July 5, 2023

Dear Clients and Friends,

At the halfway point for the year, the S&P 500 was up 16.9% and the Russell 1000 Value Index 4.7%, providing some relief to investors after a painful 2022. This salve may prove short-lived as the Fed pursues an aggressive interest rate policy to combat inflation and slow the mighty engine of the US economy, removing 30 years of investment tailwinds from low and declining interest rates. Corporate bankruptcies, perhaps a canary in the coal mine, have risen sharply recently and stand near levels seen during the COVID shutdown in 2020 and the Great Financial Crisis of 2008-2009. Globally, inflation is even worse than in the US as the world adjusts to post-pandemic demand while simultaneously seeking more resilient and secure supply chains. Tensions between nuclear superpowers are high based on fundamental disagreements over core values including individual rights, forms of governance, and territorial sovereignty, with aggressive military actions by Russia against Ukraine and resolute talk from China about annexing Taiwan as current flashpoints. Eventually, we see advances in technology and a coming golden age of problem-solving leading markets higher, but it may take time.

Despite the challenges of seeing into the future in a rapidly changing world, we believe the best strategy is to **stay invested in great businesses**. We follow a conservative investment approach that avoids leverage and excessive risk-taking. Where we are most aggressive is allocation to equities over bonds or alternatives. We embrace this asset allocation strategy because most of our clients have a longer time horizon than their own lifetime and a willingness to ride out periods of market volatility and weakness. And, if you can do both, we have found that there is simply no better way to protect and grow capital than owning a diversified portfolio of great businesses.

We have been longtime investors in Berkshire Hathaway and many of the core elements of our investment process have been learned by listening to the wisdom of Berkshire's Chairman and CEO, Warren Buffett, and Vice-Chairman, Charlie Munger. Warren Buffett gets most of the attention of the two, but it was Charlie's simple advice, **"A great business at a fair price is superior to a fair business at a great price,"** that has had the most profound impact on our approach, and Buffett's too.

Patience is Required to be a Value Investor

We have had some of our best returns in individual investments by sitting on the sidelines studying and learning for years before we find our spot to invest. We call this "practicing 9x patience." Imagine practicing your absolute best patience and then being told to do that nine times more, it's not for everyone, but you can see how it might give you an advantage. Luckily, we love the learning process and have found success with this patient approach as we waited for the right time to invest in companies like **Apple** (in 2015), **Costco** (in 2016), **Netflix** (in 2022) and **Uber** (in 2023). In each instance, we did the work to identify strong businesses with ample reinvestment opportunities and a sound valuation framework and then waited patiently for a fair price.

Standing the Test of Time: Competitive Moats and Why They Matter

We had the good fortune to attend a recent event at the Boston Museum of Science hosted by the National Outdoor Leadership School (NOLS). The keynote speaker was Melvin Leland, a NASA Astronaut and NOLS graduate. The event was exciting; Leland's story was inspirational; and the exhibits at the museum from the Mars rover to autonomous robots were a testament to innovation, but the exhibit we can't stop thinking about was a cross-section

of a Giant Sequoia Tree. The magnificent tree began life in 95BC and stood the test of time for more than 2,000 years thanks to its thick fibrous bark containing very little flammable resin. The bark is what Warren and Charlie would call "an unassailable moat," warding off forest fires and strengthening each year as the tree grew larger.

In a business context, we define a great business as one that has **durable competitive advantages** that protect it from competitive destruction and, borrowing from Buffett's imagery about the protection of a moat surrounding a castle, we refer to these advantages as "moats". There are many kinds of moats and we look for management teams that are continually re-investing to widen them every year. Our job as investors is to develop an informed viewpoint that incorporates all we know and can learn to determine the strength of each company's moat…and then to value the business and invest at a fair price.

