2020 Half Year Letter

Dear JDP Partner,

In the first six months of 2020 JDP was +19.35% (net) versus -3.08% for the S&P 500. This was our largest outperformance in a half-year since inception.

The V-shape recovery was not for everyone

In the first half nearly 73% of the S&P 500 was negative (365 companies) and 35% were down by more than 20%. Then adding in the smallest companies: 67% of all US-headquartered companies over $50 million in market cap were negative and 44% were down by more than 20%.[1]

JDP's performance was driven by extraordinary business progress of our companies operating within addressable markets growing much faster than the economy.

Despite recent gains, valuations with our current portfolio have not outpaced growth expectations.

It has been exciting to watch the next-generation companies in our portfolio enjoy structural leaps that I had previously assumed would not happen for several years.

The primary contributors to first half performance include: Spotify (+72.6%), Roku (+7.1%), Elastic (+44.5%), Cardlytics (flat), StoneCo (-2.8%), XPO Logistics (+22.5% **sold out**), Autodesk (+28.1% **sold out**), EchoStar (-28.2% **sold out**), DraftKings (+270% **sold out**).

Sales were due to either: valuation vs. opportunity cost (but would own it again), or the business no longer meeting JDP's *Survivor & Thriver* company criteria.

Our largest holdings are benefiting from three big trends: the growing reach of niche digital advertising platforms away from big social and print, increasing IT budgets around monitoring and security of cloud-native applications, and orphaned segments of mega-sized companies like podcasts and ad-supported streaming TV being re-invented by smaller/focused competitors.

Our special situations basket (limited to 10% of AUM) has three unnamed positions and was down about 7% for the year. We exited a long-time holding in March for a loss and replaced it with a REIT that owns trophy real estate in major US cities that could drive a multi-bagger return in a post-COVID world.

But the best opportunities today are not in stocks that went down the most in March, but in companies with a sustainable competitive advantage in tomorrow's economy.

[1] Capital IQ, JDP estimates

Tomorrow's economy is here early

On March 22nd I sent a *note to investors* explaining how we were approaching the market after a 29% decline in the S&P. The point was to communicate that the safer bet was to ignore companies at the epicenter of economic destruction and focus on technology businesses scaling their capacity by absorbing demand from capital intensive areas of the economy.

Since COVID we there has been a massive transfer of wealth from old to new-economy companies which partly explains the bifurcation in US stock performance in the first half of 2020.

Analogue moats such as 'property plant and equipment' once thought to be safe during economic crisis are now proving high risk due to their capital intensity and declining replacement values in a deflationary economy that is rapidly digitalizing.

Survivor & Thriver framework as a margin of safety

Cash flow will always be king and ultimately a business is only worth the cash it will produce over its lifetime. But the majority of a company's total lifetime value (public or private) is created between the day it emerges as a sustainable "competition-killer" and the day it settles in as a low-growth icon of the past.

A successful company's powerful "compounder period" lasts as long as it can continue protecting rapidly growing earning power. A company ultimately dies when competition erodes away the barrier protecting this earning power.

Think about the difference in value creation (or destruction) comparing the past 10-year stock performance of General Motors -4.5% versus Tesla +3,990%. Sticking with GM over the last decade only because of a perceived margin of safety in past earnings would have been a mistake.

Accounting metrics alone are not a framework to understand when a new king is in the process of being crowned because big change happens over years, not months, especially when the disruption is so enormous.

One-size-fits-all accounting models are dangerous

Like all managers of other peoples' money, our greatest challenge is developing a rational process to ensure we can hang on to the right companies even if they appear fully valued on the surface.

One-size-fits-all accounting models by nature are rear-view-looking and dangerous because they ignore important nuances around *why* and *how* a business will be bigger (or smaller) in the future.

In 2016 we developed the *Survivors & Thrivers* framework to help us stick with companies with the strongest potential to outperform if purchased during "peak" market conditions or appeared fully valued. It would also help us quickly sell when a company no longer fit the framework (**links here**).

Survivors & Thrivers is also a mindset to continuously question *why* and *how* a company deserves to outperform over 3, 5 and 10 years without leverage or excessive trading.

Survivors & Thrivers was the result of studying the characteristics of extreme winners and losers of hundreds of companies across sectors and market caps in the US from a market peak-to-peak period perspective of past market cycles.

Companies with the greatest outperformance share obvious connections regardless of sector or market cap: winners are able to protect unusual growth over a long period of time and initial valuation was less important to the total return.

Inversely, companies with the worst performance over 3, 5 or 10+ years clearly lacked one or more of the Survivor & Thrivor traits and valuation would have been a false margin of safety.

Survivor & Thrivor company traits:

1. Business model that is adaptable and relevant in tomorrow's economy
2. Durable pricing power protected by a growing competitive advantage
3. Capital allocation and balance sheet strategy that supports the company's moat
4. Significant alignment of interest between management and equity owners

There will always be a good reason why not to invest

The hardest part about investing is that there will never be a magic green light flashing "now is the right time to buy". No matter how great the opportunity, there will always be a good reason why *not* to invest in great companies.

Many of our limited partners have a large portion of their net worth in the fund—as does my family. The responsibility that comes with this trust is the need to be and thoughtful and calculated about everything we do.

Being thoughtful is a commitment to rapidly growing our circle of competence around sectors and businesses that were off our radar in the recent past to ensure we own future compounders.

Being calculated means not over-reacting to markets and not out-think the market during crazy times.

In March I was caught holding way too much cash out of greed for more attractive prices that never came. Our performance would have been better if I had remained fully invested throughout the Corona Dip. Clearly this was *do as say*, *not as I do* moment that cost us.

"Far more money has been lost in this business betting on the end of times" – Podcast interview with Brad Gerstner, CIO of Altimeter Capital

Brad Gerstner is an investor I admire greatly, not only for his incredible track record but his business-owner approach to passive investing that JDP also embraces.

Brad was recently interviewed on Patrick O'Shaughnessy's podcast Invest Like the Best and I identified with his points on the risks of decision making based on market timing.

In minute 29 – 31 of the interview Brad makes the point that Altimeter Capital's outperformance is rooted in a firm-wide culture of focusing on a deep understanding of their portfolio companies and sectors above anything market-related.

This business-owner approach helps protect against over-reacting in stressful market periods like March of 2020 and provides the confidence to aggressively buy during the darkest times.

Brad also talks about why an "idea of the day" culture is so destructive (most hedge funds), I highly recommend listening to the interview.

Concluding remarks

It is an exciting time for our portfolio companies and an exciting time to be invested on right side of progress.

Over the next decade there will be dozens of companies join the $100+ billion market cap club. Many of these companies exist today, both public and private, but are much smaller versions of what they will become.

JDP is in a unique position to have the framework to focus on companies positioned to survive and thrive within in a broader economy facing enormous challenges to grow.

I believe we will look back on this decade as a period when enormous wealth was created for people with the flexibility to evolve, and an incredible time to have a public-company investor.

Sincerely,