Making Bets

FOUNDERS CAPITAL MANAGEMENT
2020 ANNUAL REPORT

An innovative money management firm investing in publicly traded equities and fixed-income securities. A deep base in business management with a truly global perspective. A drive to identify true fundamental value. A commitment to buy carefully and hold for the long term. A passion to provide customized investment solutions tailored to each client's financial goals and risk tolerance.

This is Founders.

Founders Capital Management, LLC

2020 Annual Report:

“Making Bets”

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2020 INVESTMENT TEAM LETTER
From: Founders Capital Management

"Making Bets"

Our Serenity Prayer:

"Grant me the ability to understand a good investment, to accept that money can be made through informed decision or uninformed speculation, and the wisdom to know the difference."

Not since 2009 have we experienced market volatility that shook investors to the core the way it did in 2020. The housing crisis that occurred more than a decade ago had faded into a distant memory, but the pandemic crisis of 2020 brought us market déjà vu. Panic was the signature dynamic of this year and, in the midst of a severe market meltdown in March as SARS-CoV-2 (the virus that causes COVID-19) spread throughout the globe, fear reigned, and many individuals sold their holdings, opting to wait for a time when COVID-19 subsided and calmer markets prevailed. The market would fall, only to recover with stunning swiftness, leaving sidelined investors shocked as they watched the market upswing and wish they had stayed the course. Once again, many investors allowed wariness about volatility to supersede their ability to evaluate the long-term viability of businesses in their portfolios in a rational manner. Fixated on price movement, sidelined investors "knew the price of everything but the value of nothing." Investors who practice this Pavlovian response to market volatility view the market as a gambling casino and inevitably miss opportunities to invest in good businesses, sell securities prematurely, and lose potential future returns forever.

This reminds us of a story: Two young investors who were active traders in the stock market happened to run into an older investor at a coffee shop who they referred to as "Old Bull." As they stood in line, Old Bull smiled at them and said, "Morning, gentlemen—how's business?" The two young traders smiled back and nodded at Old Bull and, after leaving the coffee shop, one of them looked at the other and said, "What's a business?"

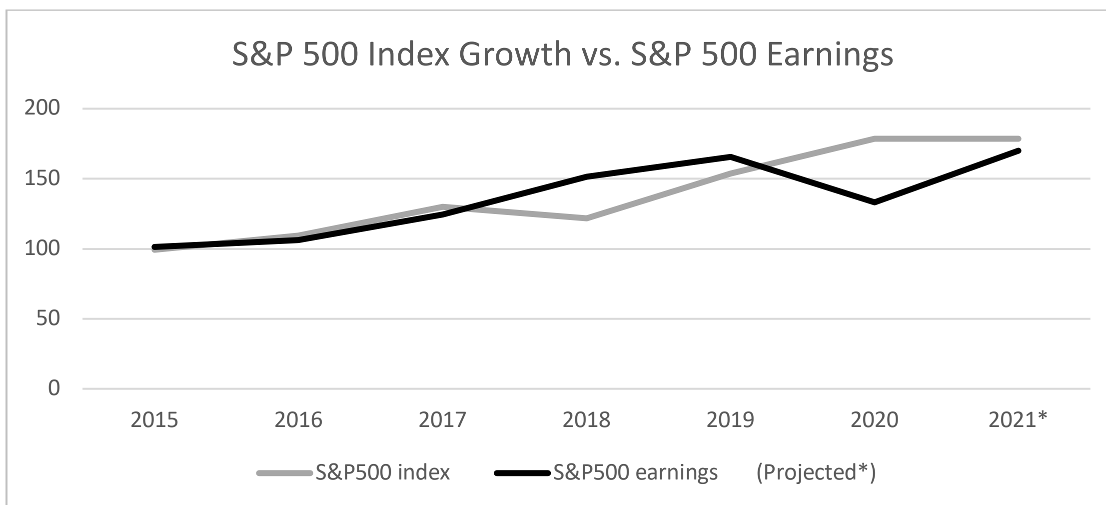
Many readers might think this story is a precursor to presenting ourselves as the wise and all-knowing "Old Bull," reminding them to act as investors as opposed to speculators, and to remain focused on the businesses (as opposed to the stocks) they own—regularly evaluating those companies' positions in the marketplace and how management is creating long-term value for owners. But we are not going to portray ourselves as the wise and all-knowing Old Bull who can prognosticate the future of the market, provide guidance on when to buy or sell companies, or predict when the next recession will come (it may already be here). This year, we will "take on" the perspective of the large majority of investors who evaluate the market and "make bets" on the movement of securities as one would evaluate odds in a casino game. Thus, the headline of this year's letter: "Making Bets."

* * *

The stock market has experienced tremendous volatility during the past few years: In 2018, the market ended down for the year after the S&P 500 had experienced a 16% decline during a three-week period in December. A market recovery that followed this sudden drop over the next 14 months led to a 44% increase in the S&P 500, only for the index to freefall 34% in just 33 days due to the sudden emergence of COVID-19. Following

this precipitous drop, the S&P 500 rose a stunning 67% by the end of 2020. **On average, investors that remained invested in the S&P 500 index over the past 24 months have gained nearly 50% on their money, despite the extreme volatility.** It seems that the only consistency about the stock market over the past few years has been the roller coaster ride that has left investors jittery and more convinced than ever that the stock market is essentially a casino in which betting on short-term market swings allows both bulls and bears to make money. But there is an old saying on Wall Street that "market bettors" need to understand: "Bulls make money, bears make money, but pigs get slaughtered."

Many people justifiably wonder: Does it pay to be involved in the stock market over the long term? Every day seems to bring disruptive news that acts like a violent wind, accelerating the market's price movement—up or down. The stock market's whipsaw dynamic has become exhausting to every participant—including professionals. It seems that rational behavior has gone out the window. When we step back and evaluate the longer-term trend of the market, however, we can see that its overall movement continues to add up to strong gains in intrinsic value over time. The following chart compares gains in the S&P 500 over seven years (assuming zero expected market gains in 2021) to the index's increase in earnings over the same time frame:



If we had placed $100 in the S&P 500 at the beginning of 2015, that investment would have turned into approximately $178.55 dollars at the end of 2020—reflecting an annual return of approximately 10.1% over the past six years. Now, let's assume (not a prediction, just for illustration) that the S&P 500 stays flat during 2021. Under this scenario, an investor's seven-year annual return would adjust to 8.6%.

As a comparison, let's look at the growth in *earnings* for all companies in the S&P 500 over a similar time period but, in this case, we will assume an expected earnings recovery to 2019's level during 2021 as the pandemic (we hope) subsides. Over the same seven-year time period, the S&P 500's collective earnings would have grown from approximately $100 to $170 per share by the end of 2021—representing an annual increase in S&P 500 earnings of 7.9%.

The salient point: Although the S&P 500 index's extreme price gyrations over seven years resulted in drops and surges in excess of 30%, investors that took a 84-month holiday from watching the market would have come home to investment gains that nearly mirrored the increase in earnings of the S&P 500 companies.

The questions market participants (including gamblers that treat the stock market as a casino) should be focused on: What are the anticipated gains in earnings among the companies that collectively make up the S&P 500 over the next five and 10 years? And what is the likelihood of this occurring? In other words, the first lesson of making good bets is to play the long game. The answer to the "five- and 10-year" question about the S&P 500 is more knowable and important than unknowable answers about short-term considerations such as "Where is the market heading in the next week, month, or year?" or "Are we going to experience a back-to-back economic recession during the next 12 months?" The point is not that one should never ask these

questions—as humans, we have a desire to understand immediate circumstances that could impact our well-being. Nevertheless, the professional gambler's question would be: What are the odds of my being able to predict the market's near-term movement? The professional thinks in probabilities of various outcomes.

The attempt by many market participants to manage decisions about short-term volatility by keeping up with political and economic events is understandable. For example, everyone expects the market to react to either positive or negative outcomes from Brexit and financial issues in Europe; challenges in the Middle East; moving interest rates in developed economies; trade disagreements involving America, Europe, and China; and the unpredictability of outcomes about a global pandemic and U.S. elections. These are just some of the concerns that plague attentive investors and lead them to try to predict with certainty the outcomes of upcoming market-driving events that may or may not actually come to pass. Unfortunately, gamblers that rely on their intuition to make big bets on the short-term market's movement with 100% certainty end up losing money time and time again.

Benjamin Graham had a saying: "In the short run, the market is a voting machine, but in the long run it is a weighing machine." Individual votes made every day may influence the market direction in the short term but may or may not add up to much when it comes to long-term economic and market outcomes. And believing that adverse current events will definitely, with 100% certainty**,** translate into market setbacks in the far future is likely a bad bet. In our view, the market's long-term returns will ultimately be tied to future growth in the global economy and the prospects of its underlying companies, and this outcome has a much higher probability of being accurately predicted. So we ask: **Why make a bet with one's life savings on short-term events that are certain to be uncertain when you can make a long-term bet that is more certain to pay off?**

Even when certain long-term market-driving events can be predicted with a high degree of probability, market gains will sometimes temporarily outpace economic and business gains, and vice versa. Given this reality, some investors make a practice of attempting to forecast market returns through "leading" or "lagging" economic indicators while taking into account assumptions about investment psychology. Over and over again, expert forecasts have proved to be incorrect more than 50% of the time—simply stated, it does not pay to forecast far-future market prices based on expert predictions of political, economic, or psychological circumstances that no one can truly anticipate.

Still, we watch many investors get caught up in short-term news (both positive and negative) that activates emotions and drives market behavior—e.g., holding off on placing new money into the market, excitedly speculating on newly issued stocks with the hope of rapidly increasing wealth exponentially through selected "bets," or anticipating imminent gloom and quickly removing money from the market before the "inevitable setback" happens. The key concept: Human beings are wired to take immediate action based on short-term emotional stimuli, regardless of their ability to accurately predict long-term outcomes. This is reflected in the behavior of individuals who decide to sell out of the stock market during a pandemic despite an objectively high degree of probability that, in five years or less, the pandemic will have dissipated into memory—by then, the economy will most likely be larger and companies more profitable than they were pre-pandemic. This phenomenon is also reflected in the behavior of investors who decide to purchase speculative "popular" stocks to make a big profit, driven by the belief that they are taking advantage of prices that will only continue to increase—even though they know that the long-term outcome of these bets is circumspect at best, given that these businesses are either unprofitable or barely profitable today and likely face tremendous competition into the future. Both these situations usually result in bad bets.

One of our favorite stories to describe the disconnect between a good bet versus bad bet is Isaac Newton's wagers on the South Sea Company. Newton made an initial investment in the South Sea Company of £7,000 (approximately $2.5 million today). After making a 100% profit, Newton sold his investment in South Sea Company and collected £14,000. He sensed that the risk in this stock was too high and, after taking his money off the table, he declared: "I can calculate the movement of the stars, but not the madness of men." Based on his statement, we can be fairly certain that Newton thought the odds were mathematically low that a future bet on the South Sea Company would be profitable. Nevertheless, shortly thereafter, as he watched nervously from

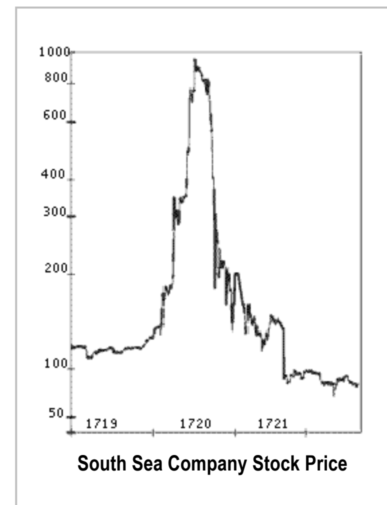
the sidelines, the stock price climbed, and he decided to jump back into the action to avoid missing out on future returns. Newton went all in, placing all his money into the South Sea Company. He then watched the stock nosedive, taking most of his fortune (£20,000—the equivalent of more than $7 million today)—with it.

The "South Sea Bubble," as it was eventually named, is worth reviewing, since it is one of history's worst financial speculations. The South Sea Company was a British joint-stock company founded in 1711, after the War of the Spanish Succession left England in debt to the tune of £9 million. The English government granted the South Sea Company a deal whereby England's debt would be financed through the firm in return for 6% interest. The government added another incentive to sweeten the deal: Exclusive trading rights with South America. The South Sea Company readily agreed to the monopoly trade arrangement in the South Seas, believing that Mexico and South America would enthusiastically trade gold and jewels in exchange for wool and fleece clothing made in England.

The South Sea Company issued stock, and the new shares were swiftly snapped up by investors who had hastily perceived value in the South Sea Company's government-backed debt and future trade monopoly in the South Seas. After reaping the success of its first issue of shares, the South Sea Company quickly issued more stock at higher prices (nothing changes over history). The stock was rapidly consumed by insatiable investors who apparently had no qualms about the company or its inexperienced management team—all they could see was a stock that was headed for the stratosphere. Many investors were also dazzled by the lavish corporate offices of the South Sea Company, which cemented its image of success and wealth. Inevitably, owning shares in the South Sea Company became a status symbol—the subject of high-society party chatter.

The South Sea Company management team fed investors' delusions of grandeur and hyped the stock. It was generally believed that the South Sea Company "could never fail," implied by its government backing. By 1718, however, a new picture began to emerge. Britain and Spain were at war again, which brought trade in the South Seas to a grinding halt. Believe it or not, investors were undaunted and kept clamoring for South Sea Company stock. Making matters worse, investors from other European countries had started to scramble frantically for South Sea shares, driving the stock up even further. All this happened despite the fact that throughout the craze's seven-year time frame, the South Sea Company had not generated any profit from its operations.

Management, realizing that the company's shares were substantially overvalued relative to its (lack of) profits, decided to sell its own shares at exorbitant prices while other investors remained unaware that the business was profitless. When word got out that the management team had sold out completely, investors who were left holding the stock panicked and immediately began to sell their worthless shares, causing many to lose their fortunes in a heartbeat—Isaac Newton among them. No one could mention the South Sea Company again in front of Isaac Newton without a backlash. Here was one of history's greatest geniuses, and he had fallen victim to a bad bet, even after acknowledging that this stock was defying gravity. (Newton's folly could not be attributed to lack of financial acumen; his recognized genius extended to finance as well as mathematics: He is credited with piloting the nation through a recoinage in 1696; initiating tying currency to gold in 1717, which eventually led to the establishment of the "gold standard;" and serving as England's Master of the Royal Mint for 27 years.)



South Sea Company Stock Price

Why did a mathematical and financial genius like Isaac Newton ultimately fail on his various bets in the South Sea Company? Newton's first wager on the South Sea Company was likely based on experience—he had doubled his money on his initial investment, a result that—in his mind—reinforced his genius. The second bet Newton made was to sell out of his initial position, after which he watched potential profits evaporate with great regret. Newton probably looked at the ever-rising investment interest in the South Sea Company and concluded that an increase in its stock price was inevitable—ongoing insatiable investor interest and soaring

stock price + implied government backing = high odds of future success. This led to his final "big bet," when he wagered and lost his fortune. Ultimately, Newton's desire to find certainty about his desired future outcome blinded him to the fact that the money he'd made from his initial bet was actually based on luck, not genius. And herein lies the problem: Placing high odds of success on conjecture, coupled with an uncertain future outcome. At the time, Newton likely believed that he was making a rational wager, and today we cite this story as an example of an irrational bet.

