

Capital



## 2022 Annual Letter

CapitalAlphabet, LLC

[CapitalAlphabet.com](http://CapitalAlphabet.com)

Alphabet

*Happy investors are all alike, Every unhappy investor is unhappy in their own way.*

My favorite quote from Tolstoy attributed to current investors makes perfect sense, This was a year of reckoning, a generational shift of high inflation, dragging things trading on moon back to earth, adjusting to new gravity was not easy for all those high fliers, fads and even blue chips trading at high valuations. Fed's pivot to handle inflation with aggressive rate rise changed the landscape and investors started running towards predictable returns instead of riskier stocks. Investors expecting 100k predictable return at the start of year needed 20 million in high grade bonds yielding 0.5%, In less than 6 months they just need 2 million to get the same return at 5%. i.e A 90% less capital to receive the same rate, since stocks trade on present value of expected future cash flows, discount rate matter and they changed a lot within a short span, either market was undervalued before start of the year or carnage is not nearly done.

All of the above is not intended to imply that market analysis is foremost in my mind. Primary attention is given at all times to the detection of substantially undervalued securities. The past year witnessed a moderate decline in stock prices but casual reading of the press or conversing with those who have had only recent experience with stocks would tend to create an impression of a much greater decline. Actually, it appears to me that the decline in stock prices has been considerably less than the decline in corporate earning power under new inflation or interest rate scenario. This means that the public is still very bullish on stocks and the general economic picture. I make no attempt to forecast either business or the stock market or interest rates, just trying to dispel any notions that stocks have suffered any drastic decline, this inflation might be persistent or transient but its clearly making market manic-depressive and for patient investors its going to present great opportunities.

My continual objective as portfolio manager is to achieve a long-term performance record superior to that of the comparable index. Unless we do achieve this superior performance there is no reason for existence of the funds(SMA's). However, Any superior record which we might accomplish should not be expected to be evidenced by a relatively constant advantage in performance compared to the index. Rather it is likely that if such an advantage is achieved, it will be through better-than-average performance in stable or declining markets and average, or perhaps even poorer- than-average performance in rising markets. I would consider a year in which we declined 15% and the Average 30% to be much superior to a year when both we and the Average advanced 20%. Over a period of time there are going to be good and bad years; there is nothing to be gained by getting enthused or depressed about the sequence in which they occur.

The above dose of philosophy is being dispensed as this is our first year of operation and will be repeated every year as I want to make sure our new partners understand my objectives, my measure of attainment of these objectives, and some of my known limitations.

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## 2022 Performance

We formed CapitalAlphabet in June and are pleased to see our portfolio outperforming its benchmark. While the index experienced a 6.69% loss, we achieved a 29.91% gain during this period.

### CapitalAlphabet Performance vs. the S&P 500

| Year  | Portfolio Gain | S&P 500 Gain |
|-------|----------------|--------------|
| 2022* | 29.91%         | -6.69%       |

\*CapitalAlphabet started in June 2022

**Note:** These represent CapitalAlphabet's time-weighted net results (after expenses, but before management fees). Client net results depend on their specific fee agreements.

Performance of 6 months is too short a period from which to make deductions, we take concentrated positions and our portfolio is usually in 5 to 10 stocks, Partners need to understand that keeping such concentrated portfolio even with high conviction bets, ride will never be smooth, As shown below in this short 6 months period there are days portfolio varied by 10% and i don't know a way to hedge around it, as we don't short stocks or market.

### Return %

| Best (2022-06-08) | Worst (2022-10-24) | Period |
|-------------------|--------------------|--------|
| 13.51             | -10.62             | 29.91  |

## Invested Companies

We started CapitalAlphabet in a down market, luckily our bets didn't turn against us so far, nevertheless we will always start with bad news as good news can wait. Here are our bottom performers, I feel our analysis is correct just too early with our purchases which will always be the case as I get excited once it hits our range with a sufficient margin of safety, we will start taking meaning full position but they usually end up much cheaper if we have little more patience, I was never able to bottom tick a purchase, though we added to ours at those prices. Luckily this time our excitement didn't cost us much as impact on portfolio is around 1% or its my premature talk and we will see how these businesses progress.

| Company Name     | Attribution |
|------------------|-------------|
| Wells Fargo(WFC) | -0.90%      |
| META             | -0.83%      |

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Our investment philosophy centers on finding high-quality businesses trading well below their intrinsic value. This year, China presented a compelling opportunity. Despite being the world's second-largest economy, it faced significant headwinds and its stock market hit multi-decade lows. We saw this as a chance to invest in two dominant Chinese companies: Tencent and Alibaba. These companies operate as a duopoly, essentially collecting a toll on most internet activity in China. Their influence extends far beyond the internet, reaching into finance, media, and cloud computing.