Geographic Advantages – The United States of America

Warren Buffett has a reputation for betting on the US and we think this about the smartest investment decision anyone can make. We recommend reading **The Accidental Superpower** for a cogent explanation of why. In summary, author Peter Zeihan presents a forecast (published in 2014) of a rapidly changing global order ending 60 years of globalization and free trade under the Bretton Woods framework, established and enforced by the US as it emerged as *the global superpower* after WW II. Zeihan argues that in the coming era, the US will retain its role as both the global superpower and partner of choice for decades to come because of its geographic and demographic moats. The advantages start with a **navigable** network of rivers and sheltered coastal waterways that is larger (in terms of length), more protected (from weather and adversaries) and more interconnected than any other waterway network on earth. The US has favorable demographics that will be a significant advantage vs. all other mature economies as Baby Boomers, a large generation in retirement now, are followed by a much smaller Gen X cohort, needing less social safety services, and behind them a much larger Gen Y cohort that begins to turn 50, maximum earning years, in 2030. The US has rich farmland, natural resources in abundance, a dynamic and diverse citizenship with strength from legal immigration, governmental checks and balances, and a culture that prizes entrepreneurship, failure and innovation. And finally, the US maintains friendly relations with neighbors to the north and south and has thousands of miles of oceans to the east and west to protect it. In short, the US is likely to remain the best place on earth to live, work and invest for decades and perhaps generations to come because of its formidable competitive moats.

Durable Barriers to Entry – Canadian National Railway

For more than a decade, **Canadian National Railway** (CNI) has been a stalwart in DWA's flagship portfolio for a simple reason: its unassailable network of train tracks in North America. It's hard to imagine a more durable moat than owning railroad tracks because of the near impossibility of securing the right of ways that would be needed for a new competitor to enter the market. And in terms of competing with existing competitors, CNI's T-shaped network (running the width of Canada from the Pacific Ocean to the Atlantic Ocean and from the center of Canada to the Gulf of Mexico) includes the lowest grade (incline) among all competitors to the West Coast offering a fuel efficiency advantage. CNI also owns a stretch of track that bypasses Chicago, avoiding a major bottleneck on the north/south route faced by competitors. Lastly, CNI has exclusive rail rights to Prince Rupert Bay, a quickly developing west coast port city with the deepest ice-free natural harbor in North America (source: CNI). As a result of these structural advantages, CNI's operating margins have averaged three percentage points above the competition over the past 10 years (source: FactSet) and at a recent investor day that we attended in person we were impressed by their investment plans to optimize the customer experience under a catchall that "the plan is sacred." The plan being a scheduled operating model that drives higher car velocity and greater customer service levels, producing a positive feedback loop of higher margins and market share gains. The plan is enabled by company-wide confidence in the

leadership of CEO Tracy Robinson and by tracking simple metrics that all employees and customers understand. This transparency and clarity of purpose contribute to CNI's winning business model.

Benefitting from Scale and Network Effects – Uber

Another DWA investment in transportation, based on a very different kind of moat, is **Uber**. Uber's moat is the result of creating a vibrant marketplace for supply and demand to meet. For years we watched Uber from afar, but early this year we concluded it was the right time to invest because the business had established both scale and network effect moats. Uber has a virtuous feedback loop where more demand (riders and customers) attracts more supply (drivers and participating businesses) and leads to better customer experiences, more customization, more demand, and more supply. Almost half of Uber's bookings today come from delivery services, predominantly takeout food. This business exploded during COVID and continues to grow and expand into additional services such as grocery and packages. On the transportation side, management sees a $5 trillion opportunity inclusive of ride hailing, shuttle services, rentals, charters, and car sharing. The Uber brand is strong, there are ample reinvestment opportunities to leverage the data they have access to, and artificial intelligence will be a powerful tool to enhance the customer experience. Uber holds just 10% of the current market, has turned the profitability corner, and because of its moat, we believe profits and shareholder value will grow rapidly.

Learning and Re-investing – DWA Update

One of the great benefits of being active investors is that we learn from studying great companies. The most satisfying application of this knowledge is to fortify our own competitive moat. Our biggest priority is to re-invest in our team and we are 10 years into a methodical succession plan and positioning the firm to serve future generations. We have significantly increased the number of active partners who own stock in DWA while also flattening the distribution of that ownership across the firm. This summer we are thrilled to welcome Elise Tursi as the newest member of our Client Relations team and to welcome a talented group of interns that provide connections to the next generation of team members and clients. We have brought on a wonderful strategic investor in Kudu Investment Management and have enlisted advisors to help us with strategic planning aimed at improving outcomes for our stakeholders. It's this large collection of human capital that constitutes the foundation of our moat and we plan to follow Charlie and Warren's sage advice to keep re-investing in widening our moat every year.

Our founders set an audacious goal early on: to become **the best** independent boutique firm in the wealth management and investment management business. This vision motivates and inspires us every day and we thank you for your support. We are energized and feel like we are just getting started!

Sincerely yours,

The DWA Team