Since we established that being dependent on a desired outcome in relation to an uncertain future usually leads to a bad bet, we should evaluate the process that leads to making a good bet. It is our opinion that a good bet derives from discipline—to have a process that logically provides an accurate state of knowledge, including the wisdom to understand what you don't know, or what is unsure. Like anything else, this involves weighing the variables that would be certain against those that are uncertain. Basically, a good bet involves placing a heavier weight on variables that are known with a high degree of certainty while being comfortable with certain assumptions about the future that are unknown and unpredictable. A bad bet has the opposite attributes—placing a *lighter* weight on variables that are known with a high degree of certainty while being comfortable with certain assumptions about the future that are unknown and unpredictable. Continuing with a modern bad-bet scenario: Let's say we are evaluating wagering on a company that primarily produces electric cars. In this scenario, our knowledge of industry variables is fairly certain:

(1) the worldwide automobile industry consists of approximately 25 companies that compete for sales of 91 million cars per year (of all types)

(2) the growth of all cars produced will be around 2% per year in the foreseeable future, with nearly 100 million cars produced per year worldwide in five years and that annual number growing to around 111 million cars in 10 years

(3) electric cars represent 2.5% (or 2.3 million) of current worldwide cars produced and will be expected to grow to 11 million in five years, and to 30 million by 2030

(4) the net profit margins on all car manufacturers remains in the range of 6%

(5) the largest electric car manufacturer produces approximately 23% of all electric cars worldwide and is expected to grow its market share to approximately 35% in the next 10 years, representing 10.5 million cars produced in 2030 (approximately 20 times today's production output)

Now that we have defined the somewhat predictable variables, we need to look at the total market value of all companies in the automobile industry. The total market capitalization for all car companies worldwide (not including the leading electric car-producing company) is valued at approximately $965 billion as of December 31, 2020. The market cap of the well-known growing electric car company is trading in the range of $850 billion at the time of this writing and is expected by some investors to reach $1 trillion in the near future, despite the same future net profit margin projections as other car manufacturers competing in the electric vehicle marketplace.

Before we ask whether we should place a bet on this emerging electric car company, let's reframe the question: If we had $850 billion to invest and had to place this money in the auto industry, would we buy 100% of the electric car company that is projected to have a 10% market share of all vehicles produced in 10 years, or would we buy every other car manufacturer on earth (except for Toyota, which has a market cap of $250 billion and produces approximately 11 million of the 91 million cars produced annually worldwide), and have a near monopoly to compete against the growing electric vehicle manufacturer? At the growing electric car company's current $850 billion market capitalization, one could buy nearly every car company that exists on earth and produce nearly 80 million of the 91 million cars needed each year around the globe and adjust certain car model lines to compete against the well-known electric car company.

Evaluating the bet!

Based on these facts, what is the probability that the well-known electric car company will be able to grab the majority share of worldwide car manufacturing required for it to align with its current market capitalization in the global automobile industry? What is the probability that this car manufacturer will be able to produce profits on each sold vehicle that is significantly higher than the industry average? If the answer to these questions is “low probability,” then any bet on this electric vehicle manufacturer today would have a high chance of producing an ultimate loss. So: If we were to evaluate wagering a significant amount of money on (a) the consistent rising price of the popular electric car company stock, or (b) the long-term financial viability of this company within a highly competitive auto industry—which would we choose?

Unfortunately, many stock market participants choose (a) using a calculus similar to that used by Isaac Newton: Ongoing insatiable investor interest and a soaring stock price + high growth of electric vehicles with a rising market share held by a single company = high odds of future success. This leads them to make a “big bet,” confidently wagering a fortune at the company’s highest trading price based on the belief that ever-increasing previous returns means the odds are favorable for tremendous future returns. Ultimately, these investors’ desire to find certainty about a desired future outcome blinds them to the fact that results from initial bets on this company were likely based on luck, not investment genius. Once again, herein lies the problem: Placing high odds of success on conjecture, coupled with an uncertain future outcome. These investors believe that they are making a rational wager by placing significant money in this electric vehicle company today, even though the short- and long-term odds that this company’s business success will equal its stock market success are unfavorable. Seeing the “known” of (a) the consistent rising price of the stock blinds these investors from seeing the unknown (b)— the long-term financial viability of this company operating in a highly competitive auto industry.

(*A side note*: The previous scenario does not mean that earlier bets on this company were necessarily bad bets, as price relative to value should always be considered when investing—and earlier investors may have enjoyed tremendous returns on their allocation of money to this company. The point is that, in the future, a bet at today’s price may not be as advantageous. We do acknowledge that money has been—and will continue to be—made from speculative bets, but one should chalk these successes up to luck vs. genius. Good gamblers have the wisdom to know the difference.)

Thinking About Stocks and the Stock Market!

In past letters, we stated that successful investing involves teaching oneself “how to think.” We know that our readers are intelligent, so maybe this should be rephrased from “how to think” to “what to think about” when making investment bets (or decisions). For example, we can opt to look at the stock market as a realm that allows one to take an ownership slice of businesses that make up the S&P 500 or, alternatively, we can choose to view investing in the stock market as a casino in which we wager on the movement of the index with the hope of making a quick profit. While both options focus on the same desired result—achieving a profit—the outcome of each approach can be vastly different.

Another choice is whether to view an investment using an “inside” or an “outside” lens. Investors using an “inside” lens apply beliefs resulting from their upbringing, past experiences, and interpretation of current information that together define what they believe to be true. (We all recognize that any two individuals can experience the same thing and explain what they experienced in two different ways.) Eventually, we become hard-wired, developing a “gut feeling” that results largely from our lived experiences.

Alternatively, one may choose to approach investing using an “outside” lens. This is a bit more difficult, as it requires resisting our natural tendency to rely on gut feeling and instead seek facts and informed opinions from the outside (i.e., seeing circumstances through the eyes of others) to ensure that we are not allowing our personal biases to influence good judgment. The outside view provides critical control over investment decision-making, since such a large percentage of gut feeling turns out to be dead wrong.

Let's return to our story about the two young investors, which is an analogue of *Reminiscences of a Stock Operator,* an investment book by Edwin Lefèvre published in 1923. The two young investors were active traders in the stock market and happened to run into "Old Bull" at the coffee shop. After their lunch, the traders returned to the New York Stock Exchange trading floor and continued talking about Old Bull. Although they dismissed him as an outmoded investor, they couldn't help but notice that he was unlike the other traders. To start, he was an older gentleman, and he never offered advice or tips to others, nor bragged about his good bets. He paid close attention to the other traders and listened intently to their thoughts, sifting fact from opinion. He also did not seek stock tips, but if he received one, he would graciously thank the trader—but never seemed to act on the unsolicited advice. He rarely seemed to trade for his account—but was known to be extremely wealthy. His real name was Mr. Peacocke, but the other traders had nicknamed him "Old Bull" because of his habit of slowly strutting around the trading floor with his head slightly down, bifocals hanging at the edge of his nose, while focused on reading various company reports and also because of how he responded to other traders requesting his advice: Someone might approach old Peacocke and tell him of an inside tip they'd received on a high-quality stock that proceeded to tank after they had bought it, or went up after they had sold it. No matter whether the tip had been to buy or sell, Peacocke would lift his head slightly and, with a grandfatherly look, reliably say, "Well, you know, the future is a bull market"—as if this advice was a guaranteed money maker. Young traders dismissed his advice as foolhardy.

One day, the "Young Cubs" (what Old Bull called the young traders from the coffee shop) walked over to him as he was standing by a Designated Market Maker (a specialist responsible for maintaining fair and orderly markets for an assigned list of stocks) and asked him, "What do you think about ASX Rail? We made two points (7%) on this stock last week and see it went down a point today—should we buy?" Old Bull smiled at the Young Cubs and said, "Well, you know, the future is a bull market." The Young Cubs had grown a bit frustrated with Old Bull's predictable response and said, "You always give the same advice. Do you still hold your ASX Rail shares?" Old Bull said, "Of course—don't plan on selling any of my shares in ASX, even if they go up or down 10 points." The Young Cubs were now extremely frustrated and pushed Old Bull for an explanation. Old Bull looked at the Young Cubs and said, "If I sold, I'd lose my position. And when you are as old as I am and you've been through as many booms and panics in various stocks and the overall stock market as I have, you'll know that to lose your position in a great business is something nobody can afford—not even Warren Buffett. I paid a high price for the business and am not inclined to throw away tuition on a second education." Old Bull continued, "After spending many years on Wall Street and after making and losing millions of dollars, I want to tell you this: It never was my thinking that made the big money for me. It was always my sitting—sitting on my hands when I wanted to raise them. Got that, boys? *You have to sit tight on a great business to make your fortune!*" The Young Cubs looked at one another and concluded that it would be silly to adhere to Old Bull's rule—this was not the modern way to get rich.

Current Stock Market Influences

Given the uncertain circumstances of the pandemic, the current state of the stock market seems perplexing. Normally, when the economic gears encounter a grinding halt, the stock market falls, and it usually takes a one-two punch of stimulus from the Federal Reserve and U.S. government to get the economic gears going again. The economy begins its recovery as jobs are regained and consumers begin to spend—reinvigorating economic growth along with a rising stock market—until the next recession is encountered. This time things are different, with a recession brought about by an unanticipated pandemic and self-induced economic coma. To slow down the spreading virus, social distancing and quarantine protocols have been instituted to minimize interpersonal contact. The economic gears that were temporarily stalled in the spring started moving again during the summer months as businesses and consumers figured out how to proceed in a semi-closed economy. The stimulus normally provided by the Federal Reserve and U.S. government to invigorate the economic gears was largely replaced by government-funded programs to provide money to citizens and businesses to keep them afloat. Unfortunately, while vaccines have been developed and approved in record time, as of this writing, administration of the vaccine within the U.S. remains behind schedule, and highly contagious new variants of the virus are emerging. Protection of U.S. citizens from the coronavirus will happen with a high

degree of certainty in the near future—we are just uncertain as to the speed of vaccine administration across the country as well as any additional challenges we may face from the new variants. In the meantime, it looks as if we are going into hibernation during the winter months, and this will have ongoing economic consequences.

Despite the eventual recovery, various parts of the economy will be permanently changed as a result of the pandemic. For example, we will likely see fewer restaurants, banking locations, and retail stores. The pandemic has also caused tax revenue to fall precipitously, creating financial stress for state and local governments.

Question: What will be the effect on the economy (and stock market), given the economic wallop the pandemic has caused in job losses, business shutdowns, tax revenue losses, etc.?

Answer: Low interest rates for the foreseeable future. In 2020, the Fed reduced the federal funds rate—the base rate that influences other interest rates (mortgage rates, etc.)—to between zero and 0.25% (in other words: essentially near zero).

In the past, the Fed has instituted low interest rates to stimulate the economy by encouraging individuals and businesses to borrow more and spend. In addition, lowering interest rates can create greater demand that leads to higher asset prices. A person who purchases a $400,000 house and decides on a 30-year, $300,000 mortgage would pay approximately $1,520 at an interest rate of 4.5%, while the monthly payment would be $1,265 at an interest rate of 3%—a $255 monthly savings at the lower rate. Assuming that incomes remain steady, people in a low interest rate environment can afford more expensive houses—causing a rise in housing prices as they bid for desired properties (which is currently happening).

Low interest rates inflate the value of other assets, including stocks and bonds. Bonds at higher interest rates will rise in price as investors compete for a higher yield—as investors bid for desired higher yielding bonds. Once all bonds rise in value and current low interest rates become embedded in their higher prices, high dividend stocks could act as an alternative. If a company like Coca-Cola pays a 3% dividend and investors can't find quality bonds to purchase due to a low rate of return offered, they may opt to purchase Coca-Cola stock as a "higher-yielding" substitute. If enough investors think this way, the price of Coca-Cola stock will rise to meet investor demand for a higher yield.

In addition, near-zero interest rates increase the value of most stocks, given that the present value of all future cash flows are discounted at a lower rate. For example, we know that an invested dollar 15 years from now is not worth the same as a dollar today due to inflation and investors' desire to earn a certain return. So, if a company produces $100 that represents distributable earnings to shareholders in 15 years, the $100 in the future is worth around $24 today if we discount the money at 10% per year. If the discount rate is changed to 5% (due to lower interest rates being projected into the far future and investors willing to accept lower returns), then our $100 15 years from now would be worth $48 dollars today—a twofold value difference.

A final consideration: Most of the time, once stocks that have reliable earnings go up enough, and low interest rates are fully reflected in their stock prices, investors begin to speculate on "growth stocks" that may be unprofitable today but are believed to have the potential to become extremely profitable in the future. When investors believe that low interest rates coupled with low returns will remain for a long period of time, risk-taking becomes prevalent.

The following characteristics of the current market economy are spurring market disruption and excessive risk-taking:

- **A bifurcated market has emerged over the past five years:** The combined valuation of FAMANG (Facebook, Apple, Microsoft, Amazon, Netflix, and Google/Alphabet) represented 8% of the total value of all S&P 500 companies in 2013, and 25% of the value of all S&P 500 companies in 2020. In other words, the weight of the FAMANG companies in the S&P 500 has tripled in seven years, and the returns of investors who did not hold several of these companies in their portfolios would likely have lagged the market significantly.

Although the rationale for today's high valuations of these technology companies can be based to some degree on the pandemic increasing demand for their offerings, the question must be asked: What are the odds that these six companies will double their collective valuation within the S&P 500 over the next five years? (The FAMANG companies would then represent more than 50% of the total value of nearly all companies traded on the stock market.)

We believe the probability of this occurring to be low due to the "law of large numbers"—in probability theory, the law of large numbers states that as a sample size grows, its mean gets closer to the average of the whole population. From a financial perspective, the law of large numbers indicates that a large entity that is growing rapidly cannot maintain that growth rate forever.

- **Business disruption has become prevalent**: Due to the advent of new technologies, old-line technologies and non-technology companies have been negatively impacted as demand for their offerings remains stagnant or wanes.

  Compared to the past, investors are currently shying away from companies that are perceived to offer lower-than-average future returns as we seem to be facing a lower-return environment in the future—especially in companies in disrupted industries. This phenomenon has further contributed to the market bifurcation. The popularity of Netflix has impacted traditional media companies like ViacomCBS and Fox. Amazon and other e-tailers have acted as business weapons of mass disruption to normal brick-and-mortar retailers. Facebook and Google have siphoned advertising revenues from traditional newspaper businesses, threatening their survivability.

- **Speculation has once again become fashionable among investors, including professionals:** Initial Public Offerings (IPOs) were popular in 2020, with new companies such as Snowflake, Unity Software, Palantir Technologies, Airbnb, DoorDash, and others entering the public market.

  The appetite for emerging companies in the technology space (in particular, companies competing in the cloud segment) have attracted extreme investor interest, resulting in these types of companies achieving multibillion-dollar market capitalizations—despite the fact that most of them produce minimal revenues and near-zero profits.

To summarize: Much of the stock market today seems to be operating on the human default setting: Gut feeling. Investors are challenged to find securities that will generate outsize returns in the foreseeable future, and speculators are trading in and out of IPOs, including biotechnology and technology companies, that they perceive to offer guaranteed rising stock prices in a difficult overall market. The reality is that many of these companies compete in "high-risk investment realms" and may never see profitability to support their current valuations.

Circling back to our story that is an analogue of *Reminiscences of a Stock Operator*: Years later, the Young Cubs described their experience with Mr. Peacocke to new traders:

> *"We've learned from Old Bull, who provides investors a tremendous education. He would not be tempted to put himself in a situation of making short-term bets—on either swings in the market or "hard to resist" speculative stocks—because of experience that had taught him lessons that had proved expensive. Old Bull's consistent response to traders asking for his advice on whether to buy or sell specific stocks—"Well, you know, the future is a bull market!"—was meant to tell them that significant money was not made by speculating on individual fluctuations, but by betting on the main movements of great businesses that were certain to grow in value over time. This lesson is demonstrated time and time again: It is never acting on the short term that makes money—big money is always made by sitting. Sitting tight on certain valuable businesses raises the odds for achieving long-term returns!"*

There will always be individuals who happen to time the market right—early bulls during bull markets and early bears in bear markets. Some are lucky and speculate at exactly the right time and begin buying or selling individual stocks when prices were at the very level that should show the greatest profit. In the long run, however, the speculator's experience invariably matches that of other gamblers—they make no real money.

Investors who can be both correct about a valuable business and sit tight are uncommon—this is the hardest thing to learn when investing. But it is only after one firmly grasps this concept that real money can be made. An individual may see clearly yet become impatient or doubtful when a business (and its underlying stock) move too slowly to achieve the returns the investor forecasted. This is why so many gamblers make bad bets on Wall Street, regardless of their intelligence. The market does not beat speculators—they beat themselves, because even though they have brains, it is difficult to sit tight. Old Bull had not only the conviction of his assessments in buying great companies, but the intelligence to sit tight.

Our Thoughts About the Recent Stock Market

It is our opinion that the "semi-shutdown" of the economy over the past nine months will reduce the annual earnings for all S&P 500 companies by around 20%, to approximately $132 per share in 2020. Although our mid-March communication stated that the S&P 500 per-share earnings would likely be in the range of $150 for 2020, the ensuing economic shutdown due to the growing pandemic severely impacted the economy for the remaining nine months of the year. Assuming that the virus will impact the economy until mid 2021, it is highly probable that the annual S&P 500 earnings that would have been $175 per share at the end of 2020 if not for the pandemic will likely rebound in 2021 to approximately $170 per share—again, please take this as a pure guesstimate based on an anticipated strong recovery during the second half of 2021.

