CLARENCE DRIVE CAPITAL PARTNER'S MANUAL FOR BUSINESS OWNERS

I want you to have a partner's manual as I believe in full transparency with investors about my principles and methods, much as one person might say to another if they were setting up a partnership. The better aligned we are on how to achieve our goal, the more likely we are to reach it together.

1. My attitude is partnership. I think of my investors as partners, and of myself as the managing partner of ownership interests in businesses that compound their value over time.

I hope my investors see themselves as part owners of these businesses, with a long-term commitment akin to owning a house, a farm or private business in partnership with family members. This is a partnership in long-term business ownership.

2. Partnership means alignment. In line with the partnership mindset, I invest virtually all my capital alongside my partners, ensuring we share the same outcomes. When they lose money, so do I. I do this not only to align our interests but because I believe in the strategy.

3. I am a long-term investor. I invest with the mindset of a private business owner, focusing on the long-term progress of the businesses I hold, not the short-term fluctuations in their stock prices. If I have good long-term expectations for a business, short-term price movements are irrelevant, except when they provide an opportunity to increase our ownership at an attractive price or to sell when shares become overvalued, and I identify significantly better alternatives.

Why long-term investing? A long-term approach capitalizes on the only sustainable edge in investing – behaviour. Most market participants are trading shares based on short-term expectations where the competition is the greatest, while I invest based on long-term expectations where the competition is least. The market's short-term obsession causes significant fluctuations and mispricing, creating opportunities for investors with a longer-term mindset of business value. A long-term approach helps me stay rational and look past the short-term swings in sentiment. I typically invest when a business is worth at least twice as much today based on where it will be in 5–10 years, while growing this value every year

How do I practice long-term investing? The approach requires diligence and patience. To best ensure that I can act in this manner and achieve our goal I have structured the business accordingly.

First, the firm's ownership structure achieves the independence necessary to implement this long-term approach. Many investment firms are pressured by external owners, leading to short-term thinking and reactionary decisions. Clarence Drive Capital is owned by the investment decision maker — me. This ensures there is no outside owner influence on investment decisions and a built-in commitment to a long-term investment strategy.

Secondly, I seek out like-minded long-term oriented partners. This means investors who keep long-term value front of mind and develop the appropriate emotional response to short-term share price movements. Typically, when a stock rises above long-term value, it's a candidate for sale; when it falls below, for purchase. However, motivated by greed and fear, investors often buy at the top and sell at the bottom. I want the market to serve my investors and not instruct them — to be fearful when others are greedy and greedy when others are fearful. This takes great emotional discipline, which is the foundation of reward in the market. When share prices are low and I see an extraordinary opportunity set, I am excited about future returns. At these moments, investors will be encouraged to consider investing capital rather than succumbing to psychological pressure and redeeming. This patient, contrarian approach supports value creation, ultimately improving long-term investment performance.

Independent ownership and long-term orientated clients are the two most important ingredients supporting the partnership to behave rationally and succeed

4. My primary economic goal is to deliver exceptional long-term returns, adjusted for risk. I aim to achieve an investment track record to be proud of and on par with investors I greatly admire. This includes long-term performance well ahead of the opportunity cost of risk-free capital — a long-term government bond — and superior to that of the world stock market index average. This average, over a period of years, will represent most of the investment industry and the results of leading investment companies. Unless I do achieve this superior performance in the long term, there is no reason for the existence of the firm. I do not employ leverage to enhance returns. I do not chase fads that contain significant downside risk. A discussion of my approach to risk can be found in section 15.7 of the manual. While I have this long-term goal, it is important to note that no rate of return can be guaranteed for my partners.

5. I am a global investor with access to a broad opportunity set. I offer only one product: my single best investment view. I think I have a significant advantage in being a global mandate with a wide opportunity set as I can look far and wide and am not required to invest in assets that do not meet my criteria. I am equity-centric but can invest across asset classes. Traditional fund management is typically bound by attributes such as asset class, geography, sectors, investment styles, and even the degree to which a fund tracks the index. As most fund managers are constrained by these mandates, excess returns should exist for those with a broader opportunity set.

