The clearest way into the Universe is through a forest wilderness.

John Muir (1838 – 1914)
The Unpublished Journals of John Muir – 1938

The redwoods, once seen, leave a mark or create a vision that stays with you always. No one has ever successfully painted or photographed a redwood tree. The feeling they produce is not transferable. From them comes silence and awe. It's not only their unbelievable stature, nor the color, which seems to shift and vary under your eyes, no, they are not like any trees we know, they are ambassadors from another time.

John Steinbeck (1902 – 1968)
Travels with Charlie – 1962

Let us cultivate our garden [grove].

Voltaire (1694 – 1778)
Candide: or, The Optimist – 1762

This is their temple, vaulted high,
And here we pause with reverent eye,
With silent tongue and awe-struck soul;
For here we sense life’s proper goal.
To be like these, straight, true and fine,
To make our world, like theirs, a shrine;
Sink down, O traveler, on your knees,
God stands before you in these trees.

Joseph B. Strauss (1870 – 1938)
The Redwoods
To: East Coast Asset Management Clients and Interested Parties

From: Christopher M. Begg, CFA – CEO and Chief Investment Officer

Date: November 10, 2014

Re: Third Quarter 2014 Update – Grove of Titans

In our third quarter letter you will find our portfolio update and general market observations. Each quarter we highlight one component of our investment process. This quarter, in the section titled Grove of Titans, I will discuss the attributes of what we think constitutes an enduring business. As is our standard practice, client reporting, including performance and positioning, has been sent under separate cover.

Market Summary

<table>
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<tr>
<th></th>
<th>S&amp;P 500</th>
<th>MSCI AC World Index</th>
<th>MSCI Emerging Markets</th>
<th>MSCI EAFE Index</th>
<th>Barclays Aggregate Bond Index</th>
<th>Gold – $/Troy Oz</th>
<th>Crude Oil</th>
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<tr>
<td><strong>Price 09/30/14</strong></td>
<td>1,972.29</td>
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<td><strong>Q3 2014</strong></td>
<td>1.13%</td>
<td>-2.16%</td>
<td>-3.38%</td>
<td>-5.74%</td>
<td>0.17%</td>
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<td><strong>YTD</strong></td>
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<td>-0.79%</td>
<td>4.10%</td>
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<td><strong>2013</strong></td>
<td>32.38%</td>
<td>23.53%</td>
<td>-2.34%</td>
<td>23.57%</td>
<td>-2.02%</td>
<td>-28.04%</td>
<td>7.19%</td>
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Over the past two months, volatility has returned to the equity markets. A six-year recovery of equity prices has many investors questioning the viability of an appreciating stock market. Projecting market expectations through a rearview mirror is a limiting strategy. Instead, we think harnessing business specific valuation and margin of safety tools are the only forward looking methods that deserve merit. In these terms, we believe our portfolio of quality businesses at today’s valuations is an attractive and intelligent place to allocate capital.

Loss aversion is a deeply embedded human trait; thus it’s only normal to feel uncomfortable when market prices move lower. While volatility can cause uneasiness, we feel that it often creates the possibility for improved expected returns by increasing per share ownership through direct purchases and company share buybacks. We think short-term volatility should often be viewed as an opportunity to the long-term investor who seeks enduring businesses at reasonable prices.

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1 The S&P 500 Index, the MSCI All Country World Daily Total Return Index, the MSCI Emerging Markets Index, the MSCI Europe Asia Far East Index (EAFE), and the Barclays Aggregate Bond Index are representative broad-based indices and include the reinvestment of dividends. These indices have been selected for informational purposes only. East Coast’s investment strategy will not seek to replicate the performance of these or any other indices. Past performance does not guarantee future results. The discussions in this letter are for information purposes only. Please consult with your investment advisor before making any investment decisions. For complete disclosures about East Coast Asset Management LLC visit our website or consult our Form ADV and Form ADV Part 2A.
Price and value are two contrasting sides of the same coin. The value of any investment is simply the present value of all future cash flows. News and related media spawn noise that create an environment where price overshoots value and they become disconnected, crisscrossing each other along a trajectory. The increasingly short-term nature of investors only serves to bolster our belief that employing a long-term business approach is a winning strategy through time.

Dialectical Materialism – The Unified Theory of Reasoning:

The quest for a theory explaining how the universe works has captured the imaginations of some the world’s most enlightened thinkers. Einstein spent the final thirty years of his life attempting to find a grand unifying principle that would explain the universe both theoretically and mathematically.

