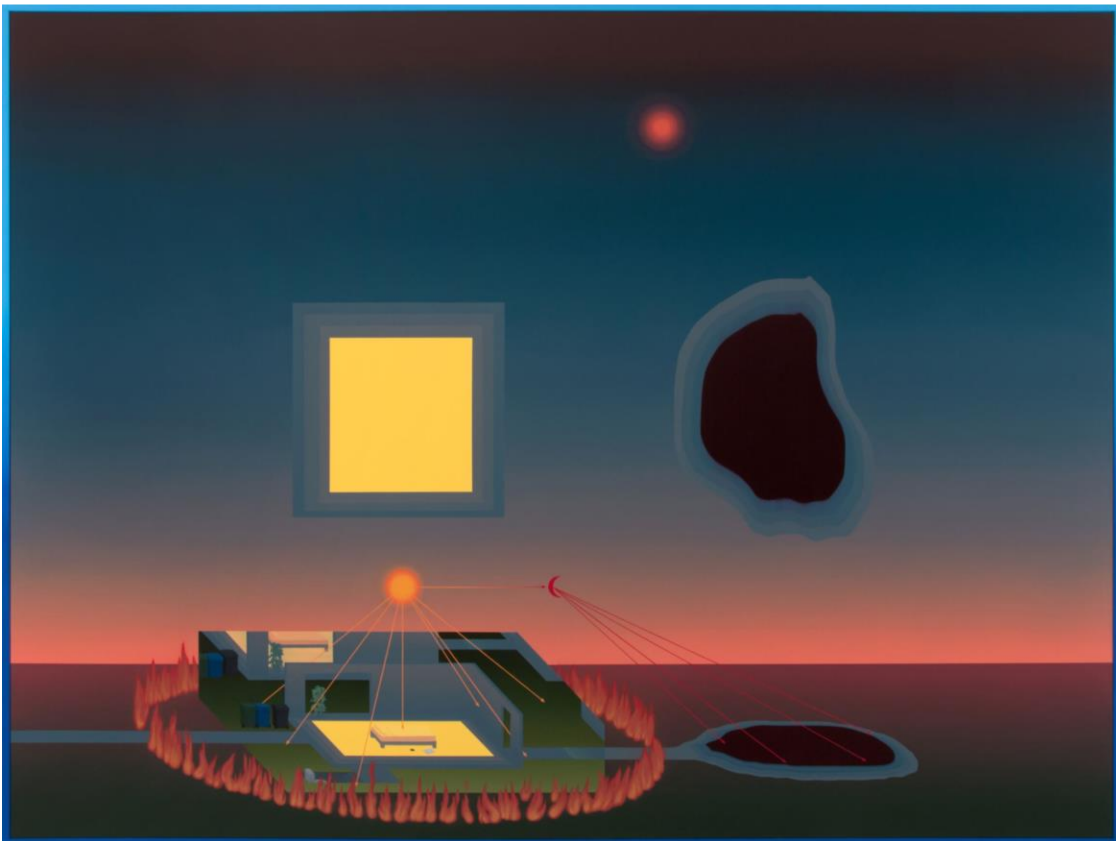
Annual Letter to our Partners 2023

30 Years

Rochon Global Portfolio



Nicolas Grenier
Écho, 2018
Oil and acrylic on canvas with painted frame
Giverny Capital Collection

Historical Summary

It has been more than 30 years since I discovered the writings of Warren Buffett, Benjamin Graham, John Templeton, Philip Fisher and Peter Lynch. I then decided to begin managing a family portfolio based on an investment approach synthesized from these great money managers. By the end of 1998, after five years of satisfactory results, I decided to launch an investment management firm offering asset management services aligned with my own investment philosophy. Giverny Capital Inc. came into existence.

In 2002, Giverny hired its first employee: Jean-Philippe Bouchard (JP). A few years later, JP became a partner and participates actively in the investment selection process for the Giverny portfolio. In 2005, two new people joined the firm who eventually became partners: Nicolas L'Écuyer and Karine Primeau. François Campeau, who joined the Giverny team in 2018, also participates in the investment selection process. In 2009, we launched a US office in Princeton, New Jersey. We also partnered with a manager from New York, David Poppe, in early 2020. He manages Giverny Capital Asset Management, based in Manhattan. Our two directors of our US offices, Patrick Léger and David Poppe, share in the culture and long-term time horizon inherent to Giverny.

We are Partners!

From the very first days of Giverny, the cornerstone of our portfolio management philosophy was to manage client portfolios in the same way that I was managing my own money. Thus, the family portfolio I've managed since 1993 (the "Rochon Global Portfolio") serves as a model for our client accounts. It is crucial to me that clients of Giverny and its portfolio managers are in the same boat! That is why we call our clients "partners".

The Purpose of our Annual Letter

The primary objective of this annual letter is to discuss the results of our portfolio companies over the course of the prior year. But even more importantly, our goal is to explain in detail the long-term investment philosophy behind the selection process for the companies in our portfolio. Our wish is for our partners to fully understand the nature of our investment process since long-term portfolio returns are the fruits of this philosophy. Over the short term, the stock market is irrational and unpredictable (though some may think otherwise). Over the long term, however, the market adequately reflects the intrinsic value of companies. If the stock selection process is sound and rational, investment returns will eventually follow. Through this letter, we provide you with the information required to understand this process. We try to be transparent and comprehensive in our discussion. The reason for this is very simple: we treat you the way we would want to be treated if our roles were reversed.

The Artwork on the cover of the 2023 Letter

We illustrate the cover page of our annual letters with a reproduction of a work from the Giverny Capital Collection each year. This year, we have selected a painting by Québec artist Nicolas Grenier entitled "Écho".

For the year ending December 31st 2023, the return for the Rochon Global Portfolio was 24.3% versus 17.5% for our benchmark, which represents a relative outperformance of 6.8%. The returns of the Rochon Global Portfolio and our benchmark include a loss of approximately 2.5% due to fluctuations in the Canadian currency.