I believe many investors suffer from home bias, investing most of their funds in the equity market of their home country. The idea of being restricted to one market strikes me as irrational. One can gain access to terrific businesses and fundamentals not available in the home country, obtain a significant advantage when comparing similar businesses across geographies, and achieve better diversification.

The typical large South African fund manager has a universe of just 40–50 companies to choose from, many of which can remain overvalued and unattractive for years at a time. In contrast, my mandate gives me the flexibility to select from tens of thousands of companies, significantly expanding my investment opportunities.

Many fund managers will raise a new fund for every possible attribute or new fad. Although this makes business sense it does not necessarily serve investors well. In contrast, I offer only my single best investment view.

6. I hold a more concentrated portfolio than most investment managers, focusing on my best ideas to outperform the market. Many fund managers spread their investments across dozens or even hundreds of stocks. The reality is that compelling investments are rare, and when I find them, I concentrate our capital to maximize returns.

Warren Buffett indicated that over the decades at Berkshire Hathaway about a dozen investment decisions accounted for 85% of their overall gains. Assuming two hundred decisions were made, it means that 6% of the decisions accounted for nearly all the gains and that such ideas only came along on average once every 5 years. Considering this rate in investing, you may understand that I believe it is appropriate to invest up to 25% of the portfolio in a single company under conditions of an extremely high probability I am correct with near zero downside risk even if I am wrong. I am obviously only going to invest such a large amount in a business very rarely. This rarity is what makes it necessary that I invest so heavily when I see such an opportunity. Warren Buffett has 99% of his net worth invested in one company and Charlie Munger had his in only a few. Notwithstanding such a position, the portfolio is likely to be somewhat more concentrated than the average portfolio and likely to contain around 10 securities. When I see more opportunities, I will diversify more than when I see few. I aim for sufficient but not excessive diversification. **That said, my results are likely to be more volatile from year to year than many of my peers who typically diversify more. Although short term volatility may be higher, so is the potential for superior long-term returns.**

Most fund managers underperform the index after fees. Largely because they own too many stocks, they effectively track the index and then underperform when subtracting active management fees. The main reason they do this is management of career risk. People realize that they get in trouble for being wrong on their own but not as part of a group, hence, why risk being different. It appears that the overdiversification that is commonplace in the industry has to do with reducing portfolio volatility, while at least avoiding underperformance by effectively owning the index. Conversely, the only way to succeed in investing is to be different from the crowd.

I believe the outcome of a more concentrated portfolio is rational given my objective and is further supported by the following principles:

- I work very hard to ensure that our largest positions are the worthiest on a risk-adjusted basis.
- As I invest globally, we will inherently achieve more diversification than investing in one market.
- The more stocks you own the less you care about each one individually. This increases risk.

In his 1964 Buffett partnership letter commenting on the inability of the overwhelming majority of investment managers to outperform the index Warren Buffett ascribed it to the product of: "(1) group decisions – his view that it is close to impossible for outstanding investment management to come from a group of any size with all parties really participating in decisions; (2) a desire to conform to the policies and (to an extent) the portfolios of other large well-regarded organizations; (3) an institutional framework whereby average is "safe" and the personal rewards for independent action are in no way commensurate with the general risk attached to such action (career risk); (4) an adherence to certain diversification practices which are irrational; and finally and importantly, (5) inertia."

The antidote, he implies, is having an independent thinker willing and able to take a contrarian stance, holding a concentrated portfolio of compelling opportunities, constantly searching for the best ideas and nimble enough to act. I believe my approach is well positioned to avoid these pitfalls.

7. I do not time the market but invest bottom-up. When I think a business is attractively priced, it would be foolish not to act on it based on an opinion of what the market might do in the short term. I do not engage in market timing, adjusting the percentage of the portfolio invested in equities based on predictions of what the market might do. Changes in equity and cash balances is the outcome of a bottom-up search for opportunity in individual businesses.