In absence of a mathematical principle that unifies the laws of the universe, I do believe there exists a theoretical unifying principle that – when applied to certain questions – can produce an answer that aligns with how things work. This principle is called Dialectical Materialism or Dialectics for short. Dialectics is a method of reasoning that I interpret to have three foundational insights:

1. **Cycle of Life**: Everything is either coming into existence or fading out of existence. As early as 99BC, Lucretius captured this idea in these words, “Nature repairs one thing from another and allows nothing to be born without the aid of another's death.” In the forest ecosystem, the forest floor recycles the fallen organic matter of trees to produce new growth. In business, lack of continuous evolution in light of the reality of change, bureaucracy, size and misaligned interests create an environment where disruptive entrants recycle the fallen business’s organic matter to produce new, emerging businesses. Dialectics reveals the transitory character of everything and the uninterrupted process of becoming and of passing away. Human nature causes us to see things in their static form versus the reality of all things being in motion.

   *Thus, the sum of things is ever being reviewed, and mortals live dependent one upon another. Some nations increase, others diminish, and in a short space the generations of living creatures are changed and like runners pass on the torch of life.*

   Lucretius – (99BC – 55BC)

2. **Form versus Essence**: Dialectics employs understanding something via its essence, not just a fixed definition, or form. For ordinary understanding there is no difference between the appearance of a thing and its essence, but for dialectics the form and essence of something can be quite contradictory. I believe this to be one of the most important competitive advantages of reason. In investing for example, most market participants are keenly focused on the form of price and are too often ignorant of the essence of intrinsic value.

   *The role of the artist, like that of the scholar, consists of seizing current truths often repeated to him, but which will take on new meaning for him … when he has grasped their deepest significance. If aviators had to explain to us the research which led to their leaving earth and rising in the air, they would merely confirm very elementary principles of physics neglected by less successful inventors.*

   Henri Matisse (1869 – 1954)
3. **Unity of Opposites**: Dialectics is the reflection of the motion of reality and how opposites assert themselves in nature. It is by the continual conflict of opposites and their final passage into one another – or into higher forms – that determines the cycle of life and the nature of how things are. Seeing things from the perspective of “form” forces one to compartmentalize and categorize with a label. Dialectics seeks to see things holistically and, through seeing the whole, one can see that in reality one opposition gives way to its contrary. The essence of everything can be found in its binary nature where the principle of opposing forces, or reciprocity, is one of the most powerful fundamental laws of the universe. **This is why inverting vexing questions to arrive at workable answers can be so effective.**

*If you are acquainted with the principal, what do you care for a myriad of instances and applications?*

Henry David Thoreau (1817 – 1862)

**Reasoning by Invariant Strategies:**

I recently invited Peter D. Kaufman, CEO of Glenair, Board Member of the Daily Journal, and Editor of *Poor Charlie’s Almanac*, to come speak to the Security Analysis class I teach at Columbia Business School. Peter Kaufman is an exceptional business operator and is also one of the great multidisciplinary thinkers of our time. On the topic of multidisciplinary learning and rational decision-making, Peter shared the approach he uses, which he refers to as his “three-bucket” framework, to arrive at universal principles that have high utility. Peter shared:

*Every statistician knows that a large, relevant sample size is their best friend. What are the three largest, most relevant sample sizes for identifying universal principals? Bucket number one is inorganic systems, which are 13.7 billion years in size. It’s all the laws of math and physics, the entire physical universe. Bucket number two is organic systems, 3.5 billion years of biology on Earth. And bucket number three is human history, you can pick your own number, I picked 20,000 years of recorded human behavior. Those are the three largest sample sizes we can access and the most relevant.*

Peter then walked the class through how compounding and the law of reciprocity can be applied to these data sets and therefore applied to reason. A light immediately went on. Applying questions to these three large data sets simplified and strengthened how I was organizing and applying mental models. Kaufman’s approach provides a framework of general laws that have stood the test of time – invariant, unchanging lenses that we can use to focus and arrive at workable answers. A multidisciplinary framework helps shift the human paradigm to one of an empathetic perspective, as if we were looking from the outside in. Just as I began this letter with the three foundational insights of Dialectical Materialism, we want to be constantly searching for these types of invariant strategies that can serve us in rational decision-making.

*Everything about which I thought or read was made to bear directly upon what I had seen and was likely to see. I feel sure it was this training, which has enabled me to do whatever I have done in science. My mind seems to have become a kind of machine for grinding general laws out of large collections of facts.*

Charles Darwin (1809 – 1882)
Peter Kaufman shared a quote by Joseph Tussman on the importance of aligning with general principles – “What the pupil must learn, if he learns anything at all, is that the world will do most of the work for you, provided you cooperate with it by identifying how it really works and aligning with those realities. If we do not let the world teach us, it teaches us a lesson.” A foundational principle that aligns with the world and is applicable across the geological time scale of human, organic, and inorganic history is compounding. Compounding is one of the most powerful forces in the universe. **In fact it is the only power law that exists with a variable in its exponent.** The power law of compounding cannot only be applied to investing but it can even, and more importantly, be applied to continued learning. Compounding knowledge through a multidisciplinary framework is an individual’s greatest enduring advantage.