Since its inception on July 1st 1993, the compounded annual return of the Rochon Global Portfolio has been 14.8% versus 9.3% for our weighted benchmark, representing an annualized outperformance of 5.5% over this period of 30 years. Our long-term and ambitious objective is to maintain an annual return 5% higher than our benchmark.

The Rochon Global Portfolio: Returns since July 1st 1993

Year *	Rochon	Index **	+ / -	$ US/Can ***
1993 (Q3-Q4)	**37.0%**	9.5%	**27.6%**	3.3%
1994	**16.5%**	3.7%	**12.7%**	6.0%
1995	**41.2%**	24.0%	**17.2%**	-2.7%
1996	**28.0%**	22.8%	**5.2%**	0.3%
1997	**37.8%**	28.6%	**9.2%**	4.3%
1998	**20.6%**	18.8%	**1.8%**	7.1%
1999	**15.1%**	16.3%	**-1.2%**	-5.7%
2000	**13.4%**	3.2%	**10.2%**	3.9%
2001	**15.1%**	-0.4%	**15.5%**	6.2%
2002	**-2.8%**	-18.3%	**15.6%**	-0.8%
2003	**13.6%**	14.0%	**-0.4%**	-17.7%
2004	**1.6%**	6.2%	**-4.5%**	-7.3%
2005	**11.5%**	3.6%	**7.9%**	-3.3%
2006	**3.5%**	17.0%	**-13.5%**	0.2%
2007	**-14.4%**	-11.6%	**-2.8%**	-14.9%
2008	**-5.5%**	-22.0%	**16.5%**	22.9%
2009	**11.8%**	12.2%	**-0.4%**	-13.7%
2010	**16.1%**	13.8%	**2.3%**	-5.3%
2011	**7.6%**	-1.1%	**8.7%**	2.2%
2012	**21.2%**	12.5%	**8.7%**	-2.2%
2013	**50.2%**	38.9%	**11.3%**	6.9%
2014	**28.1%**	17.8%	**10.2%**	9.1%
2015	**20.2%**	13.4%	**6.8%**	19.3%
2016	**7.3%**	14.3%	**-7.0%**	-3.0%
2017	**13.1%**	10.3%	**2.9%**	-6.6%
2018	**-0.6%**	-1.4%	**0.8%**	8.7%
2019	**25.6%**	22.3%	**3.3%**	-4.8%
2020	**12.9%**	15.1%	**-2.2%**	-2.0%
2021	**27.0%**	21.0%	**5.9%**	-0.4%
2022	**-15.2%**	-12.3%	**-2.9%**	6.8%
2023	**24.3%**	17.5%	**6.8%**	-2.3%
Total	**6682.2%**	**1401.0%**	**5281.2%**	**3.2%**
Annualized	**14.8%**	**9.3%**	**5.5%**	**0.1%**

* All returns are adjusted to Canadian dollars
** Index is a hybrid index (S&P/TSX, S&P 500, Russell 2000, MSCI EAFE) which reflects weights of the assets at the beginning of the year.
*** Variation of the US dollar compared to the Canadian dollar

Refer to Appendix B for disclosure statements on the Rochon portfolios.

Effect of the Canadian dollar versus the US dollar on our returns

It is informative to observe in the table above that the currency fluctuation effect ultimately had virtually no impact on our returns: since 1993, the Canadian dollar has depreciated a total of 3.2% against the US dollar—corresponding to an annualized positive effect of 0.1% on our returns.

The Rochon US Portfolio

We have been publishing the returns of the Rochon US Portfolio, which is entirely denominated in US dollars, since 2003. The Rochon US Portfolio corresponds approximately to the US portion of the Rochon Global Portfolio. In 2023, it realized a return of 26.5% compared to 26.3% for the S&P 500. The Rochon US Portfolio therefore outperformed its benchmark by 0.2%.

Since its inception in 1993, the Rochon US Portfolio has returned 5410%, or 14.0% on an annualized basis. During this same period, the S&P 500 has returned 1809%, or 10.2% on an annualized basis. Our added value has therefore been 3.9% annually.

Year	Rochon US	S&P 500	+/-
1993 (Q3-Q4)	**32.7%**	5.0%	**27.7%**
1994	**9.9%**	1.3%	**8.6%**
1995	**54.8%**	37.6%	**17.2%**
1996	**27.0%**	23.0%	**4.1%**
1997	**32.9%**	33.4%	**-0.4%**
1998	**11.0%**	28.6%	**-17.6%**
1999	**15.9%**	21.0%	**-5.1%**
2000	**11.3%**	-9.1%	**20.4%**
2001	**8.1%**	-11.9%	**20.0%**
2002	**-4.4%**	-22.1%	**17.7%**
2003	**31.6%**	28.7%	**2.9%**
2004	**9.3%**	10.9%	**-1.6%**
2005	**12.5%**	4.9%	**7.5%**
2006	**3.3%**	15.8%	**-12.4%**
2007	**-1.7%**	5.5%	**-7.2%**
2008	**-24.3%**	-37.0%	**12.7%**
2009	**28.7%**	26.5%	**2.3%**
2010	**21.9%**	15.1%	**6.9%**
2011	**4.7%**	2.1%	**2.6%**
2012	**22.3%**	16.0%	**6.3%**
2013	**40.6%**	32.4%	**8.2%**
2014	**18.0%**	13.7%	**4.3%**
2015	**1.7%**	1.4%	**0.4%**
2016	**7.5%**	12.0%	**-4.5%**
2017	**19.7%**	21.8%	**-2.1%**
2018	**-8.3%**	-4.4%	**-3.9%**
2019	**32.1%**	31.5%	**0.6%**
2020	**16.0%**	18.4%	**-2.4%**
2021	**27.9%**	28.7%	**-0.8%**
2022	**-21.4%**	-18.1%	**-3.2%**
2023	**26.5%**	26.3%	**0.2%**
Total	**5410.0%**	**1808.6%**	**3601.4%**
Annualized	**14.0%**	**10.2%**	**3.9%**

Refer to Appendix B for disclosure statements on the Rochon portfolios.

