
Margin of Safety

(Richmond Oct 25, 2024)

Karthik Tiruvarur

Relevance for today's presentation

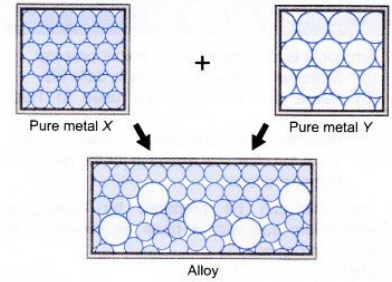
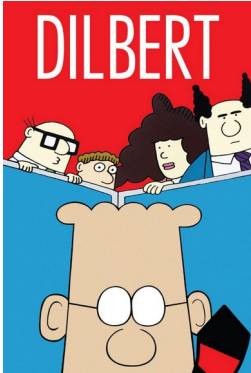


Figure Making of alloy

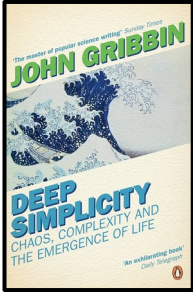


"Wretched excesses"



**A few of my learnings across
VC , Growth Equity, Public Markets**

Power Law, all around

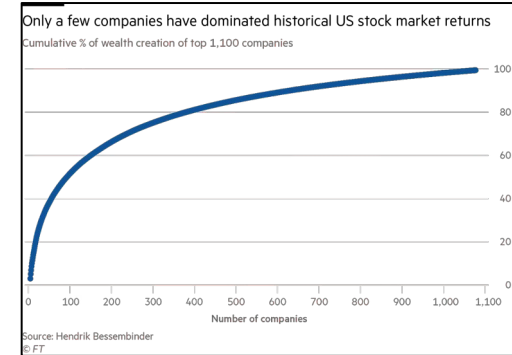


Power Law, all around (... contd)



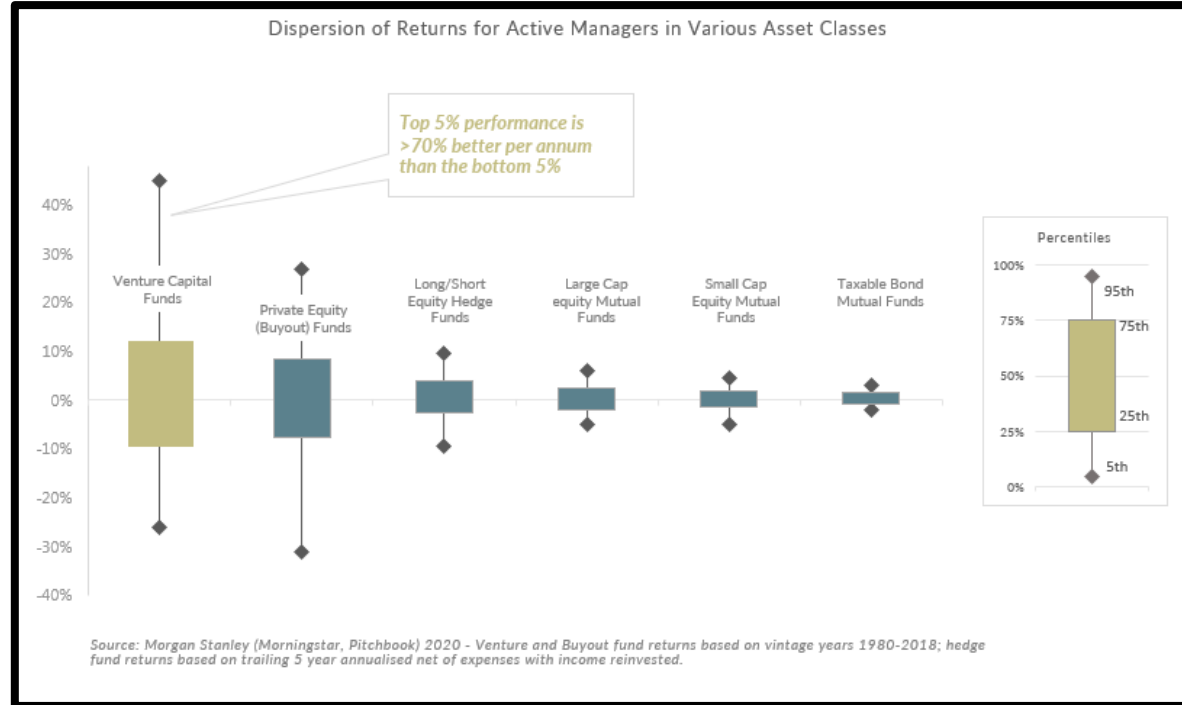
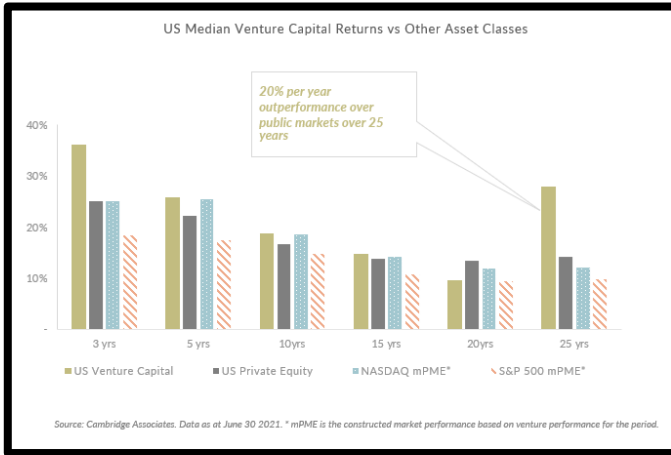
At this point, a report card from me is appropriate: In 58 years of Berkshire management, most of my capital-allocation decisions have been no better than so-so. In some cases, also, bad moves by me have been rescued by very large doses of luck. (Remember our escapes from near-disasters at USAir and Salomon? I certainly do.)

