Kopion
Asset Management

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Sowing & Reaping, Revisited

May those who sow in tears reap with shouts of joy. Those who go out weeping, bearing the seed for sowing, will come home with shouts of joy, carrying their sheaves.

-Psalm 126:5-6

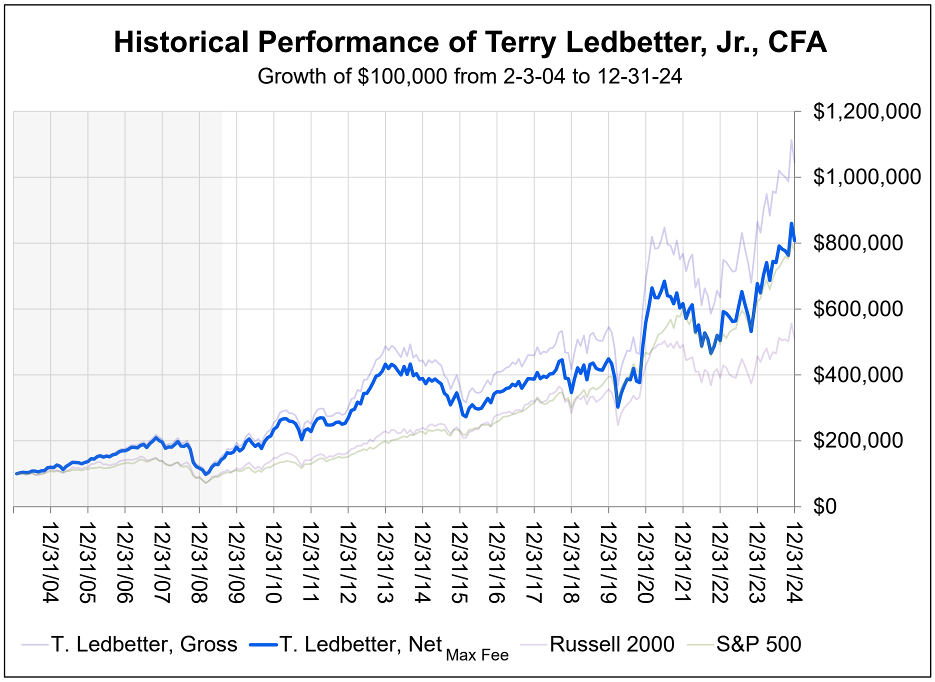
Friday, January 17, 2025

Dear Kopion Clients,

2024 was a terrific year for our portfolio. Kopion returned 20.8% before fees (19.5% after fees). The Russell 2000 and S&P 500 returned 11.5% and 25.0%, respectively.

This month marks the 10 year anniversary of a very challenging season for Kopion that we were ultimately rewarded for persevering through. I'd thus like to look farther back than a typical year-end letter to reflect on some of the "big picture" lessons from that time. These are not entirely new ideas, but I have come to understand them with a new level of depth, confidence, and nuance.

I began managing my first diversified investment account in early 2004 while working for another firm. Over my first ten years, I certainly experienced some set-backs, but they were manageable and the portfolio usually recovered to new highs relatively quickly. This changed in 2014 as illustrated by the chart on the right.



Shaded area indicates period employed by Friedberg Investment Management.
Please see Performance Disclosures for additional information.

Although the portfolio that I managed declined during the 2008-2009 financial crisis, that draw-down was during a historic recession and the time elapsed from new-high to new-high was only about 3 years. Starting in 2014, by contrast, Kopion's portfolio declined about 37% during a relatively stable economy. Moreover, while the portfolio technically regained its prior peak about 4¾ years later, it took about 7 years in total to convincingly break through to a new-high. My investment process had not changed, but it had stopped "working" in the sense that the near-term outcomes were weak. The late hedge fund manager Frederick (Shad) Rowe, Jr. wrote about this type of situation:

