



## To the Partners of BlackBird Financial LP:

2022 acted as a sifter, separating the skilled investor from those simply lucky during the long bull market that began in March of 2009. Let's see how we stacked up:

BlackBird	S&P 500	Nasdaq	30yr Treasuries
-12.1%	-18.1%	-32.5%	-33.5%
<b>ADVANTAGE</b>	<b>6.0%</b>	<b>20.4%</b>	<b>21.4%</b>

What about other actively managed funds? Surely they must have been able to outperform the broader markets as well, right? Not exactly! Here is how some of the largest, most respected mutual funds performed:

Fund	2022 Performance	Total Assets in USD
<b>FIDELITY CONTRAFUND</b>	<b>-28.3%</b>	<b>91 BIL</b>
<b>T. ROWE PRICE STOCK</b>	<b>-40.1%</b>	<b>42 BIL</b>
<b>FRANKLIN GROWTH</b>	<b>-24.9%</b>	<b>16 BIL</b>
<b>BLACKROCK MID-CAP</b>	<b>-37.3%</b>	<b>11 BIL</b>
<b>INVESCO A. FRANCHISE</b>	<b>-31.1%</b>	<b>10 BIL</b>

## Conventionality vs Conservatism

The funds above are larger and better known than we are, and therefore may superficially appear to be more conservative. Most financial advisors, who are typically far better salesmen than they are investors, would subscribe to this viewpoint. I disagree. It is unquestionably true that the mutual funds have invested their money more *conventionally* than we have, and to many people conventionality is indistinguishable from conservatism. In my view, this represents extreme naiveté. Neither a conventional nor an unconventional approach, per se, is conservative.

A conservative opportunity is one we can understand, where the facts are ascertainable and clear, and the course of action obvious. These are typically businesses with a durable

competitive advantage, strong management, and a bargain price. A glaring question presents itself: If the investment is so obviously attractive, what is the seller thinking?

To answer this question, it must be understood that every company, even those with great management and insurmountable competitive advantages, will experience challenging times. Some of these problems are like a cancer that will have long-term detrimental effects. Others are more like a serious cold; yes, their level of productivity may be hindered in the short-term, but their underlying strengths remain intact and will shine again once the temporary illness passes. Obviously, my focus lies with identifying the latter scenario.

The cycle often begins with a great company producing impressive results year after year. Then, as is inevitable, they encounter a rough patch. Results deteriorate, and investors, previously enraptured by their growth, sell in order to pursue other opportunities. Remaining investors find that red ink plasters their account statements as its price drops precipitously. A sense of unease permeates the market and generates more selling pressure. Eventually, investors dump the stock to alleviate the emotional strain it has caused, irrespective of how attractive the price may be relative to its value.

This is where we step in and invest. We end up owning a Rolls Royce for the price of a Toyota. As a result, we ensure protection from the vicissitudes of business, because even mediocre operating results can provide sensational investment returns.

I would posit that our approach is, in fact, far more conservative than those pursued by most “traditional” funds, which often rely on overly optimistic models to justify the prices they pay. Furthermore, the businesses in which they invest generally lack a meaningful competitive advantage. This leaves them in a vulnerable position, but the layman investor will be unaware of this as it cannot be explained by a simple metric.

While I believe the above argument to be strong, it is also highly subjective. If you prefer a more objective approach, I suggest you study investment results in declining markets, just as you would evaluate the reliability of a pilot by his performance in a windstorm. While not conclusive, I believe that our outperformance last year against the S&P and large actively managed funds demonstrates the conservativeness embedded in our investment approach.

## **The General Stock Market in 2022**

To better understand the environment in 2022, we need to go back to the mania that preceded it. Let’s start with an excerpt from a letter I published on January 29, 2021:

“One of the interesting developments in 2020 relates to the growth of the retail trader. As platforms such as RobinHood began offering user-friendly, commission-free trades, millions of people across the country have made stock trading their go-to pastime while

trapped at home. Citadel Securities, the top retail US equity market-maker, executing 41% of all US-listed retail volume, reported that trading from individuals now accounts for 20 to 25% of overall market activity, up from 10.1% in 2010, and 14.9% in 2019. Many of these traders/gamblers could not differentiate between an income statement and a balance sheet and have never read through an annual or quarterly report. Yet, despite their inexperience and lack of business intelligence, they feel like geniuses when the paper profits come rolling in. Very little in this world sedates rationality like large doses of effortless money...

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."

During 2022, the balloon deflated, leaving millions of naive traders with devastating losses. The primary catalyst was an increase in interest rates. Higher rates cause the present value of any future cash flow to decline. Because any productive asset, whether it be a bond, stock or office building, is merely a series of cash flows, it follows that higher rates would have a negative impact on their intrinsic value. Accordingly, as interest rates catapulted throughout the year, asset prices declined across the board, from Treasuries to high-flying technology stocks. Moreover, as losses replaced gains, we saw a sentiment shift. While investors were primarily concerned with not missing out on major profits in 2021, they now worried about losing what they had. Although this change in spirit weighed on valuations broadly, the impact was especially acute for "hot" assets referenced in my 2021 letter. It turns out that a fool and his money are soon parted. Who would've guessed?

