CIG

CUNNINGHAM INVESTMENT GROUP

March 7th, 2025

Dear Partners,

Since the founding of our partnership nearly a decade ago, the world has changed in ways seldom imagined. We've witnessed the election of Donald Trump (twice!), Brexit, mass protests in Hong Kong, a U.S.-China trade war, a global pandemic, the January 6th Capitol riot, Russia's invasion of Ukraine, decades-high inflation, rising interest rates and the Hamas-led terror attacks on Israel – just to name a few.

Although the temptation to retreat to the sidelines always seemed sensible amid such turmoil, holding cash proved costly. Over the past 10 years, inflation silently eroded purchasing power by more than 20%, while bonds offered little refuge as higher rates pushed prices lower. And for Canadians, the value of our dollar declined against nearly every major currency. Yet, contrary to many predictions, global equities delivered extraordinary returns – even after adjusting for inflation.

As Jeremy Siegel explained in his classic *Stocks for the Long Run* – widely considered the buy-and-hold Bible – owning high-quality businesses through thick and thin is one of the best recipes to build wealth. Even in today's turbulent world, the case for equities remains as compelling as it was in 1792, when the signing of the Buttonwood Agreement gave birth to the New York Stock Exchange. The next 10 years promise to be just as eventful, reinforcing the importance of staying the course amid the noise.

*****

Last year, we achieved a net return of almost 36%, outperforming the MSCI All Country World Index by more than 1,800 basis points. Since launching the CIG Value Fund at the beginning of 2019, we've delivered a gross annualized return over 15% – outpacing even the S&P 500. And we did so during one of the most challenging stretches for value investors in the past century.

Looking ahead to the next decade, we remain steadfast with our philosophy while acknowledging the dramatic shifts unfolding around the globe. The tectonic plates of geopolitics are moving, the effects of climate change are becoming more visible, and artificial intelligence is scaling at an unprecedented rate. In the words of Dorothy, *"We're not in Kansas anymore."*

That's why we are focused on thoughtfully repositioning our portfolio for the changing world order. This means turning over stones in the neglected corners of the market, where pessimism is priced in, and diversifying across geographies and currencies. We remain bottom-up stock pickers first and foremost – and as Thomas Phelps said best, the secret to investing is simple: *"Buy right and hold on."*

Performance

The table on the following page shows our performance since inception of the original partnership. All figures are reported in local currency (USD in the case of the MSCI ACWI) and are based on the total return including dividends (net of withholding taxes, if applicable). It's important to note that our results are shown *after* expenses. Therefore, our *gross* annualized return since inception is at least 100 basis points higher.

Year	CIG Value Fund	MSCI ACWI	S&P 500	TSX Composite
2015 [1]	0.4%	(4.6%)	(0.0%)	(10.6%)
2016	15.5%	7.9%	11.2%	21.1%
2017	6.4%	24.0%	21.1%	9.1%
2018	(2.6%)	(9.4%)	(4.9%)	(8.9%)
2019	24.3%	26.6%	30.7%	22.9%
2020	18.0%	16.3%	17.8%	5.6%
2021	18.2%	18.5%	28.2%	25.1%
2022	(15.2%)	(18.4%)	(18.5%)	(5.8%)
2023	11.0%	22.2%	25.7%	11.8%
2024	35.6%	17.5%	24.5%	21.7%
Total	**165.9%**	**136.4%**	**221.8%**	**123.5%**
Annualized	*10.6%*	*9.2%*	*12.7%*	*8.6%*

[1] *Represents the nine months beginning April 1st, 2015.*

Much like 2023, Big Tech dominated the market in 2024. A resilient U.S. economy received a further jolt when the Federal Reserve kicked off its current interest rate cycle with a 50-basis point cut at its September meeting. Our outperformance relative to the S&P 500 was noteworthy given we do not own any of the so-called 'Magnificent Seven.' This group – Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla – now makes up roughly one third of total U.S. market capitalization and accounted for more than half of the index's return last year, rising an average of 67%. The other 493 stocks in the index, however, rose by less than 10%.