If this scenario comes to pass, investors have a choice: They can run to government and high-quality corporate bonds that will earn interest of near-zero percent, or they can invest in the stock market—let's say, the S&P 500. Which choice should an investor bet on? The S&P 500 traded at a closing price of 3,756 on December 31st, 2020. At this level, an investor is likely to receive stressed 2021 earnings of $170 on an investment of 3,756—equaling an initial return of 4.5% (170/3,756). Most investors offered the option either to buy a 4.5% growing return in a depressed environment or to earn near-zero percent on a government bond would take advantage of the first option. Investors currently remain skittish, however, and a large number continue to opt to sell en masse and place their money in safe government securities at any price—even when they will earn nearly nothing.

What can be predicted with certainty? We understand that the market could continue to gyrate over the next 12 months as it did over the previous year, but the rational prices currently offered on selected securities seem to be fair and, as Warren Buffett stated in his 1986 shareholder letter about contagious diseases:

> *"What we do know, however, is that occasional outbreaks of those two super-contagious diseases, fear and greed, will forever occur in the investment community. The timing of these epidemics will be unpredictable. And the market aberrations produced by them will be equally unpredictable, both as to duration and degree. Therefore, we never try to anticipate the arrival or departure of either disease. Our goal is more modest: we simply attempt to be fearful when others are greedy and to be greedy when others are fearful."*

Thus, it is important to understand that we will not attempt to "time the market" for either buying or selling securities based on anticipated moves. Given the likely outcome of the S&P 500 earnings recovery in 2021, as well as an opportunity for further earnings growth beyond 2021, it makes sense to continue making investments in companies that offer quality returns in the stock market, as opposed to placing additional money in fixed-income instruments that have low yields today and are connected to a higher long-term risk of loss when interest rates eventually rise.

A Year in the Life of Mr. Market

The great investment thinker, Benjamin Graham, once likened the stock market to a neighbor with dissociative identity disorder (previously known as multiple personality disorder) with whom you have gone into business. Every day, he's willing to either buy you out of the business or sell you his share. Most days, he wakes up level-headed after a good night of sleep, and his price is a full and fair quote—a reflection of the positives and negatives of the business, calculated rationally and objectively.

But he has his days. Sometimes the quote is not from a cool-headed, rational analyst but a wildly fluctuating person who's either fantastically optimistic about the good things ahead or bleakly pessimistic about how bad things are about to get. Provided you could keep a level head, Graham said, it was during the crazier times that you should want to undertake transactions with him as a buyer or a seller.

Among the remarkable events in the financial markets this year has been the re-emergence of an incredible brand of volatility that Mr. Graham would have understood well. In some instances, the swings in emotion were very extreme, with the same business—without much change in its prospects—being valued at both x and 10x within a six-month period! We could hardly believe our eyes.

Our own portfolio tells the tale of these swings in emotion during 2020. The following table shows the high and low closing prices for the year for each of the top 10 positions in the Founders portfolio (rounded to the nearest dollar):

Company	52-Week High	52-Week Low	Low as % of High
Alphabet	$1847	$1008	55%
Berkshire Hathaway	$235	$160	68%
Microsoft	$232	$132	57%
FedEx	$305	$89	29%
CSX Corp	$95	$47	50%
Walt Disney	$183	$79	43%
PepsiCo	$148	$101	68%
CarMax	$109	$38	35%
Intel	$69	$44	64%
Wells Fargo	$55	$21	38%

These numbers make us seriously question the Efficient Market Theory, which states that all information about securities is rapidly, efficiently, and correctly applied by market participants during the daily buying and selling process.

The more correct interpretation seems to be that, in times of great uncertainty, Mr. Market reverts to a sometimes catatonic state of withdrawal, pricing certain companies as if current uncertainties, however extreme they may seem at the moment, are *permanent*.

How else can one explain the price dynamics of even the most staid and boring companies—like the CSX railroad, a descendant of a rail line first built in 1830! (The B&O Railroad, for you Monopoly buffs.) Can it really be true that CSX was intrinsically worth $36 billion one day and $72 billion months later—regardless of how quickly the COVID pandemic might resolve? Did we learn that much in the intervening months about the progression of the pandemic and how it would ultimately impact the economy? Could it possibly be rational for FedEx, transporter of hundreds of millions of packages annually, to sell for $25 billion in March and $75 billion in December—was the movement of goods simply going to come to a stop in March?

It is true that the uncertainties of the pandemic have been extreme. But CSX and FedEx, as with the other companies in the Founders portfolio, have been through many panics and many crashes, many bull markets and many bubbles—and today they are as strong as, or stronger than, they were in years past. Their businesses are fundamental building blocks of American—and global—commerce, without which the wheels do not turn.

So, instead of panicking along with Mr. Market, we took up disagreement with him in the manner prescribed by Ben Graham—we stood pat on our holdings while adding others that we believe have the strength to thrive.

Mr. Market's great swings of emotion have not ceased even as markets have calmed. One growing cloud services company was recently priced at around 100 times its annual revenue—investors are laying out $100 billion today for the prospect of earning perhaps $1 billion of total sales (the company is not profitable) this year. This is an extreme form of market speculation, whereby this company must not only grow fantastically fast but earn very high profit margins for many years to give investors a return at today's price. Even an annual after-taxes profit of $1 billion would provide a mere 1% return. A 5% return will require more than $5 billion after expenses and taxes—which may not occur for many years.

Another prominent company that premiered in the public markets in 2020 reached a temporary valuation of greater than $35 billion with effectively *no* revenue and *no* profits. (Not to mention: No real products!) This occurred in the same year that the mighty Federal Express was valued at both $25 billion and $75 billion, depending on the day.

These examples, and many more, go to show that as of 2021, markets remain markets: Prone to hope, fear, despair, and excitement, all within a few months. We approach these waters as always—with a mixture of appropriate caution and rational opportunism.

An Important Lesson Re-Learned

Another important fact emerged from this year: Some businesses were marked down because they are permanently impaired by the events of the year. It will be some time before cruise lines, commercial real estate operations, airlines, many retailers and restaurant chains and, perhaps, a great many companies in the energy industry return to their former levels of profitability and strength. In some cases, it may never happen. The changes brought on by the COVID pandemic may permanently affect them—and, even if not, the economic contraction may have harmed their financial position so considerably that shareholders will suffer either way.

Each of these industries, besides being beset by high capital intensity, high competition, and susceptibility to economic contraction, are often accompanied by high levels of debt in their capital structure, which means that tough times can feel really tough—their lenders don't (generally) waive their interest payments just because times are tough.

Many of them were lucky to come out alive but are teetering on the edge of solvency—having borrowed money to get through the crisis while enduring very harmful losses. Norwegian Cruise Lines, to take one unfortunate example, had to put up its ships as collateral for a $4 billion loan due to an almost complete disappearance of its customers—with very little visibility as to when those customers might be inclined to return (or even be allowed to do so). The company's stock price remains more than 50% off its highs—even amid the recent surge in stock prices of other COVID-sensitive businesses, with the prospect of FDA-approved vaccines looking imminent. Delta Airlines, even after receiving $5.4 billion in government funding, was forced to put its frequent flyer program in hock to the tune of $9 billion to raise more funds to cover its losses. Neither of these are poorly run enterprises, but both proved to be extremely vulnerable.

Our approach to this problem at Founders is the same as it has been since the beginning: We focus our energy on strong, durable, needed, and well-capitalized companies that can not only survive, but thrive in dangerous times. While Mr. Market's wild swings of emotion are reflected in the shares of our portfolio companies as shown in the preceding table, we believe that not one of these companies will emerge from the crisis fundamentally weaker than where it began—and, in many cases, will emerge much stronger.

To survive a crisis, one must be extra sure that one's assets are safe and enduring.

Investment Factors, Incentives, and Perspective

> **"It is hard to predict something when we don't (or can't) foresee or understand how an entire system works, what key variables are involved, their attributes, how they influence one another and their impact. Even if we know the key variables, their values may be impossible to estimate. They may also change over time and be dependent on context. It may also be impossible to estimate how they will interact over time."**
>
> ***—Mark Twain***

The market is a complex system with many influential factors. Interest rates, unemployment rates, consumer spending, politics, business cycles, credit, catastrophic events, and human emotion are just a few factors in the multilayered network that impacts the stock market. The interconnectedness of these factors adds another layer of complexity, and it can be hard to discern which factors are most important at a given time. Market participants often turn to "experts" to identify the important issues moving the market. Financial advisors, Wall Street professionals, and economic experts deploy special formulas that attempt to make a scientific study out of the market's movement. Instead of looking at the quality of a business, they become oddsmakers attempting to predict the winner in the last leg of the Triple Crown at the Belmont Stakes. They may employ an algorithm with weighted averages of figures that are applied to the historical performances of companies. Alpha, beta, delta, theta, momentum, trade volume, media volume, mentions per minute, AI news importance, analyst ratings…and a slew of other jargon represent inputs into formulas that are processed by a computer to predict estimates of future stock performance.

Relying too heavily on financial models and focusing on a number that "pops out" at the end of a string of variables can create a sense of false security about investment decisions—the numbers are used to confirm assumptions in lieu of considering the business from a strategic standpoint.

Charles Munger said, *"To convert a model into a quantitative formula is to destroy its usefulness as an instrument of thought."*

The rise and fall of Under Armour illustrates these superfluous investment factors at work. Under Armour went public in November 2005 and differentiated itself in the athletic apparel market by supplying high-tech material promising to whisk away sweat, ensuring that the athlete would stay warmer in cold environments. The company took retail shelves by storm through catchy ad campaigns that emphasized a premium product based on unprecedented technology (proprietary fabric) that sports apparel giants (Nike, Adidas, etc.) could not rival.

Over the next decade, Under Armour continued to grow its brand, expanding product offerings and signing contracts with major universities and famous athletes. The company's revenue base was rising at a consistent 25% per year. Under Armour's market cap at the time would lead one to believe that it was surging to take over as the dominant athletic apparel company. In 2013, the company's market value surpassed $18 billion, overtaking Adidas to become the world's second-largest athletic apparel company, after Nike. At this point, Under Armour's stock was trading at a grossly inflated price because Wall Street analysts were using its 25% growth rate of the past in their algorithms and model-based inputs to determine their buy-sell recommendations for investors. This growth rate was projected far out into the future, without regard for industry trends, competition matching Under Armour's products, and the company eventually meeting its terminal velocity.

In physics, the term "terminal velocity" refers to the speed an object inevitably reaches when the resistance of the medium the object travels through prevents further acceleration. Objects of smaller mass more easily increase or decrease acceleration given a constant amount of force. We can observe stocks acting similarly in the marketplace. The smaller the company, the more quickly forces such as positive analytics—and published

articles touting those analytics—can inflate the company's price. Just as quickly, however, those factors can cause companies to lose all the acceleration they once had. Under Armour and its investors fell victim to this principle, overlooking the company's terminal velocity and neglecting to ask, "When will the growth and hype underlying Under Armour's popularity and ever-rising stock price slow down, and what will be the cause of it?"

Never underestimate the competition. Under Armour continued to barrel forward like a horse with blinders as the company pushed to meet revenue growth expectations. In the process, it sacrificed its profit margins, and the competition quickly produced apparel using similar and superior materials. As these fabrics and materials were becoming more prevalent, there was simultaneously a major shift upward in the popularity of athletic apparel. Unfortunately, Under Armour was ill-prepared to adapt to its dynamic market environment. Nike, Adidas, and other major competitors saw the shift happening in the industry toward "athleisure"—fashionable and functional sporting clothing—a trend that gave rise to brands such as Lululemon and Athleta. As Under Armour's market value slipped from its $18 billion high, the final dagger came in 2016, when Under Armour signed a major deal to sell its apparel through a discount chain (Kohl's), signaling to the market that the company was no longer competitive in the premium marketplace. Within the year that Under Armor had signed this deal, the company's market value plummeted from $12.7 billion to $7 billion, where it remains today. Under Armour and its investors should have heeded the words of Tennis Champion Rod Laver—*"The time your game is most vulnerable is when you're ahead."*

Why do some investors gravitate toward highly speculative narratives? Countless articles, insights, and analyst recommendations are pushed upon potential investors promising quick returns but result in uncertain long-term volatility and loss.

It is interesting to think about the term "investing." When it comes to tangible things such as our personal education, property, and other large assets, we see the long-term potential returns of these "investments." When it comes to the stock market, on the other hand, many regard "short-term gambles" as "wise investments." To understand this conceptual "investment" phenomenon, we should ask what incentivizes the market to encourage this behavior.

How long is the average stock held? Fifty years ago, it was eight years; today, when evaluating the annual market turnover of the NYSE, the average stock is held for approximately one year. In many cases, however, the amount of time the average stock is held can be measured in seconds due to electronic trading. Electronic trading at instantaneous speeds is responsible for more than half of all market transactions today. Computer programs send and cancel thousands of orders to deceive and race each other to collect fractions of a cent on spreads between buy-sell orders for stocks. High-frequency trading also uses tactics such as flooding the market with false trade orders and executing confusing competing algorithms to liquidate large stock positions without evoking a large price swing. Our world has become a place in which buying and selling a company's stock often comes down to how fast you can purchase or offload it while making fractions of a penny per transaction. Wall Street couldn't care less about the underlying value of any specific security.

These microtransactions add up for the prominent Wall Street trading desks acting as middlemen, carrying out millions of such transactions on behalf of investors. One group that will always make ends meet in times of high volume: Wall Street traders, who laugh their way to the bank. Naturally, these traders try to create as much volume as possible. They tout research produced by Wall Street analysts, citing stocks that are determined to be "overweight, underweight, buy, hold, sell." These research recommendations are exciting and appealing to investors that are trying to find the next big winner (or loser). While this information does have useful points, it is important to take them with a grain of salt. It is critical to form your own opinion, as it is far too easy to find narratives that reinforce your inherent biases. Conversely, it is just as easy to find recommendations that negatively depict the same stock for equally legitimate reasons. This practice incentivizes trading, as constant buying and selling increases volume, which is always profitable for the trader. Keep in mind how these practices amplify swings in the market, especially with regard to our most recent experience, COVID-19.

The S&P 500 began this year at 3,231 and ended at 3,756, up 16.25%. In the absence of context, it would appear to have been a normal year for the market. Well, we all know there was nothing normal about 2020. The market system is highly sensitive to a feedback loop: Positive feedback amplifies market dynamics, while negative feedback dampens it. Initial stock sales amid an unprecedented event such as COVID-19 created a ripple effect of hysteria that resulted in a spiraling market selloff. With 20/20 hindsight, many investors can chuckle at their gut inclination to sell their portfolios due to uncertainty about the potential economic impact of the pandemic. Unfortunately, investors who acted on that impulse do not have the luxury of laughing—investors that capitulated to the falling market story and sold out compiled a permanent loss in their portfolios that equaled or exceeded an initial 34% downturn of the overall market. Many investors still, after selling out of the market, were unable to gain their capital back at the very low points, missing an opportunity to ride the 67% rebound once the dust had settled. If they had just sat back and taken no action, trusting the long-term value of what they held despite the commotion of Wall Street, they would be closing the book on the year with a healthy gain. Alternatively, investors that looked at the discount in the market during the stressful times and allocated additional capital near a low could have significantly amplified their returns.

