

Tao Value Q4 2021 Letter

February 22, 2022

For the quarter ended December 31st, 2021, Tao Value recorded a return of -4.82%, compared to +6.98% of MSCI All Country World Index (ACWI). Our full year return is -10.4%, compared to +18.67% of ACWI.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year /YTD	MSCI ACWI
2017	+1.94%	+2.34%	+0.33%	+2.80%	+4.14%	+0.07%	+2.65%	+1.76%	+1.31%	+4.69%	+1.34%	+1.60%	+27.91%	+23.97%
2018	+2.07%	-3.85%	-3.74%	-0.80%	+4.81%	+2.99%	+2.20%	+4.16%	-0.87%	-7.26%	+3.79%	-5.53%	-2.93%	-9.42%
2019	+7.68%	+2.62%	+3.19%	+1.46%	-6.54%	+3.28%	+2.40%	-1.53%	+0.43%	+0.52%	+2.42%	+1.25%	+17.88%	+26.58%
2020	+1.88%	-2.56%	-12.32%	+10.50%	+10.68%	+11.56%	+2.92%	+8.16%	-3.80%	+4.74%	+14.88%	+4.99%	+60.66%	+16.33%
2021	+7.55%	+5.30%	-8.20%	+3.17%	-3.83%	-1.30%	-9.88%	+6.58%	-3.73%	+7.01%	-6.34%	-5.04%	-10.40%	+18.67%
Since Inception (*January 1st, 2017)													+110.68%	+96.22%
Annualized													+16.07%	+14.43%

Contributors & Detractors

Contributors		Detractors	
Position	Performance (bps)	Position	Performance (bps)
Long RBLX	154	Long SE	-392
Long GOOG	125	Long PDD	-204
Long CACC	68	Long AVL ^R *	-57

* Exited position

Our top contributors this quarters are **Roblox (ticker: RBLX)**, **Alphabet (ticker: GOOG)** and **Credit Acceptance (ticker: CACC)**, adding 154 bps, 125 bps and 68 bps, respectively. The largest detractor this quarter is **Sea Ltd. (ticker: SE)** with -392 bps. It was followed by **Pinduoduo (ticker: PDD)** and **Avalara (ticker: AVL^R)** dragging -204 bps and -57 bps, respectively.

As of the end of this quarter, our top 3 positions are **Alphabet (ticker: GOOG)**, **Cash** and **China Meidong Auto (ticker: 1268.HK)**. Collectively, they are 38 % of the portfolio.

Roblox (RBLX) got significant more attention from both institutional & retail investors after Facebook announced to rename itself as Meta Platforms. I believe the price appreciation is largely attributed to the increased attention. On business side, Roblox rolled out a few successful music events and also partnered with Netflix on testing long-form media consumption in virtual world. Apple in its iOS 14.5 rolled out an impactful change for digital advertising landscape by requiring all apps to ask users to “opt in”. Yet **Alphabet (GOOG)** seemed to defy such impact and still delivered strong results, beating both revenue & earnings expectations.

On the detracting side, our largest detractor is **Sea (ticker: SE)**, which dragged 392 bps, followed by **Pinduoduo (ticker: PDD)** and **Avalara (ticker: AVL^R)**. **Sea (SE)** & **Avalara (AVL^R)** are caught in a big rotation out of high growth stocks starting from November. **Pinduoduo (PDD)** reported the second

consecutive GAAP profit quarter yet missed on the revenue due to nation-wide consumption weakness & scaled back Sales & Marketing efforts. Market disliked it and the stock price plunged on the earnings. In my opinion, the accounting profits proved the original thesis of using S&M to acquire users and using great shopping experience to keep them. After realizing the first growth curve, Pinduoduo now shifted its focus & investment to agriculture. It is still very early, but the reduced size due to price drop warrants a position to watch and continue grow with such a team with strong culture.

General and Market Commentary

A Review of the Past 5 Years

It has been five years since we started the partnership. It is due to review what has worked and what has not. Below is a visualization of the P&L (both realized and unrealized) in \$ value scale for top 5 positions on both sides in the past 5 years. The top 5 value addition are **Sea (SE)**, **Alphabet (GOOG)**, **Atlassian (TEAM)**, **Meidong Auto (1268.HK)** & **Bilibili (BILI)**, and the top 5 value destruction are **Tianli Education (1773.HK)**, **TAL Education (TAL)**, **KE Holding (BEKE)**, **Yihai (1579.HK)** & **Alliance Data System (ADS)**.



SE, GOOG & 1268.HK are among the core current holdings of “Mindful Compounder”, and appreciated 578%, 240%, & 621% respectively since initial purchases. **TEAM** is different that it is a major position grown from a small start. It appreciated 1186% since initial purchase. It is a validation of a venture-like strategy, where a small initial start in a long runway, high compounding growing business could yield significant return for the portfolio. These two themes will remain as my focus in the future.

Looking at the value destruction, **TAL Education (TAL)** & **Tianli Education (1773.HK)**, are the most painful losses. Although they both are part of the “Mindful Compounder” bucket, they impaired by 95% & 82% respectively. If anything, it is heavy price paid for learning that stock returns are driven by more

than business and market factors, but also societal factors. I personally think having 4 out of the 5 top value destructions being recently started position in Chinese stocks is a bit biased, as the market may have overacted the most to anything China-related recently. ADS, on the other hand, was a classic failed roll-up by a promotional wall street veteran CEO, optically looks very cheap. I was also lured by its seemingly drastic decision making in share-buybacks, which in retrospective, were merely clumsy “imitation” of the great capital allocator CEOs that investors loved to study.