This striking divergence of returns shouldn't come as a surprise. In 2024, the 'Magnificent Seven' companies grew earnings by more than 30%, compared to less than 5% for the other 493 companies. Although the supremacy of Big Tech looks set to continue, it would be wise to recall the old German proverb that trees don't grow to the sky. As Howard Marks warned in a recent memo, *"When something is on the pedestal of popularity, the risk of a decline is high."* Valuations cannot defy gravity forever.

Successful investing demands optimism, albeit with a healthy dose of skepticism. As we begin Donald Trump's second term in the White House, animal spirits are once again in full swing. The major indices sit near record highs, buoyed by AI fever, despite what may be the most perilous geopolitical situation since the Second World War. While the outlook for our businesses remains bright, history suggests U.S. equities may encounter some resistance in the not-so-distant future. But as the events of the past decade taught us, no amount of doom and gloom should scare you away from owning stocks for the long run.

*****

In *The Intelligent Investor*, Benjamin Graham famously wrote, *"In the short run the stock market is a voting machine, but in the long run it's a weighing machine."* And what the market ultimately weighs are earnings. The distinction between investing and speculating is the former is anchored in the present value of future cash flows while the latter is simply betting on what someone else might be willing to pay later.

Since 2022, we have been squarely focused on the underlying earnings of our businesses rather than the sporadic movement of stock prices. You should think of our partnership not as a typical mutual fund, but as a business that owns pieces of other businesses. Over time, our results will roughly mirror the growth in earnings per unit, plus any change in the valuation multiple applied to those earnings. With our current portfolio trading at roughly half the market's average P/E multiple – despite owning above-average companies – this second factor is likely to be a strong tailwind.

If earnings growth is the primary driver of stock returns, it stands to reason that we must own businesses with long runways. All else equal, paying up for a great company with decades of profitable growth ahead beats buying a mediocre one for a bargain. As Phil Fisher put it, *"Finding the really outstanding companies and staying with them through all the fluctuations of a gyrating market proved far more profitable to far more people than did the more colorful practice of trying to buy them cheap and sell them dear."*

With that framework in mind, let's take a closer look at the businesses we own, the earnings they generate and how that capital is being allocated.

What do we own?

We own a small piece of more than a dozen wonderful businesses. They range in size – from Berkshire Hathaway, which recently became the first non-technology company to surpass US$1 trillion in market capitalization (more than double our purchase price!), to Wise, a company still in the early innings of its growth story. They cover a wide range of industries, from making cars to making movies, and span the globe, from French jewelry to Vietnamese beer.

Despite their diversity, our businesses do share one common trait: each possesses a unique form of what Warren Buffett describes as an *"economic moat."* The moat varies in depth and width, but it's what enables our businesses to consistently earn superior returns on invested capital. Put simply, for each dollar reinvested in the business, shareholders get more than a dollar in value. It's like magic!

With the passage of time, economic moats often shrink – or disappear altogether. The forces of capitalism ensure this. If a business earns high returns, competitors inevitably emerge. Or, as Jeff Bezos likes to say, *"Your margin is my opportunity."* But truly wonderful businesses, those we wish to own, withstand attacks and keep their competitive advantage intact. (Visualize a castle with a moat around it.)

Take Cartier, for example, which we own via our investment in Richemont. With a storied history dating back to 1847, Cartier's reputation is as brilliant as its diamonds. Iconic designs like the Panther, Tank watch, Tutti Frutti collection and famous Love bracelet, have solidified Cartier as the *"Jeweler of Kings."*

In such a fragmented market, it pays to be the most well-known. As Warren Buffett once said, *"If you don't know jewelry, know the jeweler."* Who better to trust than Cartier. It's no wonder Richemont's jewelry maisons – Cartier, Van Cleef & Arpels and Buccellati – achieve nearly 35% pre-tax profit margins.

Then there's the magic of Walt Disney. With unmatched intellectual property, franchises such as Marvel, Star Wars and Pixar can churn out content for decades to come. An endless treasure trove of characters, brought to life by the amazing storytellers at Disney, continuously propels the flywheel. Just look at the recent success of *Inside Out 2* and *Deadpool & Wolverine*, the highest grossing animated and R-rated films of all-time!