I do not forecast stock market or short-term share price movements. I would prefer not to be asked to make such predictions, and if asked, I will respectfully decline. I do not think it is consistently achievable; I certainly have no edge in such predictions, and I do not consider it essential at all. In addition, studies show that most market timers underperform the market. The reason is that while the investor is out of the market, missing out on the best few days significantly impacts long-term performance. Rather than timing the market, I invest bottom-up, focusing on the value of individual businesses. When investments reach intrinsic value and attractive opportunities are scarce, this approach may result in a temporary increase in cash. I aim to be fully invested in equities but not at the cost of overpaying. Though a larger cash balance may seem like a view on the market, it's the temporary result of a disciplined, bottom-up approach.

8. I have an absolute return mindset and do not benchmark myself against market indices per se. I focus on generating meaningful positive returns. My goal is to make investments only when they are substantially undervalued, ensuring that I deliver returns that significantly outperform the opportunity cost of capital. It seems to me a rational starting point that from a position of cash, one wants to meaningfully beat the cash return before making an investment, rather than comparing to a randomly constructed index which may be expensive. Over the long-term, I have faith that my absolute return mindset will lead to outperforming the indices as well.

9. As I do not control the short-term direction of the stock market my performance in any given year should not be judged by whether I achieve positive or negative returns. Instead, it should be evaluated in the context of how I perform relative to the global stock market average. If results surpass the performance of the world stock market average, I consider it a successful year, regardless of whether we post a gain or a loss.

10. My intentions should be checked occasionally for results. While I prefer ten years, I feel five years is a minimum for judging performance. It is a certainty that I will have years when performance is poorer, perhaps substantially so, than the world stock market average. Consider that even the very best long-term investment track records involved underperforming the market 30-50% of the time. In the near-term results are unpredictable and are as likely to disappoint as they are to please. In the long-term results will reflect the performance and value of the businesses we own and do I expect us to do well. Clarence Drive Capital invests long-term and is not suitable for those with timeframes less than ten years.

11. I embrace market volatility. The volatility of stock markets is often perceived negatively by many investors. Contrary, volatility is our friend as it creates opportunities for me to buy undervalued businesses and sell overvalued businesses. It's my basic advantage that helps me generate good long-term investment returns.

Over the long run common stock investments offer the best returns out of all asset classes, and you should expect the market value of your investments to advance. Over shorter periods this may not be the case. Falls in market prices will make the market value of your portfolio go down, but I will only be concerned if I believe that the intrinsic value of the portfolio has declined, and I will tell you when this is the case. I seek to take advantage of these stock market fluctuations by focusing on the long-term i.e. the intrinsic value of the businesses I follow. If a 40% near-term decline in the price of your portfolio will lead to distress, you need to consider whether stock market investment is for you.

12. I will be transparent in my reporting to you, keeping you informed about the good and bad in the portfolio. My goal is to ensure that you have a clear understanding of my decision-making process and how we are doing.

Over time, most of my investments have surpassed my expectations, but occasionally I will have disappointments, and I will inform you about them. Investments that do not outperform the market are inevitable. Consider that investors who select investments where only 55% outperform the market, with an even magnitude of gains to losses, meaningfully outperform the market and end up in the top percentiles of investors. Of course, the magnitude of gains to losses is very important. I aim for a better record, and my process is designed to keep permanent capital losses to a minimum, but I have no interest in hiding mistakes from you, as clearly, they are unavoidable. I believe in learning from them, and the sooner I learn from them, the better. Documenting my mistakes may be unpleasant, but not as unpleasant as reporting selectively and not continuously improving my investment process.

I will only discuss my new ideas to the extent that it does not interfere with my ability to acquire them at good prices. Good investment ideas are subject to appropriation. When discussing new ideas, I am mindful of the cognitive bias that, by publicly committing to an investment, it may become harder subsequently to change my mind. When the facts change, it is crucial that I change my mind.

I will be communicating with you in several ways. You can expect from me an annual and interim letter and ad hoc investment articles in which I discuss my investment thoughts. I approach writing semi-annual letters with some hesitation, as they might inadvertently encourage partners to focus on short-term performance — a perspective that can be highly misleading. Try to keep this in mind and maintain a long-term perspective.
I believe more regular commentary, such as monthly or quarterly, muddies a discussion of the things that really matter and is counterproductive. From the administrator, you can expect a monthly report on the account where you are able to view all the holdings and actions taken. I believe these documents together should equip investors with the necessary information to assess my actions and performance effectively. Another opportunity for communication is the Annual Meeting, where I am delighted to spend a few hours or more answering questions about the portfolio. I remain accessible to my partners, who I hope to have reviewed my communications, and I welcome any questions regarding the portfolio.