Rochon Canada Portfolio

We introduced a portfolio that is 100% focused on Canadian equities in 2007. This corresponds approximately to the Canadian portion of the Rochon Global Portfolio. In 2023, the Rochon Canada Portfolio returned 32.2% versus 11.8% for the S&P/TSX, therefore outperforming its index by 20.5%.

Over 17 years, the Rochon Canada Portfolio has returned 1282%, or 16.7% on an annualized basis. During this same period, our benchmark had a gain of 169%, or 6.0% on an annualized basis. Our annual added value was therefore 10.7%.

Year	Rochon Canada	S&P/TSX	+/-
2007	19.7%	9.8%	9.9%
2008	-24.6%	-32.9%	8.3%
2009	28.2%	33.1%	-4.9%
2010	26.7%	17.6%	9.1%
2011	13.5%	-8.7%	22.2%
2012	24.0%	7.2%	16.8%
2013	49.4%	13.0%	36.4%
2014	20.3%	10.6%	9.7%
2015	16.0%	-8.3%	24.3%
2016	11.0%	21.1%	-10.1%
2017	27.4%	9.1%	18.3%
2018	-7.6	-8.9%	1.3%
2019	29.0%	22.9%	6.1%
2020	12.1%	5.6%	6.5%
2021	30.9%	25.1%	5.8%
2022	-1.8%	-5.8%	4.0%
2023	32.2%	11.8%	20.5%
Total	1281.7%	169.4%	1112.4%
Annualized	16.7%	6.0%	10.7%

Refer to Appendix B for disclosure statements on the Rochon portfolios.

Our largest Canadian holding is which rose by 55% in 2023. Shares in rose by 21% while increased by 60%. And fell by 1%.

Since 2007, the performance of our Canadian securities has been significantly higher than that of the S&P/TSX. We would like to repeat, once again this year, that a highly concentrated portfolio can materially exceed the performance of the indices.

2023

Very few economists or market strategists would have predicted what happened in 2023.

First, the "most predicted recession in history" has not (yet) materialized. It is true that Quebec experienced two consecutive quarters of negative economic growth (the usual definition of a recession), but this was not the case in the rest of Canada or the United States.

The stock market did very well against all odds. The S&P/TSX returned 11.8%, the S&P 500 returned 26.3% (23.3% in Canadian dollars), the Russell 2000 increased by 16.9% (14.2% in Canadian dollars) and the MSCI EAFE rose by 18.1% (15.3% in Canadian dollars).

From the first days of my investing career, I decided not to try to predict the stock market and/or the economy. Therefore, I always have been nearly 100% invested at all times. In the world of stock market predictions, agnosticism is a source of more wealth creation than dogmatism.

The US market in 2023 was buoyed by mega-cap stocks that have been affectionately dubbed the "Magnificent Seven". In fact, these seven S&P 500 stocks had a weighted return of 87%, contributing 16% of the index's 26% return (including dividends). This means that all the other 493 stocks in the S&P 500 realized 10% (including dividends). As a result, the performance of the S&P 500 was highly polarized and was not a fair reflection of the performance of US stocks as a whole. We will come back to this at the end of this letter.

Our portfolio performed satisfactorily, considering it was underweighting the Magnificent Seven. Our companies increased their profits by about 10% this year (see the section on "owner earnings"). In an environment where corporate profit growth in general was stagnant, our companies performed significantly better than average.

It was a difficult year for the US banking sector, however. It was shaken by the collapse of Silicon Valley Bank and Signature Bank last March. In turn, First Republic Bank was also hit hard. We quickly sold our First Republic Bank shares at the first signs of trouble and limited our losses to approximately 1% of our portfolios. Despite predictions of contagion proliferating in March, the situation quickly stabilized and our three other banking stocks, Bank of America, M&T Bank and Bank OZK, did well overall in 2023.

Charlie Munger (1924-2023)

Last November, a few weeks before his hundredth birthday, Charlie Munger passed away. This was like losing an old friend for me, though I only met him a few times.

The first time I heard of Charlie was probably in conjunction with Warren Buffett, his longtime business partner at Berkshire Hathaway. Buffett spoke of him as a brilliant partner, of course, but even more as a beacon of reason. In 2002, I made my annual pilgrimage to Omaha to attend the Berkshire meeting. This time, however, I included a trip to Los Angeles to go to the annual meeting of Wesco Financial since Charlie was chairman at the time. There were only a few hundred Wesco shareholders present and I had the chance to meet him.

Me and Charlie Munger (yes, I had hair!) in May, 2002.

To me, Charlie was the triumph of erudition, rationality and honesty.

His frankness was manifested, among other things, by his numerous “Mungerisms” (lucid sayings which also had the gift of being brutally honest). My favorite is: “If you’re not willing to react with equanimity to a market price decline of 50% two or three times a century you’re not fit to be a common shareholder and you deserve the mediocre result you’re going to get.” He liked to add that “the best way to get what you want in life is to deserve what you want.”

More than anything, he was an avid reader in myriad subjects. He yearned to always know more about everything. His children described him as a book with two legs. He could talk about history, architecture, psychology and science. He said that a life dedicated to becoming rich by owning little pieces of paper (stocks) was not a successful life. And that many brilliant people become prisoners of their talents. His broad erudition thus enabled him not to succumb to the maxim he had so brilliantly stated: “If your only tool is a hammer then every problem looks like a nail.”

It is probably this aspect of Charlie that influenced me the most. Of course, the investment side is at the center of my life (just like it was for Charlie). But I always wanted to have broader knowledge in several areas and – although I had already started when I was younger – it was Charlie who managed to channel this quest for broad knowledge. I have always sought to understand our world in greater depth, whether in the fields of the arts, psychology, science or history.

If there is one quote that sums up Charlie and should be the mantra of every human being aspiring to become more enlightened, it is: “I like understanding what works and what doesn’t in human systems. To me that’s not optional; that’s a moral obligation. If you’re capable of understanding the world, you have a moral obligation to become rational.”

