January 30, 2022

We officially launched Diamond Lake Capital ("DLC", "Diamond Lake") in July 2021. Starting a registered investment advisory firm comes with lots of paperwork, insurance, and rules. We're happy and relieved to have this phase official.

DLC's model portfolio returned 11%[1] from July to December, compared to 8.95% for the S&P 500 total return index[2]. A 2% edge over the "market" may not seem like much, but we're proud of the result, even if we're only into the first several pitches of the game, especially when 85% of active US stock funds trailed the market in 2021[3].

	Diamond Lake Capital		Relevant Comparison Returns	
	Gross Return	Net Return	S&P 500	Vanguard 2040 TDF
7/28 to 12/31/2021	11.00%	10.57%	8.95%	3.67%

The S&P 500 index is the standard of standards for US investment benchmarks, and there are indices that mimic its returns in a cheap and easy way to invest passively in great businesses. We've also included the Vanguard 2040 target-date fund (TDF)[4] a popular and super low-cost investment option for retirement accounts. 53% of retirement plan participants with Vanguard invest *only* in a single target-date fund[5]. Life is about opportunity costs, the menu of alternative investment options to spend one's time or money. Comparing net performance to alternatives over time is essential.

We ended the fiscal year with $1M in assets under management, including substantial partner dollars. As investors, we buy alongside you; this is a key principle of our firm, and, we believe, in the long-term interests of our clients. Few investment managers do this.

We've started our first lap carrying the baton of our philosophy of low turnover and concentrated bets, with the core portfolio comprising a mix of our DLC holdings. After the initial trades we've sat, read, and taken notes. A portfolio of 10-12 stocks held for 5 years each on average would require 2 to 2.4 changes per year, 4 to 4.8 when you count the selling and the buying. That feels right. Most months we observe and learn. As Charlie Munger says, "The big money is not in the buying and selling, but in the waiting."

Some of the businesses we've owned individually for 5 years or more, others under a year. As 2022 progresses, we have an agenda and framework to assess positions and to add or exit

[1] Gross returns, unaudited.
[2] The S&P 500 total return index includes dividends.
[3] Stock Pickers Are Struggling to Beat the Market
[4] ticker: VFORX
[5] How America Saves

investments. Our selling philosophy is about business deterioration or better opportunities, not missing-earnings-per-share-by-one-cent events. Though our investments aren't all boring, our trading logs are. Academic research[6] links high portfolio turnover with low performance. Our personalities support this.

Stock prices tend to jump around more than fundamentals warrant. Mudding the waters are investment flows, passive investing's indifference to price, the growing clout and dollars of retail investors, margin calls, and option activity. 2021 again showed this[7]. Finance theory says a stock is the present value of future cash flows, and if you do the math, even for a low growth company, next year's cash generation is well below 10% of the formula. Yet prices can swing wildly within the same year. Imagine a rental property that routinely jumps around 30-160%+ within the same year. $450,000 on one day, $1,000,000 in the summer, before hitting $800,000 at the end of the year. We don't get daily quotes on housing and those cash flows are more stable potentially but that's how the markets for stocks work. For 253 US trading days per year the market gives us a price quote on an ownership stake of a business, with amazing liquidity and tiny indirect costs. We buy, sell, hold, or ignore. Volatility doesn't always reflect reality, and our strategy is meant to capture some of that. There will be swings, more dramatic than "the market" because of it. We can stomach that and we hope you can too.

Markets come in phases and weird shapes, often with few observations of past cycles to be statistically significant, and if they were obvious, would be reflected in the prices. Sometimes history doesn't even rhyme. For example, the mortgage excesses of the Lehman Brothers phase 14 yrs ago, was unique in its details to the last one hundred years. Today's environment of historically low interest rates is led by pockets of excess. Some big tech firms have incredible businesses, make lots of cash, trade at rational multiples given interest rates and alternatives, and aren't diluting their share count or overly relying on the comically overused "adjusted EBITDA before stock compensation" even after 10 years as public companies. Knowing what to avoid in investing is a valuable early filter. No bored ape NFTs.