And during inflationary periods, Mickey Mouse doesn't try to renegotiate his contract. Disney pays the same as his first public appearance in 1928 – zero. In fact, that's the going rate for all of Disney's beloved characters, from Baby Yoda to Mufasa. And their hugely profitable theme parks bring everything together, creating a fantasy world for guests to fully immerse themselves in the Disney universe.

Last, but certainly not least, John Deere. With a commitment to serving those linked to the land, John Deere has been at the forefront of innovation since its founding in 1837. Today, the company is leading the way in precision agriculture – pioneering driverless tractors, satellite connectivity and real-time remote diagnostics. This technological prowess has earned it the nickname of the *"Tesla of farming."*

And yet, what really makes John Deere so special is its enduring relationships with exclusive dealers and loyal customers. Farming is traditionally a generational business, and John Deere has always prided itself on being a valuable member of the communities it serves. To appreciate the challenge of knocking John Deere from its pedestal, just ask Caterpillar which tried – and failed – in the early 1990's.

These are just a few examples, but the pattern should be clear. Our businesses contain a 'secret sauce.' Not every moat will hold up forever – the world is changing faster than ever, and even dominant franchises can be challenged. (Consider the impact of ChatGPT on Google's highly lucrative search advertising business model.) But when given the choice, we will always prefer to own the *crème de la crème.*

How much money do we make?

To conceptualize how much money our businesses earn, I calculate *our* share of their earnings – both in aggregate and on a per unit basis. Here's how the math works.

Take John Deere, for example. In fiscal year 2023, the company earned nearly US$10.2 billion – a record, by-the-way. Our 1,800 shares imply an ownership of approximately 0.001% (99.999% to go!). Using the average USD/CAD exchange rate over the corresponding period, we can determine our share of John Deere's earnings was about $88,048.

By performing the same calculation for each of our businesses, we find our total share of earnings was roughly $1,040,276 in 2023. That works out to $18.75 per unit after deducting expenses (i.e. audit, custody fees, interest and withholding taxes). On a price-to-earnings basis, our portfolio was valued at less than 10x to begin 2024. But keep in mind this is based on *reported* earnings, which often differ from reality.

Back in 2022, I noted that the *real* earnings power of our businesses was at least 30% higher. Over time the reported earnings would drift towards reality – accounting can only disguise the truth for so long – thus leading to a higher unit price. I'm pleased to report that is exactly what happened!

Take Berkshire Hathaway. In 2022, it reported a *net loss* of US$22.8 billion due to a temporary decline in the value of its massive equity portfolio. This was purely an accounting provision, however, as the decline reversed quickly, and in 2023 Berkshire reported a *net income* of US$96.2 billion. Over the long run, assuming a modest return on its investments, Berkshire's true earnings are somewhere in the ballpark of US$100 billion.

Or look at Walt Disney. In its fiscal year 2023, reported earnings were only US$2.4 billion. Before the pandemic, total segment operating income topped US$16 billion. Since then, per-guest spending at its theme parks has increased by more than 40% and Disney+ has grown to over 150 million subscribers worldwide. In a normal operating environment, Disney's earnings should more than quadruple in the coming years.

The reported earnings of our businesses, although still somewhat understated, were much closer to our expectations in 2023. As such, our share of earnings increased by nearly 120% on a per unit basis, partially aided by a change in portfolio composition. And, as predicted, the unit price followed suit, increasing nearly 36% on a gross basis. Thus, our portfolio ended 2024 with a P/E multiple in the low teens.

Next, let's see how those profits were allocated.

How is our money reinvested?

When a business earns money, management has several options. First, earnings can be returned to shareholders by way of dividends or share buybacks. The latter benefits remaining shareholders by increasing their interest in the business (i.e. they are entitled to a greater share of future profits). Second, earnings can be reinvested in the business via capital expenditures – like building a new factory or expanding into new markets. Third, management may choose (or be forced) to repay outstanding debt. Fourth, an acquisition may be pursued. And finally, management may elect to do nothing, simply setting aside cash for future use.

