February 21, 2022

To the Partners of BlackBird Financial LP:

2021 was a good year. It was not a good year because BlackBird showed a gain of 41.8% - pleasant as that experience may be to the pragmatists in our group - but rather because we had a relative advantage of 13.1% compared to the S&P 500's 28.7% gain, including dividends. Our performance also compares favorably with our competitors, with the average hedge fund churning out just 10.4% in 2021, according to HFM Global.

Interpreting our Investment Results

The SR-71 BlackBird set dozens of speed records during its active life. In September 1974, it flew from New York to London in 1 hour 54 minutes, a record that's never been beaten, and only weeks later the aircraft set another astonishing, timeless record with a flight from London to Los Angeles in 3 hours 47 minutes.

Like airspeed, absolute performance is objective and easy to measure. More subjective, however, is what result should be considered satisfactory. Therefore, it's crucial that we all use the same yardstick to differentiate between a good or poor outcome.

Since inception, I have used the S&P 500 as our measure of par. Furthermore, it is appropriate that a span of at least five years be used to test performance. While the S&P 500 is not perfect as a measure of performance (nor is anything else), it has the advantage of being widely known, has a long period of continuity, and reflects with reasonable accuracy the typical equity investor's experience. Therefore, the disparity between our net results and those of the S&P best highlights BlackBird's contribution.

The Year at BlackBird

Whenever investing in a new business, it's important to evaluate its prospects not only in absolute terms, but also in relation to those of the stocks you already own. Obviously, if it does not offer brighter prospects, you'd be better off using the capital to enlarge your existing positions. This principle, while so simple, seems to get lost on many professional money managers. Throughout 2021, only one opportunity exceeded this threshold. While I have no idea as to the timeframe, I am confident that this investment will do very well for us over the coming years, and I have allocated nearly 25% of our overall investment portfolio to this security.

This muted level of activity is very much in line with our focus on quality, and not quantity, of decisions. In the field of investment, oftentimes less is more.

On the Question of Size

As a product of our growth, I find that I'm being asked with greater frequency whether a further increase in size will negatively impact our performance. Indeed, this concern is very understandable. Many funds perform very well in their early years by investing in small, overlooked securities, which tend to be priced less efficiently. Then, as their capital expands and such investments are no longer feasible, their ability to outperform quickly evaporates. As Warren Buffett says, *"Size is the anchor of performance."*

In our case, however, small, off-the-beaten-path investments have not contributed meaningfully to our record. As I write this, the smallest company in which we are invested has a market cap (defined as share price multiplied by the number shares outstanding) of $32 billion dollars and has an average daily volume of more than $200 million. Therefore, if our size should eventually prevent us from holding smaller securities, there is no reason to believe it would dampen our results. This is not to preclude us from fishing in the shallow waters in the meantime; merely, we do not depend on it to achieve a satisfactory return.

General Market Environment

While the S&P advanced more than 28% last year, it masks large swaths of the market that have experienced meaningful declines in share price. This is particularly true for the stocks that were most sought after by the naive retail traders, who have proudly demonstrated yet again how mixing stupidity and public markets effectively separates a fool and his money. In last year's letter, dated January 29, 2021, I wrote the following on the euphoric environment surrounding SPACs:

> *"As was the outcome after the speculative environment leading up to the crash that began in September 1929, the precious metals frenzy at the end of the 70's, the infamous dot-com bubble in 1999, and the real estate boom leading up to the 2008 recession, there will come a reckoning, though exactly when remains unclear. The good news is that after each of the aforementioned bubbles popped, the immense selling pressure caused the pendulum to swing too far in the opposite direction, offering wonderful businesses/assets for great prices. With a large amount of cash on hand, we will be in a position to capitalize on that development when it occurs. As Bobby Unser, one of the best Indy 500 racers of all time, once said: 'Success is where preparation and opportunity meet.'"*

Since that writing, many such companies have had their price decline in excess of 75%. Moreover, you'd be hard pressed to find any that have not experienced a significant price cut, and this shift in sentiment may very well continue. My job now is to sift through the rubble, just as one might after a plane crash, collecting anything of value if it's readily given away. Thus far,

I have not spotted anything that I deem worthy of pursuit, but I'm always on the prowl, and I'm optimistic that if we observe long enough, that perfect prize will emerge. My eyes and ears are wide open!

Our Distaste for Short Positions

Given that I clearly had a strong conviction that many of these businesses were vastly overvalued, why didn't I take advantage of the situation and short them?

To best answer this question, we first need to appreciate the luxuries that are inherent when we buy an asset. Imagine for a moment we are a young boy in an orchard. One morning, in exchange for a handful of apples, we proudly acquire a tree of our own. We then sit down underneath the strong branches and, in the cool shade, collect the fruit that falls onto our lap. If we are offered a price too good to refuse, we can sell our tree. If the amount offered isn't to our liking, we need not pay any attention to it. The same dynamics are at play when you own real estate or a business, public or private. Market quotations can either be taken advantage of (if prices are too high or low), or they can be completely ignored. As Ben Graham wrote, *"The market is there to serve you, but never to instruct you."*

This is not so when it comes to short positions. Suppose that after some digging, we find a tree with dead roots. In order to take advantage of others' naiveté, we borrow the deed to this rotten tree, and sell it immediately for a basket of fruit. Our hope, of course, is that once the public realizes its condition, we could repurchase the tree for pennies, return it, and retain our fruit basket as pure profit. However, near-term prices can completely diverge from intrinsic value. Should the marketplace become euphoric enough, we may need to surrender our entire collection of valuable trees just to settle-up. When the market comes to its senses and the price plummets, it is too late. In this case, the market's whims are transformed from our servant into our almighty master.

While it was tempting to take advantage of the opportunity when I wrote to you a year ago, the technical aspects of shorting introduce an unacceptable outcome, namely, a permanent loss of capital.

Alignment of Interests

In a speech delivered in 1995 at Harvard University, Charlie Munger said:

> *"…I think I've been in the top 5% of my age cohort all my life in understanding the power of incentives, and all my life I've underestimated it. And never a year passes that I don't get some surprise that pushes my limit a little further.*
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> *"One of my favorite cases about the power of incentives is the FedEx case. The heart and soul of the integrity of the system is that all the packages have to be shifted rapidly in one*

central location each night. And the system has no integrity if the whole shift can't be done fast. And Fedex had one hell of a time getting the thing to work. And they tried moral suasion, they tried everything in the world, and finally somebody got the happy thought that they were paying the night shift by the hour, and that maybe if they paid them by the shift, the system would work better. And lo and behold, that solution worked!"

Needless to say, incentives play an important role in money management, too. I think that if our roles were reversed, I'd put an awful lot of emphasis on whether my interests were aligned with that of management. As I've mentioned in past letters, I have more than 90% of my net worth (including personal residence/property) invested right alongside all of you. This ensures that whether we do well or we do poorly, I will bear the greatest impact. If the day arrives that I am no longer thrilled to personally accept this proposition, we'll wrap up this partnership and seek alternatives. I suspect, however, that the path before us stretches far beyond where our eyes can see.

Your fiduciary, Judah Spinner, CFA, FMVA
Chief Investment Officer