Our satisfactory results have been the product of about a dozen truly good decisions – that would be about one every five years – *and* a sometimes-forgotten advantage that favors long-term investors such as Berkshire. Let's take a peek behind the curtain.



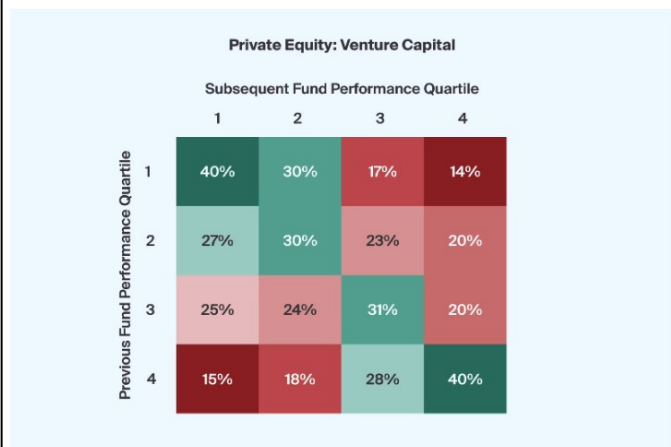
Hendrik Bessembinder, a professor of finance at Arizona State University, has documented an extraordinary pattern of wealth creation in public equity markets.³ Nearly 60 percent of companies that have been public in the U.S. over the last century or so have failed to create value, defined as earning total shareholder returns in excess of one-month Treasury bills. And only 2 percent of companies were responsible for more than 90 percent of the aggregate net wealth creation.

Power Law effects more extreme in VC > growth equity > public market managers



PE managers demonstrate Persistence of returns

Mature venture capital funds demonstrated a strong pattern of performance persistence, particularly for those preceded by the best and worst-performing funds (Exhibit 3)



Source: Preqin; includes all Preqin Venture Capital funds from 1969 to 2013 identified with a Fund Series and Fund Series number. Quartile is Preqin Quartile Rank, a ranking based on a comparison against a larger sample size of peers that have reported performance within the most-up-to-date range. As of July 31, 2023

Finance and Economics Discussion Series (FEDS)