We are also investment advisors on Health Savings Accounts (HSAs)[8] and the investment accounts tied to them. A family can contribute $7,200 per year, tax-shielded, and compound it by investing, withdraw it at retirement to pay for healthcare costs in retirement, all without writing a check to the IRS. Fewer than 5% of HSA holders do this, due to market immaturity and educational awareness issues**.** We will continue to spread the word. Most spend HSA money or park it in cash, earning a substantial negative real return. 2021 shows that inflation is becoming a noisier thief.

Healthcare costs, now, and in retirement are actually quite manageable. According to actuarial tools we've built, and market data, a 30 yr old male with a typical medical plan has less than

[6] Portfolio turnover activity and mutual fund performance
[7] In 2020 many stocks traded for valuations that moved 4-fold
[8] The most tax-advantaged retirement account, albeit with lower annual contribution limits, that's portable and doesn't have to be spent each year like its FSA cousin. HSAs must be paired with a high deductible health plan, which the IRS says is $1,400 or more.

$500 in out-of-pocket expenses per year[9]. $250 per month saved and invested at a 5% real return in an HSA goes a long way to covering the average $4,000 to $5,000 in annual out-of-pocket costs in retirement. Even a 45-year-old with a modest HSA balance today can hedge healthcare costs by saving and investing in such a way and reasonably accumulate $200,000 by age 65, enough to pay annual costs, the principal balance intact.

Of the 31M HSA accounts in the US, and $100B in assets[10], we estimate around 200,000 accounts have balances of $50,000 or more. If you have a large balance HSA, let's talk. We think this is a gateway to other pools of investments, such as 401ks or IRAs, where Diamond Lake can also help.

TRENDS

CPI was 7% in 2021, the highest it's been since 1982. Some of this is shortages and supply chains and some of it is money printing. Alternatively, nominal interest rates have stayed low through Fed activity, which has led to unprecedented growth in housing prices *and* cheap loans. The attitude of many seems to be to buy high in hopes to sell higher. It's likely the Fed will increase interest rates in 2022 to help curb inflation, adding extra gravitational pull to valuations–interest rates are a key brick in building valuations. Assumed annual inflation over 10 years has averaged 1-2.5%, and stands at 2.4% per year, the higher end of recent numbers[11]. Our investments reflect this.

The world is flatter. The global pandemic pushed companies to allow remote work–in September 45% of full-time employees worked remotely in the U.S., and 9 out of 10 workers prefer some remote work[12]. Companies will continue recruiting talent regardless of geography and those workers will continue moving to favorable living areas. We're likely to see housing growth continue in rural areas and remote workers moving to lower tax, more affordable communities, a great feature of the US federalist system that helps states compete.

Nothing in policymakers' tool kits shows any sign of taming top-line healthcare costs in the US. Politicians continue to favor subsidies over anything harsher and organic to reduce healthcare as a percentage of GDP[13]. Price controls in Medicare spill over to higher costs and lower wages for workers (high health insurance premiums come out of wages). 2021 tells a story of out-of-pocket healthcare growing at 2% (the number used in medical CPI), insurers guiding to 5-6% medical inflation, and healthcare at a percentage of GDP growing at close to 10% (Covid cash poured in). Covid-19 will eventually subside and Covid-'22 carries a new more relaxed approach and healthcare innovation will grow. We don't think it's irrational as a nation to spend more of your wealth on preserving health. Investors should hedge in both healthy behaviors and in investments.

---

[9] DLC Health Savings Calculator
[10] 2021 Midyear Devenir HSA Research Report
[11] FRED: Economics Data 10-Year Breakeven Inflation Rate
[12] Gallup poll: Remote Work Persisting and Trending Permanent
[13] 2021 ACA enrollments show 96% qualifying for subsidies compared to 85% in previous years.

PORTFOLIO ANALYSIS AND SELECT STOCK PERFORMANCE

Our core portfolio returned 11.00% in 2021, based on a truncated year from inception of July 28 to December 31, 2021. The S&P 500 (including dividends) returned 8.95% over the same period. Additionally, it's helpful to view our top-weighted holdings and specific performance. We also think it's valuable to provide a brief summary of the return attribution of these holdings.

