Dear Limited Partner,

The Baupost® partnerships posted high single-digit gains for the year ended December 31. A detailed report on our investment returns will be available on our website in early February together with a number of charts and tables displaying the largest individual position gains and losses, as well as year-end allocations to various asset classes and our 10 largest positions at December 31.

While the partnerships ended 2019 on a strong note, our results for the year were dampened by a combination of factors including our conservative positioning, the continuing underperformance of value equities, the persistence (especially in the first half of the year) of a generally lackluster opportunity set, and a few mistakes. Indeed, Baupost's performance relative to the market over the last several years has been quite subdued. Nonetheless, we continue to have the utmost confidence in our approach, knowing that the rocket fuel that propelled markets in 2019 will run out. Interest rates won't forever be close to zero, after all, and market volatility is bound to re-emerge. Perhaps most importantly, we know that in the long-run valuation matters, and strongly believe that the expected returns from our current portfolio, under conservative assumptions, are robust.

Rather unexpectedly, over the second half of 2019, a surprising number of compelling opportunities emerged across our main areas of focus, including distressed debt, private and public equity, and real estate. As a result, we have been particularly active of late, reducing or trading out of situations where the price has come to more fully reflect underlying value, while deploying capital into more attractive investments. Cash balances at December 31 totaled roughly 31% of the portfolio.

Sometimes, the market tells you one story, even as the performance of the underlying businesses tells you another. This is the case with many "value equities" today, which have been significantly underperforming the market even as operating cash flows are strong. The value of an investment, of course, derives not from what the market opines at a point in time but from the underlying business fundamentals as measured by such attributes as the cash flow that a company or asset generates – or should reasonably be expected to generate – and the growth rate and reliability of that cash flow. The stock market valuation of a company is, by contrast, an ephemeral blip on a screen indicating only where the supply of shares offered for sale meets immediate demand. Short-term market gyrations matter little unless one wishes to – or is forced to – transact.

Investment trends can be intense and powerful forces, resulting in opportunities to buy or to sell. Capital has been draining out of value investment strategies for most of the past 12 years, leading value to significantly underperform. Since 2007, for example, the Russell 1000 Value Index has returned 6.6% a year compared to 11.0% for the Russell Growth Index. Since mid-2017, the performance gap has actually widened, with value returning 9.5% a year compared to 18.5% for growth. This is not just a U.S. phenomenon; in Europe, the valuation premium of growth over value recently exceeded the 2000 peak. Verdad Research notes that larger cap and higher multiple stocks significantly outperformed in 2019, a sharp divergence from the performance record of the last 30 years. This disparity was extreme: the cheapest and smallest quartile in 2019

returned less than 1%, while the top quartile in terms of size and valuation returned 25%. Verdad notes that allocating capital toward large capitalization companies is consistent with how index funds (by design) and mutual funds (by necessity) behave.

The relative underperformance of small cap value has been only more extreme twice in history – in 1929, right before the Great Depression, and in 1999, at the height of the tech bubble. We are certainly not making the argument that all, or even most, "value stocks" (stocks trading at a low multiple of cash flow or book value) are undervalued or worth owning. Some are firms whose outlook is deteriorating, whose days may be numbered. But many do not fit this description. We believe that ongoing selling pressure of value names has contributed to mispricings that represent potential opportunity for long-term investors.

The hedge fund ecosystem that expanded rapidly a decade ago is now experiencing retrenchment. Human nature being what it is, the Great Financial Crisis raised fear levels, and many investors flocked into hedged vehicles or other "alternative assets." Investors bought into the concept of achieving strong but uncorrelated returns with downside protection. Overall, hedge fund assets more than doubled from 2008 to 2015. Unsurprisingly, as their assets were surging, it became harder for hedge funds to differentiate themselves from the pack and to add value. As markets more than quadrupled off the 2009 lows, hedge fund performance in the aggregate began to significantly lag the leading equity market indices, especially after fees. A decade of steady market gains racked up by traditional long-only and index products has made many asset allocators less interested in hedged strategies. (The idea of hedging, itself, may seem increasingly passé to many market participants, as it has been costly, futile, and, with perfect hindsight, largely unnecessary.)