As shareholders, we do not have a strong preference for how earnings are allocated – it depends on the unique circumstances of a business at a given point in time. In the 1970's, for example, it made sense for Walmart to reinvest essentially all its earnings to open new stores. Today, the business has reached maturity so excess earnings are better off in the hands of shareholders, who can then redeploy that capital elsewhere.

In all cases though, it is of utmost importance that capital be allocated intelligently, whether in our hands or entrusted to management. The table below summarizes how our share of underlying earnings, as reported, was allocated over the past two years (expressed in Canadian dollars).

	2022	**2023**
Net Income	$582,900	$1,040,276
Dividends	134,542	150,089
Payout Ratio	*23.1%*	*14.4%*
Share Buybacks	186,479	178,106
Debt Repayment	25,012	56,874
Capital Expenditures	512,676	806,580
Depreciation & Amortization	*438,843*	*604,670*
Acquisitions	87,881	138,167
Retained Earnings	75,155	315,130

What stands out most is the jump in net income, up nearly 80% year-over-year. This was driven by three main factors. First, Berkshire Hathaway's aforementioned swing from a net loss to a net gain. Second, a larger allocation to Porsche SE, which currently contributes the biggest share of earnings. And third, a fourfold increase in Fairfax's net income from US$1.1 billion in 2022 to US$4.4 billion in 2023.

Now, let's examine each of the line items in closer detail as it relates to our businesses.

Dividends

Typically, companies that pay a dividend are considered 'safer.' But that's not always the case. Often, businesses that pay out the highest dividends do so because they lack attractive reinvestment opportunities. In other words, the business (or industry) has plateaued or may be in a state of decline. I learned this the hard way with our past investment in Harley-Davidson. A tasty dividend yield can be a warning sign.

That said, many of our businesses do pay a modest dividend. Since reinvestment opportunities are finite, we support such a policy when it makes sense. In aggregate, the dividend payout ratio – the proportion of earnings paid to us as dividends – was 14.4% in 2023. That's a reasonable figure for our collection of businesses, but was lower compared to 2022 due to the sharp rise in reported earnings at Berkshire Hathaway and Fairfax without any corresponding increase in dividend payments.

In some cases, the payout ratio is much higher. Michelin, for instance, returned 45% of net income via dividends. This is sensible given the stable industry outlook and limited avenues for organic growth. After all, you can't reinvent the wheel!

Others, like Wise, don't pay a dividend at all. Why? Because there are better uses for the capital. Given his track record of success, I am more than happy for Kristo Käärmann (co-founder and CEO of Wise) to reinvest 100% of earnings to support the company's long-term growth initiatives.

At year-end, the dividend yield of our portfolio was 1.7%, roughly in line with the prior year and meaningfully higher than the S&P 500 (~1.2%). For several of our holdings, the yield is quite a bit higher. Porsche SE, for example, currently yields over 7%. But in that case, the elevated yield is more a reflection of the company's undervalued share price – something we hope gets corrected in due course.

When dividend payments are received, we have the opportunity to reallocate capital across our portfolio. We might invest the dividends from Richemont into Yum China – or vice versa. In other cases, we reinvest directly into the same business, as we did with Thai Beverage Public Company.

Share Buybacks

Share buybacks have become increasingly popular over the past decade, and for good reason. As Warren Buffett notes, they are *usually* beneficial for remaining shareholders.

Mechanically, when a company repurchases its own shares, those shares are cancelled, reducing the number of shares outstanding. This means the remaining shareholders own a larger slice of the pie. While buybacks don't put money in our pockets right away, they can create shareholder value over time by increasing earnings *per share,* which in turn tends to drive the share price higher.

The problem occurs when management repurchases shares *without* regard for price. No business is worth an infinite price. If shares are repurchased at an egregious price, shareholders will be worse off.

Many of our businesses engaged in large-scale share buyback programs in 2023 following the bear market. In total, our ownership increased by approximately 1.6%, slightly ahead of 2022. This may seem like a pittance, but you should never underestimate the power of compounding. (In fact, the total amount of money our businesses spent on share buybacks exceeded what they paid in dividends.)