The illustration to the right outlines how I have applied this framework of reasoning. Readers of our quarterly letters will recognize that the first two hexagons are the two lenses every investment is taken through – the lens of the business (Six Sides of Great) and the lens of the investment (M-Theory). The final three hexagons, or lenses, as described above, observe a thesis’s alignment with the invariant strategies that we can curate from human, biological, and physical history. In this letter I will put this framework into practice as we apply the question of business endurance to biology – Coastal Redwoods.

The illustration for this framework is based on the sixth hexagonal number, 66. When a hexagonal number is plotted, it creates this cornered hexagon geometry – the sixth hexagonal number creates five hexagons born from a single point. The single point represents general laws and foundational principles.

66 is the path of a people in flight, refugees from dust and shrinking land, from the thunder of tractors and shrinking ownership, from the desert’s slow northward invasion, from the twisting winds that howl up out of Texas, from the floods that bring no richness to the land and steal what little richness is there. From all of these the people are in flight, and they come into 66 from the tributary side roads [of compartmentalized knowledge], from the wagon tracks and the rutted country roads [of ingrained thinking]. 66 is the mother road, the road of flight.

John Steinbeck (1902 – 1968)
*Grapes of Wrath*
Seeing the Forest and the Trees:

One of the most limiting biases for individuals attempting to make sense of complex systems is that they are a part of the system. When you are part of the system it becomes increasingly difficult to see the forest for the trees. Each individual tree’s uniqueness and complexity can lead to confusion and ambiguity. The key is to attempt to step outside of the system and see the forest and trees for the essence of what they are. How can we find these groves or islands of simplicity in an infinitely complex world?

Jason Zweig of the Wall Street Journal asked Charlie Munger to describe a key attribute of Berkshire Hathaway’s evolution over the years. His response: “There isn’t one novel thought in all of how Berkshire is run. It’s all about what [Mr. Munger’s friend] Peter [Kaufman] calls ‘exploiting unrecognized simplicities.’” Peter Kaufman was sitting with Charlie during this interview after the recent Daily Journal annual meeting. The entire quote that Charlie was referencing was one that Peter attributes to a 28 year old writer for Sports Illustrated named Andy Benoit, who wrote these words to describe the essence of a particular quarterback’s genius: “Most geniuses—especially those who lead others—prosper not by deconstructing intricate complexities but by exploiting unrecognized simplicities.” This quote captures the essence of genius and can serve as a roadmap to the Grove of Titans.

Finding unrecognized simplicities requires one to step outside the forest, outside of the human system to see and measure holistically without biases. I’ve found geometry to be the most effective way to think about and measure an infinitely complex world – a world one can simplify and illuminate with two geometric tools: Euclidean and Fractal.

To appreciate the nature of fractals, recall Galileo’s splendid 1632 manifesto: [Philosophy] is written in the language of mathematics, and its characters are triangles, circles, and other geometric figures, without which … one is wandering about in a dark labyrinth. Observe that circles, ellipses, and parabolas are very smooth shapes and that a triangle has a small number of points of irregularity. These shapes were my love when I was a young man, but are very rare in the wild. Galileo was absolutely right to assert that in science those shapes are necessary. But they have turned out not to be sufficient, “merely” because most of the world is of great roughness and infinite complexity. However, the infinite sea of complexity includes two islands of simplicity: one of Euclidean simplicity and a second of relative simplicity in which roughness is present but is the same at all scales.

Benoit B. Mandelbrot (1924 – 2010) – The Fractalist

Decision-making that arrives from Euclidian thought can be solved using simple tools, as if we were measuring a circle, triangle or square. These simplicities are often hiding in plain sight but, while the answers can be quite obvious, they may not seem that way to participants within the system. In our system of investing, the failure to recognize what is hiding in plain sight is often due to neglect, fear or lack of focus, and often leads to a mispricing. A rich area of Euclidean sourcing is when we find a business with high returns on tangible assets, with a sustainable competitive “moat,” trading at a reasonable price due to the market’s lack of focus on the business’s economics. These mispricings are often time horizon mismatches between a short-term consensus and a longer-term view. In our opinion, Euclidean decision-making is preferred. However, in the world of investing, mispricings tend to look more fractal in the wild.
Fractal Geometry is the ability to measure roughness and complex patterns that repeat in nature. Benoit Mandelbrot coined this term and this type of physics helped make sense of the rest of the world, which appeared infinitely complex and immeasurable. Mandelbrot and other Fractalists came to the conclusion that they could, for example, mathematically measure the roughness and complexity of the bark of a redwood tree, a cloud, or the irregular geography of a coastline. What the Fractalists further concluded was that there was self-similarity within some of these patterns of roughness that could be measured. To multidisciplinary decision-makers trying to make sense of complex systems, this is an effective way to think about perceiving simplicities when the questions or problems are optically rough or obscured. When we view certain complexities, at a proper perspective, what we find is a beautiful pattern of repeating self-similarity. A few great value investors are quite skilled at recognizing these patterns and have a process for sourcing these self-similar fractals. Once someone points them out they seem so obvious, but for most participants they hide in plain sight, “fractally” camouflaged.