> *. . .with the possible exception of Warren Buffett—who seems to be an investor for all seasons—money managers have cold spells. . . Competent people can look and feel extremely incompetent. It is exasperating. . . If investors stick to their* <u>*disciplines*</u>*, those feelings of self-doubt pass fairly quickly. But, for investors who rely almost exclusively on intuition rather than on strong fundamental disciplines, the feelings of self-doubt may very well be justified. International investors, for example, who try to keep up with currencies, global warming, politics in the Balkans, etc., are more subject to "losing it" than Graham-and-Dodd-type value investors.*[1]

Kopion's investment process, what Rowe referred to as "disciplines," was solid, and I wrote in our 2014 client letter about how I would continue "sowing" the seeds of Kopion's investment process despite disappointing short-term results. After several years of perseverance, our results improved markedly as shown in the chart above. The commitment to continue "sowing" throughout the challenging years underpinned the "harvest" many years later.

The challenging years, however, did uncover two important areas where Kopion's process needed to be refined. The first related to risk management. Investing more funds in beaten-down positions is a common practice among value investors. Earlier in my career, I had done this somewhat mechanically, but around 2014, that simplistic approach led to some large holdings that underperformed for several years. I eventually came to recognize the need to become slower and more discerning when adding to beaten-down positions because out-of-favor stocks sometimes remain so for a long time. The second refinement related to stock selection. While the preponderance of Kopion's portfolio had been made up of "A grade" compounders, a few "C grade" companies had made it into the portfolio over the years due to their extraordinarily low valuations. Some value investors can do well with those types of stocks, but that approach requires a ready willingness to sell. Kopion's compounder-centric process, by contrast, is geared towards holding on tight and buying more when stocks decline. There was thus a mismatch between Kopion's process and a few of our holdings. This also contributed to my process not working as I expected it to during that time. Entering the mid-2010's, we had a small number of such "C grade" holdings, but they were among our larger positions. We were eventually able to divest them on reasonable terms and now focus exclusively on compounders.

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[1] Rowe Jr., Frederic E. "Losing it." *Forbes*, June 1991, pg. 140. Emphasis added.

The conviction that was tested most severely during the difficult years relates to how I define success. Fairly early in my career, I had come to view success as making good decisions, regardless of the results. In my opinion, Kopion is ultimately in the decision business. We are looking to pile good decision upon good decision in the hopes of achieving good outcomes over time. My intellect, however, had a firmer grasp of this concept than my heart. During Kopion's challenging years, I discovered that part of my heart still shared the world's definition of success, which is rooted in comparison. As C.S. Lewis explained:

> *Pride gets no pleasure out of having something, only out of having more of it than the next man. We say that people are proud of being rich, or clever, or good-looking, but they are not. They are proud of being richer, or cleverer, or better-looking than others. If everyone else became equally rich, or clever, or good-looking there would be nothing to be proud about. It is the comparison that makes you proud: the pleasure of being above the rest.*[2]

The magnitude of my disappointment during the challenging years opened my eyes to how I had been deriving part of my sense of worth and security from outperforming other investors. The Bible, by contrast, offers a rival view of value and security. It claims that there is a God who made each of us and who loves us so much that He paid an exorbitant price (read: "value") to pursue a close relationship with us. Looking to this exclusively for my sense of worth has been difficult, but I am making progress.

A final lesson I will touch on from Kopion's challenging years is the paramount importance of staying power. Fortitude has got to be one of the most important, but least discussed attributes of an investment firm. It is required to eventually reach a good harvest! And our commitment to sowing has continued during the recent years of improved annual returns. For example, in 2024 we were able to invest in two new compounders that for various reasons had fallen to their lowest valuations in several years.

In summary, ten years ago Kopion entered a period that would test my convictions. We "sowed in tears," but stayed the course, became better investors along the way, and eventually enjoyed a good harvest.

Thank you for sowing with me!

Best regards,

Terry Ledbetter, Jr., CFA

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[2] Lewis, Clive. *Mere Christianity*, Harper Collins, 1952, pg. 122. Emphasis added.