April 2016

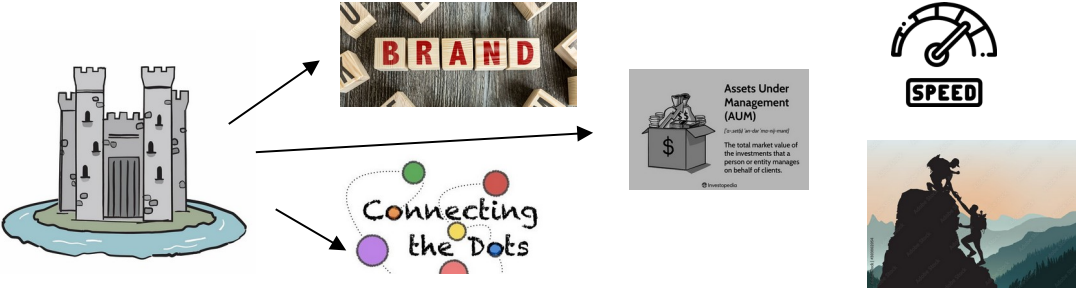
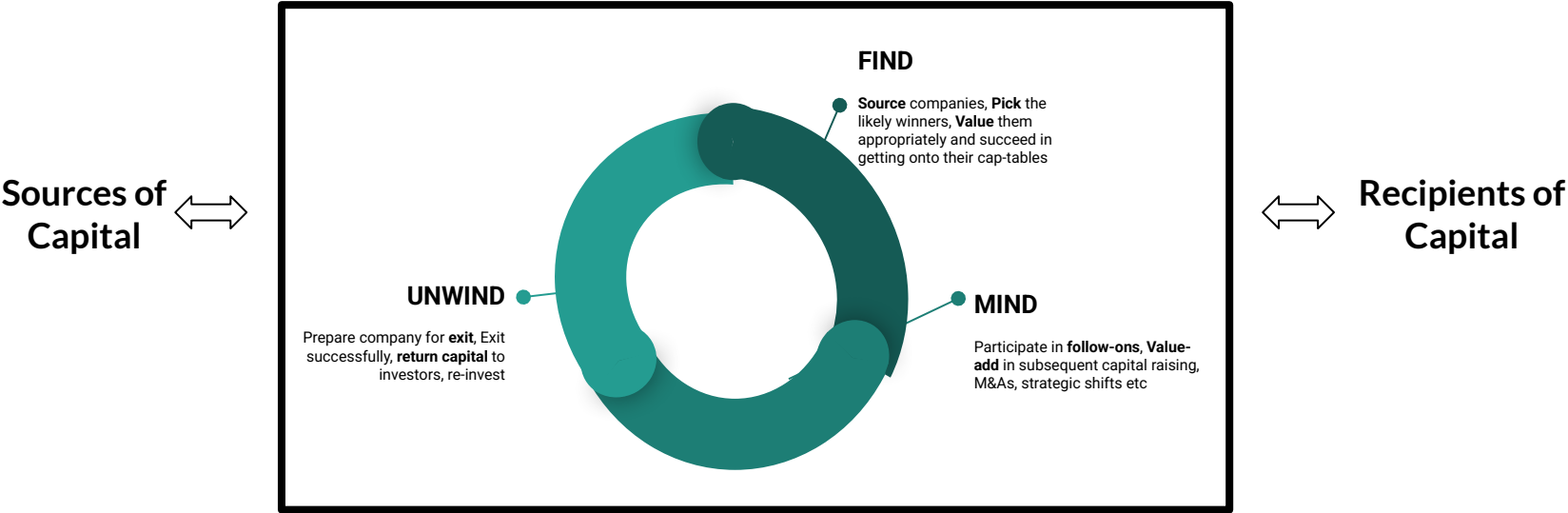
Only Winners in Tough Times Repeat: Hedge Fund Performance Persistence over Different Market Conditions

Zheng Sun, Ashley W. Wang, and Lu Zheng

Abstract:

We provide novel evidence that hedge fund performance is persistent following weak hedge fund markets, but is not persistent following strong markets. Specifically, we construct two performance measures, *DownsideReturns* and *UpsideReturns*, conditioned on the level of overall hedge fund sector returns. After adjusting for risks, funds in the highest *DownsideReturns* quintile outperform funds in the lowest quintile by about 7% in the subsequent year, whereas funds with better *UpsideReturns* do not outperform subsequently. The *DownsideReturns* can predict future fund performance over a horizon as long as 3 years, for both winners and losers, and for funds with few share restrictions.