13. Fees

Investors who invest directly do not pay initial fees or redemption fees. I welcome direct communication with investors and believe initial fees or redemption fees unnecessarily hinder performance.

As a long-term investor portfolio turnover will be low, allowing me to keep transaction costs to a minimum—resulting in cost savings.

Traditional fund managers often charge a fixed annual management fee based on assets under management (AUM), along with a performance fee. I have carefully considered the most equitable fee structure and developed a unique approach based on the original Buffett Partnership. Philosophically my position is that a fixed annual management fee should not generate a profit for the business as I do not create value for investors by managing a portfolio per se but only when I perform. I therefore believe its most appropriate to be compensated when I deliver performance.

In this performance-based fee structure, the management fee is strictly limited to covering the fixed operational costs of the business. In this way the business cannot earn a profit from the management fee, and I can pass on the low operating costs of the business to investors. As AUM increases, the management fee decreases as a percentage, directly benefiting investors.

My goal is absolute returns, meaning I aim to generate returns that meaningfully surpass inflation and reflect the opportunity cost of capital. For context, long-term bond returns have been around 5-6% in US dollars. My performance fee is structured with a 6% US dollar hurdle (approximately 10% in South African Rand) and includes a high-water mark. This means I must exceed previous peak values before I can earn performance fees again, ensuring I only profit when my investors profit over the long term. An absolute return goal encourages prudent investment decisions, especially in expensive markets where the risk of loss is elevated.

Since I run segregated mandates, I can provide investors with flexibility. The first three rows of the fee table reflect the options available under the original Buffett partnership model. The partnership covered the fixed operating costs of the business, estimated at 0.3% of AUM. The fourth and fifth rows highlighted in bold outline the two options I offer to investors: a performance-oriented fee or a fixed-fee structure.

The performance-based fee is set at 0.8% plus 20% of profits exceeding the 6% US dollar hurdle, with a cap on the annual management fee at 0.8%. This fee will decrease as AUM grows, when it covers the fixed operational costs of the business and will be revisited at the very least every October. For investors who prefer a fixed-fee arrangement, I offer that option as well at 1.4% per annum. Both fixed fees contribute to covering the operational costs of the business and will therefore serve to reduce the 0.8% fixed fee percentage of the performance-based fee structure. The detailed fee structure is as follows:

Effective fees based on different returns and fee structures									
Based on returns before fees in US dollar	**2%**	**4%**	**6%**	**8%**	**10%**	**12%**	**15%**	**18%**	**20%**
Fee structure									
0.3% annual fee and a third of the profit above 6%	0.30%	0.30%	0.30%	0.97%	1.63%	2.30%	3.30%	4.30%	4.97%
0.3% annual fee and a quarter of the profit above 4%	0.30%	0.30%	0.80%	1.30%	1.80%	2.30%	3.05%	3.80%	4.30%
0.3% annual fee and 15% of the profit above 0%	0.30%	0.90%	1.20%	1.50%	1.80%	2.10%	2.55%	3.00%	3.30%
0.8% annual fee and 20% of the profit above 6% in US$	**0.80%**	**0.80%**	**0.80%**	**1.20%**	**1.60%**	**2.00%**	**2.60%**	**3.20%**	**3.60%**
1.4% annual fee and no performance fee	**1.40%**	**1.40%**	**1.40%**	**1.40%**	**1.40%**	**1.40%**	**1.40%**	**1.40%**	**1.40%**