The table below highlights which of our holdings saw the largest reduction in shares outstanding in 2023. Several would qualify for what Mohnish Pabrai calls *"uber cannibals."*

Reduction in Shares Outstanding	
John Deere	6.0%
Prosus	5.7%
Alibaba	5.1%
Ralph Lauren	4.4%
Yum China	4.2%
Brookfield Corporation	3.2%
Fairfax Financial	1.4%
Berkshire Hathaway	1.3%

John Deere led the pack, as its share price has largely traded sideways since mid-2021. Since our initial investment in 2015, John Deere has been an active buyer of its own shares when the price is right (Bob Barker would approve). Over that period, shares outstanding have fallen by nearly 20%, which means our ownership has grown by 25% – without buying a single additional share!

Ralph Lauren made the list again, reducing shares outstanding by 4.4% last fiscal year. In effect, the company returned 100% of its earnings through a combination of US$450 million in share buybacks and US$195 million in dividends. This was made possible by a substantial cash reserve, even after repaying US$500 million in debt the prior year. This kind of financial flexibility is exactly why we prefer owning businesses with net cash positions. As Peter Lynch wryly says, *"It's very hard to go bankrupt when you don't have any debt."*

But were these buybacks a smart use of shareholder capital? In Ralph Lauren's case, I believe the answer is a resounding yes. The average price paid in 2022 and 2023 was approximately $115 and $155 per share, respectively. The company has a rock-solid balance sheet, remains an attractive acquisition target for a luxury conglomerate like LVMH, and was selling for just 10 times earnings not long ago. As anticipated, we were handsomely rewarded when the stock surged to an all-time high of $289.33, driven by stronger-than-expected holiday sales and continued growth in China.

Alibaba was also high on the leaderboard, as management worked to deploy its vast cash reserves. While growth in its core e-commerce business has stalled in recent years, the company's balance sheet remains pristine, with more than US$85 billion of cash, minimal debt and a one third stake in Ant Group conservatively valued at US$25 billion. I expect the remaining share repurchase program, totalling US$20.7 billion through 2027, to prove accretive over time.

The decision regarding share buybacks requires thoughtful consideration by management as there is no one-size-fits-all approach. The key is maintaining discipline despite constant pressure to please the market. Shareholders would often be better off if management did nothing, adhering to the market advice of John Bogle: *"Don't do something, just stand there!"*

Capital Expenditures

Not all capital expenditures are created equal. A dollar reinvested in a business may yield more or less than a dollar of shareholder value. And it is often hard to judge without the passage of time. In 2023, our businesses purchased property, plant and equipment meaningfully above depreciation and amortization expense. (If you're not an accounting nerd, this means net fixed assets increased.)

Yum China is a textbook case of value creation through reinvestment. Although they pay a small dividend and opportunistically repurchase shares, the bulk of Yum China's earnings are reinvested into opening new restaurants. In 2024 alone, the company added over 1,500 new KFC locations (many of which were opened by franchisees) and aims to maintain that torrid pace this year. To put it in perspective, a new KFC opens in China every six hours!

Why is this such a big deal? The upfront cost of opening a new store is approximately US$400,000, depending on location, size and format. This covers kitchen equipment, in-store décor and outdoor signage.

Because KFC is the undisputed leader in China's fast-food market (with more than triple McDonald's footprint), new restaurants are highly profitable from day one. In Shanghai, for example, KFC recently opened its 500th store (yes, you read that right). And despite having a presence in 1,900 cities, there are still more than 800 cities in China *without* a single KFC. The party is just getting started!

On average, a KFC restaurant generates over US$1 million in sales and US$150,000 in after-tax profit. Based on an upfront cost of approximately US$400,000, that represents a return on investment of nearly 40% with a payback period under three years. Now that's *finger-lickin' good*.

If you apply a standard 15x multiple to the newly created earnings, the market value of each new restaurant is around US$2.25 million. We know this is a reasonable estimate because Yum China recently acquired over 700 KFC stores from a franchisee at a valuation of nearly US$3 million per restaurant.