30 years of investing in the stock market

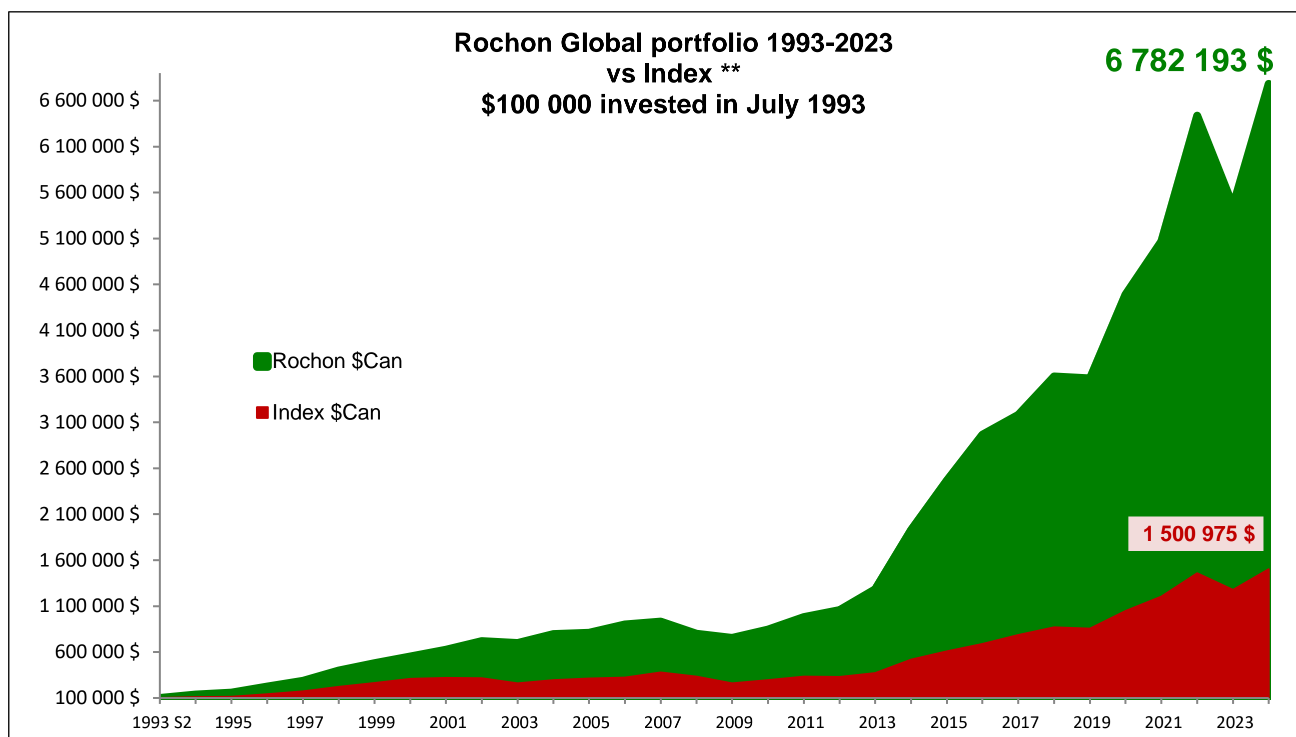
I have now been investing in the stock market for over 30 years. I first read the writings of Ben Graham and Peter Lynch in November 1992 and discovered a rational approach to investing in the market. I read all of Warren Buffett’s writings at the beginning of 1993 and discovered a philosophy of selecting quality companies with a very long-term horizon. I decided to try to put Mr. Buffett’s concepts into practice with my own money from that moment on.

Three decades later, the Rochon Global portfolio (which has served as a model for Giverny Capital since its founding) has achieved a total return of 6,682%, or approximately 14.8% on an annualized basis. I have always remained faithful to the same investment philosophy as in the early days. Although I gradually synthesized a more personalized approach, I always remained anchored to the solid principles set out by Mr. Buffett (he would add that if principles change over time, they are not principles!). I am immensely grateful to him for his wise teachings.

Warren Buffett was Ben Graham’s disciple and likes to remind us that we can summarize Ben Graham’s ideas in three main basic principles that I have also made mine:

1. Think of buying stock as the act of owning a business. An investor is all the more intelligent (according to Graham’s view) if he behaves like a businessman and not like a speculator.
2. The stock market is a manic-depressive entity and you must know how to remain impervious to stock market fluctuations and instead focus on what’s happening with the company. In other words, you have to focus on the intrinsic value of a company rather than its stock price.

3. We must maintain a margin of safety in our business evaluation process. In the same manner that an engineer build a train bridge that can support 500 tons of rolling stock would make calculations based on 750 tons.



** Benchmark is a hybrid benchmark (S&P/TSX, S&P 500, Russell 2000, MSCI EAFE) reflecting assets composition at the beginning of the year.

Refer to Appendix B for disclosure statements on the Rochon portfolios.

One might assume, by looking at this graph, that this was a period of strong growth which occurred in a straight line without any major crisis. This was not the case. This graph reflects increases on an annual basis. Had we used a long x-axis, perhaps using a weekly methodology, we would see enormous fluctuations in the stock market since 1993. There was no shortage of crises over these three decades, with the stock market dropping by more than 50% twice and by more than 20% seven times.

I have learned many lessons over the years. I had already dealt with this during the 20th anniversary of the portfolio and I do not want to repeat myself (I invite you to reread the 2013 letter). The lesson that remains king of all lessons is this: **the best stock selection philosophy is futile if you try to predict the stock market**. The worst mistake made by stock market investors is trying to predict the direction of the market over the short term (a few years or less).

Our mission at Giverny Capital is to be long-term owners of around twenty above-average companies and to remain unfazed by the vicissitudes of the economy, geopolitics and financial markets.

Of course, there will always be investors who want to try to predict the stock market despite all the studies which demonstrate the futility of such a quest. The intentions of these investors are laudable (optimizing the return on their capital) but they remain illusory. This translates into phrases like "I find the market expensive, and I think we should get out of the market temporarily" or the famous and recuring phrase: "I don't think it's a good time to invest in the stock market." The reasons provided change from one year to the next, but it always comes down to the same mistake: depriving oneself of owning quality companies out of fear of macro-economic and/or political events (which are undoubtedly temporary in nature).