Returns after fees									
Based on returns before fees in US dollar	**2%**	**4%**	**6%**	**8%**	**10%**	**12%**	**15%**	**18%**	**20%**
Fee structure									
0.3% annual fee and a third of the profit above 6%	1.70%	3.70%	5.70%	7.03%	8.37%	9.70%	11.70%	13.70%	15.03%
0.3% annual fee and a quarter of the profit above 4%	1.70%	3.70%	5.20%	6.70%	8.20%	9.70%	11.95%	14.20%	15.70%
0.3% annual fee and 15% of the profit above 0%	1.70%	3.10%	4.80%	6.50%	8.20%	9.90%	12.45%	15.00%	16.70%
0.8% annual fee and 20% of the profit above 6% in US$	**1.20%**	**3.20%**	**5.20%**	**6.80%**	**8.40%**	**10.00%**	**12.40%**	**14.80%**	**16.40%**
1.4% annual fee and no performance fee	**0.60%**	**2.60%**	**4.60%**	**6.60%**	**8.60%**	**10.60%**	**13.60%**	**16.60%**	**18.60%**

$100 000 compounded for 10 years after fees									
Based on returns before fees in US dollar	**2%**	**4%**	**6%**	**8%**	**10%**	**12%**	**15%**	**18%**	**20%**
Fee structure									
0.3% annual fee and a third of the profit above 6%	118 361	143 809	174 080	197 330	223 338	252 391	302 373	361 094	405 746
0.3% annual fee and a quarter of the profit above 4%	118 361	143 809	166 019	191 269	219 924	252 387	309 201	377 278	429 866
0.3% annual fee and 15% of the profit above 0%	118 361	135 702	159 813	187 714	219 924	257 026	323 292	404 556	468 499
0.8% annual fee and 20% of the profit above 6% in US$	**112 669**	**137 024**	**166 019**	**193 069**	**224 023**	**259 374**	**321 857**	**397 575**	**456 594**
1.4% annual fee and no performance fee	**106 165**	**129 263**	**156 789**	**189 484**	**228 191**	**273 874**	**357 918**	**464 500**	**550 614**

To provide context for the table, it's important to note that historically, the market has delivered an average real return of around 6%. With long-term inflation in US dollars targeted to be around 2%, the market is projected to generate approximately 8% returns in US dollars over time. This translates to about 12% in South African Rand assuming an inflation rate of 6%. The performance fee structure enhances after-fee performance up to a 9% return in US dollars. Below this level of market-like performance, investors benefit more from the performance fee structure compared to the fixed fee structure and will benefit significantly more as the business scales and the 0.8% fixed fee reduces.

It's worth considering that most fund managers fail to outperform the market, yet they often charge a fixed fee. In such cases where we underperform market like returns, investors are better off with the performance-based fee structure. However, when performance exceeds the market's normal return + 1% and reaches returns above 9% in US dollars, the investment manager earns relatively more, and at this point, investors may find a fixed fee structure more beneficial.

Ultimately, the investor has the choice: with the performance fee structure, they pay lower fees when returns are modest, but higher fees when returns are strong. In contrast, with a fixed fee structure, the investor pays a higher fee when returns are low but a comparatively lower fee when returns exceed a normalised outlook.

14. Tax

Paying taxes on capital gains is a positive outcome—it means we've made a profit.

Tax minimization typically involves reducing the tax liability from realised capital gains by offsetting them with capital losses from other investments. While there may be situations where this approach makes sense, prioritizing tax avoidance can often lead to suboptimal investment decisions.

An unrealized loss occurs when a stock's price declines, but in most cases, I find the company more attractive at a lower price and are more likely to buy than sell. If a tax strategy would impair the quality of an investment, I prefer to let taxes occur naturally rather than focusing on avoidance. I will generally therefore not have tax avoidance as the primary goal. However, if I can buy a similar business at a similar or greater discount it may make sense to realise a loss to offset any realised gains.

15. MORE ON HOW I INVEST

Section 15 provides further insights into my investment process.

My approach entails studying businesses closely to assess their worth. I invest when a company is unpopular and trades at a significant discount to its intrinsic value, and I sell when it becomes popular and reflects its full value. My strategy prioritizes high-quality businesses that have the potential to compound value over time. I continuously strive to enhance the portfolio's price-to-value ratio by selecting new investments that offer better potential than those currently held.

