COHO CAPITAL

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February 11, 2021

Dear Partners,

Coho Capital returned 81% for the year compared to 18.4% for the S&P 500. We benefitted when some of our holdings, including Netflix, Amazon, Peloton and Spotify, rerated materially higher as the Covid pandemic pulled demand forward in dramatic fashion. Portfolio gains were also aided by portfolio protection early in the year in the form of long volatility calls, as well as puts on cruise ship operators. Our insurance cost was negligible but asymmetric in payoff given muted pricing in late January.

At present, our top five holdings consist of the following companies in alphabetical order:

Amazon
Facebook
Netflix
Pershing Square Tontine Holdings
Spotify

We acquired our Pershing Square shares, the Bill Ackman SPAC, through purchasing units (SPACs often go public with units including a common share and a fraction of a warrant). We bought at an average price of $21.39, slightly below the offering price of Pershing common stock at $20.00 when including the bundled one-ninth of a warrant (Pershing warrants started trading around $6.20), and two ninths per share additional warrants if held through merger $(2.07 altogether if held through merger and warrant prices hold). This provided us the opportunity to engage in nearly risk-free arbitrage on Bill Ackman finding a suitable candidate to take public. Of course, there is no guarantee that Ackman will find an attractive company to merge with his SPAC, potentially creating opportunity costs due to stranded capital. There is also the risk of combining with an enterprise with unappealing investment prospects. In such a case, we would not receive our two additional warrants but would be able to redeem our SPAC shares at $20.00 and sell our 1/9th of a warrant on the open market. In that scenario, we would be risking a 3% loss on our Pershing Square holdings (common stock and warrants combined). In short, if we don't like the merger, 3% of our investment is as risk, where as if we like it, we were able to build the position in a risk-free manner. Given the dearth of investment opportunities as of late, as well as our immense respect for Bill Ackman's investing acumen, we thought this was a suitable place to park our funds, creating the ultimate Dhando investment - heads I win, tails I don't lose much.

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Apart from Pershing Square, I have written extensively about our top holdings. So, for this letter, rather than conduct a deep dive on a portfolio name, I thought it would be a good time to look back on our first thirteen years of operations, reflecting upon key learnings, the evolution of our investing mindset and what's next. For purposes of brevity, the reflections that follow focus on structuring our work environment and conducting an emotional and mental audit for investing success.

**How it Started**

Coho Capital was forged in crisis, launching as a long-only (we still do not short but we now occasionally use puts to defend capital) fund in October of 2007, two weeks from the market top. Our first purchase was Fairfax Financial, which we bought for its portfolio of credit default swaps (CDS) on the financial companies most exposed to the credit meltdown. We had tried to acquire CDS for the fund but were rebuffed due to not meeting the $100 million in assets under management (AUM) requirement (we had $1.7 million). It is frustrating to have missed one of the trades of the century due to regulatory clearance, but every fund manager will have their share of bad and good luck in their careers.

While we outperformed the S&P 500 during the Great Recession, we were bruised and battered. From peak to trough the S&P 500 dropped 56% and the Russell 2000 declined by 70%. This was a real stampede for the exits. With correlations trending toward one, there was nowhere to hide. It was as if all the rules of investing had suddenly become disconnected from the markets. Regardless of balance sheet strength, industry dynamics or recession resistance, no stock was immune from wave after wave of selling.

"The chaos is so extreme, the panic selling so urgent, that there is almost no possibility that sellers are acting on superior information. Indeed, in situation after situation, it seems clear that investment fundamentals do not factor into their decision-making at all" – Seth Klarman, 2008 Baupost Group Annual Letter

We felt like we kept our head during the chaos writing in our 2008 letter:

"It is a market truism that the seeds of outperformance are planted during bear markets. Eventually, stocks will be priced according to fundamentals and the economics of their balance sheets. Those that have the courage and discipline to invest in sound companies during calamitous economic conditions reap the rewards. What matters in stock picking is not buying at the right time but buying the right business for the right price. At some point,

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probably before economic headwinds have abated, panicked buyers will stampede into the market fearful that they will miss the bounce after experiencing so much wealth destruction."

