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Playing a Very Long Game

Monday, July 12, 2021

Dear Kopion Clients,

During the first half of 2021, Kopion returned 22.9% before fees (22.3% after fees). The S&P 500 and the Russell 2000 returned 15.3% and 17.5%, respectively. Our recent results have been very encouraging, especially since they build directly upon our strong performance in 2020. That said, I would like to remind everyone that Kopion is playing a very long game. We simultaneously look to the future with an expectation of success while accepting that this is a journey with both progress and setbacks.

For most people, the overall investing game spans decades. The underlying assets, accounts, and related professionals can change over time, but there is a continuity for the dollars. For example, a young couple may open a Roth IRA, later use some of those funds towards a down payment on a first home, eventually upgrade to a larger house, and ultimately downsize to a small home and use the proceeds for living expenses. In cases where assets are left to heirs, the investment process will extend even longer. Those initial IRA dollars would have followed a very long journey. In my opinion, it is thus essential to relate to investing on a very long time scale because investing is a fundamentally long-term endeavor. This is unfortunately at odds with the natural human tendency to place too much importance on recent events. So how do we reckon with the present in all its forms and simultaneously persevere towards a goal in the distant future? I believe that success on this front requires a deep foundation of relevant knowledge and a personal character that strikes a balance between confidence and humility. To draw on a sports analogy, when a basketball team completes a game, they will face choices about how to interpret their performance. Are adjustments needed? In cases where the team's strategy is already sound, the best choice could be to stay the course. Indeed, making certain adjustments might actually lead them away from their ultimate goal, which is to have a good season.

Kopion's ultimate goal is to grow your assets over a long period of time. In industry parlance, we are in the "capital appreciation" game. The variability and length of this endeavor, however, raises two important questions:

1. Is Kopion following a good strategy for playing this game?
2. If we believe that investing is a very long endeavor, how do we ensure that we can stay in the game?

I have discussed the merits of Kopion's strategy at length previously, so I will only touch on one facet of our approach that relates to the current moment in the stock market. Many observers are concerned that the overall market is currently overvalued. If they are proved correct, the next bear market is not necessarily imminent, but returns could be weak in the coming years.¹ Kopion is not entirely immune to this, but we do regularly trim our positions in stocks that have gotten ahead of themselves and reinvest the proceeds into other holdings that offer more attractive valuations. Index funds, by contrast, simply allow overvalued holdings to become over-represented. I thus believe that Kopion's investment process has enabled us to maintain good overall values in our portfolio. This should conceptually put us on better footing, looking out over the next several years. (For more details about Kopion's strategy, please refer to [The Kopion Difference](#) or [Client Letter Archive](#) pages of our website.)

I'd now like to turn to the question of "staying in the game." Remaining in a long game requires foresight, preparation, and resolve. This is the reason that when I initially meet with prospective clients, I explain the need to be emotionally committed to staying with Kopion for at least five years if they join. It is also the reason that I so often discuss perseverance in my client letters. With respect to Kopion's own ability to stay in the game, I have made and upheld many design decisions that are centered around Kopion's longevity. A few simple examples include:

- Marketing the firm in a way that will only attract like-minded clients who share our long-view of the future.
- A low and variable expense structure for Kopion as a business. This results in a low revenue breakeven level, which allows us to endure extended down cycles.
- A single Model Portfolio and standardized investment service. This ultimately maximizes our time available for research, which increases the quality of our decision making.
- Never buying stocks on margin or short selling. Investors who engage in these tactics are sometimes forced to take a short-term view, which can result in crippling mistakes.
- A commitment to limit Kopion's size. I will return to this point shortly.

These and other attributes have greatly enhanced our ability to stay the course through difficult times, such as what we endured from 2014 through 2016. This staying power is absolutely critical. It protected us from being forced to quit at a low point or adjust our strategy in short-sighted ways. Moreover, remaining faithful to our investment process during that period set the stage for the strong results that we have enjoyed since then.

I will now return to the matter of Kopion's size. As of this writing, Kopion is managing about \$144M. A key part of our strategy involves investing in companies that are relatively early in their lifecycles and still offer strong opportunities for growth. These companies are usually smaller in size, and their shares trade in lower volumes. This makes them inaccessible to many professional investors who typically need to accumulate a very high

¹ For a balanced and cogent discussion of this, please refer to Mark Hulbert's article, "How Long Might the Next Bear Market Last?," published in *The Wall Street Journal*. on July 5, 2021.

number of shares. This corner of the stock market thus attracts less attention and is more likely to offer good deals. Kopion is still a small firm, but accumulating shares in small stocks is already becoming more challenging. This has led me to rethink the point at which Kopion will need to stop accepting deposits. In 2015, I formally committed to do this when our assets under management reach \$400M. My current thinking, however, is that we will need to close to new assets somewhere around \$200-250M. At that point we would begin a waiting list. I have not settled on the final number, but this is a key decision for me to cement in order to ensure that Kopion can remain faithful to its investment process.

Our lives involve many different long games, even though we don't always recognize them as such. I am discovering that relating to life on a very long time scale can help me to remain content when circumstances are difficult. I have been reading through the Psalms in the Bible, and a recurring pattern has been the writer's initial dismay in the face of mortal danger, followed by a conviction that God is in charge and will ultimately protect him. Said another way, he enjoyed peace when he could recognize and play the long game. Indeed, the Bible's broader message is that God is playing the longest game of all, painstakingly drawing people back into relationships with Himself.

Thank you for letting Kopion be part of your long game.

Best regards,

Terry Ledbetter, Jr., CFA

PERFORMANCE DISCLOSURES

Period	Kopion, Gross	Kopion, Net <small>Max Fee</small>	S&P 500	Russell 2000
1st Half of 2021	22.9%	22.2%	15.3%	17.5%
Annualized*				
1 Year	26.4%	24.8%	18.4%	20.0%
3 Years	14.5%	13.1%	14.2%	10.2%
5 Years	13.5%	12.1%	15.2%	13.3%
10 Years	10.4%	9.1%	13.9%	11.2%

*Ending 12-31-20

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 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 reflects actual fees.

Kopion has provided the returns of the S&P 500 and the Russell 2000 indices in order to provide the broader stock market context of Kopion's (and Mr. Ledbetter's) returns. The S&P 500 tracks the performance of relatively large publicly traded companies, and the Russell 2000 tracks the performance of relatively small 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. Mr. Ledbetter has primarily focused on small and medium sized firms, but he has also invested in some large companies as well. This is why Kopion has provided the results of both the S&P 500 and Russell 2000. 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 S&P 500 or the Russell 2000. 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 S&P 500 or the Russell 2000.

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