15.1 What is a quality business?

At the heart of capitalism is the idea that a company earning excess returns on invested capital will eventually attract competition, which drives those abnormal profits down. That is, unless the company has some enduring advantage or moat that allows it to sustain its higher profitability.

Quality businesses generate high future returns on capital, underpinned by sustainable competitive advantages and effective capital allocation by management. When these businesses have growth potential, they can reinvest at high rates for extended periods which creates substantial value that many investors often fail to fully anticipate. What are the sustainable competitive advantages that enable a company to achieve sustained high returns on invested capital? I typically identify and invest in the following moats:

- **Network effects**: Think of companies like Meta with their Facebook, Instagram and WhatsApp apps with nearly 4 billion monthly active users. The value of the network increases as more participants joins while replicating it can be nearly impossible if everyone is already on the existing network and consumer preferences have been formed. Networks often create natural monopolies or oligopolies, with first movers achieving dominance. Another example is Airbnb: An increasing number of hosts attract more travellers, and more travellers encourage more hosts to join, enhancing the overall platform's value. Or consider marketplaces like Amazon: The vast number of buyers attracts more sellers, enhancing product variety and competitive pricing, which in turn draws more buyers, creating a virtuous cycle.
- **Other intangible assets**: **Strong brands** that lead to pricing power and/or consumer loyalty**, intellectual property** (patents, trademarks, copyrights and trade secrets) **and licenses** can also offer protection against competition. Brands must be able to influence consumer behavior to be valuable. If a brand can reduce the time a consumer has to spend on deciding or it commands pricing power, it is valuable. Patents are typically less durable due to their limited lifespan, after which competition inevitably arises. Licenses are particularly advantageous when regulatory approval is required to operate in a market, but prices or capital investments aren't regulated.
- **Switching Costs:** When customers face significant effort or expense to switch from one product or service to another, the business providing the product or service gains pricing power. For instance, Microsoft Office users who are familiar with Microsoft Word, Excel, and other Office software may face a steep learning curve and lost productivity when switching to a competing product.
- **Cost advantages:** In industries where price is the key factor in purchasing decisions and substitutes are readily available, the lowest-cost producer typically wins. Cost advantages can arise from factors like location, which reduces transport costs; unique assets that lower extraction costs, as seen in mining; but typically scale - in other words being large relative to the competition in a high fixed cost business. Scale which includes distribution scale and manufacturing scale allows fixed costs to be spread over more units, lowering the cost per unit. For example, Netflix benefits from scale, as it can spread its high fixed content costs across a large subscriber base, making it more profitable. Scale can also entail dominating a niche market, where the size of the market makes it uneconomical for new entrants to invest the required capital, particularly if specialized knowledge or expertise is needed.

These competitive advantages often combine to create a powerful moat that results in excess returns that are difficult to erode. I typically look for companies where this dovetails with a superior value proposition to the customer. My goal is to identify these excess returns on capital when they are out of favour, offering the opportunity to acquire them at a bargain price.

15.2 What makes a good management team?

Another key factor in a business's future returns and value creation is how effectively management allocates capital. I seek out entrepreneurial, owner orientated managements that treat their shareholders like partners – people with the character to pursue strategies designed to create long-term value and who have skin in the game and are economically aligned with us. When evaluating management, I ask the following questions:

1. **Is management able and trustworthy?**

   Are they honest and direct in their communication and deliver on their promises?

2. Are they owner-oriented – pursuing strategies designed to create long-term value?

a. Is management purpose driven, customer focused and long-term oriented?

b. How successful has management been in allocating capital? I assess their track record of reinvestment decisions, acquisitions, share buybacks, dividends, and debt repayment. Do they resist the institutional imperative to become large at any cost and do they have the character to avoid capital misallocation that mindlessly imitate peers. What is their current capital allocation framework, and does it make sense?

c. Does management's current strategy deepen the competitive advantages of the business, what is the likelihood of success, and what is the likely return on incremental investments?

d. Is management economically aligned with long-term value creation? Incentives shape behavior and the motivation of a company management can be a very important force in determining the outcome of an investment. I assess the management team's renumeration structure, insider ownership and director buying and selling. This indicates their alignment with long-term orientated shareholders.