In the words of John Maynard Keynes: *"Worldly wisdom teaches us that it is better for reputation to fail conventionally than to succeed unconventionally."*

* * *

At Founders, our market behavior remains simple: We hold on tightly to our value investing philosophy, and we seek to invest where intrinsic value strengthens over the long term, in areas in which can ascertain the results of a fair return with a degree of certainty. We always act with honesty and integrity—there is no other way. Although we are unable to provide an exact answer to questions about any market's near-term direction, we remain agnostic to the market's short-term movements, avoiding the influence of emotional reactions to fluctuations. Instead, we will keep our eyes open for opportunities that emerge in an uncertain environment—and thus, we will continue to exercise patience. Given the more speculative market behavior taking place in recent times, however, we are strongly adhering to one of our favorite quotes:

> **"The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs."**
>
> ***–Warren Buffett***

We will continue to invest with our eyes wide open and with the confidence that we have acquired a collection of securities at prices that will provide a fair return over time (despite gyrating markets and higher-than-normal speculation). This includes our investments in selected fixed-income instruments that offer a commensurate risk/reward relationship, as well as acquiring interests in strong individual companies through the equity market that are very profitable and have a wide competitive moat. Our investment activity in all market conditions reminds us of another Warren Buffett quote:

> **"We will continue to price, rather than time, our purchases. In our view, it is folly to forgo buying shares in an outstanding business whose long-term future is predictable, because of short-term worries about an economy or a stock market that we know to be unpredictable. Why scrap an informed decision because of an uninformed guess?"**
>
> ***–Warren Buffett***

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MANAGEMENT'S DISCUSSION & BUSINESS UNIT REVIEW

Equity Holdings: 2020 Highlights

The intrinsic value of our aggregate equity holdings held steady during 2020, despite the pandemic. We remain positive about our capital allocations, including expected returns over the next 10 years—despite any short-term economic and political challenges that surfaced this past year and will likely continue into 2021.

Given uncertain market circumstances, we'd like to reiterate the following points about our core holdings:

- **We are confident in the high character displayed by the leadership of the companies in our portfolio** and believe that the companies are managed in a flexible manner that allows them to adapt in changing times.
- **We believe that we are business partners in actual companies that are focused on increasing long-term profitability,** as opposed to being members of a group of shareholders that are interested only in a rising stock price that is divorced from a commensurate movement in business value.
- **We believe that we own a collection of businesses that fall into the "valuable" and "invaluable" categories and that their increasing intrinsic business value will be realized over time.**
- **Our invested companies possess business models that are durable, support a long-term competitive advantage in their respective industries, and have earnings capabilities that are predictable and sustainable over the foreseeable future.**

As long-term investors, we wake up each morning knowing that the wonderful businesses we own—Coca-Cola, PepsiCo, CSX, Federal Express, Microsoft, Google, Intel, Berkshire Hathaway, American Express, Wells Fargo, CarMax, Home Depot, Disney, and our other holdings—continue to strengthen their long-term enterprises independent of any short-term gyrations in their stock prices.

Following is a summary of business highlights from our portfolio companies during 2020, along with our expectations for 2021.

CONSUMER GROUP

Our primary consumer holdings—Coca-Cola and PepsiCo—had a difficult challenge growing their global franchises during 2020 due to the economic impact of the pandemic. On a combined basis, these entities reported a decline in global sales of approximately 1.7% compared to 2019—however, both companies continued to develop their respective franchises during the recent economic crisis. Aggregate reported operating profits for these combined entities decreased approximately 6.5% in 2020 as consumers complied with stay-at-home orders due to the pandemic—attendance at sporting events and restaurants was either minimized or prohibited, while most movie theatres and tourist attractions were closed—all of which impacted beverage purchases. Although consumer-related businesses will continue to face challenging economic and competitive conditions in the upcoming year, we are pleased with the resilient performance of our consumer group businesses in 2020 and expect to see positive results during 2021 as the economy recovers once society fully reopens. The future of Coca-Cola and PepsiCo remains bright as these entities continue to cultivate their presence in both developed and emerging global markets.

Why are we optimistic about the long-term prospects of our global consumer franchises—specifically, Coca-Cola and PepsiCo?

1. An estimated 65 billion servings of non-water beverages will be served each and every day around the globe in 2021. Coca-Cola and PepsiCo supply approximately 2.85 billion (4.38%) of these beverage servings, and their volume grows at ~2% to 3% per year over time. Although the total consumption of Coca-Cola and Pepsi beverage products equates to around 130 annual servings per person on earth, there

remains a lot more market share to grab. It is our opinion that these big companies can become much larger in the future as large, emerging markets like China and India continue to develop.

2. Coca-Cola and PepsiCo are not "just carbonated beverage companies." Between the two companies, hundreds of well-known beverage brands are served in more than 200 countries—including water; ready-to-drink tea; and coffee, fruit, vegetable, and sports drinks. If the world desires a new type of drink (such as health-conscious beverages), it is likely that one or both of these companies will offer it—in many varieties. In addition, PepsiCo is the largest snack-food company in the world, with a global product offering that exceeds its beverage counterpart.
3. Both Coca-Cola and PepsiCo possess vast, impenetrable supplier and distribution networks. For example, Coca-Cola's $50+ billion supply-chain network, established between the company and its principally segregated bottling system, is one of the largest and most complex of any organization on earth. Coke and its 225 bottling partners use more than 500,000 vehicles to distribute more than 500 beverage brands and 3,500 beverages through 28 million retail outlets every day (PepsiCo's beverage and snack delivery system shares a similar complexity). These juggernauts' supplier and distribution components may be their most important hidden competitive advantage. When Coca-Cola or PepsiCo introduce a new product or acquire a complementary brand, they can immediately put this merchandise through their tremendous distribution networks and make them available throughout the world.

Coca-Cola and PepsiCo occupy our "extremely valuable" business category—enterprises that can grow far into the future and stand the test of time. Their consistent brand development, product diversity, global distribution strength, and unique cultural depth provide investors the ability to forecast the future with a relatively high degree of probability. It is highly likely that each business will substantially penetrate developing markets over the next 10 to 30 years, and the accumulated potential growth of these businesses cannot be fully identified using traditional valuation models—in other words, each of these businesses possesses superior intrinsic value, underscored by their long-term value-creation potential.

NOTE: In the following summaries, "pass-through earnings/yield and "owner earnings/yield" should be evaluated by the investor. "Pass-through earnings/yield" is determined via actual cash distributed to shareholders, whereas "owner earnings/yield" is cash earnings available for distribution to shareholders. Companies may choose to "pass through" extra money to shareholders beyond their cash earnings by issuing additional debt and/or by selling off assets—or they may decide not to pass through all earnings available to owners, opting instead to maintain a portion of these funds for future investment or to pay down debt.

Coca-Cola

In 2020, The Coca-Cola Company remained a large holding in our portfolio, and one that we have held since Founders Capital Management was formed. Although Founders is a relatively small holder of Coke's overall stock, we are among the top 575 reported shareholders of this great company.

During 2020, The Coca-Cola Company's overall case volume declined approximately 7%. Over the past seven years, case volume increases have remained lower than the annual 4%–5% annual growth achieved prior to 2013. Much of this is due to a negative trend of consumers moving away from sugary, carbonated drinks as well as the COVID-19 pandemic during most of 2020. These issues present a short-term challenge for Coca-Cola, considering its market dominance in the soda category. Nevertheless, we believe the future is still very bright for this company as a "total beverage business" that has a small market share of global beverage consumption. In 2020, Coca-Cola's net operating revenue declined around 11.4% to approximately $33 billion, while net income declined approximately 10.9% year-over-year in 2020, to $8.17 billion.

For the past seven years, Coke had been experiencing revenue declines in reported sales, and although this downward trend turned a corner with sales growth in 2019, the revenue decline in 2020 due to the unexpected pandemic presented a setback to Coke's return-to-growth trend. We expect that sales growth to rebound in 2021 and that Coke will return to consistent growth in future years compared to its past declines.

Some important background: Approximately 10 years ago, Coca-Cola began working with its bottling partners to develop a business model that served the changing consumer landscape. As consumers' beverage preferences moved from carbonated drinks to noncarbonated drinks, Coke faced requests from bottling and distribution partners to invest vast sums in their businesses to bottle both types of beverages. (Since the water temperature requirement for producing each beverage is different, additional machinery was needed for developing noncarbonated drinks.)

In 2010, it made sense for The Coca-Cola Company to better control the production and distribution of both types of beverage products to manage the consumer taste evolution. As such, Coca-Cola decided to acquire the North American territories of Coca-Cola Enterprises (the North American bottler and distributor for Coca-Cola products) and make the necessary capital investment to deliver the beverage choices consumers were demanding. By consolidating bottling and distribution for all Coca-Cola products in North America, Coke gained control over its production and delivery systems—essentially, the flexibility required to respond to a changing beverage marketplace. The downside to consolidating bottling and distribution was the temporary increased capital intensity of Coca-Cola's beverage business, which impacted cash returns, even though Coke applied vast sums of debt to support this acquisition. The result: Revenues increased exponentially with this initial transaction, but profits stayed relatively the same.

Fast forward to today: Coke's bottling system, customer service, and product supply chain share a common technology platform, and the required changes to the bottling and distribution business to respond to consumers' diverse and changing tastes have been completed. Coca-Cola restructured its business model and sold back the controlled North American bottling and distribution system to bottling partners through refranchising arrangements. This "reverse move" lowered revenues through deconsolidation but increased the company's financial flexibility by reducing capital intensity. As of the end 2020, Coke has fully completed the refranchising of its territories, and in upcoming years, Coca-Cola will resume its revenue growth.

The repositioning of Coca-Cola allowed the company to evolve from a primarily carbonated-beverage company to a "total beverage company" that serves all consumer tastes. Few people realize that The Coca-Cola Company controls almost half of all non-alcoholic brands worldwide, which generate more than $1 billion in annual revenue. In addition, the company sells more than 1,000 varieties of juice drinks, including Simply™, Minute Maid®, Fruitopia®, Hi-C®, Fuze®, and Odwalla®. Coca-Cola also still sells beverage brands such as Glacéau Vitaminwater®, Dasani® water, Honest Tea®, and Powerade®.

The 2020 pandemic may have placed a damper on Coke's immediate growth, but we believe that Coca-Cola is on track to take advantage of the more than 1.5 billion people around the world that are projected to join the middle class by 2030, and that the initiatives Coke is executing will renew the company's volume and revenue growth in the future while further increasing its intrinsic business value.

The Coca-Cola Company will produce approximately $6.5 billion of adjusted cash for shareholders in 2020, despite extreme business stress brought about by the pandemic. We anticipate that Coke will generate approximately $8.3 billion of adjusted cash for shareholders in 2021, assuming that consumers return to normal routines when the pandemic subsides and social life resumes. Coke currently pays an annual dividend of $1.64 per share, which represents an approximately 3% yield, and we believe that the company will increase its dividend approximately 2.5% in 2021—to around $1.68 per share. Coca-Cola will likely recommence its share repurchase program in 2021 as the company allocates excess capital to shareholders. The forward dividend and share repurchase program currently provides shareholders an approximate 3.5% pass-through yield and owner-earnings yield of approximately 3.9% at Coke's year-end price, compared to a .93% yield on a 10-year U.S. Treasury bond. For the 2021 year, we expect Coke to earn around $2.10 per share.

PepsiCo

We have stated in the past that, while PepsiCo may be Coca-Cola's greatest competitor in the beverage space, this company does not have the same business attributes as Coke. Like Coke, PepsiCo owns a stable of diverse brands, but PepsiCo uses a different distribution system and has a different global footprint (PepsiCo has a

lower international presence compared to Coke, with slightly more than 60% of its sales produced in the U.S.). Let's further clarify the differences between these two businesses:

1. PepsiCo's product line is not a mirror image of Coke's—PepsiCo is much more than a pure beverage company, with a dominant share of the snack-food industry. Its mainstay global food and snack business, which represents approximately 55% of revenues, generates more than 60% of the company's operating profits. PepsiCo's snack-food business has an estimated *tenfold* relative global market share advantage compared to its closest competitor, with prospects for long-term future global growth.
2. Due to its more diverse product line, PepsiCo requires a different retail distribution system and supplier network than Coke. For example, PepsiCo uses direct store delivery (DSD) to deliver beverage and snack products to retail stores, where products are merchandised by both employees and bottlers that "dual-display" snacks and beverages for maximum visibility and appeal. For products that are less fragile and perishable and have lower turnover, PepsiCo delivers directly from manufacturing facilities and warehouses to customer warehouses and retail outlets. In addition, PepsiCo leverages synergies when food service and vending sales forces can work jointly to deliver food, snacks, and beverages to third-party food service and vending distributors. As for its supplier network, PepsiCo contracts with farmers in emerging markets such as India and China, providing them seeds, access to a ready market for agricultural products such as potatoes and corn, advanced agricultural technologies, farm credit (loans), and crop insurance. The contract farming agreements between farmers and PepsiCo for the production and supply of agricultural products (at a pre-agreed price and specified quantity) creates a supplier network that is loyal, growing, and difficult to duplicate. These are valuable assets that are not obvious from looking at PepsiCo's financial statements.

We point out these differences to deter any notion that there is a large overlap between our investments in Coca-Cola and PepsiCo. In fact, we expect these differences to widen, and we look for PepsiCo to build on its snack-food stronghold.

2020 was a year of ups and downs regarding consumer demand. While the pandemic significantly impacted overall consumption, it also resulted in an increased in-home consumption rate. Despite overall consumption trends being down, PepsiCo's revenue grew 3.7% in 2020 and is estimated to return to revenue growth of between 4% and 4.5% in 2021 as the economic environment stabilizes (this increase excludes the impacts of foreign exchange translation and acquisitions as well as structural and other changes). PepsiCo's year-over-year net income decreased slightly—approximately 1.5%—due to cost increases resulting from the pandemic. In addition, PepsiCo's net income was diminished by the company's acquisition of South Africa-based Pioneer foods to add to its international offerings. PepsiCo continued to increase its return to shareholders, however, raising the annual dividend 7% in 2020, from $3.82 per share to $4.09 per share. We expect PepsiCo to raise its dividend in 2021 to approximately $4.25 per share, which implies an approximate forward dividend yield of 2.9% at the year-end stock price. In addition, we anticipate that the company will repurchase $2.4 billion of stock during the next 12 months. This action adds another 1.2% return to shareholders, reflecting a 4% forward pass-through yield. In 2021, we expect PepsiCo to earn around $6.05 per share, representing an approximate 10% increase from 2020 earnings.

In summary, PepsiCo proves resilient to downturns and systematic deterrents in the market. We like the long-term potential and economics of the beverage and snacks business and think it holds a multi-decade growth opportunity for dominant companies in this industry. PepsiCo has a large and growing position in these business segments and will remain a long-term holding in our portfolio.

INDUSTRIAL AND TRANSPORTATION GROUP

Our primary industrial and transportation holdings—CSX Railroad and Federal Express—are unique businesses that we believe will grow as economies develop around the globe. These businesses are capital-intensive and sensitive to economic cycles, however, which subjects them to setbacks when tougher economic conditions emerge from time to time. Although economic growth stalled in 2020 due to the pandemic, we

remain sanguine about future global economic growth and believe that these businesses will gain further traction in upcoming years. A future improvement in the European and Asian economies, followed by political support for U.S. infrastructure investment, should allow these businesses to make further advances over the next decade.

Our industrial and transportation group is composed mostly of highly networked, infrastructure-related businesses focused on transportation efficiency and product innovation. Each of our infrastructure businesses offers high-end products and/or services that are extremely expensive to produce and/or duplicate—attributes that normally would be detrimental to a business' profitability. These special businesses possess "networking effects" that allow profitability to grow faster than revenue, however, due to expanded customer usage occurring over fixed-cost investments. This tends to result in oligopolies, with two or three competitors dominating the industry. As globalization continues, the consolidation of businesses involved in transporting purchased goods is a natural development, with fewer companies positioned to provide the breadth of products and services customers demand. Thus, the trend is for these industrial and transportation companies to become ever more entrenched, expanding their competitive advantages—and profitability.

Our transportation investments in CSX and FedEx have comparable advantages. For example, it has taken nearly two centuries to build the U.S. railroad infrastructure, and it would take an extraordinary amount of time and capital to create a business transportation system that competes with railroads such as CSX, Union Pacific, and Burlington Northern (which is owned by Berkshire Hathaway—another Founders holding). This holds true in the air freight and overnight package business as well—FedEx and UPS have spent decades building out their air and ground infrastructures, and it would take enormous time and capital to create a transportation system to compete with these entities. Although industrial and transportation businesses are capital-intensive, certain attributes make this type of investment attractive in any economic environment. In today's rapidly changing distribution and logistics environment, companies seek to run more efficiently to minimize costs. Moving greater amounts of goods over a fixed-rail and fixed-air and ground infrastructure instead of via higher-cost alternatives enables companies to lower costs and achieve large gains in productivity. For example, rail transportation is approximately three to five times more fuel-efficient than truck transportation, and it is likely that railroads will play a larger role in the efficient transportation of goods throughout the U.S. in the future.