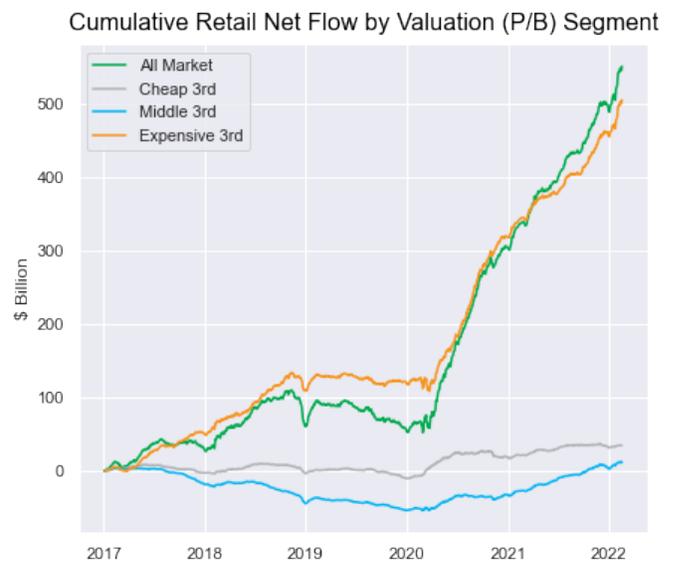
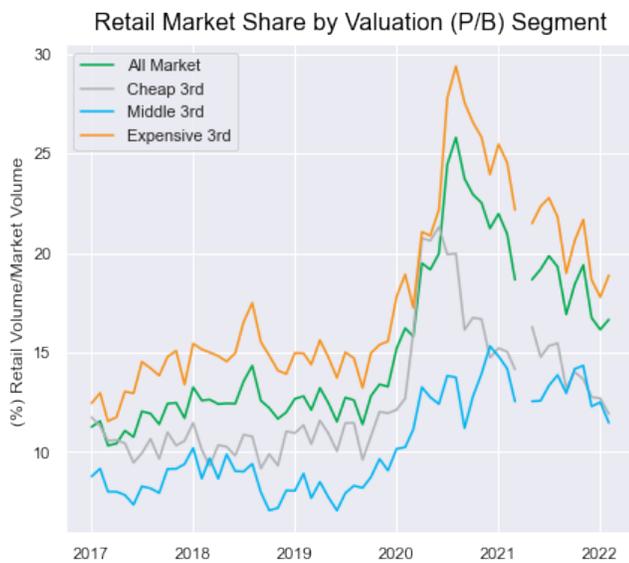
Market Temperature and What’s Ahead

A year ago, I wrote about the “Retailization” of the market in our Q4 2020 letter, and I feared that “we may be at the beginning of a larger “bubble” than Nifty Fifty, yet in a faster pace.”¹ I listed below similarity between current market and the 1970s bull markets.

- The rise of a new breed of investor, who make “profiting in stock market” seemingly easy.
- The rise of star fund managers using new paradigms.
- Market is transformed by an influx of new generation with experience of a prolonged bull market.

Things started to turn in 2021. As the retail investors played an ever more influential role in driving stock price, I believe retail flow data will be helpful to understand this new market regime. Below are two very important charts helpful for understanding the current market state.

For this analysis, I used all US listed equity (about 5000 names) as the market (Green line below), and used P/B ratio as the valuation metric to segregate the market into 3 segments (the cheapest 3rd in Grey, the middle 3rd in Blue & the most expensive 3rd in Yellow). On the left is the retail market share (in % of total market volume) over time. After reaching the top at 25% in August 2020, retail market share has come down quite a bit to a level at 16%. This reversal is present in all 3 segments, yet in different scale.



¹ <https://taovalue.net/2021/01/27/the-great-retailization-of-us-market/>

On the right is the cumulative net flow from retail investors in the same color scheme. The first obvious observation is the sudden net influx since March 2020 of the market. The green line made a sharp upright turn which persisted to date. Furthermore, it is striking that such net inflow actually came exclusively from the most Expensive 3rd segment (the Yellow line pretty much drove the Green line). Interestingly, the Yellow line started to go under the Green line in February 2021 (i.e. the cheap & middle segments as a whole finally had positive net retail inflow for the first time since mid 2017).

Combined insights from both charts, I believe:

- The retail driven bubbles are likely within certain pockets and may not impact the whole market.
- The market seems to cool off as retail tide ebbed and would become less erratic.
- The retail investors are still buying within the most Expensive 3rd segment even when some bubbles started to pop. That means there could be uglier things to come. Thus, avoiding such risk would be wise for our portfolio.

Portfolio Updates

We have no new position this quarter and have made below changes to our portfolio.

We sold **Tianli Education (1773.HK)**, after the industry was demolished and the Chairman/CEO was rumored to be detained for local officials' corruption cases investigation. We also sold **Avalara (AVLR)** & **Palantir (PLTR)** as I identified them subject to high retail bubble risk (using above method) and are not part of our core "Mindful Compounder" holdings. We also sold the **VMWare (VMW)** shares distributed to us via its spinoff from **Dell Technologies (DELL)**. Lastly, we trimmed **Atlassian (TEAM)** for the first time since our initial purchase, for its high valuation as well as to control its relative size.

Final Note

As we started a new journey after a five-year ride, I want to thank all partners again for trusting me to manage your hard-earned wealth. Although the road might be bumpier in the next five years, I hope you can rest assured as they are being managed alongside my own significant wealth. I'm confident that our investing methods are based on the fundamental principles of how businesses and capital markets work and should stand the test of time.