The example of McDonald's in 1967

There is a fascinating film about the beginnings of a great company called "The Founder", which tells the story of Ray Kroc and the McDonald's brothers.

We discover, among other things, how Harry J. Sonneborn had the genius idea of transforming the McDonald's business model by adding a corporate real estate component. Mr. Sonneborn thus helped Ray Kroc put together one of the most spectacular growth stories in the history of capitalism. Mr. Sonneborn became the first president of McDonald's in 1959.

Unfortunately, the two men had a disagreement and Mr. Sonneborn left the company in 1967. Mr. Kroc believed that McDonald's should continue its aggressive expansion while Mr. Sonneborn advocated caution since he believed that the US would fall into recession the following year and that the company should put its growth plans on hold.

Over the next five years, McDonald's sales grew from $51 million in 1967 to $385 million in 1972 and earnings per share (EPS) rose from $0.20 to $0.95 (using the number of shares from 1972). By 1977, McDonald's annual sales had reached $1.4 billion, and EPS were 17 times higher than in 1967.

2024 Outlook

As always, we remain agnostic regarding the economic and stock market outlook for the coming year.

Our companies continue to navigate the choppy waters of the global economy despite the many sources of worry that create sleeplessness for many investors. The current year will most likely see its share of uncertainties, disappointing economic data and geopolitical (or political) fears.

We remain tooth and nail convinced that our companies should continue to enrich investors at rates above the average over the long run. We are confident that our companies will, in aggregate, achieve record profits in 2024.

Owner's Earnings

At Giverny Capital, we do not evaluate the quality of an investment by the short-term fluctuations in its stock price. Our wiring is such that we consider ourselves owners of the companies in which we invest. Consequently, we study the growth in earnings of our companies and their long-term outlook.

Since 1996, we have presented a chart depicting the growth in the intrinsic value of our companies using a measurement developed by Warren Buffett: "owner's earnings". We arrive at our estimate of the increase in intrinsic value of our companies by adding the growth in earnings per share (EPS) and the average dividend yield of the portfolio.

We believe that analysis is not exactly precise but approximately correct. In the non-scientific world of the stock market, we believe in the old saying: "It is better to be roughly right than precisely wrong."

	Rochon Global Portfolio			S&P 500		
Year ***	Value *	Market **	Difference	Value *	Market **	Difference
1996	14%	29%	15%	13%	23%	10%
1997	17%	35%	18%	11%	33%	22%
1998	11%	12%	1%	4%	29%	25%
1999	16%	12%	-4%	12%	21%	9%
2000	19%	10%	-9%	15%	-9%	-24%
2001	-9%	10%	19%	-21%	-12%	9%
2002	19%	-2%	-21%	13%	-22%	-35%
2003	31%	34%	3%	12%	29%	16%
2004	21%	8%	-12%	20%	11%	-10%
2005	14%	15%	0%	15%	5%	-10%
2006	14%	3%	-11%	24%	16%	-8%
2007	10%	0%	-10%	-4%	5%	9%
2008	-3%	-22%	-19%	-31%	-37%	-6%
2009	0%	28%	28%	6%	26%	20%
2010	22%	22%	0%	50%	15%	-35%
2011	17%	6%	-11%	18%	2%	-16%
2012	19%	23%	4%	9%	16%	7%
2013	16%	42%	26%	8%	32%	24%
2014	13%	19%	6%	10%	14%	4%
2015	11%	4%	-7%	1%	1%	0%
2016	9%	10%	1%	4%	12%	8%
2017	14%	20%	7%	14%	22%	11%
2018	20%	-8%	-28%	23%	-4%	-26%
2019	10%	31%	20%	3%	31%	29%
2020	-2%	15%	17%	-9%	18%	27%
2021	32%	28%	-4%	48%	29%	-19%
2022	5%	-20%	-25%	7%	-18%	-25%
2023	11%	27%	16%	2%	26%	24%
Total	2887%	2859%	-28%	917%	1194%	277%
Annualized	12.9%	12.9%	0.0%	8.6%	9.6%	1.2%

* Estimated growth in earnings plus dividend yield
** Market performance, inclusive of dividends (refer to Appendix B for disclosure statements on our returns)
*** Results estimated without currency effects

The intrinsic value of our group of companies increased by around 11% this year (dividend included). Despite the few changes made to the portfolio, we believe that this estimate of EPS growth for our companies in 2023 is an adequate reflection of their economic realities. The stocks in our portfolio achieved a market return of around 27% (estimated without the impact of currency). Our securities thus performed better than their underlying companies. This increase corrected the underperformance of our securities in 2022 compared to their intrinsic performance.

The companies making up the S&P 500 have seen their profits increase this year by around 0.4% (about 1.6% when dividends are included) and the index achieved a total performance of 26% (including dividends).

Since 1996, our companies have grown their intrinsic value by approximately 2,887% and their stock prices have achieved a total return of approximately 2,859%. On an annualized basis, our companies achieved an intrinsic performance of 12.9% versus 12.9% for their stock market performance (dividend

included in both cases but adjusted net of any currency effect). The undeniable similarity – over a long period – between these two figures is not a coincidence. This is in line with the fundamental principle that, in the long-term, securities on the stock market end up reflecting the intrinsic value of the underlying companies (if obviously, a reasonable price was paid for said securities initially).

We are confident that if our companies continue to grow their intrinsic value at higher-than-average rates, the stock market performance of their shares will follow—in absolute terms and also relative to indices.

Five-year Post-mortem: 2018

We purchased shares in three new companies in 2018: Facebook (now Meta Platforms), Charles Schwab and NVR.