While we felt like our process was sound, our numbers took a beating with Coho down 40% at one point. The downdraft in performance forced a reckoning with our process. Adjustments included less concentration (down from 12% to 5% at cost), an increased focus on buying assets below liquidation value and less reluctance to part with holdings near our full appraisal of customer value (even if that value was growing). They say you should never let a crisis go to waste, but in this instance, we clearly did as our reflection induced adjustments left the fund worse off. Balance sheet plays are often just a waystation between former glory and irrelevance or bankruptcy, while concentration is a product of discipline and typically results in greater fund security not less, at least if the fund manager is underwriting to protect the downside. Last, a superior business model is the ultimate hedge. Why sell a superior business that is early in its growth trajectory to buy a subpar business at a greater discount to value?

These decisions put Coho in the wilderness for a few years. We roared back in 2009 with a 40% gain but sabotaged our results by selling too soon under the guise of protecting capital. In 2010 and 2011, we carried high cash balances due to our concern over the EU breaking apart. We posited that a mismatch between monetary and fiscal policy was structurally untenable and would end badly. Given the correlations we experienced in 2008, we did not want to be on the other side of that trade. Of course, we weren't the only ones that had such concerns and the markets climbed a wall of worry while Coho underperformed by 31% over two years. We spoke about the harm this miscalculation caused the fund in our year-end 2011 letter:

"Our decision to hold excess cash as a defensive maneuver was the wrong course of action. After coming through the Great Recession, we erred on the side of caution and that has cost us in performance. While our performance would have benefitted from a worsening of the sovereign debt crisis in Europe, such an approach is flawed because it is not a repeatable action. As Peter Lynch once said, "far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in the corrections themselves." In the future, we plan on focusing on the knowable. This approach has been the hallmark of our investment process, but we became more tactical in our allocation the past two years given the enormity of the macro economic challenges facing us. We will always pay attention to how macro factors can influence our individual positions but will do so only as a component of risk control rather than as an exercise in tactical allocation."
Howard Marks once remarked, "To be good in this business, you have to be comfortable being wrong for a period of time." This is a common trope in investing and while true is

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often used to mask all manner of mistakes rather than look in the mirror for answers. For us, it was clear we had a twinge of residual PTSD from the Great Recession. As a result, we had let macro stimuli corrode our investing framework. In addition, we had invested in lesser quality business models either in the pursuit of upside, or paradoxically, in the form of protection from assets worth more than market quotations. Further, and perhaps most damaging, our lack of stellar results induced a kind of myopia where we invested as if our Partners were looking over our shoulder. Ego is the enemy of investing. Clearly it was time to reassess.

**Coho Capital 2.0**

Like the family photo in Back to the Future, we felt like our future was fading fast lest we turn things around. Rather than make incremental adjustments, we deconstructed our entire process, examining how we structured our working environment, spent our working hours and made decisions. We reasoned if we could better control the inputs the outputs would follow.

One of our most important realizations was resetting the terms of what we were trying to do. Coho's mission is to deliver better than market returns while taking on less risk, but how you frame that objective is important. While we wholly subscribed to the idea of process over outcome, we realized the goal of beating the markets had been too important to us. Such an approach was bound to fail as it is more concerned with optics than learning. To move forward, we needed to sublimate our ego and let the inputs drive the output. Thus, we made a conscious decision not to make beating the S&P 500 every year a part of our goal orientation. Taking away the performance anxiety of beating the S&P 500 was tremendously liberating. We had always strived to underwrite our investments on a two to five-year time horizon but too often let performance anxiety intrude on the process. We found that removing the pressure to win changed our framing, extended our horizon, and created a more organic research process. Said another way, we would rather win the decade than win the year.

**Failure is the Best Teacher**

One of the most significant changes for Coho has been where we hunt for opportunities. Our original aim was to find those companies likely of going up 50-100% in a couple of years. Such an approach, however, often led to turnaround situations or companies in capital destroying industries. Moreover, we found a return-focused approach corroded our

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framework for identifying resilient business models. By focusing on return potential, we had hijacked our ability to focus on business durability first, leaving a universe of less savory investing candidates.