15.3 Distinguishing between good and bad growth

While investors fixate on earnings per share (EPS) growth, not all growth is created equal. Growth only adds value when it is achieved by investing capital at returns above the cost of that capital. Short-term EPS growth can be generated through investments, but if those investments do not generate returns that exceed the cost of capital, the growth will ultimately harm the company.

Companies may pursue growth in low-return areas outside their core strengths, make costly acquisitions, or buy back shares when they are overvalued—leading to value destruction. New industries may appear to offer attractive growth, but if the barriers to entry are low, an influx of competitors will drive returns on capital down, resulting in value destruction despite apparent growth.

By combining my analysis of a company's sustainable competitive advantages, management's capital allocation decisions, and the fundamentals driving growth, I gain a clearer picture of the company's ability to create long-term value. This analysis is central to my valuation process. Once I have determined the intrinsic value of a business, I am disciplined about the price to pay for the business.

15.4 Investing with a margin of safety

I always acquire assets at a significant discount to my assessment of their intrinsic value. By investing with a margin of safety, I seek to minimize the risk of loss and maximize returns. Furthermore, to avoid overpaying for businesses, I carefully analyse the reasons behind any mispricing and assess whether I have an advantage over the market.

This edge typically stems from two factors: analytical and behavioural. My analytical edge often comes from drawing conclusions based on publicly available information that differ from the consensus view. My behavioural edge typically stems from the emotional discipline of maintaining a long-term focus — weighing what a business is worth, while the market votes on the present.

15.5 Businesses I aim to avoid

As Charlie Munger wisely said, "All I want to know is where I'm going to die, so I'll never go there." I take the same approach in investing — by inverting the question. Instead of focusing solely on what I should do, I ask myself what I must avoid.

I try to avoid risky, structurally disadvantaged businesses with poor returns on capital or companies with long-term fundamentals suggesting declining business value. In addition, I steer clear of companies where management is not aligned with long-term value creation, where current capital allocation is poor, or companies with too much debt.

While waiting for the discount to close, the underlying value of your investment in such businesses is more likely to erode than grow. In these cases, time becomes your enemy. In some instances, when declining business value is coupled with excessive debt, equity shareholders may not survive a downturn at all.

For businesses that meet my investment criteria but are not of the highest quality, I require a larger margin of safety and typically sell when the price approaches fair value. For higher-quality businesses that compound their value over time, it is often more beneficial to hold them for extended periods.

For cyclical businesses, I only consider investing at the low point of the cycle — when returns on capital are depressed, capital is exiting the industry, and the business is trading at a significant discount to its intrinsic value over the full cycle. This approach may cause me to forgo certain cyclical opportunities.

15.6 How I strive to stay rational

To succeed in investing, one must balance both confidence and humility. I need the confidence to act decisively when I have done the necessary work and formed a well-reasoned, differentiated opinion. At the same time, I must remain intellectually honest, acknowledging that the other side of the trade may be correct, and I may be wrong.

I find that a focus on potential risks, rather than risking overconfidence by focusing only on what can go right, is a productive starting point. As Mark Twain wisely said, "It's not what you don't know that gets you into trouble, but what you know for sure that just isn't so." And as Charlie Munger reminds us, "The human mind is like the human egg. Once an opinion gets in, it shuts itself off to other opinions." People tend to cling to their conclusions, even when they may be incorrect. I believe in reserving judgment until I have thoroughly worked through my mental models, rather than jumping to conclusions based on one appealing aspect of an investment thesis. In this way I hope to stand a better chance of not deluding myself and staying rational. When new information arises, I strive to avoid inertia. I revisit my thesis and investment markers regularly, so when the facts change, I can adapt my thinking. As Charlie Munger aptly put it, "Any year that you don't destroy one of your best-loved ideas is probably a wasted year."