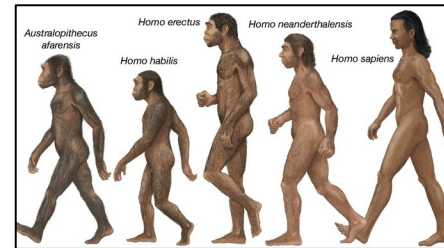
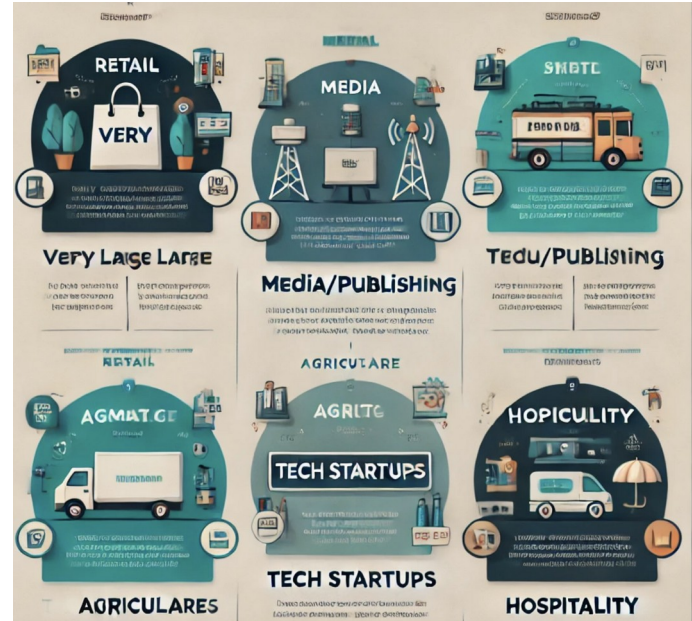
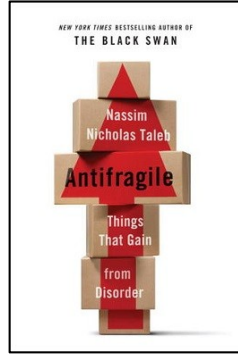
Persistence of returns (contd... the PE process)



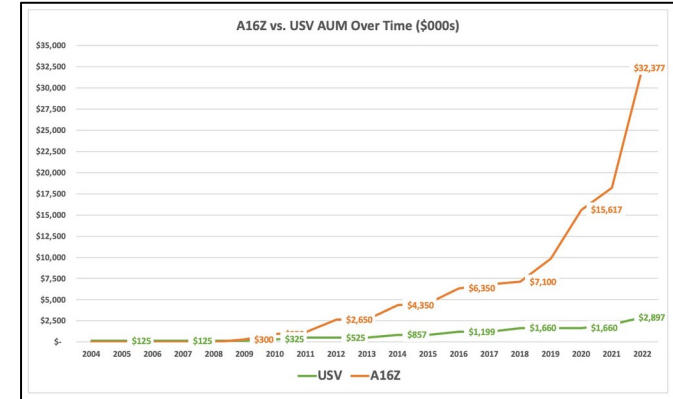
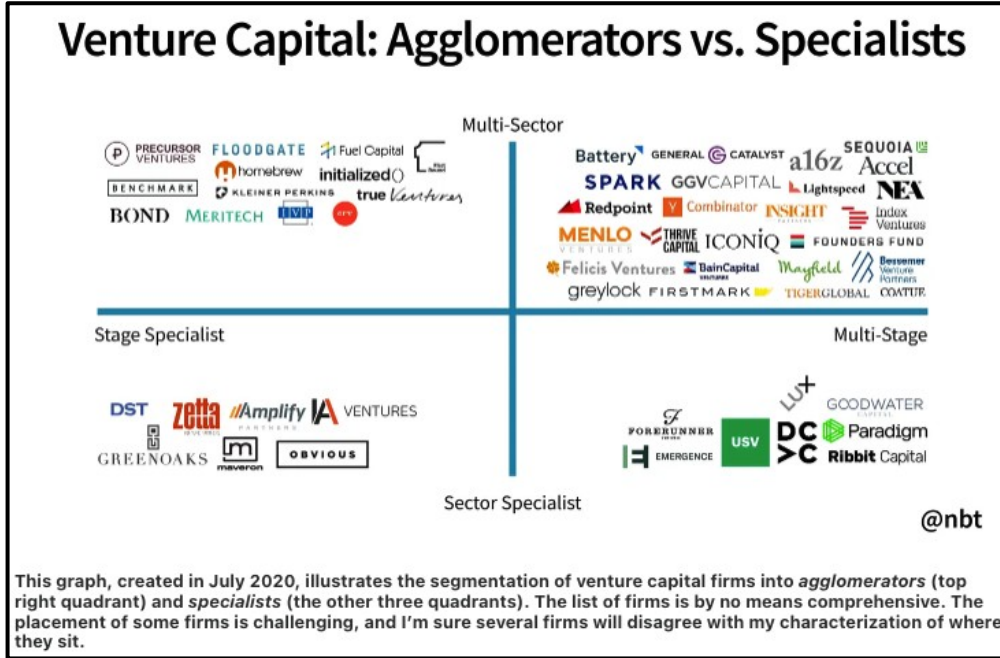
Results in large getting larger



The missing middle (specialize, scale or be squeezed)



The middle squeeze (contd..)