We conducted a post-mortem across our investing history and found that in almost every case, we fared worse in price taker industries, while some of our best returns were with competitively differentiated companies who controlled their own destiny. While our process was geared toward strong business models we found we were too often tempted by a low price, thinking we could make money with what Peter Lynch called "crappy companies on the way to semi-crappy companies." We subsequently realized that melting ice cube businesses were unsafe at any price. This sounds obvious in hindsight, but as a value investor it was a difficult pivot to make. We had little competition for some of the businesses we were buying and there was a real analytical edge in assessing whether a price misappraisal was caused by an excisable issue. There is money to be made in these hunting grounds, but everyone needs to decide what strategies they want to play. For us, we realized we were better at teasing out the return potential of superior business models than running a valuation Geiger counter over everything. We also found it was much more fulfilling to get behind companies we believed in rather than waiting for the market to rerate our holdings. They say excitement is the enemy of returns but as value investing heretics we often find ourselves broadly enthusiastic about our holdings.

Our pivot toward high-quality business models was not overnight. We still took advantage of special situations, such as the post Great Recession tarp warrants, but in general we began to migrate toward better businesses. Any time we strayed from such an approach we received an unfriendly reminder from the market gods – Jackson Hewitt, AIG. Every smackdown by the markets further entrenched our preference for high-quality business models.

In many ways, it was better to have our bad habits laid bare early in our investing journey rather than later. A bull market hides a multitude of investment sins giving investors the impression they can't lose. Failure, however, is a great teacher. In a way, acquiring battle scars is like acquiring immunity from making the same mistake twice, serving as a booster shot for future returns. Starting Coho against ferocious headwinds prompted us to reassess everything we did. By heeding the lessons of our mistakes, we planted the seeds for Coho's eventual success.

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**How it's Going**

Since our course correction, Coho Capital has compounded at 25% net over the past nine years. Most important, we have structured the business around what we're good at. It's a far better match than Coho 1.0, where our structure and thought processes were misaligned with delivering optimal results. The ability to course-correct is one of the most underrated skills in investing. Too often ego gets in the way of admitting your wrong. We like the way investment manager Ray Dalio frames it, "pain plus reflection equals progress."

**Know Thyself**

"You better check yo self before you wreck yo self." – Ice Cube

One of the most instructive works in my journey as an investor has been Guy Spier's book, *The Education of a Value Investor*. It is unlike anything else I have read in the investing canon. Rather than offering prescriptive tools, Mr. Spier turns the lens inward in a journey to figure out how he makes decisions. Specifically, he details how his personality and emotional leanings influences his investment decision making. This was an aha moment for me.

The amount of reading available on becoming a better investor is laden with detailed lists of dos and don'ts. But here was a work that asked of its readers to master themselves rather than master the material. The approach instantly struck a chord with me. Having read dozens of investment books, I felt I was hitting the point of diminishing returns on the path toward investing enlightenment. At some point, even the most enterprising of investors will have read most of what they need to build out their tool kit. For some reason, it had never occurred to me to hold up a mirror.

While I had endeavored to catalog my efficacy in utilizing different investing tools, I was less well versed on how I could be a liability. Had I been paying attention, I would have been more aware of the ways in which I defeat myself. For example, earlier in my career, I would find myself succumbing to classic behavioral economic mistakes despite having a firm grasp of those mistakes. Spier's book was the cue I needed to turn the quest to investment success inward. I realized that without gaining greater clarity into the contours of my temperament, I was bound to be a second-rate investor.

As best I could, I assessed my emotional and mental liabilities and constraints. Just the process of awareness alone, made me a better investor. I realized where my comfort zone

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resided as well as the types of companies and industries where I was vulnerable to being emotionally hijacked. Higher consciousness of self has sharpened my pattern recognition skills to be a better observer of which opportunities are most relevant for my style of investing. It has also made me quicker at recognizing when I am out of my depth. Ultimately, my emotional excavation has considerably narrowed my universe of investing candidates leaving an opportunity set tailor-made for my success. Said another way, if success is avoiding stupidity, then best find out in which circumstances you're likely to make stupid mistakes.

Confucius said, "real knowledge is to know the extent of one's ignorance." I think it's a nice bookend to Buffett's idea of Circle of Competence. I think investors often work on the Circle of Competence piece but spend little time on mastering themselves. It's been a core insight for me. In fact, one of the hacks we apply when researching a new company is to assume we are wrong. It is easy to talk about market inefficiencies but there is great value in collective wisdom and the market is right most of the time. By grounding our process in humility, we place a higher burden on proving out a variant point of view and a more honest foundation upon which to pursue research. If you are looking to improve your investing batting average, rigorous scrutiny of what makes you tick is a great place to start.