Examples of where we find self-similar fractal patterns are in companies that are transforming (systemic, separations, and secular), businesses or industries that have a short-term cloud over them that obscures truths, and/or situations where there is a large constituency of shareholders selling for uneconomic reasons. In both Euclidean and Fractal terms we are looking for situations that are misunderstood and where there is an unrecognized simplicity hiding in plain sight.

In the illustration to the right I have demonstrated (using simple successive rules) the evolution from an equilateral Euclidian triangle toward Fractal geometry. We progressively arrive at the Koch Snowflake, which is an interesting fractal shape because we can continue our simple successive rule (of dividing each side of a triangle in three parts and bumping out the middle) into infinity. The shape and area of the hexagon remain the same, yet the perimeter is infinite. This expresses the universal idea that within a bounded system (niche or circle/hexagon of confidence) we can produce boundless outcomes. Infinite wonders leap from persistent, incremental progress eternally repeated.

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2 You will also note that the interior of our hexagons shows another simple rule repeated. Applied are the iterations of a plane-filling curve (Peano) to show how knowledge can compound and be plane filling with a domain (hexagon) of confidence. The plane filling shape begins with the stylized E and its unity of opposites – denoting essence, everlasting, and eternal and fills the plane through simple rules repeated without end.
Grove of Titans –
Coastal Redwoods as a Model of the Enduring Business:

The Grove of Titans is home to the largest ecosystem of redwood trees that has been discovered to date. Long hidden in plain sight off a popular hiking trail in Jedediah Smith Redwoods State Park, the Grove boasts the Lost Monarch, the largest coastal redwood on earth. The Lost Monarch and the nine other Titans that surround her have stood and observed nearly two thousand years of geological time: the rise and fall of Rome, the discovery of America, two World Wars, industrial and technological revolutions and the growth of the population on Earth from 200 million to 7 billion. The Grove of Titans was discovered in 1998 by explorers Dr. Steve Sillett and Michael Taylor. A handful of others have found the Grove since then, but none have revealed its location, even though hikers walk by it every day. The hikers are unable to see the Grove of Titans for the density of the trees before them.

The Coastal Redwood tree is not only the tallest living organism on the planet but, as a forest, it is the oldest living ecosystem on Earth. Some of the Coastal Redwood trees have been around since Lucretius wrote On the Nature of Things in 99 BC. What is it about the nature of things that endow the Coastal Redwood with near immortality that we can apply to recognizable traits that would sustain greatness in businesses? And for business operators, what traits can we borrow to cultivate our businesses from a garden of greatness to a Grove of Titans?

A tree can be thought of as in the business of selling oxygen. For a tree to produce oxygen there is a simple formula that a tree engages in with nature’s counterparties, called photosynthesis. A tree needs six molecules of carbon dioxide (CO2 = cost of goods sold) and six molecules of water (H2O = salaries and operating expenses). It, then engages in a transaction with the light energy of the sun (photosynthesis = a customer order), which then produces six molecules of oxygen (O2 = the final product for delivery) and sugar (C6H12O6 = profits). The sugar, or profits, is stored as cellulose, which is what allows the tree to grow (mass = intrinsic value).

While all trees have the capability to produce oxygen, only one tree has unlocked the capability to grow to rarified heights, grow more mass than any living organism on the planet and sustain life for thousands of years. Using the Coastal Redwood as a model, I have compiled six lessons from this monarch of biology that align with what allows a great business to be truly everlasting.

I. Culture – Hexaploidal DNA of the Organization

Just as all trees produce oxygen, a business’s product differentiation is not an enduring moat. If the differentiation has any merit, it will eventually be copied and advantages will soon be frittered away. Xerox, Kodak, BlackBerry and countless other businesses once held product dominance and fell to this fate. The only moat that is not fleeting, and conversely the only moat that is truly enduring, is culture.
And they asked me how I did it; and I gave 'em the Scripture text, "You keep your light so shining a little in front o' the next!" They copied all they could follow, but they couldn't copy my mind, And I left 'em sweating and stolen a year and a half behind.

