.

We still see plenty of hidden risk in the U.S. economy. The level of debt at the federal government is completely unsustainable. The burden of debt service will only grow in the months and years ahead as interest rates climb and deficit spending continues, yet lenders continue to lend to the government at reasonable rates. That will end at some point, probably soon. We have limited direct exposure to the U.S. government and the U.S. economy. Fortunately, we are finding plenty of opportunity outside the U.S..

Besides having a world-class group of investors, we have structured our business to have an unbelievably fertile and vast opportunity set. An asset manager employing a large cap U.S. value strategy has an opportunity set of less than 150 investments at the moment. Our opportunity set is over 14,000. Just the way we like it. We commit to our investors to keep our asset base small and our investment mandate broad so we can maintain an opportunity set orders of magnitude larger than our competition.

We work every day to gain and keep your trust. All the best to you and your families.

Sincerely,