SORFIS
INVESTMENTS

February 20, 2024

2023 Annual Letter

2023 was far different than 2022 in the stock and bond markets. After one of the worst years in history that saw stock and bond markets tumble in 2022, stock market indices soared in 2023, and the bond market returned to a more modest, positive return.

In our **Diversified Strategy**, where we diversify widely and adjust the asset mix based on a client's life situation and risk tolerance, we mainly experienced positive returns somewhere between upper-single-digit and mid-teens percent returns for clients in the strategy for the entire year. Returns in this strategy tend to vary widely, given how we adjust portfolios to each client. But we continue to keep bond durations short in the current environment and, on the equity side of things, tend to lean toward the "value" end of the spectrum instead of the "growth" end—which helped relative performance in 2022 but hindered in 2023.

For clients in our **Absolute Return Strategy**, we had another year of returns better than I would have expected, given what happened in the market. Remember, this is a concentrated strategy that we expect to be volatile in its goal of trying to outperform the S&P 500 over the long run or match the S&P 500 with lower risk. After achieving slightly positive returns in 2022, when the S&P 500 had a big negative year, clients in the Absolute Return Strategy for the entire year all achieved a return of 25% or more during 2023, approximately matching or exceeding the benchmark.

In a year when the so-called "Magnificent Seven" stocks drove much of the stock market's return—and drove a significant portion of media coverage during the year—it was difficult to keep up with the S&P 500 if one didn't have some exposure to that group. In the Absolute Return Strategy, we thankfully had exposure to one of them, Meta Platforms, Inc. ("Meta"), and our timing on making it a full position at the end of October 2022—for those who were clients in that strategy at that time—proved to be the critical factor in making 2023 a great year instead of just a good one for that strategy.

Like the energy investments we made that helped us during 2022, Meta is another example of a stock that I wouldn't have expected we'd own before we bought it. I have no idea how the future of artificial intelligence (AI) will play out, and I have little opinion on it all. But a major driver of our determination of risk and reward is price, and sometimes, a business is priced at such a low valuation that it can become a lower-risk investment even if a cloud of uncertainty surrounds it. In a newsletter[i] to which I help contribute, I wrote a possible thesis for buying shares in Meta at the time, which was the simple thesis I had in Fall 2022:

> "At this price, the stock is trading around a P/E ratio of less than ten times the peak earnings of the businesses which are still there and growing, albeit barely growing, but competitively-advantaged. Management has made some great capital allocation decisions in the past that people thought were dumb when they made them. Maybe the investments in the Metaverse and AI will pay off. Maybe they won't. But the core businesses are profitable and eventually, given management's history and incentives, more capital discipline will come back when the future is a little clearer."

Of course, even good investments rarely work so quickly, and there was plenty of luck with AI-hype driving up multiples higher than business progress might otherwise have justified. But the best mispricings often occur when people overreact to news and when sentiment on a business reaches such lowly depths that its stock price becomes a bargain. That's what I believe we experienced with Meta, and it's something that we hope to experience again when similar situations appear in the future.