What follows below are some of the additional constructs we have found helpful in priming our head space for investment success:

**Be Willing to Look Like a Fool.** Even the best investors are wrong a fair amount. These investors understand they are not infallible and are quick to cut their losses if their original thesis no longer holds merit. To be sure, this should be a labored decision as interrupting the compounding process betrays a long-term mindset. Yet, if the writing is on the wall, admit your mistake, study it, and move on. This is even more important for concentrated portfolios, which should possess a high bar for entry.

**Be Willing to Be Popular.** The converse is also true. Alternative fund managers won't score any style points for owning popular companies. But this is silly, as mental agility and dogged research can lead to outlier insights even on widely held names.

"I tell people around here to wake up petrified and terrified every morning." – Jeff Bezos

**Let Humility Guide You.** We are always paranoid we don't know enough about an investment and continually play Devil's advocate with our thesis. That does not come from a lack of confidence but rather from the notion that it is impossible to know everything. We are trying to incrementally build confidence by parrying down every volley. Such an

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approach ensures you never rest on your laurels and continue to build conviction through additional work.

"I'm not Warren Buffett and neither are you." Lisa Rapuano, Bill Miller's former investment partner

**Be the Best in Your Time.** We all start with a preconceived notion of what constitutes value. For many of us, the framework flows from the timeframe in which we studied investing or started allocating capital. While we all stand on the shoulders of giants, a past is prologue approach is a hazy way to look at the future. For example, many value investors have missed out on digital companies as traditional accounting metrics penalize intangible investments (intangible investments make up 84% of the enterprise value of the S&P 500, up from 14% in 1975), which are expensed through the income statement, rather than capitalized as an asset on the balance sheet. The mismatch between an asset-based accounting system and the modern economy fails to capture the increasing returns to scale offered by digital platforms. Unlike physical assets which depreciate with use, the value of digital assets increases with use. This is an important example of how narrative often lies beyond the numbers. A holistic approach to research, informed by the past but not constrained by it, leaves one better equipped to spot opportunities in contemporaneous times.

**Flexible and Focused Beats Large and Approval Seeking.** It's important for investors to play to their advantages. Investment institutions have cadres of analysts, unlimited research and IT budgets, lush travel funds and cross-discipline pollination capabilities. Yet, in concert, these forces can often lead to what Warren Buffett called the "Institutional Imperative," the tendency for large organizations to mimic each other and engage in irrational behavior. Meanwhile, the solo manager is free to take their time thinking between four walls. The freedom granted by a lack of meetings, busy work and office politics frees up mental space to focus and tune out the noise. This is a significant advantage in a job that is academic in nature.

At Coho, we have arranged our partnership to ensure a long-term mindset and protect our time for contemplation. We only write to investors twice a year, have a two-year lock-up for new investors, and closely guard against all other commitments that imperil our ability to be thoughtful. This is the structure that is most attune with how we operate and the types of investors we hope to attract.

**Learned Talent Beats Innate Talent**. Innate talent is quick out of the gates, but their tool kit is limited. Bestowed with gifts from birth, there is no need to course-correct and as a result their ceiling may be more limited. Learned talent, however, is hungry. It has a chip on

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its shoulder and is paranoid it does not know enough. It is always evolving, adapting, utilizing new tools and technologies. These incremental refinements compound through the years.

Learned talent rarely makes the same mistake twice whereas innate talent is quick to assign blame. Sure, bad luck happens, but most of the time mistakes are due to something you failed to see or investigate. Nonetheless, give yourself permission to make mistakes. If you're not making mistakes you're not trying. Adopting a growth mindset and embracing bottom-line responsibility for your results leads to continuous improvement. Meanwhile, innate learners will probably blame the Fed.

**Optimists Win.** Investors like to flex their skeptical bent – believing they can see through the nonsense because they are sober-minded and demand a margin of safety unlike 'those gamblers.' A certain degree of cynicism makes sense as we are hard-wired to perceive threats more forcefully than positive events. Further, doubt is a bulwark against the Wall Street hype machine. Yet, in our experience, we find optimists most often win the day. Skepticism is inherently valuable in investing, but I have found I need to engage skeptically with my pessimism not my optimism. Optimists are more likely to be persistent and have more imagination. Imagination would seem like one of the worst, if not harmful, investing traits to have - yet it opens up more what-if scenarios and adds balance to the prevailing pessimistic chorus.