	2018 EPS	2023 EPS	Annual Growth	2018 Price	2023 Price	Annual Return
Meta Platforms (Facebook)	7.57$	14.87$	14%	$131	$354	22%
The Charles Schwab Corp.	2,45$	3,13$	5%	$41.5	68.8	11%
NVR Inc.	195$	463$	19%	$2,437	7,000$	23%
Average for three companies			**13%**			**19%**
Comparison with S&P 500	162	221	6%	2477	4770	10%

After five years, our conclusion is that two of these three stocks were good investments: Facebook and NVR. The first almost doubled its EPS over five years and the stock climbed from $131 to $354 for an annual return of 22%. NVR has also done very well, with its EPS growing by 19% annually and the stock has almost tripled since our purchase.

We acquired Facebook in 2018 when the stock was very unpopular after the Cambridge Analytica scandal (which today the vast majority of investors have probably completely forgotten about). The company's valuation was very attractive at that time.

We also acquired NVR after the stock fell that year. The rise in interest rates in 2018 (which was short-lived) then affected shares of homebuilders. We had been following NVR for years and therefore took the opportunity to become shareholders.

Charles Schwab was a more disappointing investment. EPS only increased at 5% annually, despite the large acquisition of TD Ameritrade. We believed Schwab would perform well during an interest rate hike and that was not the case. The share price still increased by a little more than 50%, but that does not change the fact that it has been an investment below our expectations so far. In our opinion, however, Schwab's competitive advantages have increased over the past five years and the long-term outlook remains strong. This is the why we've decided to remain shareholders.

This postmortem would be incomplete without adding that we used a portion of the Bank OZK sale to finance the Schwab purchase. We kept a small weight in OZK, but, looking back five years, it is clear that this transaction was a mistake. Indeed, over those five years, OZK has increased its EPS by 12% per year and the stock has risen by around 12% annually (around 15% annually if we include dividends). We would have had a better return in the end if we had simply continued to hold on to all of our Bank OZK shares.

The flavor of the day

You usually don't have to look very far to find the flavor of the day on the stock market. It's often a sector that has recently done well on the stock market and which also has, for the lack of better words, a good story.

Though Artificial Intelligence (AI) has been taking off for several years now, it was a topic of discussion more than ever in 2023—both in terms of generative AI machines (Google's Gemini and ChatGPT for OpenAI) and in terms of the powerful servers and multiprocessors necessary to use AI.

Stock market popularity often means high valuation, of course. A stock with a high P/E usually discounts many years of future profit growth. You can be right about the success of a company without necessarily achieving a good return on your investment when you lack caution to the price paid.

More precisely, we must realize that companies selling server equipment used for AI are benefiting from an explosion in investment spending (from the Facebook, Microsoft, Amazon and Google of this world). These expenses will not necessarily always be recurring in the future. Thus, capitalizing the current profits of such companies many years into the future could prove to be an optimistic assumption.

Our Companies

Note: This section of the annual letter is always long. We want to provide you with an accurate update of the companies in our portfolio companies. In fact, we are trying to present you with the information we would like to know if our roles were reversed. Prices are as of December 31, 2023.

Section of the letter reserved for Giverny Capital's partners

The Podium of Errors

Following in the Giverny tradition, here are our three annual medals for the "best" errors of 2023 (or from past years). It is with a constructive attitude, in order to always improve as investors, that we provide this detailed analysis. As is often the case with stocks, errors from omission (non-purchases) are often more costly than errors from commission (purchases)… even if we don't see those on our statements.

Bronze Medal: Brown & Brown

We were shareholders of Brown & Brown (a Florida-based insurance brokerage company) for five years, from 2004 to 2009. We like the insurance brokerage industry which is more stable and less risky than the underwriting business. However, this industry is composed of many players, and it is more

difficult to maintain a competitive advantage. Brown & Brown appeared to be extremely well managed and had a long period of very strong growth, mainly through acquisitions.

The company went through a period of stagnant profits after the 2008 crisis. We were also disappointed with the succession plan of the company's founder, Hyatt Brown. We decided to sell our shares in 2009 because there were plenty of bargains at the time and we found several other stocks with better return prospects.

Brown & Brown's profit stagnation continued, and it wasn't until 2013 that the company returned to its level of profitability from 2007. EPS growth was 14% per year from 2013 to 2023 and the stock climbed from $14 at the beginning of 2013 to $71 at the end of 2023 (or about 16% on an annualized basis). It has become clear that the new CEO, Powell Brown, has done an exceptional job. One other conclusion is that you should always continue to follow the companies you sell. Things can change for the worse, but also sometimes for the better.

I don't think selling the stock in 2009 was a mistake. What was a mistake was to stop following the company. I could have noticed the improvement in Brown & Brown's business fundamentals.

Silver Medal: Chipotle

Chipotle Mexican Grill is a Mexican fast-food chain. The company was founded by McDonalds and became independent in 2006. My interest in the company obviously meant that I went to try one of their restaurants in 2007. I enjoyed my experience. From 2007 to 2015, revenues more than quadrupled from $1 billion to $4.5 billion and EPS climbed from $2 to $15. I had met with the company a few times over the years and always admired its senior management and culture.

The company unfortunately had to deal with a crisis related to food illness at the end of 2015. Sales and EPS were affected, and the stock fell by half from a high of $759 in 2015 to a low of $353 in 2016. At that point, we decided to take a closer look at the situation.

I had concluded that the company would most likely slowly get back on its feet and within a few years would not only return to its 2015 profitability, but even possibly double its EPS from 2015 to $30 in the early 2020s. With a price-to-earnings of 25x, this gave the stock the potential to at least double over five or six years. But I didn't act on that conviction.

The situation took time to resolve itself and it was only in 2018 that sales surpassed their 2015 level. EPS reached $13.7 in 2019. The stock had then risen to a high of $800 in 2019. Then came the Covid-19 pandemic and Chipotle's stock dropped to $415 in a matter of days in March 2020. It was a second chance for us to invest. I passed on this opportunity again.

Chipotle's EPS reached $45 in 2023—three times the 2015 level. And the stock ended the year at $2287. In my defense, it could be argued that the 2016 food illness crisis was a significant unknown as to the likelihood of the company's recovery. This was no longer the case in March 2020, and we could have quintupled our money in less than four years had I decided to act on this opportunity.