CSX Railroad

CSX is one of the nation's oldest railroads, with roots in the nation's first common carrier—the Baltimore & Ohio (B&O) Railroad, which was chartered in 1827. As one of two major north/south railroads, CSX provides an important link to the transportation supply chain through its approximately 21,000 route miles of track that serves major population centers in 23 states east of the Mississippi River, the District of Columbia, and the Canadian provinces of Ontario and Quebec. The company is large, with more than 4,000 locomotives and more than 78,000 freight and container cars that provide access to more than 70 ocean, river, and lake port terminals along the Atlantic and Gulf coasts, the Mississippi River, the Great Lakes, and the St. Lawrence Seaway. CSX also has an intermodal business that links customers to railroads via trucks and terminals.

CSX expanded its network in 2020, announcing on November 30 the signing of a definitive agreement to acquire New England's Pan Am Railways, whose rail carrier subsidiaries comprise North America's largest regional railroad. Pan Am Railways operates a highly integrated, nearly 1,200-mile network and has a partial interest in the more than 600-mile Pan Am Southern system. Pan Am's network across New England provides CSX further access to multiple ports and large-scale commodity producers. This acquisition also expands CSX's reach in Connecticut, New York, and Massachusetts while adding Vermont, New Hampshire, and Maine to its existing 23-state network. With this addition, CSX gains a strong regional network in one of the most densely populated markets in the U.S., creating new efficiencies and market opportunities for customers as the company continues to grow. We are excited about this acquisition and look forward to the positive results of Pan Am's and CSX's integrated network.

In 2020, CSX generated approximately $10.5 billion in revenue—11.9% less than in 2019. As a result of the pandemic that led to an economic slowdown and revenue shortfall, CSX's net profit for the year decreased by $445 million, to $2.75 billion. Despite the setback in 2020, the company continues to execute its new operating model—precision-scheduled railroading—that is focused on developing and strictly maintaining a scheduled service plan that emphasizes optimizing railway assets. CSX has executed this operating model successfully over the past few years, improving its customer service, lowering costs, and increasing free cash flow. We expect further efficiencies to emerge at CSX as the pandemic passes and the economy recovers. Given CSX's profit growth the previous few years, we believe this positive trend will continue and remain very optimistic about our ownership position in this one-of-a-kind railroad. A few highlights from CSX in 2020:

- CSX's unit volume decreased approximately 7% in 2020, and revenue decreased approximately 12.8% due to pricing pressure on transported goods carried. Additional railroad cost efficiencies subsided in 2020, leading CSX's net profits to fall by around 13.8%. In 2020, metals and equipment volume fell 10%, and fertilizer volume decreased by 4%. Coal and automotive volume decreased by 29%–30% this past year—significantly impacting revenue. Looking into the near future, we expect that a rebound in manufacturing during 2021 will lead to increased demand for metals and equipment, coal, and automotive.
- As economic growth slowed worldwide during the 2020 pandemic, CSX's intermodal business experienced a slight volume decline of 1%, and revenue declined 6% due to pricing pressure in this category. Intermodal represents a large part of CSX's business, accounting for approximately 45.7% of volume and 15.8% of revenue in 2020. Intermodal will continue to be a key part of CSX's business activity, and we expect CSX's intermodal business to grow in 2021 as trade resumes and the global economy recovers.

During 2020, CSX distributed approximately $1.7 billion of cash to shareholders in the form of dividends (around $800 million) and share repurchases (another $900 million). In 2021, we anticipate that CSX per-share earnings will grow by 20% as the U.S. economy recovers and the railroad continues to execute on precision-scheduled railroading. We expect CSX to distribute an additional $3.0 billion to shareholders through a combined dividend and stock repurchase program. This provides shareholders an approximate 4.3% forward pass-through yield at CSX's year-end price, and we believe that this yield will continue to grow over time as freight traffic increases over CSX's fixed-rail network.

In summary, we think our investment in CSX is an opportunity to participate in the growth of the U.S. and global economies, which may accelerate in the next five years due to anticipated infrastructure investment. We believe that the growth in CSX's freight volume will endure over the upcoming decade and may increase more than many analysts expect. Furthermore, we expect CSX to continue to execute on precision-scheduled railroading to lower the company's expenses, increase revenues, and improve its operating ratio. (The operating ratio is an important measurement in the railroad industry, representing the percentage of revenue used to operate the railroad—the lower, the better.) The projected long-term growth in freight volume and strong pricing, coupled with lower expenses, will continue to leverage CSX's income and cash available for shareholders. We remain excited long-term owners of CSX, which occupies an important position in our portfolio.

FedEx Corp.

During the latter part of 2018 and through 2019, we accumulated a position in FedEx Corp. We happened to begin buying FedEx just prior to the trade impasse with China, and this proved to be a mistimed placement of capital—FedEx's stock price went precipitously south after our initial purchase due to trade skirmishes between the U.S. and China. Of course, after this initial decline, a significant offset occurred when the pandemic hit in 2020, forcing people to stay home, shop online, and have their goods delivered. This boon in business during challenging times catapulted FedEx's revenues and profits, along with its stock price.

We remain extremely positive about our long-term investment in FedEx and believe that the shipment and delivery of goods throughout the world will continue to grow. Greater customer use of this company's fixed network will improve profitability and returns on capital in the future, adding value to FedEx and shareholders.

Some background on this company: FedEx provides a broad portfolio of transportation, e-commerce, and business services through its collective business segments that operate under the respected FedEx brand:

- **FedEx Express**, the world's largest express transportation company, offering time-definite delivery to more than 220 countries and territories through 650 airports, connecting markets that represent more than 99% of the world's gross domestic product.
- **FedEx Ground**, a leading North American provider of small-package ground delivery services. FedEx Ground provides low-cost, day-certain service to any business address in the U.S. and Canada, as well as residential delivery to 100% of U.S. residences through its FedEx Home Delivery service.
- **FedEx Freight**, a leading North American provider of less-than-truckload ("LTL") freight services across all lengths of haul—offering FedEx Freight Priority when speed is critical to meet a customer's supply chain needs, and FedEx Freight Economy when a customer can trade time for cost savings. FedEx Freight also offers freight delivery service to most points in Puerto Rico and the U.S. Virgin Islands.
- **FedEx Services** provides sales, marketing, information technology, communications, customer service, technical support, billing, and collection services, along with certain back-office functions that support its transportation segments. The FedEx Services segment includes FedEx Office and Print Services, Inc. ("FedEx Office"), which provides document and business services as well as retail access to the company's package transportation businesses.

Each FedEx company focuses exclusively on the market sectors in which it has the most expertise and tailors its operations, cost structure, and culture to serve that market segment's unique customer demands. This allows FedEx to adapt its networks in response to changing transportation needs, including:

- **Growth of e-commerce**: E-commerce continues to be a catalyst for FedEx and is a vital growth engine for all business segments as the internet is increasingly used to purchase goods and services. While FedEx residential e-commerce revenues are much smaller than business-to-business revenues, it is the fastest-growing market and requires innovation to make delivery to consumers more flexible, convenient, efficient, and cost-effective. As global transportation and technology networks continue to develop, FedEx will greatly benefit from the growth of e-commerce.
- **Globalization of trade**: As the world's economy becomes more fully integrated, companies are sourcing and selling globally. With customers in more than 220 countries and territories, FedEx facilitates the supply chain through its global reach, delivery services, and information capabilities. Despite recent trade tensions, globalization will drive international volume growth over the long term.
- **Supply chains and logistics**: Companies of all sizes continue to depend on the delivery of just-in-time inventory to help them compete. FedEx integrates its business segments with customer supply chains and provides real-time information to manage inventory-in-motion, which reduces overhead and obsolescence and speeds time to market.
- **High-tech businesses and high-value-added goods**: High-tech and high-value-added goods have increased as a percentage of real economic output, and FedEx's various operating businesses offer a unique menu of services to fit all shipping needs of high-tech and high-value-added industries.

These trends provide FedEx an opportunity for long-term expansion and unprecedented integration of customer goods, services, and information. Through a complex global transportation, information technology, and retail network, FedEx is positioned to connect customers and consumers throughout the world. And FedEx continues to expand its network—on December 28, 2020, FedEx completed the

acquisition of ShopRunner, the e-commerce platform that connects millions of online shoppers with their favorite merchants and brands, offering a seamless experience across merchants, from shopping through delivery. Member benefits include free two-day shipping, free shipping on returns, member-exclusive discounts, and seamless checkout. ShopRunner's data-driven marketing and omnichannel enablement capabilities also help merchants acquire high-value customers and accelerate their digital innovation by using ShopRunner's e-commerce platform. ShopRunner's capabilities will complement and expand the FedEx e-commerce portfolio and are expected to create increased value for both merchants and consumers.

We believe that it would be extremely difficult, costly, and time-consuming to replicate the FedEx global network, which includes the world's largest all-cargo air fleet and connects more than 99% of the world's gross domestic product.

FedEx Corp. is expected to earn $4.6 billion of net income in its fiscal year ending May, 2021, or an adjusted $17.22 per share—an 81% year-over-year increase from May, 2020. We expect combined per-share earnings to increase approximately 10% in fiscal 2022, to $18.95 per share. When comparing forward earnings to the company's year-end stock price of $259.00 per share, investors are receiving an entry earnings yield of 7.3% on their FedEx investment—and we expect per-share earnings to grow over the next decade, especially given the company's strategy to take advantage of the growing interconnected global economy.

TECHNOLOGY GROUP

Each year, we begin this section by highlighting the investment opportunity potential of the information technology sector, along with the difficulty of choosing the right companies to invest in over the long term. Business disruption is the norm in this sector and, therefore, companies and their investors can never rest on past success. During 2020, the technology sector once again experienced change at never-ending breakneck speed as device miniaturization continued, cloud computing thrived during the pandemic, and software enhancements enabled the further advancement of artificial intelligence (AI) in the technology marketplace.

The inherent disruption and warp-speed change of the IT sector continue to make it extremely difficult to determine which companies will succeed or fail. Nearly 14 years ago, Steve Jobs introduced the iPhone® to the world, and this single device allowed Apple to become a primary technology disrupter. That technology cycle has now passed, with market share-hungry competitors developing "copycat" Apple products. Although Apple continues to innovate, disruption is now taking hold as more innovative devices enter both the consumer and commercial markets. In addition, exponential growth in cloud-based services continues in both consumer and commercial markets. Amazon is the leading technology disrupter with its cloud service business, Amazon Web Services (AWS), which is used by companies such as Netflix to manage and stream content to customers.

Computer miniaturization and the emergence of the "Cloud Computing Era" are driving a new generation of products and services that empower individuals to interconnect, shop, be entertained, and stay informed 24 hours a day, 7 days a week. Technology advances have yielded powerful computers that fit into the palm of one's hand or on one's wrist, with the ability to track activity and fitness at every step and the power to capture health data in the cloud. The new types of devices, high-speed connectivity, and fast-changing information services remain a challenge for old-fashioned technology companies that rely primarily on sales of previously popular hardware devices such as PCs.

Which companies gain competitive control in the evolving IT ecosystem continues to be anyone's guess. But we remain committed to watching for and responding to investment opportunities as they arise in this fast-moving sector. Our goal is to identify the difference between price and value with certain technology companies that we believe occupy a strong competitive position in the evolving technology landscape—and have the ability to survive in the future. Even with this desired objective, we are unable to point to any one company in this industry that could be placed in the "guaranteed invaluable business basket"—there is too much disruption, which makes it hard to call.

With this perspective, we are invested in what we believe to be technology companies that provide core technology that all individual and commercial customers need. Our large technology holdings include Microsoft, Alphabet (Google), and Intel.

Microsoft

Microsoft is a perfect example of the uncertainty inherent in investing in technology companies. Although Microsoft has been a business success since its public debut in 1986, the past 35 years have hardly been easy for this technology titan as it faced trying times with competition, the U.S. government, and a rapidly changing technology landscape. Eight years ago, Microsoft was being written off as a dinosaur as the company struggled with its primary product—Windows—in a dramatically changing technology landscape. This resulted in the company's decision to become "more like Apple," leading to its purchase of Nokia's phone business for $7.2 billion in late 2013—a highly competitive arena that included Apple, Samsung, LG, and many others. Microsoft's shift to a consumer-centric business model was ill-conceived, however, and the company's business and leadership stumbled—leading many investors to question the company's ability to survive.

Just as Microsoft's ill-adapted business model seemed to threaten the company's viability, the company's board of directors, influenced by Bill Gates, decided to make a crucial management change. In early 2014, Microsoft's board chose Satya Nadella to lead the company. Applying his background in cloud and enterprise computing, within 72 months, Mr. Nadella led Microsoft back to the forefront of technology change. The organization had turned on a dime, successfully shifting its primary focus away from Windows and devices, and has emerged as a leader in providing enterprise applications and cloud-based services to small, medium-size, and large businesses.

The emergence of cloud computing—the delivery of computing as a service instead of as a product—has vastly changed the technology landscape since its introduction in 2006. Using cloud computing, customers share resources, software, and information that are provided as a metered service over the Internet to personal computers and other devices. Cloud computing is analogous to an electric utility, whereby the power station delivers power to the electrical grid, and consumers draw down on that power as they need it—and are charged for their usage. The infrastructure that supports cloud computing comprises large data centers (i.e., server farms) that are owned and operated by companies such as Amazon, Microsoft, Google, Adobe, IBM, and Rackspace. Obviously, cloud computing offers businesses an opportunity to reorganize their IT infrastructures and decrease their reliance on corporate servers—resulting in overall savings in their IT spending budgets.

This area of the technology industry is "sticky" because corporate customers are not as fickle as retail consumers, who change products in a heartbeat. The "utilitization" of the enterprise cloud business segment is very attractive, as well as potentially very profitable, due to its "tech tentacles" and long-term annuity-like attributes. Large organizations such as eBay, Samsung, Boeing, CarMax, Coca-Cola, Exxon, and others are using Microsoft's data management, machine-learning analytics, and cognitive services to infuse intelligence into their business applications. The far-reaching applications of Microsoft's "intelligent" cloud business include cognitive uses such as vision, speech, and text as well as facial and emotion detection. Microsoft's market share of the cloud infrastructure business jumped from 10% in 2017 to approximately 18% in 2020, with Microsoft Azure serving nearly 285,000 companies and growing in excess of 45% annually. Although Amazon Web Services (AWS) maintained a leading 32% share of the cloud infrastructure market this past year, the cloud computing business is still in the early innings, and Microsoft continues to gain ground. We believe that the future presents unlimited potential for Microsoft, and that Mr. Nadella is committed to staying at the forefront of this technology revolution – example, Microsoft Teams (similar to Zoom) has grown exponentially in 2020 as companies increased collaboration online during the pandemic.

Microsoft had another year of exciting business results in 2020, and we are enthusiastic about the company's prospects in 2021. Microsoft's adjusted earnings are expected to be approximately $6.75 per share in its fiscal year-end June, 2021, putting the company on pace to reach per-share earnings exceeding $7.50 by its fiscal year-end 2022. During this fiscal year, Microsoft will generate approximately $49 billion of owner earnings

and will return a large amount of this cash to shareholders through net share repurchases of approximately $25 billion and around $16 billion of dividends (an approximate 2.4% pass-through yield at the year-end stock price). With a consistent return of cash to owners of this company and an excellent position in the technology industry, Microsoft will remain a long-term position in our portfolio.

Alphabet (Google)

During 2017 and 2018, we made a large investment in Alphabet (Google) and have continued to add to this position whenever conditions are advantageous. This allocation was originally a transition from our emphasis on IBM and is currently our largest holding at Founders. We will maintain a significant position in Alphabet (Google) and consider this investment to be a long-term strategic holding in our portfolio.

We have stated that the technology industry landscape has changed dramatically over the past seven years, enabling the emergence and application of artificial intelligence (AI). With the rise in cloud computing, massive amounts of data are housed on interconnected computers around the world, and companies seek to transform this information into useful knowledge through the implementation of various applications and data analytics capabilities. Cloud data warehousing services such as Snowflake provide companies an opportunity to combine data from various cloud providers, while “edge computing” and “fog computing” allow intelligence to be distributed to individual devices, such as phones and computer tablets. In addition, “serverless computing” has become an innovative way of writing software—a form of utility computing whereby the cloud supplier owns the servers, and pricing is based on the actual number of resources consumed by an application on the backend rather than on pre-purchased units of capacity. The term “serverless” is a misnomer, since this computing still requires servers; the term "serverless computing" reflects server management and capacity-planning decisions that are independent of the developers subscribing to the service. “Serverless computing” is also combined with “open source” software, which is software that is released through a specific kind of license that makes its source code legally available to be studied, modified, and redistributed by the software-writing community. Ultimately, the cloud has made for unprecedented efficiency and data-sharing within the software development community. The standardization of the cloud across all major players, however, has weakened programmers’ brand loyalty to any one cloud provider. The tradeoff is the unlimited amount of data being shared and the flourishing of innovative, openly shared software development.