While the Chinese government is currently taking steps to regulate these powerful companies, it's important to note that this influence wasn't built overnight. For two decades, Tencent and Alibaba have been allowed to grow and become deeply integrated into the Chinese economy. This unique position creates significant moats around their businesses – their scale and reach are incredibly difficult for competitors to replicate.

We bought into both Tencent and BABA, I'm always on the lookout for smart buys and arbitrage opportunities. We might not have access to the same deals as Warren Buffett (i.e. convertibles in BAC), but with a bit of research, we can find ways to save. This gives me a sense of satisfaction – I believe you make your profit when you buy wisely.

Tencent and Alibaba share an interesting history. Both tech giants were founded two decades ago and received significant early investments from visionary investors. These investors still hold over 25% ownership, with their holdings trading at a substantial discount. While SoftBank itself trades at a discount to its Alibaba holdings, I opted to invest in Alibaba directly. Leverage can be risky, especially with Son's [SoftBank's CEO] tendency for aggressive moves. As Buffett wisely states, "If you're smart, you don't need leverage. If you're dumb, it will ruin you."

Koos Bekker, the mastermind behind Naspers, is a fascinating figure in the business world. He took a traditional newspaper company and transformed it into a powerhouse. First, he expanded into media, and then, with a long-term vision, he turned Naspers into a public venture capital firm. Bekker's strategy resembled a long-term investor like Warren Buffett's Berkshire Hathaway, but with a twist. He focused on early-stage ventures and held them for the long haul. Here's a cricket analogy: If Buffett is considered the "Sachin" of value investing, Bekker could be seen as the company's "AB de Villiers." Just as de Villiers revolutionized modern batting, Bekker applied the investment principles of venture capital giant Sequoia Capital to public markets. He built a public holding company fueled by the profits from Naspers' legacy media business. This company housed high-growth, profitable internet ventures. Bekker remained conservative on leverage, demonstrating a prudent financial approach.

Bekker's Tencent investment is probably an all time greatest investment record and he is trying to replicate the same in India and other high growth economies, hope he succeeds but for us Naspers is trading at 30% discount to Tencent, assuming all other investments they did past 10 years going to 0. Tencent itself is hated and trading at huge discount to its intrinsic value. Nasper's seems like a no-brainer we talk-about, so took a concentrated bet and it saved our portfolio single-handedly, Nasper's management realized the significant discount its trading at and took Henry singleton's playbook and started unlimited buyback of their stock selling

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equivalent Tencent stock till discount is neutralized, Its a wonderful idea as even after these Tencent sales, the per share underlying value of Tencent will improve with this buyback.

Here are our top performers, Naspers is our current rockstar, and Alibaba is hanging in there. Fingers crossed for a boost when China opens up!

| Company Name  | Attribution |
|---------------|-------------|
| Naspers(NSPY) | 32.75%      |
| Baytex(BTE)   | 1.58%       |
| BABA          | 1.51%       |

We also invested in O&G through Canadian mid and small cap companies Baytex and Gear. These companies are well managed, Baytex is drilling in Clearwater and these wells emerged as the most profitable plays in North America, Baytex reduced its debt by 50% in a year and will start returning 50% profits as dividends and buybacks. On the other hand Gear is debt free and giving a cash dividend of 12% at the prices we bought, off-course commodities investments like these have a speculative nature on the price of underlying commodity but we believe in this management, they operated in much tougher environments of oil going to negative \$30 on April 20th 2020 . During the pandemic time they had significant debt and was not able to shut their taps but if it happens again they know how to handle and you can't go bankrupt if you have no debt. We won't go overboard on these cyclical and will prune and add based on opportunity.

I want our partners and prospective partners to realize the results described above are distinctly abnormal and will recur infrequently, if at all. This performance is mainly the result of having started our fund at a time when the market declined. It does not reflect any ability on my part to guess the market (I never try). We fully expect to have years when our method of operation will not even match the results of the index, although obviously I don't expect this on any long-term basis or I would throw in the towel and buy the index.

I'll cut this sermon short with the conclusion that, We are a happy investor this year but I certainly do not want anyone to think that the pattern of this year is likely to be repeated, I expect future performance to reflect much smaller advantages on average over the index.

Cordially,

Venu G. Vallabhaneni