BENCHMARK

- Low Velocity, Higher IRR / MoM
- Main advantages = signaling, building a board of directors
- Disadvantage = expensive capital
- Best for: early founders looking for validation/help

Dead Zone

andressen. horowitz

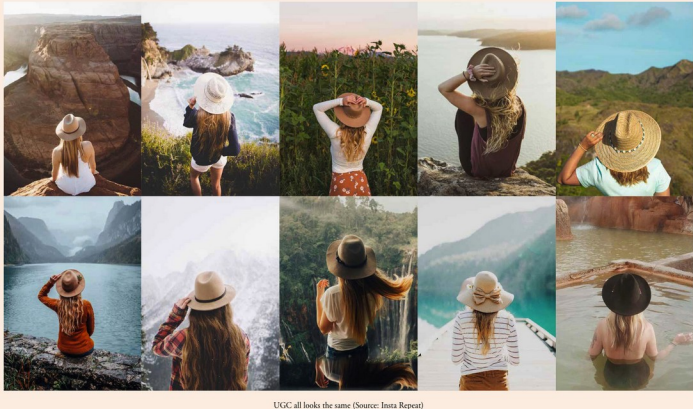
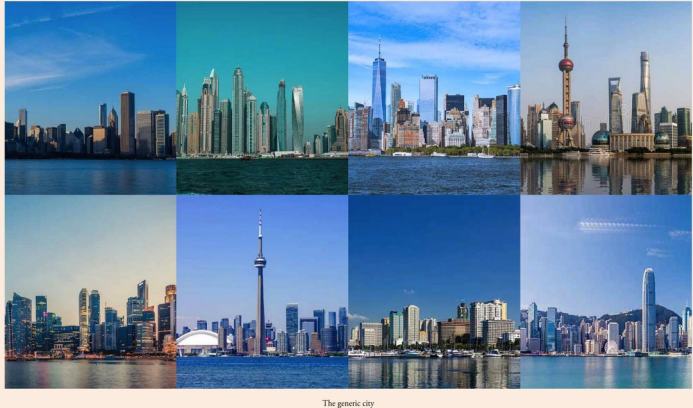
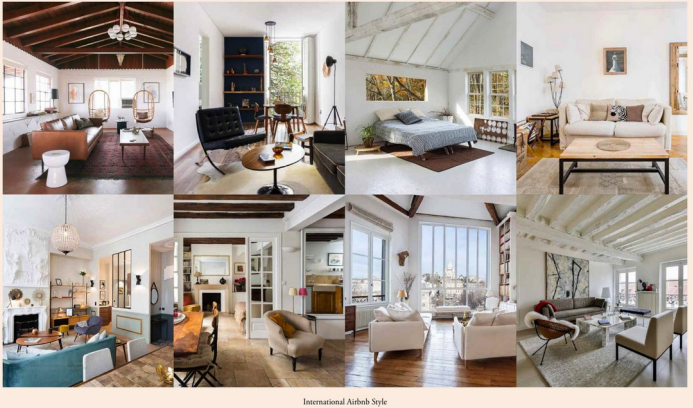
- High Velocity, Lower IRR MoM
- Main advantages = speed, cost of capital
- Disadvantage = no signaling
- Best for: late-stage businesses that need no help

TIFFANY & CO.