For your amusement, I've included a sample of the carnage:

<b>Company</b>	<b>2022 Performance</b>
<b>BED BATH &amp; BEYOND</b>	<b>-83%</b>
<b>BEYOND MEAT</b>	<b>-82%</b>
<b>CARVANA</b>	<b>-98%</b>
<b>GOODRx</b>	<b>-86%</b>
<b>REDFIN</b>	<b>-89%</b>
<b>RIVIAN</b>	<b>-82%</b>
<b>SHOPIFY</b>	<b>-75%</b>

Large losses were not exclusive to “smaller”, unproven businesses. Let’s have a look at how the big boys fared:

<b>Company</b>	<b>2022 Performance</b>
<b>FACEBOOK (NOW META)</b>	<b>-65%</b>
<b>AMAZON</b>	<b>-50%</b>
<b>APPLE</b>	<b>-26%</b>
<b>NETFLIX</b>	<b>-52%</b>
<b>GOOGLE (NOW ALPHABET)</b>	<b>-40%</b>

### **The Times They Are A-Changin’**

“Bull markets go to people’s heads. If you’re a duck on a pond, and it’s rising due to a downpour, you start going up in the world. But you think it’s you, not the pond.” — *Charlie Munger*

One of the key contributors to the lavish investment returns over the past four decades has been a decline in interest rates. Let’s consider that a mature, stable company that earns one billion dollars of profit annually may be valued at only \$5 billion when interest rates are 14%, as they were in the early 1980s (and for a brief moment in 1981, 10-year treasuries yielded more than 15% and the S&P 500 sold for seven times earnings!). In contrast, the same company (earning identical profits) might have been bought and sold for \$20 billion dollars in 2021, when long-term treasuries yielded less than 2% and the S&P sported a P/E ratio in the mid-twenties. In this case, the change in interest rates alone provided a 300% capital gain, without an increase in the company’s earning power. Furthermore, when you mix lush capital gains with cheap borrowing costs, you get the perfect concoction for the highly leveraged investor—just ask the private equity funds. While they would never acknowledge it, especially to themselves, much of their wealth is thanks to low interest rates and not their own skills. They may soon find this out the hard way.

Well, as Herbert Stein once said, “If something cannot go on forever, it will stop.” Clearly, a decline in interest rates of a similar magnitude cannot be replicated in the coming decades. In fact, it would not be surprising if rates remain meaningfully higher than they have been since the downturn in 2008. Many equity and real estate investors naively believe it inevitable that the easy money days will return and that markets will behave as they did in the decade following the Global Financial Crisis. My point is not that they are necessarily wrong, but that their certainty is a reflection of their naiveté and is not rational.

## Our Activities in 2022

The following are the most noteworthy investments we made last year, in order of importance:

1. During 2022, we allocated a meaningful percentage of our capital to an investment that was first initiated in December of 2021. It's now the largest single investment in the history of BlackBird. Here are some "back-of-the-napkin" numbers:

	USD IN BILLIONS
<b>Price (as of 12/30/22)</b>	<b>240</b>
<b>Subtract Net Cash</b>	<b>50</b>
<b>Enterprise Value</b>	<b>190</b>
<b>Subtract Non Core Investments</b>	<b>100</b>
<b>Price for Core Operations</b>	<b>90</b>
<b>Net Income from Core</b>	<b>16</b>
<b>Core Earnings Yield</b>	<b>18%</b>

Qualitatively, this business possesses the following strengths:

- A very strong, durable competitive advantage. While the field has many players, none are in the position to offer a product of the same grade. It is not for lack of trying! In fact, for more than two decades, competitors have attempted to take market share, but have made no inroads. In my view, our investee has a lead that is insurmountable.
  - A management team among the best I've encountered. I've been following this company for some time now, and have found that the decisions made by the executive team have been consistently intelligent and in the interest of shareholders.
  - A conservative capital structure with no dependence on debt. Even a great enterprise can be vulnerable under a heavy debt burden. In the case of our investee, this exposure does not apply.
2. In October, we invested in a company I consider to be one of the gems of our generation. They exhibit many of the same strengths as the company above and would typically fetch a very rich valuation. Thanks to an industry-wide cyclical slowdown, however, the price has fallen to a bargain level. While the existing headwinds will impact operating results in the short-term, the company's underlying strengths are intact and their long-term prospects have not been diminished.

3. In November, we invested in a merger arbitrage opportunity. I believe the price is very attractive on an expected value basis. While the current market price implies a 40% probability of completion, I have studied the key factors and believe this to be extremely pessimistic. Nevertheless, because this investment provides far less assurance of a profitable outcome than the two previously mentioned positions, its size is limited. In fact, should the deal fail to consummate and the price falls, the impact on our overall results for the year will amount to no more than a rounding error.

### **Outlook for 2023**

It always amazes me when I hear financial analysts proclaim market forecasts as a fool's errand, then proceed to offer a forecast of their own, rendering them a fool by their own admission! These are intelligent, well educated people, but they don't behave in a sensible manner. There is an infestation of irrational thinking on Wall Street, and it is on full display when many major analysts publish their price targets for the year ahead. Since there is little likelihood that they are correct, their forecasts are useless. Even so, they will continue this practice year after year. I would never call them insane, but Einstein might.

It follows that if you've been seeking an array of 12-month price targets, you've come to the wrong place. I will say, however, that you should be prepared for a fair dose of volatility in the year ahead since our largest holding will likely continue to exhibit meaningful price gyrations. Like most of you, I would prefer less volatility, all else being equal, but we will not forgo better performance just to avoid a bumpy ride. As Warren Buffet says, "I would much rather earn a lumpy 15 percent over time than a smooth 12 percent."

All in all, I have never felt more confident about our long-term prospects. Coming into 2023, our portfolio is more attractive than it has ever been. While it won't be a straight line, I expect we'll earn very good returns in the years ahead, and I'm thrilled to have you along for the ride.

Your fiduciary,

Judah Spinner, CFA  
Chief Investment Officer