So, like magic, an investment of US$400,000 quickly turns into more than US$2 million of shareholder value (a >5x return). Repeat this formula thousands of times and the compounding effects are extraordinary. In Yum China's case, they plan to triple their store count in the coming decades as market penetration in China remains well below that of similar countries.

But only businesses with an impenetrable economic moat have this magic wand at their disposal. Most restaurants can only dream of such unit economics. While it would cost a competitor the same amount of money (or perhaps more) to open a new restaurant, their earnings would be far less. Even the mighty McDonald's can't match the profitability of KFC in China.

On the flip side, capital expenditures can be value destructive for shareholders. Consider money "invested" in opening new Blockbuster stores just as the video rental industry was collapsing. If a company's return on invested capital is *lower* than its cost of capital (i.e. the return demanded by shareholders), every dollar invested will yield less than a dollar of shareholder value.

Porsche SE, via its 31.9% economic interest in Volkswagen AG, accounted for the lion's share of fixed asset purchases in 2023, investing in plants, machinery and technology. In its drive to become a leader in electric vehicles, Volkswagen plans to invest €180 billion over the next five years. The German automotive giant's "electrification and digitalization" strategy is supported by its robust profitability and balance sheet strength.

While automakers have historically earned mediocre returns on capital, luxury car brands are in a different league. Lamborghini, Bentley and Bugatti – all of which are wholly-owned by Volkswagen – generate mouth-watering profits and are poised for continued growth as demand far exceeds supply. Our investment in Porsche SE was predominantly based on these crown jewels. The prospect of Volkswagen (and Porsche, one of the world's most valuable brands in its own right) emerging a major player in the EV market is simply the cherry on top.

Debt Repayment

As you know, our businesses are in a net cash position – meaning they hold more cash than debt. This is no coincidence, as we deliberately avoid companies with excessive leverage. That said, some of our businesses do carry debt on their balance sheet. For example, Walt Disney has nearly US$50 billion in debt following its spree of acquisitions by CEO Bob Iger, including the landmark purchase of 21st Century Fox.

While Disney's debt load is manageable, I am eager to see it come down. Encouragingly, they continued to make progress last year. The company suspended its dividend at the onset of the pandemic, initially to preserve liquidity during a time of enormous uncertainty, and later to fund growth in its streaming segment and accelerate debt repayment. In 2024, however, Disney reinstated its dividend at $1.00 per year.

John Deere, Michelin and Porsche SE also made significant debt repayments last year. They were comfortably able to do so owing to their strong earnings and excess cash positions. With interest rates now much higher than in previous years, repaying debt as it comes due – rather than refinancing at more expensive rates – is a prudent move. That said, not all debt is bad. When used wisely it can be a source of shareholder value.

Prosus offers a good example, as they issued debt to repurchase deeply discounted shares. Similarly, Porsche SE issued holding company-level debt to fund its purchase of a 12.5% direct stake in Porsche AG as part of the IPO completed by Volkswagen AG in 2022. This transaction increased our look-through ownership of Porsche AG by more than 5%, an outcome we were very pleased with.

Berkshire Hathaway has also made savvy use of debt, issuing bonds in Japan to take advantage of ultra-low borrowing costs and fund the purchase of Japanese equities. In fact, nearly one-fifth of Berkshire's debt is denominated in Japanese yen. This was clearly a smart move as the stocks purchased have all increased substantially while the yen has weakened against the dollar – making it a particularly shrewd trade.

Acquisitions

From time to time, one of our businesses makes a meaningful acquisition. While there were no headline-grabbing deals in 2023, Brookfield kept up its steady pace amid attractive market conditions. Led by CEO Bruce Flatt, Brookfield invested more than US$5.6 billion, including capital calls from Brookfield-sponsored private equity funds. As one of the world's largest owners and operators of *real* assets, Brookfield is poised to capitalize from the global shift towards sustainability.