PERFORMANCE DISCLOSURES

Period	Kopion, Gross	Kopion, Net $_{\text{Max Fee}}$	Russell 2000	S&P 500
Annualized*				
1 Year	20.8%	19.3%	11.5%	25.0%
3 Years	10.8%	9.4%	1.2%	8.9%
5 Years	13.9%	12.5%	7.4%	14.5%
10 Years	8.9%	7.6%	7.8%	13.1%

*Ending 12-31-24

Past performance does not guarantee future results. Investments with Kopion may lose value.

Terry Ledbetter, Jr. began managing his first diversified investment account on 2-4-04 while employed by Friedberg Investment Management (FIM). Mr. Ledbetter left FIM on 7-31-09 and founded Kopion Asset Management, LLC (Kopion), which became a legal entity on 8-24-09. Importantly, when Mr. Ledbetter founded Kopion, he continued to manage the same accounts that he had been managing while employed by FIM. The accounts, investment strategy, and investment process all remained the same. The performance information cited throughout Kopion's marketing materials includes all of the diversified investment accounts managed directly by Mr. Ledbetter since 2-4-04, which is when he began managing his first diversified investment account. This information is provided for both Mr. Ledbetter's entire performance history as well as for the portion of Mr. Ledbetter's performance history that occurred after Kopion was founded and became a legal entity.

The performance information cited throughout Kopion's marketing materials has been thoroughly documented, and it has been calculated using normal industry protocols, which are described in more detail below. This information has not, however, been audited by an independent third party. Dividend and interest income in these accounts was reinvested. Returns for these accounts have been asset-weighted to calculate historical returns. Said another way, the accounts were aggregated into a single group and then performance was calculated for that single group. This group includes some sub-accounts and securities that were carved out of larger accounts in order to exclude assets like mutual funds that Mr. Ledbetter did not manage directly. Those mutual funds were managed by professionals at third party firms, and Mr. Ledbetter's involvement was limited to being a passive shareholder of those mutual funds. In addition, some of those mutual funds followed fixed income strategies, which were very different from the strategy used by Mr. Ledbetter when he was employed by FIM and later at Kopion. Performance information that includes assets like mutual funds that were not managed directly is available, and Kopion will provide it promptly upon request.

Kopion reports its Time Weighted Returns (TWRs). TWRs make adjustments for deposits and withdrawals so that those transactions do not influence performance results. Consequently, deposits do not increase the return, and withdrawals do not decrease the return. TWRs thus allow for performance comparisons between Kopion's (and Mr. Ledbetter's) history and market indices.

Kopion reports both "gross returns" (which are returns before Kopion's management fee) and "net returns" (which are returns after deducting Kopion's management fee). Kopion's management fee schedule is graduated, which means that the fee rate begins to decrease after an account's dollar value exceeds a certain threshold. The label "Net $_{\text{Max Fee}}$" indicates that the net returns being presented reflect Kopion's maximum fee rate for all periods presented. The words "net" or "after fees" without the words "Max Fee" in subscript lettering indicates that the net returns being discussed reflect actual fees.

Kopion has provided the returns of the Russell 2000 and the S&P 500 indices in order to provide the broader stock market context of Kopion's (and Mr. Ledbetter's) returns. The Russell 2000 tracks the performance of relatively small publicly traded companies, and the S&P 500 tracks the performance of relatively large ones.

Kopion does not “benchmark” its portfolio against indices in the traditional sense of carefully managing the portfolio for comparison against a specific index. Instead, these two indices are used as broad indicators of the stock market’s performance. Kopion (and Mr. Ledbetter) has primarily focused on small and medium sized firms, but it (and he) has also invested in some large companies as well. This is why Kopion has provided the results of both the Russell 2000 and the S&P 500. These indices cannot be invested in directly, but mutual funds and exchange-traded funds that track these indices (“index funds”) are available in the market. Kopion’s (and Mr. Ledbetter’s) investment strategy carries more risk than investing in an index fund that tracks either the Russell 2000 or the S&P 500. This is primarily because Kopion’s (and Mr. Ledbetter’s) strategy involves investing in a relatively small number of stocks and those stocks are primarily for small to medium sized companies. This approach results in greater volatility and greater risk of capital loss than index funds tracking either the Russell 2000 or the S&P 500.

Indices’ performance figures have been obtained from sources believed to be reliable.