Cloud, fog, and serverless computing capabilities, along with cloud data warehousing, are especially robust in the enterprise and hybrid computing environments, where massive amounts of crucial government and corporate information are gathered, stored, and combined with public information. The need to transform massive storehouses of data into working knowledge has led to the emergence of cognitive computing—the simulation of human thought processes in computerized models—whereby computers systematically learn and can even teach, to an extent. Today’s digital intelligence is based on massive data-gathering and analysis, and increasingly sophisticated AI is becoming more prevalent.

Computer giants such as Amazon, Microsoft, Alphabet (Google), and IBM are working diligently to make advanced computer learning a reality in this new environment. We believe that Alphabet has a tremendous opportunity to penetrate the growing AI technology segment. Alphabet has been making major acquisitions and investing in the cloud space to compete for this growing market. Google Cloud revenue has grown 45% year over year but only makes up 7.5% of Alphabet’s total revenue. This industry space will continue to be a large contributor to future growth, and Google Cloud services will enable a seamless avenue for Alphabet’s other products and services to be delivered to customers.

Alphabet is the parent company of Google’s growing portfolio of businesses that span several industries including technology, life sciences, investment capital, and research. Google remains Alphabet’s largest subsidiary. Google focuses on Internet-related products and services that include internet search, online advertising technologies, cloud computing, and software and hardware development. Google’s market share of global online searches exceeds 90% (most people just “Google” it!). The company's meteoric growth since its

founding in 1998 has triggered a number of products, acquisitions, and partnerships beyond Google's core search engine. Google offers services designed for work and productivity (Google Docs), email (Gmail), scheduling and time management (Google Calendar), cloud storage (Google Drive), language translation (Google Translate), mapping and navigation (Google Maps/Waze), video sharing (YouTube), and a multitude of other products. The company also developed the Android mobile operating system (71% market share), the Google Chrome web browser (70% market share), and Chrome OS, a lightweight operating system based on the Chrome browser that has a 63% market share among all laptops and tablets in U.S. K-12 classrooms.

So why does Alphabet have a tremendous opportunity in the AI space? The pervasive use of Google's search engine enables Alphabet to gather, manipulate, and understand our individual and collective behaviors in a multitude of beneficial ways. The massive amount of compiled data gives the company an edge in developing AI. Google itself is a learning machine that adapts each day based on the intelligence it gathers. Businesses using Google Cloud have access to immediate software solutions, increased efficiency through data management, and improved operational excellence via AI influence. The information gathered through both individual data (search, health, maps, etc.) and through business operations through Google Cloud allows Alphabet to develop related offshoot businesses as the company scales its learning capabilities. The information gathered acts as a catalyst to propel these to compete in emerging markets, such as self-driving vehicles (Waymo), data science and healthcare (Verily), the application of AI (DeepMind) and home security and connectivity (Nest). These additional "bets" are all strategically integrated around Alphabet's most valuable asset—the information gathered through its products and services. Information that is continuously gathered allows Google to learn and adapt instantly to emerging consumer trends and deliver the most user-friendly, consumer-driven software on the market. Google's pervasive network of interconnectivity also creates consumer reliance on integrated Google software and hardware that will continue to grow as the company adds products and services in the future.

Alphabet is an extremely profitable company that produced adjusted earnings of $39.25 billion in 2020, or $56.55 per share. In 2021, Alphabet is expected to grow its per-share earnings to $68.00 and produce adjusted earnings of approximately $47 billion. This will add to Alphabet's $132+ billion cash hoard on its balance sheet, with minimal debt. With Alphabet's total year-end market capitalization of $1.18 trillion and removing cash of approximately $132 billion, a buyer of Google is obtaining a 3.8% owner-earnings yield that is growing at approximately 15%+ per year. At the current price, Alphabet continues to provide us an opportunity to own a great collection of promising enterprises that have high growth potential through expanding service interconnectivity.

Intel

Intel is a leading designer and manufacturer of advanced integrated digital technology platforms. An Intel platform consists of a microprocessor and chipset that may be enhanced by additional hardware, software, and services. Intel sells technology platforms primarily to original equipment manufacturers (OEMs), original design manufacturers (ODMs), and industrial and communications equipment manufacturers in the computing and communications industries across the computing continuum—in servers; in desktop, laptop, tablet, and mobile phone devices; and in the Internet of Things. (The Internet of Things is the concept of a network of Internet-connected entities such as electronic devices, vehicles, buildings, kitchen appliances, etc. that are able to collect and exchange data using embedded sensors, empowering real-time computing in digital surveillance, new in-vehicle experiences, advancements in industrial and office automation, solutions for retail and medical industries, etc.).

Intel holds a dominant market share in many of its product categories. Despite this dominance, however, technology disruption continues to impact Intel as consumers rapidly transition from primarily using desktop and laptop computers to smaller tablet and mobile devices. On top of the shift from midsize to smaller devices, the growth of cloud-based computing based in large data centers is replacing the need for people to acquire and maintain "home-based" personal computing capabilities. Because of this double-whammy technology shift, Intel's mainstay platform sales to the midsize, local computing segment (i.e., PCs) is declining. Thus, Intel

continues to face a challenging period, and the company is evolving its business model to meet the growing demand for integrated digital devices and cloud computing products.

Another disruption confronting Intel is a rapid change under way in semiconductor chip manufacturing. Semiconductor companies used to integrate proprietary-designed semiconductor chips and manufacturing (or fabrication). For decades, Intel led both semiconductor chip design and fabrication, which provided the company a competitive advantage in the semiconductor industry. Intel controlled product cadence by introducing the next generation of semiconductor chips every two or so years through Moore's Law (named for Gordon Moore, a co-founder of Intel who authored the principle that propelled the digital revolution—the prediction that the number of transistors that would fit on a microchip would double every two years, with the cost of computing halved). Adhering to Moore's Law, Intel would focus on research and design, introducing a new chip just when competitors were matching their previous product. This one-step-ahead approach allowed Intel to lower the price of its previous semiconductor chip just as competitors were introducing their versions to the marketplace. At the same time, Intel would introduce a superior-functioning semiconductor chip at a higher price—maximizing the company's profitability and market share of high-performing semiconductor chips as other industry participants struggled to keep up.

Of course, every strength can eventually lead to a weakness. Over the past few years, Intel competitors decided to focus only on research and design of semiconductor chips while outsourcing manufacturing to other fabrication companies. Taiwan Semiconductor is now the largest chip fabrication company in the world, manufacturing designed chips for fabless semiconductor companies such as Advanced Micro Devices, Apple, Broadcom, Marvell, Nvidia, and Qualcomm. This fabrication disruption has allowed Intel's competitors to become nimble. Along with a slowdown in Moore's Law (it now takes more than two years for the power of computing to double), this new competitive environment has created immediate challenges for Intel's integrated business model.

So, why are we maintaining a large position in Intel, especially as the company encounters a disruptive period that creates additional business uncertainty?

We believe that Intel has embarked on a promising strategy (encompassing both hardware and software) to solidify its position in a new era in which computing is interconnected and distributed across a variety of platforms. The company offers enhanced energy-efficient performance and connectivity and provides platform solutions that now span the computing continuum—from high-performance computing systems running trillions of operations per second to embedded applications consuming milliwatts of power.

As the boundaries of computing expand, with billions of devices connected to the Internet and to one another, Intel remains focused on the following areas:

- accelerating the company's growth in data centers
- extending the company's growth in the Internet of Things
- developing memory and programmable solutions

Intel's emphasis on these areas is driving the company to develop complete and connected platform solutions that will maximize the computer user experience. These focus areas are also driving synergistic business organization and growth among Intel's business groups: Data Center Group, Internet of Things Group, and Non-Volatile Memory Solutions Group.

Intel's microprocessors form the backbone of the Internet and cloud-based computing. Data Center Map (a web service that serves as a liaison between providers and buyers of data center services) states that approximately 4,710 co-located datacenters in 126 countries (around 38% located in the U.S.) make up the "global computing platform." These datacenters collectively contain approximately 100 million interconnected computer servers, most of which are running on Intel products.

We are witnessing Intel transform and broaden its scope as the Internet of Things develops. As more devices become smart and connected, demand will grow for data centers to not only connect these devices but to

capture and analyze the data they create. In addition, improvements in memory technology are enabling faster and more efficient microprocessors. Intel calls the cycle of growth that results from the synergistic interaction of these three market segments the "Virtuous Cycle of Growth." As the company executes its networked, integrated product strategy, these market segments will continue to have greater impact on the company's results and further widen its competitive advantage.

In summary, Intel is managing the current technology disruption, and the company is positioning itself for the next generation of computing, including outsourcing fabrication of low-end chips. We believe that Intel will play an important role in evolving computing technologies and will obtain a terrific revenue and profit annuity stream in future years through its multi-product offering in both high-end and low-end computerization.

Intel's revenue grew approximately 4.7% in 2020 versus 2019, to approximately $75 billion. Profits increased slightly, to $20.7 billion, as the company experienced moderate growth in the PC and data center markets. As a result, Intel will earn approximately $4.85 of earnings per share in 2020, representing a 3.8% year-over-year adjusted increase. In 2021, we expect Intel to face headwinds as the company adjusts its business model in a changing semiconductor industry. As such, during 2021we expect Intel to generate approximately $18 billion of owner earnings and return approximately $16 billion of cash to shareholders through dividends of $5.6 billion and share repurchases of approximately $10 billion, respectively—Intel's dividend yield is approximately 2.6% at the year-end stock price, and the forward pass-through yield is approximately 7.8% when including share repurchases. We will be watching Intel closely as it adjusts to the evolving semiconductor marketplace. We still consider Intel a well-positioned technology company with a bright future, and a good investment at its current price.

FINANCIAL SERVICES GROUP

Berkshire Hathaway

Berkshire is among the oldest holdings in Founders' portfolio—and for good reason. Warren Buffett's holding company is a true powerhouse, with massive operations in insurance (including Berkshire Hathaway Reinsurance, GEICO, National Indemnity, and General Reinsurance), railroads (the BNSF system), heavy industry (Precision Castparts), utilities (Berkshire Hathaway Energy), food (Kraft Heinz), portfolio management (a $200+ billion equity portfolio), and dozens of smaller services and industrial businesses that together make up another large chunk of Berkshire's value. Berkshire's total assets are valued at nearly $830 billion, and the company holds more than $420 billion of shareholders' equity—the largest for any publicly traded corporation in the world. At the current pace, Berkshire's book value per share should grow at a high single-digit rate in 2020 even given the difficult year, ending somewhere in the neighborhood of $190 per B share, or $445 billion—a record high.

Berkshire's size and diversity mean a few things. First, Berkshire is robust to events such as those of 2020. The railroad, utility, and insurance business provide Berkshire a stable platform of earning power in nearly any year. The industrial and services businesses are a bit more susceptible to the vagaries of the economy, but in general and over time, provide a healthy and growing level of profits to add to the bunch. Berkshire's massive stock portfolio, located for the most part inside of its insurance enterprise, adds another growing element to its value.

Early in the crisis, Berkshire was criticized somewhat for not acting forcefully to acquire assets at bargain prices during the panic. Mr. Buffett seemed more concerned with making sure Berkshire was healthy enough to make it through the crisis soundly—and, of course, there were never any suggestions to the contrary.

However, as the year went on, Berkshire did make some moves. For some observers, the most surprising was the initiation of a large stock buyback program indicating that—at the prices prevailing earlier in the year, at least—Mr. Buffett believed Berkshire was considerably undervalued in the market. In total, through the first nine months of 2020, Berkshire spent an unprecedented $15.7 billion repurchasing its own stock—a far larger

sum than Mr. Buffett had ever committed to his own stock previously. That outlay alone reduced Berkshire's shares outstanding by almost 4.5%.

We are very encouraged to see this. In past years, we have commented on Berkshire's growing struggle to commit the large sums of capital at its disposal to continue to grow at a healthy rate. Berkshire's willingness to repurchase its own shares in 2020 when conditions were appropriate gives the company a very useful and—more important—*sizable* tool with which to continue allocating capital for shareholders' benefit. As long as Berkshire uses this strategy with great discretion—only purchasing shares when they are discounted—value should accrue to remaining shareholders like us when they take action.

Berkshire also committed $4 billion to purchase gas pipelines, $730 million to enter the IPO of Snowflake (a cloud-based data-warehousing company), roughly $2 billion increasing its interest in Bank of America, and just over $5.5 billion acquiring shares in several of the largest U.S. pharmaceutical companies.

Outside of its railroad and insurance operations, Berkshire's largest financial commitment is probably its large stake in Apple, at more than $122 billion, which alone represents 28% of Berkshire's shareholders' equity. This may come as a surprise to those who see Mr. Buffett as a Luddite who famously refused to invest in technology stocks in the 1990s—the single most profitable investment Berkshire has ever made is a technology company! Apple is a wonderful business, and Mr. Buffett purchased it at just the right time—it is now the largest publicly traded company in the world, and Berkshire's pre-tax profit exceeded $83 billion after it had sold a few shares in the third quarter of 2020. As shareholders, we cannot help but be pleased.

Berkshire continues to allocate capital and continues to grow. Its greatest challenge remains its large size, massive cash flow looking for a home and, of course, the aging of Mr. Buffett and his partner, Mr. Munger. Berkshire now has a more diversified management structure, with insurance genius Ajit Jain heading up the insurance division, the extremely capable Greg Abel (formerly of Berkshire Hathaway Energy) heading up all non-insurance businesses, and two investment managers helping Mr. Buffett with the investment portfolio. We hope to continue to see Mr. Buffett address his eventual departure by naming talented managers to run Berkshire's diverse operations. This is probably the area of Berkshire that we watch and evaluate most closely.

Berkshire's shares remain fairly priced, the enterprise continues to grow steadily, and it is perhaps the strongest large business in the world—constructed to survive and thrive in any conceivable financial environment.

Wells Fargo

2020 has proven a difficult year for our main bank holding, Wells Fargo. Banks, in general, were hit with a double-whammy set of effects in 2020: A compression of the interest rate spreads on which they make their living, and an increase in loan losses due to the effects of the virus.

A bank like Wells Fargo has a relatively simple business model: Money that is deposited in various savings and checking accounts is also out on loan. The money on deposit can generally be demanded at any time (unless it is a CD) and pays a low interest rate compared to the amount being charged on loans. In addition, the bank collects charges in the form of account fees, overdraft fees, credit card fees, loan origination and servicing fees, wealth management fees, and so on. Together, the "spread" and the "fees" constitute the cash inflows of the business. Deduct the operating expenses needed to run the bank and the value of any loans not paid back (i.e., net of the collateral collected), and you have the bank's pre-tax profit.

As one can guess, banks are under pressure on two fronts: First, because interest rate spreads have compressed, short-term interest rates paid to depositors are indeed rapidly approaching zero, but long-term rates on loans have declined more steeply. This is happening continuously in banking—spreads are constantly contracting and expanding. This year happens to be a year of contraction—and spreads are now at levels that do not allow for banks' former levels of profitability unless they are extremely diligent in cutting costs to match.

At the same time, it has been a difficult year for bank customers, and loan defaults have increased. Wells Fargo set aside $14 billion for losses in the first nine months of 2020, compared to a mere $2 billion the prior year.

This heavier provisioning is temporary as long as economic conditions continue to rebound, of course; 2021 is likely to show a much lower level of losses. But it is in the nature of banking to have a few bad years—and 2020 was one of them for *all* banks.

Wells also has its own specific issues to work through. The bank continues to operate under a $2 trillion asset cap that is preventing it from deploying capital to grow its balance sheet (and, consequently, its earnings). Wells is in the midst of fixing issues addressed by its regulators, which we detailed in last year's letter; the issues are steadily being solved under the new CEO, Charles Scharf. As these fixes continue and Wells' profitability is pinched due to the COVID pandemic, to preserve capital, Wells cut its dividend and its share buyback program.