Like Brookfield, both Berkshire Hathaway and Fairfax Financial have been built through decades of thoughtful acquisitions. When you have an exceptional capital allocator at the helm – as all three companies do – acquisitions are often the most effective use of shareholder capital. Consider the transformative impact of Berkshire's first insurance acquisition in 1967, National Indemnity. That single deal laid the foundation for one of the greatest compounding machines in financial history. The rest, as they say, is history.

Retained Earnings

If none of the options above seem attractive, or management has in mind some future use of cash (perhaps a planned acquisition or simply saving for a rainy day), retained earnings accumulate on the balance sheet. In 2023, the increase in retained earnings was primarily driven by three of our businesses, namely Fairfax Financial, Berkshire Hathaway and Porsche SE.

Fairfax had an extraordinary year, raking in a record US$4.4 billion in 2023. Its insurance subsidiaries once again generated strong underwriting results in a hard market and its sizable bond portfolio is now benefitting from higher interest rates. These tailwinds are expected to persist for years, with earnings per share projected to exceed US$150. That bodes well for shareholders as Fairfax's share price closely tracks growth in book value per share – historically driven by an average return on equity of nearly 20% since Prem Watsa took the helm in 1985.

Berkshire Hathaway continues to sit on a staggering cash pile, currently over US$350 billion! As one of the world's largest insurance companies, financial stability is paramount. Warren Buffett will never jeopardize the company's reputation, always holding at least US$50 billion of cash to cover potential insurance catastrophes. The remaining capital, however, is dry powder for the next elephant-sized acquisition.

With interest rates no longer anchored at zero, the return earned on idle cash is once again meaningful. As Howard Marks has emphasized on numerous occasions since his memo *Sea Change*, this sets the bar higher when evaluating alternative uses of capital – whether it be buybacks or acquisitions. All the sudden, there is a real opportunity cost when deciding to invest cash.

What role does management play in capital allocation?

The CEO holds the keys to the castle. Alongside oversight from the Board of Directors, they are ultimately responsible for how shareholder capital is allocated. This part of the job rarely makes the headlines, yet is arguably one of the most critical responsibilities.

All too often, CEOs are tempted into making poor decisions at the expense of shareholders. Cheered on by Wall Street, buybacks may be pursued indiscriminately, with little regard for valuation. Lured by the prospect of running a larger empire, acquisition price tags have the tendency of creeping higher. And inadequate financial analysis (the concept of return on invested capital is generally underappreciated in many boardrooms) can lead to poor capital expenditures. Good capital allocators are the exception that make the rule.

Consider our former holding, Alphabet. CEO Sundar Pichai and CIO Ruth Porat are tasked with allocating more than US$75 billion – every year! Over the span of a decade, that works out to approximately one third of Alphabet's current market cap. Decisions made today will have a profound impact on the share price tomorrow. For keen investors, the cash flow statement is the right place to begin any analysis.

*****

Fishing in Hong Kong

Early in 2024, Hong Kong equities sank to one of their lowest levels since the Global Financial Crisis. The benchmark Hang Seng Index was down nearly 60% from its 2018 peak. Needless to say, Hong Kong has endured a lot in recent years which is clearly reflected in the weakness of its stock market. In fact, stock prices at the start of 2024 were only marginally higher than they were on July 1st, 1997 – the day of Hong Kong's handover to China. Talk about a sideways market!

Chinese equities, including those listed in Hong Kong (referred to as H shares), were clearly out of favour. China's economy has languished since the lifting of Covid restrictions at the end of 2022, with the property sector hit especially hard. The threat of escalatory tariffs imposed by the Trump administration only adds to the uncertainty, further dampening consumer sentiment. These challenges have led many commentators to label China as 'uninvestable.' But as Howard Marks said, *"I've made my whole career buying assets that other people consider uninvestable and when you do that, you have a chance of getting a bargain. To me, that word is music to my ears."*

As you know, we have been closely following Hong Kong equities since 2018. This includes frequent diligence trips to the city and extensive on-the-ground research across China's mainland – spanning 20 provinces and more than 40 cities – where many Hong Kong-listed companies operate. This culminated in a watchlist of several dozen stocks out of more than 2,000 companies listed on the Stock Exchange of Hong Kong, of which we turned over every stone! (We took Warren Buffett's advice to *"start with the A's."*)

I'm happy to report that these efforts paid off as we were able to act quickly by purchasing a basket of 10 stocks near the bottom of the sell-off last year. Our investments initially jumped as sentiment turned slightly more optimistic following a slew of stimulus measures announced by the Chinese government. Despite a pullback to end the year, we are still meaningfully in the green and are comfortable owning these businesses longer term, especially given their attractive valuations.