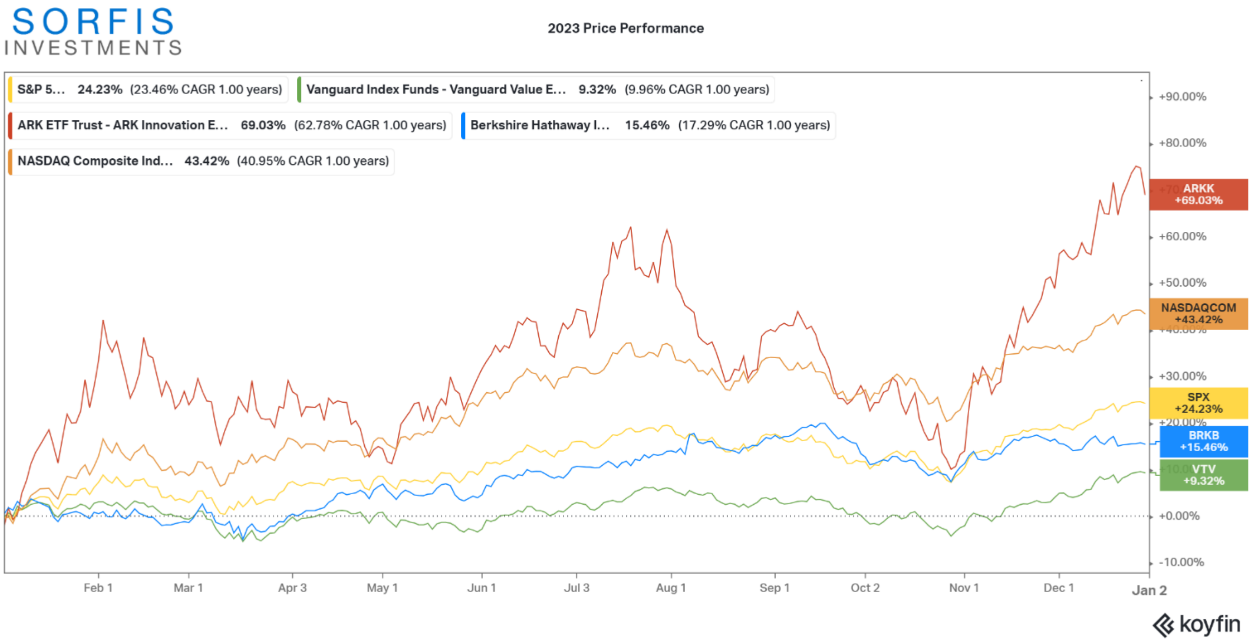
Sequence and Returns

The oft-cited fact that it takes a 100% return to get back to even after a 50% loss is used to illustrate the difficulty of recovering from big losses in the stock market. And that's a good example to remember, but one of my favorite quotes to illustrate the importance of sequence in investing (and other matters) comes from a presentation[ii] that Professor Sanjay Bakshi gave on the topic of ergodicity back in 2019:

> *"Sequence matters. If you wash your pants, then dry them, and then wear them you get different results than if you dry your pants, then wash them, and then wear them." —Alex Hardy*

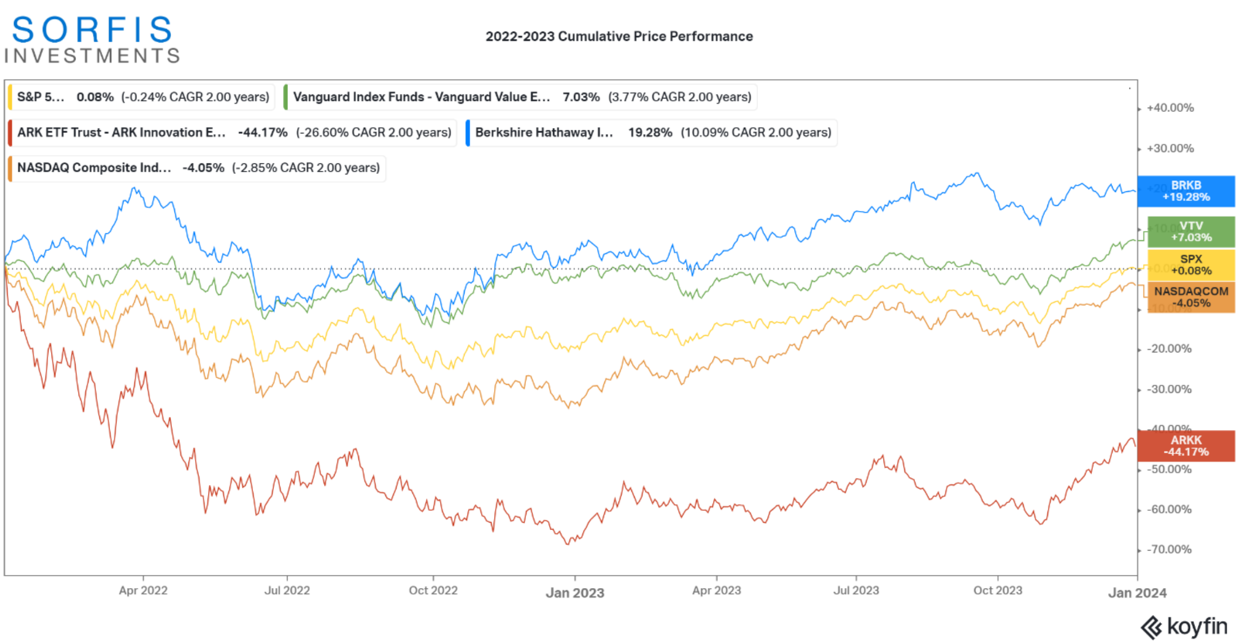
The stock market results during the last two years show how important it is to consider the complete picture of returns when looking at a given result. Let's look at a few securities for illustration. We'll use the S&P 500 as our broad stock market selection, the Nasdaq Composite and the ARK Innovation ETF ("ARKK") as our "growth" proxies, and Berkshire Hathaway ("BRKB") and the Vanguard Value Index Fund ETF ("VTV") as our "value" proxies.