Rudyard Kipling (1865 – 1936)
Excerpt from The Mary Gloster

Evolutionary biologists attribute the DNA\(^3\) (hexaploidal – sets of six totaling 66) of the Coastal Redwood as the phylogenetic competitive advantage that drives its ability to endure through time, as it has an exponential amount of genetic coding to adapt to an ever-changing ecosystem to evolve and survive.

The culture, or DNA, of any organization is defined by the unique manner in which it adapts to change, which can be measured by how effectively the business works with its constituent counterparties. When viewing the business from an external perspective, I believe there are six key counterparties that every business is responsible for: suppliers, customers, employees, owners, stewards and society. Collectively these six counterparties makes up the organization’s ecosystem. An enduring business must be hexaploidal with its counterparties, meaning it must create a win-win relationship with each counterparty over time. Business endurance is sum multiplicative – if a business scores a zero with any one of its counterparties over time, it introduces a disease that will eventually limit its growth and its likelihood of survival.

1. Employees – The Leaves: Enduring businesses honor their employees in exceptional, authentic ways. The leaves of the tree perform the most important function. They accomplish interacting with all of the tree’s counterparties and this is vital. Nature honors this function by giving them the greatest glory of beauty, height, color and stature. **Enduring businesses turn the organizational chart upside down – invert always invert.** Everlasting businesses know that the environment of trust and loyalty they engender with employees is of supreme importance.

2. Suppliers – The Roots: Enduring businesses think about their suppliers as partners. The Coastal Redwood’s ability to grow to heights higher than the Statue of Liberty is directly related to its strong, collaborative foundation in its roots. A Coastal Redwood’s roots provide the important function of foundational strength and feeding the tree with its critical needs of nutrients to survive and prosper. A winning relationship with suppliers is one of the most overlooked areas for business sustainability. Most businesses nickel and dime their suppliers to extract short-term profits. Enduring businesses know that their supplier base is truly the base of the organization’s strength. In some Titans I have studied, a few suppliers feel so well respected and valued by the enduring business that they are content to have them as their only customer. Mutual collaboration and trust create a leaping emergent effect.

\(^3\) The current working hypothesis of evolutionary biologists is that the Coastal Redwood genus (*Sequoia Sempervirens* – Everlasting Redwood) emerged in the Jurassic period when two existing species, the Sequoia and Dawn Redwood, hybridized and created a new species. This branch off in the tree of life is even more unique as both of these ancestor species, like humans and most conifers, have sets of two chromosomes in their DNA (46 in humans). The leaping emergent effect when the Coastal Redwood hybridized is that the species became polyploidal – more than sets of two. In fact the Coastal Redwood became hexaploidal – sets of six chromosomes that total 66.
3. Stewards – *The Trunk of the Tree*: The leaders of enduring businesses are not just effective operators and intelligent capital allocators, but they think of themselves as stewards of the enduring enterprise. **They want to leave the business in better shape for the leadership that follows.** The trunk of the tree has an important job as it sets the tone of the whole tree – controlling the speed at which water and nutrients must be transported, employing resources to fight disease, and allocating resources into cellulose to foster growth. The trunk of the Coastal Redwood operates the essential long pipes, the xylem, between our aforementioned counterparties of suppliers and employees.

Stewards of enduring businesses operate the businesses to last through time. They do this by persistent incremental progress repeated without end, continual improvement of processes and systems and by persistent innovation through research and development, sowing seeds for the future. These investments may be at the expense of short-term profits for a longer-term reward. If they starve the future of these nutrients the organizations will not endure. Wall Street celebrates when companies eke out small incremental profits at the expense of investments in marketing and research and development. Thus many business leaders are easily persuaded and motivated to ignore this critical counterparty.⁴

4. Customers – *The Light*: The Coastal Redwood’s DNA, or culture of excellence, figured out something quite important in its evolution. Trees need to synthesize sugar from sunlight to survive and thrive, so they genetically modified themselves to assure unequaled access to this source by growing higher than any other species on Earth. In our model of what makes an enduring business, this is quite fitting as the businesses that can altruistically grow closest to the customer’s needs and desires are the ones that will deserve unequaled access to their demand. All of us can look back as consumers where we felt completely served by a business because they listened to our needs and wants humanely and delivered a product or service that surpassed our expectations.