Gold Medal: Novo Nordisk

My Novo Nordisk mistake deserves more than a gold medal—it deserves an Oscar for Lifetime Achievement.

Novo Nordisk is a Danish pharmaceutical company that is the world leader in developing drugs for diabetes. I started following the company around 1998 when the stock was trading at about $1.25 (adjusted for splits). The stock has risen by a factor of about 100 times over 25 years (a compounded annual return of 20%). That's reason enough to award the Oscar mentioned above.

But more to the point, it's really in 2014 that my lightbulb should have lit. I then went to Copenhagen in June to visit the company's headquarters. I studied Novo Nordisk in more detail and realized the full extent of the competitive advantages that its drugs possessed. The stock was trading at $22 at the time and the company was earning about $0.83 in EPS. The company maintained an EPS growth rate of around 10% through 2022 (plus a dividend yield of around 1.5%).

However, a new catalyst energized Novo's growth: the company launched a drug called Ozempic primarily intended for people with diabetes, but which also proved to help with weight loss. I had a front-row seat since I had followed the company closely.

Ozempic's sales took off phenomenally in 2023 and Novo's EPS increased by 51%. Further growth of around 25% is expected for 2024. The stock is now trading at $133, 6 times the level of 10 years ago. With the dividend, we could have achieved an annual return of 20% on this investment. I've always found the stock "too expensive" which is a very poor excuse for my inaction.

Conclusion: Significant polarization for the S&P 500

I want to go back to the S&P 500 stocks that have been dubbed the "Magnificent Seven".

As depicted in the following table, these seven stocks currently make up about 29% of the weight of the entire S&P 500 (and therefore the other 493 stocks account for 71%). Their average price-to-earnings is 40 times and 33 times if you exclude Tesla (which has a high P/E) from the calculation. This 33x ratio is about twice the average P/E of all other stocks in the S&P 500.

The "Magnificent Seven"	% of S&P 500	Est. 2024 P/E *
Microsoft	7.2%	33
Apple	6.2%	26
NVIDIA	4.6%	42
Amazon	3.8%	56
Alphabet	3.7%	20
Meta platforms	2.5%	25
Tesla	1.3%	80
Average		40
Average without Tesla		33

* estimated by Giverny

Data as of February 29, 2024

You'll notice that we own only two of these seven stocks (Alphabet and Meta), which are also the two stocks with the lowest valuations (20x and 25x respectively). We also indirectly own a stake in Apple through Berkshire Hathaway.

Such a polarization of the S&P 500 into a few stocks is not the norm but has happened in the past. Often, it can also create a craze in the buying of S&P 500 index funds.

What I would call an "index waltz" can be summarized as follows: A few very large-cap stocks are doing very well and propelling the S&P 500 to strong returns. Many money managers who don't own these stocks (or are underweight them) are underperforming the index and a number of their clients are jumping ship to invest in index funds.

Some of those managers, motivated not to lose their jobs, are throwing in the towel and buying up the index's largest stocks in increasing numbers to curb their underperformance. And these purchases propel these stocks to new highs, which accentuates the underperformance of other managers different from the indices. And so on and on.

How does this waltz stop? In the same way that the law of gravity governs all particle matter in our universe, the law of intrinsic value always ends up winning out in the stock market: it eventually brings stocks that trade above their underlying values back to Earth. The difference between this law of intrinsic value and gravity is that it doesn't happen instantaneously. To use scientific jargon: the time variable is not part of the equation.

Let's go back a bit for more historical perspective. Here are the top 10 companies in the S&P 500 in 1973 and 2000:

Top 10 S&P 500 in 1973	Top 10 S&P 500 at the start of 2000
IBM	General Electric
AT&T	Intel
Exxon [1]	Cisco Systems
Kodak	Microsoft [2]
GM	Pfizer
Sears	Exxon Mobil
Xerox	Walmart
General Electric [1]	Oracle
3M	AT&T
Texaco	Nortel Networks

[1] Still in the top 10 in 2000 [2] Still in the top 10 in 2023

An analysis of this table shows that few of the companies that were dominant in the past remain dominant over a very long period of time. Of the 10 largest companies in 1973, only two were still on the list in 2000 (and none are in the 2023 top 10). As for the 2000 top 10 list, only one company is still on the list today (Microsoft).

We saw the same phenomenon as today in the late 1990s and early 2000s: the S&P 500 had outperformed the vast majority of managers propelled by its top 10 companies.

What happened next?

Period from 2000 to 2023 (24 years)	Total	Annual
Top 10 S&P 500 (Giverny estimate)	223%	5.0%
S&P 500	412%	7.0%
Giverny Benchmark (USD) *	433%	7.2%
Rochon Global Portfolio (estimated in USD) **	1242%	11.4%

* Benchmark is a hybrid benchmark (S&P/TSX, S&P 500, Russell 2000, MSCI EAFE) reflecting assets composition at the beginning of the year.

** Refer to Appendix B for disclosure statements on the Rochon portfolios.

During the 24 years in this period, the S&P 500 has underperformed its historical average with an annual return of about 7%. The top 10 stocks in the S&P 500 in 2000 generated an even lower return—about 5% on an annualized basis. And the Rochon Global portfolio has achieved an annual return of more than 11% (in USD) during this period.

So, even if you invest at a time when stocks are expensive (like in early 2000, just before the 2000-2002 stock market correction), you can get very acceptable returns if you maintain a long-term horizon. We can also conclude that if you buy what is expensive and popular, you can end up with disappointing returns even if you thought you were taking a passive approach.

But I don't want to badmouth index funds, as the overall concept makes sense. The problem lies instead in the human nature of investors. The urge is too strong for many investors: they'll buy what has worked over the short term and often at the worst time (after a sharp rise). Then they will often throw in the towel at the worst possible time (after a sharp drop).