To outperform I must identify instances of market irrationality. The discipline that helps me stay rational:

- A sound bottom-up process to analysing businesses independently before forming opinions.
- Focusing on the consequences of being wrong and probabilistic thinking over certainty.
- Having the patience to wait for the right price before making an investment.
- Maintaining a long-term perspective to maintain emotional control.
- Tracking my investment thesis and being open to changing my mind when new information comes in.
- Documenting investment decisions and learning from mistakes.
- Revisiting a behavioural checklist to avoid common biases.

15.7 How I manage risk

Nothing is more important to me than the ability to sleep soundly at night. Consider that risk and return are not always positively correlated as commonly thought. The riskiest assets do not necessarily earn the highest return. The more risk you acquire the lower your returns may be because of losses incurred. Warren Buffett have said it many times and said it best that the first rule of investing is to not lose money, and the second rule is to not forget the first rule. The goal is to make money but with limited risk. Over time, by again and again avoiding loss, you are on your way toward achieving healthy gains.

Risk control is fully integrated into my investment process. I adhere to a common-sense view of risk, namely what is the probability of loss and how much of an investment I can lose permanently if I am wrong. I manage risk for each position and at the portfolio level.

1. **Risk management for individual securities.**

- I clear a high bar before making an investment. I have a minimum set of criteria for each business. I may disqualify a business if it does not meet some of the following qualitative elements: a strong competitive position or moat that sustains business success and high returns on capital, fundamentals that imply stable to growing business value, a trustworthy and owner orientated management team, low cyclicality or low in the cycle, unpopularity, conservative financing, and where I have an edge over the market.

- Buying undervalued securities offers a margin of safety i.e. it lowers the risk of loss. I therefore seek to control risk investment by investment by methodically evaluating each opportunity and buying at a discount to my estimate of intrinsic value.

- Risk means many outcomes are possible but only one outcome will occur. I therefore believe that the key is to limit one's bets to situations where the probability of being right is way above 50% and even if I'm wrong and the low probability event occurs, that the downside risk is limited.

- I stay on the side of conservatism when valuing businesses.

- I require adequate compensation or margin of safety given the risk. The prospective return must be generous relative to the risk incurred. I therefore require a significantly higher discount or margin of safety for a riskier business with a less predictable cash flow stream, where the upside must be many multiples of the downside, than for a less risky more predictable business.

- Risk is also mitigated by ongoing monitoring of our positions and knowing why each investment I make is mispriced.

- Sell discipline - By selling near intrinsic value, I avoid the permanent loss that is likely to result from continuing to hold an asset that ultimately corrects back to or below fair value.

2. **Risk management at portfolio level**

- I further control risk via position sizing. Higher quality lower risk businesses with more predictable cash flow streams and high conviction ideas with very little downside risk can achieve a higher weight in the portfolio. The best assets and the best ideas (lowest risk of loss) receive the highest weight. Few positions will exceed 10% of assets at cost.

- I further reduce risk through diversification across business, sector, and geography. The combination and variety of individual margins of safety creates a safe portfolio.

- Cash. I may reduce risk by my willingness to hold cash when I am unable to identify attractive opportunities.

16. About Clarence Drive Capital

Clarence Drive Capital is an independent investment management firm established in 2024, specializing in global equities and with the ability to invest across asset classes.

The firm was founded by me, Johannes Visser, after serving as analyst, head of research and global portfolio manager for fifteen years at leading boutique asset managers in South Africa.

I became an investor to make a real difference in peoples' lives and for the appeal of a multi-disciplinary pursuit.

I invest partner's money as I invest my own, incorporating a broad opportunity set and aligning my capital alongside partners to my one best investment view.

I believe that a focused portfolio, constructed from my most compelling opportunities around the world, is the most effective path to achieving superior long-term risk adjusted returns.

I practice a long-term approach that seeks to identify businesses that are significantly undervalued. My strategy prefers high-quality companies that have the potential to compound value.

My focus is to ensure the firm's competitive advantages are reflected in the portfolio to drive long-term results. This edge stems from a genuinely long-term approach that allows me to look past short-term swings in sentiment, a broad global opportunity set that enables high selectivity and an ownership structure and clients that empower me to act long-term.

17. Contact me

If you're interested in learning more, I'd love to hear from you. Feel free to reach out to me at clarencedrivecapital@outlook.com.