*The light [customer] is a messenger, carrying a story about the form [essence] of the object [objective].*

William L. Bragg
1915 Nobel Prize for invention of X-ray Crystallography²

5. Owners – *The Mass of the Tree*: The Coastal Redwood astutely takes its excess profits or sugars and reinvests, creating cellulose that gives these Titans their extraordinary mass – height and width. Enduring businesses take great care in how they allocate the resources of the business to grow the per share value proportionally to all owners. Great businesses often grow intrinsic value at exceptional rates as they gain a larger percentage of the revenues of their market by organic growth. Last quarter, I wrote about the importance of an owner mindset in the letter *Horse in Motion.*

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⁴ An enduring business culture with stewards in place asks the question: “What is the one thing our competitors do not want us to do?” And answer consistently with – “Let’s do that!” Berkshire Hathaway’s Geico Insurance is a prime example. If you are in a region where they operate, look at how they blanket every billboard and advertisement opportunity for the benefit of long-term gain. How many public insurance companies would spend nearly all of their earnings to gain a very large reward for the future leaders and owners of their business? That is why Titans are a rare breed, breathing rarified air.

⁵ X-ray crystallography has been associated with twenty-nine Nobel Prizes including the discovery of the double helix structure of DNA. Many of these discoveries were harnessed by the culture of the Cavendish Laboratory – a model of what it takes to build an enduring enterprise.
6. Society – The External Ecosystem: If you were to ascend the canopy of a Coastal Redwood, you would find a unique ecosystem where the Marbled Murrelet, the Northern Spotted Owl, and countless other species who make their homes only in these old growth forests. Coastal Redwoods are also one of the greatest consumers of the excessive carbon we create on our planet. Any business is only allowed to endure because it is sum additive to both the community and the environment – collectively its external ecosystem. Lose-win, win-lose, and lose-lose systems with the community and the environment are models destined for failure. Great enduring businesses celebrate and share their success with society and society will then honor and celebrate what fruits they enjoy from their success. The general law of reciprocity in practice.

II. Thrive on Adversity – Fires and Floods:

Earlier in this letter I shared the model of dialectical materialism as a living reality of life. Everything is either coming in or fading out of existence. Every one hundred years a flood or fire has been the bane of existence for trees through time; complete forests are wiped out and growth begins anew. The hexaploidal survival instincts embedded in the DNA of Coastal Redwoods is keen to this truth and has adapted to not just resist dialectal materialism’s greatest weapon, but to thrive through it; the most remarkable characteristic of this species is how their bark evolved to grow very thick and fire resistant. When the fires come to the forest through natural or human means, scientists have shown that the species is not only unharmed, but the fire clears the forest floor of competing species and these Titans gain more share of the forest. The same event occurs during floods, as their root structure is highly resistant to the rot and disease that can infect most other species.

Organizations that endure look at time scales that are beyond immediate. They look at the fire and flood time scales and not only anticipate and prepare for these circumstances, but they also welcome this reality. They are keenly aware of the downside of financial, operational and reputational leverage. Prepared for flood and fire, it is in the inevitable economic cycles, similar to the one we experienced in 2008, that they thrive. In these periods, enduring businesses reinforce partnerships with suppliers by helping them. They reinforce trust with employees by resisting lay offs, even if it means short-term profit impairment. In fact, most enduring businesses go into the marketplace and look for great talent to add to their team. They lead through example to the benefit of society.

III. Seams and Edges – Fog – Where there is mystery there is margin:

The Coastal Redwood does not thrive in every environment and location. The Coastal Redwoods occupy a narrow strip of land approximately 470 miles in length and between 5 - 47 miles in width along the Pacific coast of North America. They usually grow in the mountains where there is significant precipitation in the form of fog from the nearby ocean. Coalescence of coastal fog accounts for a considerable part of the trees' water needs.
Great businesses become great because they occupy a niche that they can serve over a long period of time, operating with care and doing such an exceptional job that they gain a larger and larger share of that niche. Competitors will exit or fail because the towering, altruistic Titan above starves them of the light of the customer. This niche is often in an area at the seams and edges of big competitive markets for goods and services. The Titans dominate this niche where they can earn extraordinary profits because the customer is willing to pay a fair price for an exceptional product. These niches are often obscured in a fog of mystery because a few businesses dominate the domain, or to compete against entrenched players would be near impossible. One of the most important business sayings I have ever heard is fitting to describe these niche opportunities for operator and investor—“where there is mystery [fog], there is margin.”

All services, professional as truly as other services, obey the law of supply and demand. There is always a large supply of poor work in all walks of life and for that sort of service a limited demand. There is always a small, a very limited supply of good workmanship and a correspondingly great demand for it. And it always commands high compensation and that, too, of various desirable kinds. Every step a man takes in capacity to work, and to do better work will bring him into a higher plane of action—a plane in which there will be fewer competitors, greater demand, and higher rewards. The life of such a man will be a pyramid, which rises higher step by step, with ever narrowing competition, until it reaches the summit of excellence, influence, and success, where a man stands at the head of his profession.