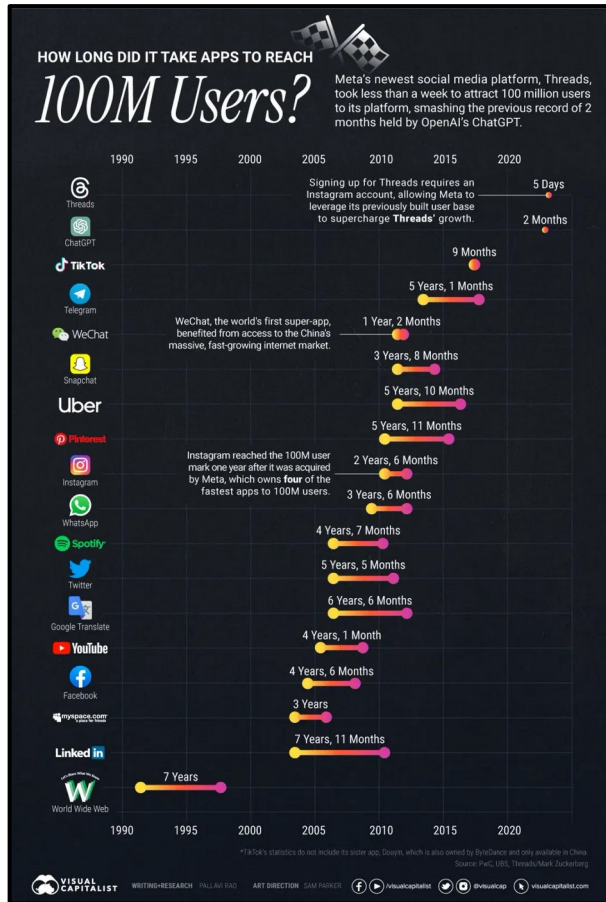
JCPenney

Walmart
Save money. Live better.

Age of standardization, averages and sharing content ...



... reinforcing power laws, hollowing out the middle



| | Video name | Uploader | Views (billions) | Date |
|----|---|---|------------------|-------------------|
| 1 | "Baby Shark Dance" ^[7] | Pinkfong Baby Shark - Kids' Songs & Stories | 15.15 | June 17, 2016 |
| 2 | "Despacito" ^[10] | Luis Fonsi | 8.56 | January 12, 2017 |
| 3 | "Johny Johny Yes Papa" ^[18] | LooLoo Kids - Nursery Rhymes and Children's Songs | 6.96 | October 8, 2016 |
| 4 | "Bath Song"  ^[19] | Cocomelon - Nursery Rhymes | 6.87 | May 2, 2018 |
| 5 | "Wheels on the Bus" ^[20] | Cocomelon - Nursery Rhymes | 6.61 | May 24, 2018 |
| 6 | "See You Again" ^[21] | Wiz Khalifa | 6.42 | April 6, 2015 |
| 7 | "Shape of You" ^[26] | Ed Sheeran | 6.34 | January 30, 2017 |
| 8 | "Phonics Song with Two Words"  ^[29] | ChuChu TV Nursery Rhymes & Kids Songs | 6.03 | March 6, 2014 |
| 9 | "Uptown Funk" ^[30] | Mark Ronson | 5.35 | November 19, 2014 |
| 10 | "Gangnam Style" ^[31] | Psy | 5.31 | July 15, 2012 |

Some themes I pay attention to

Zig, when others Zag (ownership)

SEQUOIA ✦ HERITAGE



Fox or Hedgehog?

* Foxes are great at raising capital - they thrive in bubble markets. Hedgehogs would rather bootstrap - they do far better during the inevitable crashes.
- Altos Blog "Foxes and Hedgehogs in Silicon Valley" (2006)
altos.typepad.com

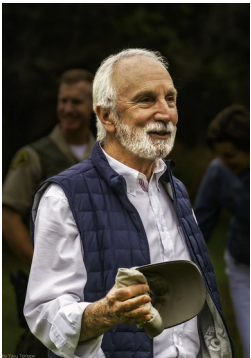
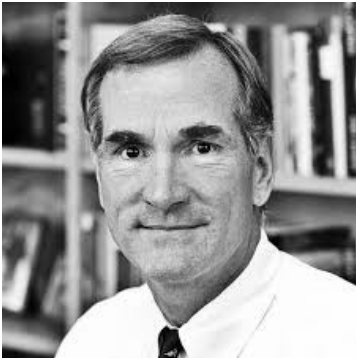
Together



S A T O R
G R O V E
H O L D I N G S



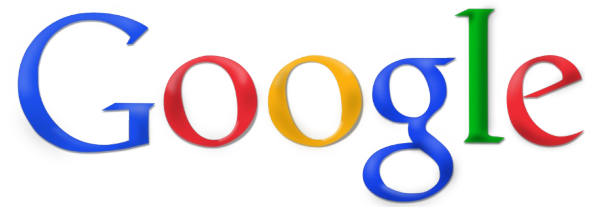
Zig, when others Zag (silent execution)