As a result of lagging performance over this period, many hedge funds have experienced significant redemptions and some have closed. In 2019 through November, an estimated $82 billion was pulled out of hedge funds, more than twice as much as in 2018. For each of the past four years, more hedge funds have closed than opened. This, in turn, is putting selling pressure on stocks and other securities widely owned by hedge funds, precipitating a vicious circle of underperformance: selling leading to falling prices, which in turn drive poor performance and redemptions, driving further selling, leading to even worse results. For Baupost, this period of hedge fund retrenchment, which may be far from over, has started to improve the opportunity set at hand. In areas where hedge funds have been particularly prominent – e.g., value equities, distressed corporate debt, and arbitrage and post-arbitrage investments – capital outflows of late seem to be resulting in less efficient pricing, and emergent bargains are becoming even more compelling for those who can hang on and grow their exposures.

In their landmark book "Security Analysis," Benjamin Graham and David Dodd argued that in the short-term, the stock market plays the role of a voting machine, while in the longer-term, it's a weighing machine. But in the shortest run, perhaps we can agree that it's really an ATM. Graham and Dodd's point – that securities prices can and do depart from the underlying value of companies – still holds. People buy and sell securities for a variety of reasons; greed and fear have always played a prominent role. But today, in a world where investors entrust their capital to professionals who offer near-immediate liquidity to their clients but have little or no control over those inflows and outflows, clients' short-term need for cash and day-to-day asset allocation

whims have the most immediate impact on the supply of and demand for shares and therefore on share prices.

Market mispricings aren't driven only by panicky or cash-short investors, of course; securities prices can depart from fundamental value for many reasons. To begin with, there is no universal formula for determining the underlying value of a business. Each of us can reasonably make different assumptions, plan for different time horizons, develop differing projections, and employ different discount rates when undertaking such an assessment. The intensely short-term orientation of today's investors undoubtedly also contributes to market mispricings. (Few seem willing to get long ahead of a few quarters of anticipated bad news regardless of valuation, and few seem interested in exiting a high flier as it continues to soar.) Stocks that trade down in price may fail to attract much fresh buying interest, while stocks that rise can easily overshoot.

Moreover, as funds continue to flow into the hands of indexers, stocks not included in prominent indices relentlessly lag, while the beneficaries of such inflows move more or less in tandem, sometimes seemingly regardless of diverging fundamentals.

Fortunately for Baupost, investing is not a sprint but a marathon. Over the long run, major mispricings are eventually corrected – the share price and value of a business tend to converge – because short-term illusions are pierced and enduring characteristics become more apparent.

Price may be what you pay, in other words, but value is what you get. Sometimes, price and value are forced into alignment through a catalyst, such as when a business is sold, at which time the verdict of the private markets overrides public market trading levels. At other times, the convergence is more gradual as the earnings power of the business proves out the company's intrinsic value, or as share buybacks at undervalued levels prove accretive to per share value.

2019 Financial Market Year in Review

For much of 2019, economic growth abated, the Fed hesitated, was berated, and then cooperated, and the financial markets accelerated, levitated, and resoundingly celebrated on the heels of unprecedented and relentless central bank stimulus. Between September and year-end 2019, the Fed balance sheet, which after a decade of expansion had finally been shrinking, suddenly surged by $400 billion, fueling a formidable fourth quarter stock market rally. With the U.S. running a staggering annual budget deficit of one trillion dollars, the ensuing sugar high boosted economic activity throughout the year, undoubtedly creating jobs in the process. To illustrate the magnitude of this profligacy, the federal government borrowed and spent $3,000 in 2019 above what it took in for every man, woman, and child in the country. Correspondingly, the U.S. unemployment rate hit a 50-year low of 3.5% in September. Despite tightening labor markets, inflation remained generally subdued in 2019. But not everything came up roses; after rising at an annualized 3.1% rate in the first quarter, U.S. economic growth faded to an annualized 2% rate for the remainder of the year, a continuation of the secular stagnation that former Treasury Secretary Larry Summers described in his heralded paper nearly four years ago.