Dr. Martin B. Anderson
Teacher/Mentor to Frederick Taylor Gates – University of Rochester
*Chapters of My Life (1928)* - Memoir of Frederick Taylor Gates
Trusted Advisor to John D. Rockefeller, Sr.

IV. Evolution – *Persistent Incremental Progress Eternally Repeated*:

Compounding, evolution, and human and business success are only made possible by persistent, incremental progress, repeated without end. The Coastal Redwood, with the help of an evolved cultural hexaploidal DNA, doggedly progresses incrementally every day, every year, some over the last two millennia. Always getting better, flood and fire prepared, quenched by drinking in the fog of uncertainty in the niche they dominate, leaning toward a shifting angle of the sun, growing deeper roots through evolving geology. The Coastal Redwood also importantly controls growth. Most trees grow too fast reaching for the sun. *Overreaching* is one of most common causes of death in trees as it creates an air pocket in the trees’ pipes, xylem, which is why trees will often rot from the inside out.

Enduring businesses avoid this fate by employing resolute incremental growth. The stewards of these enduring businesses know that most business failures are the direct result of overreaching. Instead of incremental progress, they overreach in an effort to ‘get theirs now.’ Quite often, that unnecessary “extra” decays the organization from the inside out. If you study business failure, you can point to overreaching as the single biggest cause of dialectical materialism in business. We see it every day in the marketplace, in how management rewards themselves with options,
and in how management teams follow inferior mergers and acquisitions strategies. How often do we see mergers and acquisitions work well in biology? It is a biologically flawed objective, so why should it work seamlessly in business? It is a short-cut strategy to produce growth that often creates that same embolism that will eventually rot the decent business as they try to merge contrasting DNAs. There are evolved business systems that can integrate mergers and acquisitions well, but they are outliers.

V. Limits and Enduring Societal Value – Cathedral Rings and Fairy Rings:

While Coastal Redwoods are nearly excluded from the saying that “trees do not grow to the sky,” they are not immune from the laws of physics. Size and age eventually can prove limiting, even for redwoods. If you walk in the Grove of Titans, and in other redwood forests, you will notice that many of the large redwoods grow in circular rings. The rings are referred to as cathedral rings or fairy rings and are formed after a large Coastal Redwood has been felled and eventually dies. The immortal nature of the Coastal Redwood genus is that new growth will asexually spring from the old monarch’s root system around the trunk of the decaying tree.

Enduring businesses often find it necessary, at times, to divide in order to thrive. John D. Rockefeller’s Standard Oil Company is a living example of a cathedral ring in business. When the government found it necessary to break up Standard Oil in 1911, it created 33 “Baby Standards” that would evolve over time. Exxon Mobil, Chevron, and other sprouts born from Standard Oil represent the largest immortal case study on business that exists in human history. Chernow’s biography, aptly titled Titan, is in my opinion the best biography ever written that documents the history of how Rockefeller conducted his affairs. Charlie Munger recently commented on John D. Rockefeller Sr. and Titan at the Daily Journal meeting.

Question: You mentioned recently that you enjoyed Ron Chernow’s book on John D. Rockefeller, Sr.

Munger: Oh, hugely. If any of you haven’t read that book, you should read it. That’s a wonderful biography. [Titan, by Ron Chernow] It shows how high grade that man was as a business partner. He may have been tough on competitors, but as a partner, he was one of the most admirable people who have ever lived. And as a philanthropist — you can actually chart what his philanthropy has accomplished — some of the most remarkable things in the whole history of philanthropy.

What Titans of enduring businesses do with the wealth they create is of meaningful importance to society. Just as Standard Oil’s cathedral ring thrives today, as Charlie references above, John Sr. created another ring of philanthropy that has not been equaled yet in human history. With the intelligent insight of his most trusted advisor Frederick T. Gates and his son John D. Rockefeller Jr., created a Fairy Ring of philanthropies that have done unprecedented compounded good for

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A fitting memorial to the good works of John D. Rockefeller and the Rockefeller Family can be found artistically in the Union Church of Pocantico Hills. Just as the Grove of Titans has nine Coastal Redwoods surrounding the Lost Monarch, the Union Church has the last work of the master Henri Matisse, a stained-glass rose window surrounded by nine Marc Chagall stained-glass windows, which includes his masterpiece – The Good Samaritan in memory of John D. Rockefeller Jr.
society. Today we are witness to an equally unprecedented philanthropic force in the form and essence of The Gates Foundation, endowed by Bill and Melinda Gates and Warren Buffett.

VI. Freedom – *Organizations in Flight*:

The essence of everything eternal lies in its freedom. Freedom is written in the signature of all things. If we carefully ponder the physical universe, the biological, and human history, freedom is this untenable force in motion that is at the essence of which we see in form. The Coastal Redwoods seek freedom, which assures them unblocked access to sunlight.