Holding	Portfolio Weight	2021 Performance (7/28-12/31)
Virtu Financial (VIRT)	15.5%	13.2%
JD.com (JD)	13.6%	0.2%
Costco (COST)	12.0%	34.4%
Brighthouse Financial (BHF)	11.3%	21.8%
Microsoft (MSFT)	8.2%	17.0%

Virtu Financial (VIRT, $3.2B market cap) is a market maker in stocks and options that collects a bid/ask spread on investment transactions, a sort of picks and shovels play on market volatility and volumes. Retail trading, gamification of stocks, and zero commission trades are here to stay. Trading volumes print money and it doesn't correlate with the market. VIRT is the only publicly traded firm in its industry that has the earnings power to buy back all of its shares in the next 5 years. It trades at 9x forward earnings and has a dividend yield of over 3%, which we reinvest. Returns on invested capital have ranged from 30-70% in the last three years. Citadel is 1.7x larger in retail market share but a recent investment values them at 3.4x VIRT's total enterprise value (equity + debt).

JD.com (JD, $120B market cap) is in a "China's Amazon" category, a leading e-commerce and retail logistics company, which owns fulfillment infrastructure (189M square feet across 1,000+ facilities) and last-mile delivery and the tech behind it, providing same or next-day delivery to over 500M customers in China, a studying logistical feat. The firm grew by 30% in 2021 with revenue of $144B[14] and trades at about 30x earnings. An investment in JD is an investment in China's GDP, growing consumer wealth, and its internet transformation.

Brighthouse Financial (BHF, $4.2B market cap) is one of the nation's largest independent life insurance and annuity businesses with over 400 partners and 2.8M policies. BHF is a legacy business spun off from MetLife insurance. Due to derivatives accounting, reported earnings are choppy but the business franchise is intact, the ability to grow slowly and use excess cash to buy back stock–as owners, our share of the pie grows. The stock trades at a large discount to book value, or net accounting value, a valuable guidepost for banks and insurance companies,

[14] 900B RMB

and under 3x expected 2021 earnings of $18.21 per share. Excess insurance costs for Covid deaths as of November were 1/5th of what management had accrued for. Expectations matter in stocks and management guidance.

Costco (COST, $215B) operates just over 800 membership warehouses, most of which are in the U.S. Most goods are sold at or close to cost–the exception being Costco branded items, i.e. Kirkland. That means earnings are largely driven by membership fees, which currently have a 91% loyalty rate. Costco doesn't have an advertising budget. They spend virtually $0 on marketing–compared to .5 - 2% of revenue for retailers like Walmart and Target. They'll likely continue to expand internationally. We expect opportunities for e-commerce growth, other services, and potentially prescription drug expansion.

Microsoft (MSFT, $2.1T) is renowned for its Windows operating system and main suite of business products, Office. Software usually has high margins, and given Microsoft's dominant market share and brand loyalty this is no different (40% operating, 35% profit). Microsoft has also become a major market player in cloud storage with Azure, a fast-growing $40B space.

Microsoft has also managed to compete well in the gaming space with Xbox. The acquisition of LinkedIn in 2016 gives it an opportunity to compete in recruiting, networking, and other career-related services. There's competition in each of these areas; the government is also putting increasing pressure on regulation as they move past $2T in market size.

LOOKING FORWARD

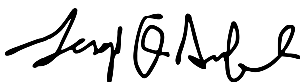
We continue to make infrequent weighted bets based on the information we have, our collective experience, investment vision, and discipline. We will strike out at times but our interests are aligned with our investors. We're excited to be on this journey with you, to continue to build, and to add value to retirement, HSA, and other assets.

We're always around to talk and answer any questions you may have.

Your partners,

Greg Greer

Joe Andelin



DISCLOSURES

Diamond Lake Capital, LLC is a registered investment advisory (RIA) firm. This letter is not investment advice and should not be deemed as investment advice or a recommendation to purchase or sell any specific security. Information referenced in this letter comes from sources we believe to be reliable and accurate. Opinions written are subject to change and past performance is not a guarantee of future results. Additional information on DLC (CRD #314605), including form ADV, can be found on the SEC's website.