Within this context, the shares are down considerably. The main question is—what do we see going forward? Are these problems temporary or permanent?

Wells has some important enduring advantages: It is one of only three banks with a $1 trillion deposit franchise—now up to almost $1.4 trillion, a number that has continued to *grow* this year due to an influx of government-provided COVID relief money into its customers' hands. Wells still derives a massive fee base from these deposit customers (recall that these are also loan customers in many cases), an industry-leading mortgage operation, and 7,400 branches spread across the country to create the fourth-largest bank by assets in the nation. There are also only a few banks in the country able to handle the massive capital needed by large, Fortune 500-level businesses, and Wells is one of them —in fact, Wells CEO Scharf has recently expressed a desire to use the bank's size to *further* increase its dealings with large global corporations.

Wells' customer base has proved resilient and stable—and that is the base on which Wells' future profits will be built. Unfortunately, its asset cap means that some new and old customers are being turned away to keep the bank from growing—but this is temporary, and 2021 may be the year that Wells is finally "let off the hook," with the bank working full time to satisfy regulators that its problems are a thing of the past. When that happens, Wells will be in a good position to pick up new customers again.

Interest rate spread problems should also prove temporary, although the timing on this is very hard to predict. In general, the past has shown that with a healthy economy comes higher interest rates—and higher interest spreads. Wells will need to see the return of former interest rate relationships to fully resume its prior profitability of more than $4 per share, but it certainly can—and will—earn healthy profits even at current levels.

We believe that Wells Fargo has better days ahead. If any good has come to the bank from this crisis, it's that it has given Wells a clean slate: Old processes can be updated, bad cultural practices can be remedied by new management, and—because they cannot grow—there is no pressure to make poor loans. We believe Wells has a sound book of business.

Wells is likely to have a slightly-better-than-breakeven year when it reports its 2020 results, compared to earnings of $4.28 per share in 2019. When things begin to normalize, Wells will eventually reinstate its former dividend, pay out excess capital in the form of stock buybacks, return to a more normal level of profitability and, eventually, begin to grow again. When that happens, we believe the currently depressed shares will be worth a great deal more than what investors value them at today. We plan to watch the situation closely and continuously evaluate Wells' progress toward restoring its business to health.

American Express (Don't Leave Home Without It)

Our third-largest financial services investment is American Express (Amex). We began purchasing Amex in 2015 and completed our investment in this company with additional purchases during 2016. Although the pandemic severely curtailed travel in 2020, American Express remains a large part of our portfolio, and it is worth reemphasizing this company's underlying business strategy in light of the temporary setback.

Many know that the American Express Company's principal products and services include charge and credit payment card products as well as travel-related services offered to consumers and businesses around the world.

The company's full range of products and services go well beyond charge and credit payment card products and include network services; merchant acquisition and processing, servicing, and settlement; marketing and information products and services for merchants; fee services, including fraud prevention services and the design and operation of customer loyalty and rewards programs; expense management products and services; merchant financing products; travel-related services (including traveler's checks); and stored-value/prepaid products. American Express products and services are sold to diverse customer groups that include consumers, small businesses, mid-size companies, and large corporations.

American Express is truly a one-of-a-kind company that enjoys a unique credit and charge business based on a "closed-loop system." The simplest way to explain Amex's closed-loop system is to describe its opposite—i.e., an "open-loop system," which is how Visa and MasterCard operate. Visa and MasterCard clients are primarily banks and financial institutions, known as issuers, that issue cards to their customers bearing the Visa or MasterCard logo and bear all risks associated with extending credit. When a cardholder uses a Visa card to purchase goods or services from a merchant—let's say a store—information is sent via Visa's network to the merchant's bank, known as an acquiring bank. The customer's card-issuing bank pays the merchant's bank through the network, which then pays the merchant. The card-issuing bank then sends a monthly statement to its customer for all charges incurred during the period and may earn interest from the cardholder on any outstanding balance the customer does not pay immediately. The issuing bank may also charge the customer a fee for the use of its credit card. In addition, the issuing bank earns an interchange reimbursement fee from the merchant's bank, which charges a merchant discount fee for handling the merchant transaction. Visa participates in this network exchange by charging data-processing fees and service fees to its financial clients but is not involved in lending money. Thus, unlike an issuing bank, Visa is not exposed to any credit risk and earns revenue on the volume of transactions carried out through its associated cards. Leaving aside all this transaction complexity, all we need to remember about the open-loop system business model is that it involves five separate parties that all receive a portion of the financial benefit for each transaction.

In contrast, using a closed-loop system, American Express acts as both the issuer and the acquirer by issuing its own cards through its banking subsidiaries. The company's primary source of revenue is the discount fee it charges merchants that accept the American Express card (Amex's merchant fees are usually higher than those of other financial institutions, and we will explain why later). These fees are charged as a percentage of the charge amount processed for the merchant and account for approximately 60% of the company's total revenues. American Express may also generate revenue from interest earned on loans that are issued to cardholders, from cardholder membership fees, and from travel services. Unlike the Visa and MasterCard model, the American Express revenue model does not depend on the volume of transactions processed but focuses on the total amount spent by each customer. Thus, American Express employs a "spend-centric" business model, attracting affluent customers who are likely to spend more than average (an American Express customer's monthly spend is up to 2x greater than that of a Visa or Mastercard customer).

The American Express Competitive Advantage

In addition to its use of a single closed-loop system, American Express holds a dominant market share of major corporations' travel and entertainment expenditures. This requires explanation and demonstrates how the closed-loop system plays a crucial role.

Large corporations bid out the management of their travel and entertainment budgets to travel management companies, and American Express is by far the largest in the world. Amex supplies travel and entertainment management systems to its large corporate customers that encompass travel planning software as well as travel and entertainment payments, including expense reporting. As part of their travel policies, corporations require employees to charge all business-related travel and entertainment expenses on their corporate-issued American Express cards. Because American Express has a dominant market share of travel management systems used by major corporations, travel and entertainment entities that wish to serve corporate clients—including restaurants, hotels, car rental companies, and airlines—must accept the American Express card. Imagine a large corporation's salesperson taking prospective customers out for dinner and presenting a corporate-issued

American Express card for a large bill—and being told that the restaurant doesn't accept the American Express card. For obvious reasons, this scenario is a rarity. American Express leverages this advantage by charging merchants more for accepting the American Express card. This issue is a longstanding bone of contention between merchants and American Express—and a difficult one for merchants to negotiate, since American Express dominates the corporate travel industry.

American Express developed the closed-loop system to optimally serve its base of corporate clients that require effective management of large corporate travel and entertainment budgets. The American Express travel and entertainment expense management system collects all travel and entertainment information and allows American Express and its corporate customers to jointly negotiate discounts for airfares, hotel and car rental rates, etc.

American Express' competitive advantage lies in the company's unique ability to assist the corporate customer segment with a travel and entertainment expense management system that is unmatchable. The company's wide-ranging closed-loop network is unique in this realm and will continue to provide a competitive advantage as social media evolves and targeted advertising to corporate customers in a mobile world becomes more prevalent. This one-of-a-kind business model will continue to serve a broad-based platform for consumers, merchants, and future partnerships like no other product.

The benefits of Amex's closed-loop system are not limited to providing major corporations exceptional management of travel and entertainment expenses. This special business system also serves small and midsize companies by providing a different and unmatchable supply-chain management-expense control system. The American Express OPEN product leverages the closed-loop system to tie in a company's suppliers (for inventory and payables) as well as its customers (for receivables). The way it works: American Express has an extended merchant network that includes many different suppliers and small businesses that purchase from each other, which then sell to large corporations that already are part of the Amex network. Deploying emerging data analytics and artificial intelligence technology, American Express is able to provide a unique capability that matches suppliers to corporations and assists in inventory management as well as cash management—offering additional terms, as well as benefits, to suppliers and corporate customers. Amex can also leverage the knowledge/information generated by its extended network to negotiate discounted rates on various supplies that small companies may not be able to achieve on their own.

Opportunities for small businesses are further extended through American Express partner relationships. For example, American Express and Amazon Business co-launched a card designed especially for small- to medium-size businesses that sell through Amazon. The card is available in two versions—the Amazon Business American Express Card and Amazon Business Prime American Express Card. These cards offer small to midsize businesses a range of benefits, including payment flexibility and spending insights.

It is our opinion that American Express is not (and never has been) just a "card company" that serves the masses. Amex leaves the chase for low-producing, price- and credit-sensitive consumers that are not brand-sensitive to banks that have a desire to create scale primarily by lending to lower-quality, fickle consumers (most consumers in this segment seem to trade credit cards like we used to trade baseball cards). American Express has an ongoing opportunity to cross-sell and increase its share of customer financial transactions through additional cards it issues in the growing high-end consumer segment. This niche opportunity will continue to develop for many decades as the percentage of "wealthy consumers" grows globally.

During 2020, American Express experienced an approximate 17% decline in revenue, to $36.2 billion, due to a significant decrease in global travel as a result of the pandemic. The company produced around $2.7 billion of earnings during a tough year, or $3.35 per share—representing a decline of 59% from $8.20 per share in 2019. The company maintained its dividend and distributed about $1.5 billion to shareholders during 2020. American Express significantly reduced its stock repurchases during the pandemic crisis, however, buying back approximately $1.0 billion of stock during 2020 to conserve capital. In 2021, we expect American Express' business to rebound, especially in the second half of the year. The company is expected to produce around $6.80 of earnings per share in 2021, and we anticipate a full recovery in 2022 once the pandemic has passed

and American Express resumes growing its franchise throughout the world. With American Express' tremendous future in a global marketplace in which cash sales are diminishing, higher-income consumers are increasing in number, and corporate productivity pressures are mounting, we remain enthusiastic owners of this great franchise.

RETAIL GROUP

Our major retail holdings—CarMax and Home Depot—collectively had another year of expansion in 2020, with combined retail sales growing at 14.3% at these specialty businesses. We expect continued growth for our retail group in 2021, anticipating an approximate 2% increase in sales. The expanding intrinsic business value of CarMax and Home Depot was once again reflected in their increased stock prices this past year. We plan to remain owners of these great businesses, confident about the collective growth in intrinsic value these retail franchises possess as they continue to execute on the four essential elements of retail success:

1. **Excellent customer service:** If individuals walk into your store and get a whiff of poor customer service, they will likely turn around and shop elsewhere. Customer service is paramount in the retail business and not something any retailer can compromise on.
2. **Product selection and superiority:** A retailer must constantly ensure that it is offering the right selection of products at the best possible price. You can provide a great service to your customer with attentive associates and a wonderful retail atmosphere, and then deliver a disservice by stocking the right products at the wrong price, the wrong products at the right price, or—worse yet—the wrong products at the wrong price.
3. **Value creation:** It is tough—perhaps very tough—to make money in retail. A robust understanding of product turnover, day-to-day revenue and expense management, and long-term capital allocation decisions all play into successful value creation.
4. **How to blend one's "bricks and mortar" offering with the new "online channel":** Interconnected retail continues to be a growing dimension of this industry. Successfully integrating the in-store and online customer experience is essential to creating customer and company value.

We have stated in the past how retailing has many moving variables that require tending each and every day. Inattention to any of these details leads to self-destruction—for example, Sears, JCPenney, and Pier 1 have all gone through bankruptcy, and once-robust retailers like Gap, J.Crew, and Bed Bath & Beyond continue to struggle in one or more of these areas, resulting in ongoing deterioration of sales and profitability.

Our interest is in large, industry-specific retailers that gain economic value as their industries consolidate over the long term—CarMax and Home Depot continue to fit our retail holding requirements. These retailers are adding value as their specialty segments continue to undergo consolidation and small competitors fall by the wayside, a dynamic that seems to be accelerating in the used auto and home improvement spaces—especially during the pandemic. Despite tough competition, these retailers continue to gain ground in their difficult respective retail realms and will likely gain additional ground in upcoming years—perhaps worldwide. We have not changed our view: Our retail enterprises are extremely valuable, and it is very difficult for new competitors (including Amazon) to gain a foothold in these specialized retail segments that require substantial networked infrastructure and real estate development.

CarMax

Founders has had a large established position in CarMax for almost two years now. CarMax is the largest single seller of used cars in the U.S., with 832,640 cars sold at retail in fiscal year 2019, and 547,021 sold in the first nine months of fiscal 2020.

Of course, CarMax has had a difficult 2020, with the pandemic leading to closings of some of its dealerships in April and depressed sales after re-opening during the summer due to lingering consumer reluctance to enter retail stores. CarMax's fiscal quarter ended May 31 reported sales down almost 40%, almost certainly the

worst quarter in the company's history on that metric. For the full 2021 fiscal year (the 12 months ending in February 2021), annual sales are likely to have decreased a mid single-digit percentage to around $19 billion, down from more than $20 billion in fiscal 2020, and earnings may be down more than 15% year over year to around $4.50 per share.

CarMax took aggressive steps in response to the pandemic and associated financial market panic by drawing on its credit line (which it did not end up needing), paring down costs, suspending its share buyback program, and creating a "no touch" car-buying experience for worried customers.

As consumers have increasingly begun to resume visiting retail stores, CarMax's business has picked up quickly—the company announced in September that it had resumed its share buyback program, with the worst of the pandemic closings behind it.

Even though its numbers will be down, 2020 was a banner year in some important ways for CarMax. Moving nimbly to keep pace with a quickly moving industry, CarMax has completed its "omni-channel" rollout—consumers can now buy cars either totally online, in their local store, or a combination of both—all at the same price, at their own convenience. While CarMax is not the only online car-seller now, with competitors like Carvana and Vroom each ramping up their own efforts, they are the only one with a true omni-channel effort. While it seems inevitable that (like many other categories of retail goods) cars will increasingly move to an online sales model—especially for younger consumers who have never had the "pleasure" of a typical car dealership experience—the in-store model still vastly dominates used cars sales and will for some time to come. CarMax is now positioned nicely in both worlds.

CarMax still has a lot of room to gain ground in the used car sales industry. In its segment focus—the 0 to 10-year-old used car with less than 100,000 miles—CarMax still has less than 5% total market share—even after more than 25 years of consistent sector growth. The industry CarMax grew up in is, of course, not the one it will face going forward: All car dealers must now reckon with the force of no-haggle dealers; easy, streamlined online used-car purchases (complete with seven-day hassle-free return period); and highly educated customers. Whereas CarMax originally entered a lazy, entitled industry with a poor reputation, its future competition will be increasingly more strategic and capable.

CarMax shows every sign of matching and, in many cases, exceeding that competition—the company has grown up and gotten big and strong, too. Historically, CarMax opened roughly 12 or 13 dealerships per year, growing its store base at around 7% per year while growing its comparable store sales in the low single digits and repurchasing 2-3% of its shares per year, leading to per-share earnings growth in the low to mid teens. That sort of performance is still achievable, but as the years roll on, CarMax may change the way it accomplishes this.

As its growth increasingly comes from the online channel, CarMax is now spending much of its time and money opening centralized Customer Experience Centers and is likely to moderate the pace at which it opens local dealerships over time. It's conceivable that CarMax may consolidate its store base and inventory to even fewer pieces of real estate than it has today—if that is the case, such a progression can only free up even more cash for distribution to shareholders.

We believe that CarMax has many strong years ahead and that shares continue to be fairly priced, offering better-than-average returns for shareholders that are willing to stay the course.

Home Depot

It was a good year for Home Depot. With 2,295 stores at the end of November 2020 (a very slight increase over 2019), the company is likely to report the best year in its history. Annual sales are likely to have risen more than 18% to $130 billion, and earnings are likely to have risen to a new high of almost $12 per share, up from $10.25 the prior year.

Home Depot stock was down more than 40% during the March panic, surprising some—and certainly surprising the financial markets—since Home Depot and its main competitor, Lowe's, have been major

beneficiaries of the crisis. With few places to spend money and even fewer places to go, a large swath of American consumers decided to spend their time and money remodeling their houses. In the third quarter alone, Home Depot—already the largest home improvement retailer in the world—added $6.3 billion in sales over the prior year—growth of 23% year over year that occurred almost entirely in the same stores as those that were open in the prior year. That's a lot of added business! Adding in Home Depot's "just in case" borrowings and its suspension of its share buyback program during the COVID crisis, its balance sheet is now flush with cash, with more than $14 billion at the end of November 2020, its most recent report.