If freedom is the *essence* to that which endures, how does one assure the *enduring* benefits that freedom bestows? My answer is that it can be found in *altruistic* meritocracy. The only path toward freedom is to rightly deserve. The best, most deserving product provides the freedom of price. The most enlightened win-win system with all counterparties assures the freedom to celebrate success. Altruistic meritocracy is not a business model of survival of the fittest but a model that looks to engender freedom by having a win-win relationship with all counterparties. The meritocracy that is most deserving of freedom over time in both business and in human history has three important attributes: deeply fluent literacy with the terrain in which it operates, delayed gratification instead of a focus on short-term reward, and an elevated purpose where life’s reward is not finite, time stamped and compartmentalized, but rather holistic of a well-examined life. Liberty enlightening the world!

Firm Updates:

- **Research Analyst/Trader:** We welcome Daniel McQueen to East Coast in the role of Research Analyst and Trader. Dan recently graduated with honors from Bentley University. Dan was captain of the varsity golf team at Bentley and at the time of joining us he had a ‘plus one’ handicap. While we expect his handicap to increase, we have already seen the same work ethic and determination to succeed in his role at East Coast. We are lucky to have Dan on our team.

We look forward to meeting and talking with you soon. We greatly value your support and trust.

*When we try to pick out anything by itself, we find it hitched to everything else in the Universe.*

John Muir (1838 – 1914)

On behalf of the firm,

Christopher M. Begg, CFA
CEO, Chief Investment Officer, and Co-Founder

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**EAST COAST ASSET MANAGEMENT**
Appendix: A Titan’s Last Puzzle

In the last decade of his life, the artistic Titan Henri Matisse turned almost exclusively to cut paper as his medium and scissors his chief implement. He created what became known as “cut-outs.” His “cut-outs” would be used in paintings, prints, tile murals, and stained-glass windows. The *Matisse Cut-Outs* exhibition just arrived this month at the Museum of Modern Art (MoMA) from the Tate Modern in London, where its summer exhibition set attendance records.

In 1954, Henry Matisse was commissioned by the Rockefeller Family to create a stained-glass rose window in memory of Abby Aldrich Rockefeller, the wife of John D. Rockefeller Jr., in the family’s Union Church, Pocantico Hills, Tarrytown, New York. Abby Aldrich Rockefeller was a founding member of MoMA, and great admirer and collector of Matisse’s art.

Matisse’s final puzzle and last creation, known as *La Rosace*, began with a request to create an original stained-glass work within the restraints of the pre-existing framework – twenty-five lights that varied in size. This complexity perfectly suited the simplicity of Matisse’s “cut-out” technique, the process he used to create the maquette for the window. Although Matisse was confined to a wheel chair, he still managed to find infinite freedoms through his work. “When I am doing the cut-outs, you cannot imagine to what degree the sensation of flight which comes to me, helps me better to adjust my hand as it guides the path of my scissors.” “Cut-outs” allowed Matisse to transcend the form of a painted outline with filled-in color and move directly to essence. “Cutting into color reminds me of a sculptor’s direct carving.”

Due to his failing health, Matisse was unable to travel from France to New York to see the church. Instead, he was sent a full-sized architectural drawing of the framework, including time and light studies, which were hung in his studio bedroom. Henri Matisse solved this design in the final days of his life, as he died November 3rd, 1954, just days after writing to the family. Matisse reported that he “had been able to complete, I think happily, ... the newness and the absorbing aspect of this work for me was to express myself in a well defined space, fragmented, and equally small as that contained in the woodwork of the rose window.”

I felt compelled to visit the Union Church at Pocantico Hills recently to see *La Rosace*. Through my visit, I learned that Nelson Rockefeller eventually decided to plant a conifer tree behind the church in front of Matisse’s window. Rockefeller insisted on this in order to prevent the sun from shining too powerfully through the window, thus ensuring that it gave “the kind of light originally planned by Matisse.” When the tree matured its branches could be seen swaying through the glass, adding a third dimension of motion to the window and casting beautiful shadows, an intersection between nature and art that Matisse might well have appreciated.

*La Rosace* is often overlooked in the Matisse canon due to the nature of the commission and the medium being misunderstood. In my opinion, it is Henri Matisse’s most profound work of genius. *La Rosace*, like the Koch snowflake, expresses the universal idea that within a bounded area one can produce boundless outcomes. *La Rosace* portrays in its austerity how the natural light of persistent, incremental progress eternally repeated can produce infinite abundance and wonder. Matisse, through his artistic medium, searched for essence, freedom, and simplicity and from what he discovered earned immortality. Titans – ambassadors from another time.