First, let's look at 2023's performance:



As you can see from the chart, growth was on a rocket ship during 2023, with ARKK up almost 70% and the Nasdaq up over 43%.

But things look a little different if we consider the two-year cumulative performance for 2022-2023:



As this chart shows, value's outperformance during a difficult year in 2022 more than made up for the underperformance during 2023 when one considers the two-year total return for BRKB and VTV.

We can't predict what will happen during a one- or two-year period, but, as those who have followed us for a while might expect, we aim for results that more closely resemble BRKB and VTV in the charts above. It'll be hard for us to keep up with speculative, high-flying markets. But we realize the importance of protecting our clients' hard-earned savings and take that responsibility seriously. In short, we're happy to emulate the tortoise in the fable of "The Tortoise and the Hare."

Goodbye to Two Heroes

"Choosing your heroes is very important. I tell that to the students when they come. Because you are going to gravitate toward the behavior of those around you." –Warren Buffett

"Tell me who your heroes are and I'll tell you how you'll turn out to be." –Warren Buffett

In life, one person can often make a major difference in how your story unfolds. And a handful of people that you choose as heroes can take you down a completely different path than you would have otherwise pursued. For me, two of those people were Dr. Gerald Boyles[iii] and Charlie Munger, both of whom passed away in 2023.

Dr. Boyles was the college professor who sparked my interest in investing. I may not have been introduced to the value investing philosophies of Warren Buffett and Charlie Munger that I've pursued during the last two decades without him. And even more important than that spark was his friendship and guidance post-graduation that I'll remember forever.

As for Charlie Munger, when I started studying him and his multidisciplinary approach to life and learning, another spark ignited inside me that changed how I did everything. While I'll miss him—and his continuing wit and wisdom—I'm so thankful that he was around for so long on this earth to guide and teach those of us "groupies" who could never seem to get enough.

Ch-ch-ch-ch-changes

Theresa and I, and our respective households, moved from the great state of North Carolina to the great state of Ohio in 2023. My wife and I also had our second child—a girl, and we are more than happy to hear any advice from our clients and readers who have daughters of their own—and Theresa got married during the summer.

So, it was an eventful year. We still plan on spending plenty of time in the Carolinas, but our home base is now in Chardon, Ohio. If you find yourself passing through, let us know.

This has been another year on a journey we hope to last decades. We're building Sorfis and investing client capital the same way we'd want our capital and the capital of our families and friends to be invested—because it *is* how we have our capital and that of our families and friends invested.

We're independent, and always will be, so that we can provide clients with the unbiased advice we think they deserve, which is sometimes lacking in this industry. We keep our business costs low so that we can pass much of those savings along to clients in our pursuit of delivering fair fees and great service.

Our contact information is included below for easy reference. As always, feel free to call or email us if you have any questions. And thank you for your support!

All the best,

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Portfolio performance is shown net of the advisory fees of 0.75%, the highest fees charged by Sorfis in its strategies during the year. Performance does not reflect the deduction of other fees or expenses, including but not limited to brokerage fees, custodial fees, and fees and expenses charged by mutual funds and other investment companies. The data used to calculate the portfolio performance was obtained from sources deemed reliable and then organized and presented by Sorfis.

The performance calculations have not been audited by any third party. Actual performance of client portfolios may differ materially due to the timing related to additional client deposits or withdrawals and the actual deployment and investment of a client portfolio, the length of time various positions are held, the client's objectives and restrictions, and fees and expenses incurred by any specific individual portfolio.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

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[i] https://coinvestorclub.substack.com/p/coreport-994

[ii] https://fundooprofessor.com/2019/10/13/non-ergodicity/

[iii] https://www.msfh.net/obituary/DrGerald-Boyles