In addition, the incredible ease of buying and selling index funds makes turnover much higher than for other strategies. The holding period of exchange-traded funds (ETFs) is dramatically shorter than the average holding of stocks in general or of an actively managed mutual fund. The equation is simple and mathematical: the more investors trade, the lower their returns. The index-based approach, which must be passive and long-term to be beneficial, becomes active and short-term most of the time. Ultimately, financial results from these strategies don't meet the objectives for a large number of market participants.

Our investment philosophy of carefully selecting high-quality and reasonably priced companies and holding them for many years on average has greatly rewarded us to date. What's more is that it makes a lot of sense.

To Our Partners

We believe that the companies we own are exceptional, led by top-notch people, and destined for a great future.

We want you to know that we are fully aware of and grateful for your vote of confidence. It is imperative for us to not only select outstanding companies for our portfolios, but to also remain outstanding stewards of your capital.

We certainly like to achieve good returns (and have taken a liking to it), but it must not come at the cost of taking undue risk. Our philosophy is to favor companies with solid balance sheets and dominant business models, along with purchasing these companies at reasonable valuations.

We also want to offer you a service that always meets your expectations. Please do not hesitate to contact us with any questions you may have about your account.

Thank you from the entire Giverny Capital team and we wish a great 2024 to all our partners.

François Rochon and the Giverny Capital team

APPENDIX A

Investment philosophy

Note: This section is repeated from prior annual letters and is aimed at new partners.

We saw a large increase in the number of Giverny Capital partners (the term we use for our clients) in 2023. With all these newcomers, it is imperative that we write again (and again) about our investment philosophy.

Here are the key points:

- We believe that over the long run, stocks are the best class of investments.
- It is futile to predict when it will be the best time to begin buying (or selling) stocks.
- A stock return will eventually echo the increase in per share intrinsic value of the underlying company (usually linked to the return on equity).
- We choose companies that have high (and sustainable) margins and high returns on equity, good long term prospects and are managed by brilliant, honest, dedicated and altruistic people.
- We avoid risky companies: non-profitable businesses, with too much debt, with a lot of cyclicality and/or run by people motivated by ego instead of genuine stewardship.
- Once a company has been selected for its exceptional qualities, a realistic valuation of its intrinsic value has to be approximately assessed.
- The stock market is dominated by participants that perceive stocks as casino chips. With that knowledge, we can then sometimes buy great businesses well below their intrinsic values.
- There can be quite some time before the market recognizes the true value of our companies. But if we're right on the business, we will eventually be right on the stock.

Experience and common sense teach us that an investment philosophy based on buying shares in companies that are undervalued, and holding these companies for several years, will not generate linear returns. Some years, our portfolio will have a return that is below average. This is a certainty that we must accept.

Another important point: the significant volatility of the market is often perceived negatively by many investors. It's actually the contrary. When we see stock prices as *"what other people believe the company is worth"* rather than the real value (at least in the short term), these fluctuations become our allies in our noble quest for creating wealth. Instead of fearing them, we can profit from them by acquiring superb businesses at attractive prices. The more that markets (the "other" participants) are irrational, the more likely we are to reach our ambitious performance objectives.

Benjamin Graham liked to say that the irrationality of the market provides an extraordinary advantage to the intelligent investor. The person, however, who becomes affected by short-term market fluctuations (less than 5 years) and who makes decisions based on them transforms this advantage into a disadvantage. His or her own perception of stock quotes becomes their own worst enemy. Our approach at Giverny Capital is to judge the quality of an investment over a long period of time.

So patience – ours AND that of our partners – becomes the keystone for success.

APPENDIX B

Notes on the returns of the Rochon portfolios

- The Rochon portfolio is a private family group of accounts managed by François Rochon since 1993. The returns of the period from 1993 to 1999 were realized before registration of Giverny Capital Inc. at the AMF in June of 2000.
- Returns for the three portfolios include transaction fees, dividends (including foreign withholding taxes) and other investment income, but do not include management fees.
- The Rochon Global portfolio serves as a model for Giverny Capital's clients but returns from one client to the other can vary depending on a multitude of factors. Portfolio returns of the Rochon Global portfolio have been generated in a different environment than Giverny Capital's clients and this environment is considered controlled. For example, cash deposits and withdrawals can increase the returns of the Rochon Global portfolio. Thus, the portfolio returns of the Rochon Global portfolio are often higher than the returns realized by clients of Giverny Capital. In addition, depending on when they arrive at Giverny Capital, returns may vary from one client to another.
- Past results do not guarantee future results.
- The index benchmark group is selected at the beginning of the year and tends to be a good reflection of the asset composition of the portfolio. Weighted indices presented may not be representative of the Rochon Global portfolio. In 2023:
  - Rochon Global Portfolio: S&P/TSX 16% S&P 500 40.25% Russell 2000 40.25% MSCI EAFE 3.5%
  - Rochon US Portfolio: S&P 500 100%
  - Rochon Canada Portfolio: S&P/TSX 100%
- The returns for the various indices used for comparable purposes are deemed reliable by Giverny Capital.
- It should be noted that currency effects on the returns of the Rochon portfolio and indices are estimated to our best effort.
- The financial statements of the three portfolios are audited at the end of each year. The auditor's data are those provided by our custodian (NBCN). The auditor's annual reports are available upon request.
- For more information, please see the "returns" section of our website.

Forward-looking information

Some information set forth in this letter constitutes forward-looking information which involves uncertainties and other known and unknown factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. When used in this letter, words such as "expects", "anticipates", "intends", "may", "believes" and similar expressions generally identify forward-looking information. In developing the forward-looking information contained in this letter, the manager has made assumptions (for ex.: with respect to the outlook for the global economy and publicly traded companies). These assumptions are based on the manager's perception of factors believed to be relevant (for ex.: historical trends, current conditions, expected future developments). Although the manager believes that the assumptions made and the expectations represented by such information are reasonable, there can be no assurance that the forward-looking information will prove to be accurate. Actual results or events may differ materially from those expressed or implied in the forward-looking information. Giverny Capital Inc. undertakes no obligation to publicly update or revise these forward-looking statements.