Zig, when others Zag (size)



Zig, when others Zag ('takes one to know one')



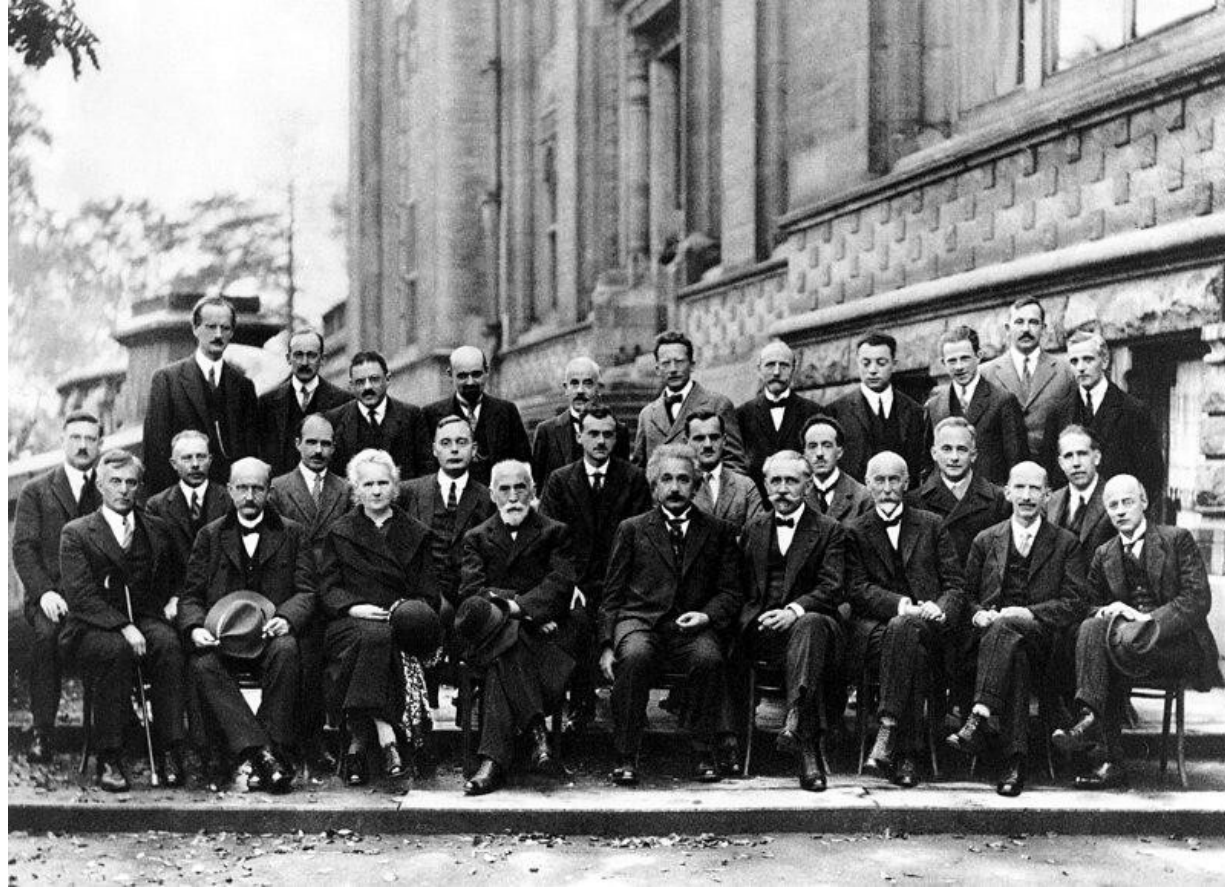
Zig, when others Zag ('takes one to know one')

"The Irascibles" (Abstract Expressionists), *Life Magazine* cover story, 1951



Theodoros Stamos, Jimmy Ernst, Barnett Newman, James Brooks, Mark Rothko, Richard Pousette-Dart, William Baziotis, Jackson Pollock, Clyfford Still, Robert Motherwell, Bradley Walker Tomlin, Willem de Kooning, Adolph Gottlieb, Ad Reinhardt, Hedda Sterne

Zig, when others Zag ('takes one to know one')



SOLVAY CONFERENCE
1927

"IF I SAW THIS
FAR, IT IS BY
STANDING ON
THE
SHOULDER OF
GIANTS"

Taleb's work on
fat tails;
coincidences
happen more
often that we
anticipate