Obviously, Home Depot has not been a casualty of the Retail-apocalypse caused by the rise of e-commerce and the gut punch of COVID. The company has benefited from a few major trends over the past five years: The final recovery of the housing market after the 2008 financial crisis; the decline of its formerly strong competitor, Sears; and harvesting the fruits of its own labor in having set up a powerful hybrid e-commerce system that allows customers to order online and opt to either pick up at in-store lockers or receive fast home delivery. The latter came in handy in 2020, and Home Depot grew its online sales a whopping 80% during the third quarter, representing a record high 13% of total sales.

Home Depot has also made a major push over the past three years to build out a streamlined, personalized, one-stop shop for its contractor customer base (which it calls "Pro"), including a specialized website, specialized customer management software for Home Depot sales associates, deliver-to-the-job-site capability, and a buy-on-credit program to allow contractors to acquire supplies and pay when the job has been completed.

In November, the company announced another major event in its push to serve the "Pro" customer more thoroughly, as well as spend some of the cash hoard accumulating on its balance sheet: The $8.7 billion acquisition of its former subsidiary, HD Supply.

Home Depot acquired HD Supply—then called Maintenance Warehouse—in 1997 and added to it with its purchase of Hughes Supply in 2006. Seeing an opportunity to redeploy capital into repurchasing its own shares, Home Depot then sold the renamed HD Supply in 2007 to a group of private equity operators, which took the company back into the public markets in 2013. In 2020, Home Depot decided to bring it back home.

HD Supply is an "MRO" operation—Maintenance, Repair, and Operations—that distributes a vast inventory of industrial supplies to professional customers ranging from bleach and gloves to screws, bolts, light bulbs, and even air conditioners and welding machines. Basically, HD Supply is a massive logistics and distribution operation, connecting contractors, builders, plumbers, electricians, painters—tradespeople of all kinds—to the supplies they need to do their jobs. Home Depot should have no problem tying this huge operation into its goal to create a customized "one-stop shop" for the Pro customer.

Given its continual dedication to operational excellence, customer focus, employee development, and shareholder returns, we are pleased to have been Home Depot shareholders for many years. While we can no longer put Home Depot shares in the "inexpensive" category, the price still seems fair given the company's continuing excellence.

MEDIA & ENTERTAINMENT GROUP

Media and communications businesses continue to be a challenging investment area. The industry remains extremely competitive and dynamic due to its exposure to changing technology infrastructure, including a large disruption in distribution due to content producers going direct-to-consumer combined with consumers "cutting the cord" and leaving traditional cable providers. Due to the vast and growing number of platforms available for content distribution and the multiple channels through which consumers can access entertainment, it is paramount that media companies create and distribute "great content" to attract customers and advertisers. We know of no other business in which a customer or advertiser can switch loyalty as quickly as in the media business. And a migration of advertising revenues into emerging new media companies continues to accelerate due to the disruption of "streaming content" offerings in this industry by companies

like Amazon Prime, Netflix, Apple, Hulu, YouTube, etc. As a result, several legacy media companies that rely on advertising revenues to drive profitability continued to struggle with static revenue and lower earnings generation in 2020. Clearly, it is important to choose media companies that have a special grip on the marketplace by producing exceptional content that continually attracts various advertisers and consumers, despite the disruption created by services such as Netflix and Amazon Prime. In this category, we continue to hold what we consider to be the best media business in the industry: Disney.

The Walt Disney Company

Disney is the one business that we place in the "invaluable" category due to its unique franchise. The invaluable nature of Disney is based on its different and unmatched content (films, characters, etc.) that is analogous to an oil well that keeps producing indefinitely after incurring an initial development expense. Each time the company develops an animated or iconic film, much of the film development is expensed at the time of its introduction. In future years, when the company re-launches these classic films in updated formats (e.g., 3D and—soon—virtual reality), Disney attains additional revenues and profits without incurring the original development costs. We refer to these re-launches from the company's film library as "accessing the Disney vault." That the content of this vault consists of gooses rather than golden eggs is an important investment point—the magic gooses keep laying golden eggs—e.g., *Snow White and the Seven Dwarfs, Pinocchio, Bambi, Cinderella, Alice in Wonderland, Peter Pan, The Little Mermaid, Beauty and the Beast, The Lion King, Aladdin, 101 Dalmatians, Frozen, Frozen 2*, etc. We can envision our grandchildren's grandchildren watching many of these classic Disney films in the far future, no matter what mediums may be available by then for delivering content. The value of the Disney vault is incalculable because of the 100-year annuity associated with placing iconic new films as well as reissuing previous Disney films as novel delivery mediums emerge and as new generations of children—future viewers of these movies—are born each day.

Disney's CEO, Bob Iger, stepped down in February 2020, leaving the reigns in the hands of Bob Chapek, a 26-year veteran of The Walt Disney Company. Bob Iger will remain in an advising role; before his departure as CEO, he and his team established a long-term strategy to expand Disney's invaluable library of content, broaden its distribution network, and embrace new technologies that complement and enhance the Disney experience. In addition, under his leadership, new film franchises (i.e., golden gooses) continued being added to the Disney vault through the company's creative team, which is unmatched in both animated and unanimated film.

Since Disney closed on its $71.3 billion acquisition of certain entertainment properties of 21st Century Fox in March 2019, the company has been aggressively integrating the acquired assets. This deal was a game-changer for Disney that has enabled the company to offer vast content on its own streaming platform, "Disney+." Disney+ generated more than 10 million subscribers within 24 hours of its offering— blowing past analysts' forecasts of between 10 million and 18 million in its first year. A year after its launch, Disney+ has amassed more than 86.8 million subscribers! This incredible subscriber growth has propelled Disney even as production of new films has been delayed due to the pandemic. Disney+ has also shed light on the evolution of blockbuster films releasing directly to our homes. The 2020 release of the live action film, *Mulan*, was immediately available on the streaming platform at a one-time purchase price of $30 for Disney+ subscribers. This $30 price is less than the amount it would cost a family of four to see the film at a cinema. In addition, the film is brought to the comfort of the consumer's home and, upon purchase, the film is added to the user's Disney+ library, available to be re-watched any time. While we are likely to see this model evolve, there is no doubt that this Disney product offering has been a roaring success. We expect to see Disney offer even more innovation and revenue opportunities through Disney+ in the future.

We believe that Disney has stronger long-term growth prospects than most investors realize due to the company's highly competitive position in the media and entertainment industry. In addition, Disney's broad range of content offerings, growing international presence, and broad distribution capabilities will allow the company to extend its global reach for many years to come. We remain enthusiastic owners of Disney as the company continues to expand its global franchise, adding value for shareholders.

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FIXED-INCOME INVESTMENTS

The Barclay's U.S. Aggregate Bond Index, which represents the broad debt market, experienced a 7.51% gain in 2020. In evaluating the current fixed-income market, we remain extremely cautious over the long term with any investment in most forms of fixed-income securities. If individuals stepped back and looked at their fixed-income investments in a similar manner to investing in a business, they would become skeptical about their prospects for future returns.

Let's say that a business with zero debt is able to produce a steady 10% return on equity. If management elects to retain the annual earnings of this business and plow the funds back into the company, investors can expect to see their "equity bond" double in a little more than seven years.

Now let's look at a bond through a similar business lens. If you purchase a bond at par that produces a 10% tax-exempt coupon and choose to retain the annual earnings from this bond and reinvest the money into the same bond at par each year, you will also double your money in a little more than seven years—producing a similar result to our business example.

Based on this example, it is our opinion that people purchasing bonds today are not applying a business perspective, despite the steadfast low(er) interest rate environment. For example, putting aside tax implications, if we purchased a 30-year U.S. Treasury bond on December 31 at a 1.65% yield and chose to reinvest the coupon payments into those same bonds at par, it would take more than 42 years to double our money. If we presented our clients with a similar arrangement to invest in a business at book value that produces a 1.65% return on equity and retains all the proceeds to repeat this poor return, our judgment would justifiably be severely questioned, regardless of whether the business was assured survival. Unfortunately, today's absolutely abysmal return of 1.65% on a 30-year U.S. Treasury bond is guaranteed to lose money against inflation, which will likely average more than 3% over the next 30 years (once again, we will refrain from any actual forecasting). Nevertheless, many financial advisors and individuals who adhere to traditional rules of asset allocation to fixed-income instruments continue to place a greater-than-average portion of assets in *un*businesslike opportunities. (This does not mean that bond prices will never rise, as they did during 2019 and 2020—lower interest rates, investor panic, and/or deflationary pressures can attract additional money to fixed-income investments, even at very low yields.) We believe that the current bond market is likely in a bubble.

We continue to emphasize several points that concern us about fixed-income instruments: Besides the poor long-term yields being generated in this area, looming risks associated with this "secure investment vehicle" include interest rates eventually rising and increasing chances of default among entities that are laden with debt due to their increased borrowing at such low interest rates. We remain concerned about low long-term market interest rates, which are destined to eventually move upward based on the Federal Reserve's ultimate change of direction on maintaining a low interest rate environment while economic conditions remain challenging. As the economy recovers, unemployment improves, and inflation begins to rise, the Federal Reserve will seek to raise interest rates to minimize the chance of growing inflation negatively impacting the future economy. Ultimately, the Fed's action to raise interest rates would put pressure on the value of fixed-income instruments as well as other interest-sensitive assets. Although many predict that fast-rising interest rates are in the distance, previous experience should remind us that the prophecy crowd is often wrong. Market interest rates could unexpectedly move upward at a faster rate and/or sooner than anticipated, which would quickly result in large losses on low-yielding, long-term fixed-income investments.

In 2020, we have ongoing tranches of municipal and corporate bonds coming due. We will elect to reinvest the proceeds in fixed-income instruments where we can find worthwhile securities that will provide a fair return. We will continue to maintain a businesslike attitude about our fixed-income investments, carefully allocating money to securities that offer a fair risk and return over the duration of the holding.

WHAT'S NEW AT FOUNDERS?

Our firm remains fortunate to have individuals that practice caring for others as they care for themselves. This is a main reason we invest our own money alongside that of our clients. This "others-centered" versus "self-centered" mindset permeates Founders, and we remain proud of this special culture.

Transparency is paramount to the success of any partnership. We remain committed to communicating openly and fully with our clients and with each other. At Founders, we continue to share a greater portion of our duties within the firm, allowing everyone to grow in their responsibilities. During 2020, Lisa has taken on increasing operational and regulatory compliance duties. Ted continues to administer our security filings with the SEC, facilitates and manages trading along with relationships with trading firms, undertakes equity research, assists with portfolio analysis, and works on capital allocation. Jeff primarily conducts broad equity research and works on capital allocation—especially large commitments. Starting January 2021, Jeff is also assuming the lead role with the University of Connecticut investment course, teaching and supervising highly selected students that are charged with managing a portion of the school's endowment fund.

During the pandemic, it was prudent to stagger our work between the office and our homes, but due to everyone's care for clients, we never missed a beat in meeting our commitments. We also decided to upgrade our offices starting in mid-November—after 15 years, we thought it was time for a renovation. When you visit Founders in 2021, you will see a new waiting area, kitchen, and dedicated conference room. We are pleased with our new surroundings and hope you will be, too.

I pinch myself every day when going to work, feeling lucky to be associated with such talented and skilled individuals while serving the best clients imaginable. Each of us at Founders Capital Management remains grateful for your business and for your faith in our stewardship. We thank you for the opportunity to serve you and for your continued trust. We look forward to working with you and continuing our shared journey in 2021.

The examples and descriptions of investments in this client letter do not represent all the investments purchased, sold, or recommended by Founders and instead represent:

(1) the 10 largest equity positions held by Founders' clients;

(2) all equity positions that account for 3% or more of the total funds allocated by Founders to equity holding.

The performance of these investments was not a criterion in determining the representative list. It should not be assumed that the investments identified and discussed were or will be profitable.

The views expressed in this report represent the opinion and analysis of Founders Capital Management based on data available from public sources at the time of writing. This report is not intended to provide any recommendations with respect to the purchase and/or sale of any specific security. It is recommended that individuals conduct their own research or consult with an investment advisor prior to making any investment decisions.

APPENDIX

Founders Company and Investment Culture

What Do We Focus On?

- **Act as business owners for the long haul,** as opposed to looking at investments as "paper to be flipped"
- **Act with "Rs: in mind: Reputation** (never lose it), **Responsibility (**always take it), **Reliability & Results (**focus on execution)
- **Act with character**—it's hard to describe, but we know it when we see it (when in doubt, always place others' interests before one's own)
- **Practice "mindful investing,"** fully understanding where our money is invested, as deep down as we can observe. Take complete responsibility for allocating capital, and do not abdicate money management and research to others
- **Understand the value of our held assets,** both those that are directly held and any investment with underlying assets
- **Care for clients and for each other**—collectively, we are Founders' greatest assets
- **Invest our own money as we invest for clients,** ensuring that we "eat our own cooking"
- **Maintain a human growth orientation**—for individuals and clients over revenues and profits (size does not matter, but growing knowledge and embracing quality does; enrich the lives of those we interact with)
- **Seek and generate ideas, and learn from mistakes**—because mistakes are bound to happen—face them, and don't sweep them under the rug
- **Learn to learn**—think "different" and "unmatchable," and become an organizational "learning machine"
- **Share knowledge**–hoarding knowledge is like hoarding love—the more you keep it for yourself, the more you lose it
- **Think in questions vs. answers**—insightful questions leads to greater intelligence and create options for decisions
- **Remember that the will to prepare is more important than the will to win**

How Do We View Risk?

- **Seek spread, safety, and certainty in our investments**—when practiced, speculation is eliminated
- **Always remember security:** Purchase what is dependable / defendable and predictable / protected. Analyze the potential loss before gain and focus on scenarios that can go wrong with an investment
- **Observable Risks**—"See what others see"
- **Identify developing risks**—aspire to see what others may not see, including risk creep, aggregation risk, and potential events that can cause financial fragility
- **Allow for Unavoidable Uncertainty**—expect the unexpected, as the unexpected is certain to happen
- **Remember to be humble, aware, and careful—**acknowledging what we don't know is the dawning of wisdom
- **Risk sensitivity = "Margin-of-Safety**": Be mindful of valuation and interest rates, capital structure and liquidity, franchise, business model, and management risk
- **Remember that the greatest risk is not fluctuation in the stock and bond markets—**the largest risk resides in purchasing lower-quality issues that look good today but in the long run face erosion in real value
- **Always avoid dealing with people of questionable character**—we will be associated with the company we keep. Remember that reputation and integrity are our most valuable assets—and can be lost in a heartbeat

How Do We Invest?

- **Focus on absolute over relative returns:** The investment world is full of illusory short-term comparisons that ultimately lead to permanent loss. Be risk-adverse, and abhor losing money under any circumstance
- **Seek industry and business ecosystem insight** vs. making macro predictions on the economy or market, which are certain to be wrong
- **Don't develop a master plan when investing**—be situation-dependent and opportunity-driven
- **Avoid unnecessary transactional taxes and frictional costs**—never take action for its own sake
- **Enjoy the investment process**, because studying and researching businesses is where we live
- **Recognize and adapt to the nature of the investment world**; don't expect it to adapt to us
- **Continually challenge and willingly amend the "best-loved investment ideas"**
- **Recognize investment reality even when we don't like it**—perhaps especially when we don't like it
- **When investing, think multidimensionally and look at investment from all angles**—this is captured by the quote "Invert, always invert"
- **Develop disciplined thinking around investment spreads**—seek to maximize cash yield spreads and practice short-term and long-term arbitrage
- **Practice 2nd- and 3rd- level thinking when investing**—always ask, "And then what happens?"
- **Develop "deep insight" and focus on value**—discern the truly valuable from the illusory
- **Remember the key elements to company evaluation:** Understand the "industry ecosystem;" describe the "investment insight"—including the company's competitive advantage, its strategic position within the industry ecosystem, and potential disruption that could erode the company's sustainability
- **Decipher the difference between certainty and uncertainty**: Understand the difference between what is knowable and important, unknowable and important, and unknowable and unimportant. Place a high value on a probable certainty of outcomes
- **NEVER SPECULATE IN ANY INSTANCE—**THIS IS A RECIPE FOR EVENTUAL FAILURE

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Investing for the Long Term. Every Day.