These holdings will be included as an Appendix in future Portfolio Valuation Statements, but for your reference, here's the full list along with a brief description of each:

BYD Company – Based in Shenzhen, BYD has grown to become the world's largest manufacturer of battery electric vehicles, with quarterly sales surpassing Tesla for the first time in 2024. Charlie Munger once described CEO Wang Chuanfu as a genius, saying, *"The guy at BYD is better at actually making things than Elon [Musk] is."*

ANTA Sports Products – China's top sportswear brand, recently overtaking Nike and Adidas, with majority stakes in Amer Sports (Wilson, Salomon and Arc'teryx brands), FILA (in China mainland) and Maia Active (a Chinese female athleisure brand akin to Lululemon).

Tsingtao Brewery – China's leading brewer, founded in 1903 and headquartered in the former German concession city of Qingdao on the eastern coast of China's Shandong province.

Ping An Insurance – Considered to be the world's largest insurer, Ping An (which translates to "safe and well") has expanded from a traditional life insurance company into asset management, banking, healthcare and other financial services, with over 240 million retail customers.

Vitasoy International – A ready-to-drink beverage company (primarily lemon tea and soy milk) founded in 1940 with a leading market share in Hong Kong and southern China.

Xinyi Glass – One of the world's largest integrated glass manufacturers, specializing in float glass, automobile glass and energy-saving architectural glass. It is also the largest shareholder in Xinyi Solar.

Tencent – The global leader in video games and parent company of WeChat, China's dominant all-in-one social messaging and mobile payment app. (We previously owned a stake in Tencent via our shares in Prosus N.V. which trade on the Euronext Amsterdam exchange.)

China Resources Land – A premier owner and operator of real estate across China mainland, with properties ranging from luxury shopping malls (e.g., MixC) to office towers and private residences.

CK Hutchison – Diversified conglomerate with sprawling assets including some of the world's busiest ports, retail, and telecom, founded by Hong Kong business magnate Li Ka-shing (aka 'Superman').

Postal Savings Bank of China – One of China's largest state-owned banks, PSBC focuses on underserved rural and low-income customers through an extensive network of nearly 40,000 branches.

Most of these companies are constituents of the Hang Seng Index, providing us with broad exposure to the overall Hong Kong market. In aggregate, we acquired this basket of stocks at deeply discounted valuations – less than 10 times earnings – with a dividend yield of 5%. If you recall, we already held a small position in Shangri-la Asia which will now be included in this basket, along with 1,000 additional shares of Yum China purchased in Hong Kong.

Final thoughts

Trying to predict Trump – or the market's reaction – is a fool's errand. In the short run, stock prices tend to follow a random walk. That's why we focus on owning high-quality businesses at sensible prices, regardless of which direction the economic winds blow. It's far more important to be right about *what* will happen than *when* it will happen. So have faith our businesses will stand the test of time.

Our goal remains to make money safely and predictably over the long run. So far, mission accomplished. While we may not own the most popular names on Wall Street, our businesses form the backbone of the *real* economy. We have no interest in keeping up with the Joneses, which is why we rarely change seats. But as Jackie Chan wisely said, *"Being still and doing nothing are two very different things."*

It's a privilege to share this journey with such thoughtful and supportive Partners. Ruby and I are deeply grateful for your enduring trust and unwavering commitment to the principles that guide our approach. We look forward to seeing you all at our next annual meeting, and in the meantime, we wish you a happy, healthy and prosperous year ahead!

Sincerely,

Chris Cunningham

think big.