**Patience is A Superpower.** We have been pretty good at identifying good business models early. We have been less good at holding through periods of overvaluation. If the company is still early in its growth trajectory, and thus years away from multiple compression, selling is a cardinal sin. A predilection for patience helps an investor take control of their psychology and leave the heavy lifting to portfolio stalwarts.

**You Are the Competition.** While investing is a zero-sum game it is ultimately about mastering yourself. Winning at investing does not entail crushing someone else but rather being the best version of yourself. Many fellow portfolio managers seem to rejoice when their peers struggle. If you are getting your satisfaction from the travails of others, you are doing it wrong. We have made many friends in this business over the years and we are always cheering them on. Their success has nothing to do with how we finish up. We have gained many valuable insights from our peers and we always aspire to reciprocate.

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"Much of what I stumbled into by following my curiosity and intuition turned out to be priceless later on." Steve Jobs, 2005 Stanford Commencement address.

**Curiosity Builds Pattern Recognition.** The best investors are driven by perpetual curiosity. They are naturally interested in the world at large and enjoy the puzzle of discovering how things work. Over their lifetimes, curious people develop a broad constellation of data points. As a result, cross-discipline intuition is more habitual and pattern recognition surfaces more readily. Consequently, curious folk possess an advanced ability to filter information and tease out core insights. This is a huge advantage in an industry which requires hoovering up voluminous troves of information and connecting the dots.

**Information Omnivores Need Focus Guardrails.** The web is an intellectual bazaar. If you are curious by nature, there has never been a better time to learn. But internet reading is often morsel-sized, preventing the type of break through thinking that long-term engagement engenders. It can certainly be stimulating but leaves one intellectually impoverished. Further compounding the challenge is the proliferation of outlets in the information business – blogs, Medium, Substacks, Twitter, podcasts. The firehose of information makes reading intentionally more critical than ever. MIT's endowment, MITIMCo, came up with a great hack on information filtration, which we have adapted:

"We noticed some years ago that much of the information we consumed was expiring knowledge…. By deliberately tilting our time more in favor of long-term knowledge and less towards expiring knowledge, we can slowly create a long-term advantage." – MITIMCo Ten Year Memo

Asking the right questions is the cornerstone of a purpose-built process. Starting at the top of the funnel with information procurement strikes at the source of the research process. We have found MITIMCo's information screen to be an invaluable tool in cutting down on intellectual junk food and sharpening our research process.

**There's a Fine Line Between Obsession and Burnout.** Investing is one of the most competitive fields in the world, but more work is not always the answer. The ravaged market backdrop of Coho's investment launch prompted us to work harder but often not smarter. Now we're better at taking a walk. We strive for balance and have sought to eradicate points of stress. Investing requires a clear head. Taking the time to invest in yourself outside of work is a sound way to bring mental clarity.

**What's Next.** Since inception, Coho has almost exclusively focused on our investment process with little regard for marketing or growing assets. As our AUM has grown, however,

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we realize it's imperative to grow the business as well. We have kind of viewed marketing as a dirty word and think of Coho as an asset manager rather than an asset gatherer. We have come to realize that's a false dichotomy. Growing assets strengthens the foundation of our business and makes for a more resilient enterprise better able to take advantage of market dislocations. Further, our investors are a valuable network of successful operators from a variety of industries. Coho's partners include CEOs from multibillion-dollar firms, C-level executives from genre defining unicorns, fund managers, family offices and successful operators and entrepreneurs across a variety of industries and geographies. We also have our seed investment from the Diller-von Furstenberg family office as an anchor investor. We're proud of the company we keep. They form part of the learning network at Coho, sharpening our insights, challenging us, and opening new ways of thinking.

As we grow the firm, we ultimately hope that the type of investor who wishes to join us on our journey self-selects for Coho's culture and operating principles. If you think Coho can help you achieve your investing objectives, please feel free to reach out.

Our business is built upon a singular premise - deliver favorable risk-adjusted returns. We believe we have delivered on that premise having outperformed the S&P 500 by 229% net since inception. Our pivot to high quality business models in 2012 has improved our process resulting in 386% outperformance of the S&P 500 over the past nine years. We have been through market cycles and volatility regimes and learned how to invest within ourselves. Like the managers we admire, we have structured our environment, our incentives, and our psychology, around winning the long game. We will always be trying to master ourselves but hope to get a little bit better every year.

Respectfully yours,

Jake Rosser
Managing Partner
Coho Capital Management