<u>Shareholder Letter to Partners</u>

CLEARDROP
INVESTMENT

Partners,

2022 presented fierce challenges in the macroeconomic environment. With the Federal Funds Rate rising rapidly from nearly 0% to 5.25%, long investors had to reconsider while short investors were presented with many reasons to rejoice. Interestingly, we managed to raise capital from investors during this tumultuous period. Hence, bearing ripe returns for those who committed capital in moments of market-wide panic. Hence, as valuations lowered, we acted with vigor and made sizable investments into companies presenting more than favorable characteristics. Financial markets tend to reward discipline and patience over long time horizons.

1) “Mimicking the herd invites regression to the mean”
   One critical facet of investing is simply that the investors are endowing their long and hard-earned capital to the investment manager to increase each investor's net investment returns. Thus, it is important for the investment manager to not only be different in order to outperform specified indices, but also to be correct in taking positions against the crowd. In other words, the barrier for standing out amongst the crowd is substantially heightened. Hence, managers who exude calm, focus, and unwavering temperaments tend to succeed at the highest levels.
   Managers following the institutional imperative may question why they are adhering to such a company-wide policy or worse, not question the imperative set by larger institutions and simply accept the status quo.

2) “We can easily forgive a child who is afraid of the dark; the real tragedy of life is when adults are afraid of the light”
   Plato highlights the universal theme of the human condition: fear and the pursuit of knowledge. Such a saying encourages individuals to embrace the light and overcome their fears, suggesting that the path to personal growth and fulfillment lies in confronting and comprehending the unknown. Investment analysis involves reading financial statements, determining whether such statements portray an accurate picture of the financial position of the organization and then proceeding to determine whether the promised future returns justify the outlay of cash. Many individuals possess the skillset to assess the merits of an individual security or organization. The question remains, why is a large swath of the population choosing not to delve deeply into the statements? Ignoring access as a limiting factor, one critical reason stems from the avoidance of the uncomfortable truths embedded in such reports, which, if analyzed correctly, can yield inordinate measures of wealth. In other words, disconfirming evidence is sometimes too painful so most operate under false pretenses.

3) “Ideas are the source of all things”

For investors and shareholders alike, knowing what is known and knowing what is not known allows for the boundaries of one's knowledge base or circle of competence to be drawn. Investment ideas drawn from intensively observing business performance will contribute to higher returns over time. One core idea I would like to impart upon those reading this letter is that exceptional business returns come from organizations that are performing similar activities to what they were six, seven, or even 12 years ago. Dramatic change and exceptional returns do not mix well. In fact, the melange of the right ideas can compound both insights and returns, while the wrong concoction can play a role in imploding any positive results. Therefore, it is important to take away that errors of commission are far more fatal than errors of omission.

I have tried to highlight important points as well as impart knowledge of our philosophy. If there are any questions, I welcome hearing from you.