For the year, U.S. stocks handily recovered from their Q4 2018 swoon, and the major equity indices repeatedly hit all-time highs in Q4 2019 as stocks rallied strongly into year end.

Corporate-free cash flow margins continued to rise, reaching levels double those of two decades ago. The gains were relentless; the S&P 500 rose on 60% of all trading days in 2019, putting last year in the 97th percentile of performance since 1962. Ninety percent of the S&P 500 stocks gained ground; two-thirds appreciated 20% or more and 16% rose by more than 50%. In the face of these unrelenting gains, the CNN Fear and Greed Index unsurprisingly flashed a warning at year end: Extreme Greed. The Wall Street Journal recently reported the curious fact that nearly 40% of listed companies had no earnings whatsoever in 2019. The S&P 500's gains were primarily concentrated in two stocks, Apple and Microsoft, which alone were responsible for roughly 15% of the S&P increase. The 10 biggest S&P gainers together comprised nearly one-third of the uplift, with technology and financial firms dominating the list of top contributors.

ETFs and index fund assets hit $6 trillion in 2019, exceeding for the first time the total controlled by active managers. Bank of America Merrill Lynch recently noted that "of total U.S. domiciled equity funds, 45% are held in passive vehicles, where the buy/sell decision is determined not by fundamentals but by flows." Actively managed mutual funds continued to experience significant outflows, while comparable sums flowed into ETFs. Passive vehicles now hold approximately 15% of the outstanding shares of the S&P 500 members, more than double the amount in 2010, raising concerns about both dwindling market liquidity as well as the unfortunate implications for informed proxy voting.

Meanwhile, even as global debt rose to record levels in excess of $250 trillion in 2019, 30-year U.S. Treasury yields fell to record low levels as the Fed cut interest rates three times. The European Central Bank and Bank of Japan continued their own easy money policies, and late last year, a whopping $11 trillion of global debt (largely in Europe and Japan) still traded at negative yields, although that total was down from $17 trillion in August. While the markets applauded the dovishness, former Treasury Secretary Larry Summers is one of those concerned about the behavior of today's central bankers. Grant's Interest Rate Observer recapped an August Twitter thread from Summers as, "Will they (central bankers) not consider the possibility that ultra-low nominal yields might actually reduce aggregate demand while breeding financial instability, bank failure, 'zombification' and reduced economic dynamism?"

Betting that central banks can hold things together has been a winning investment strategy of late, but it is far from a riskless one. As financial commentator James Grant recently observed, "The Federal Reserve and its overseas counterparts, by muscling long-term bond yields lower and lower, indeed, not stopping even at zero percent, will supposedly make the world richer and safer. Or so says the 21st-century narrative." Why and how we got here – maintaining a preternatural faith in the power of central bankers – is a tale of human nature and its tendency toward overconfidence and complacency.

Until recently, few traditional economics textbooks would have seriously discussed negative interest rates. Policy rates had never in history been negative, and most people would not have imagined that they could be. Lowering rates below zero, central bankers apparently hoped, would force capital out of so-called "safe" assets like highly rated government bonds and into greater risk-taking (where it might find a positive return), which would have the desired effect of lifting economic growth.

However, protracted near-zero rates have failed to deliver the desired growth or consumer price inflation, though they have driven asset price inflation. Today's situation resembles what economists call a liquidity trap – a circumstance where further easing fails to generate the desired incremental economic activity. In an economy running below full productive capacity, negative rates act as a tax on savers and lenders. Incremental ticks down in rates have effectively been providing scaffolding to further boost equity prices. This exacerbates wealth inequality, further fueling the rise of populism. Negative rates have proven highly problematic for the banking sector in particular, which has been unable to maintain its customary interest rate margins. The Swiss Banking Association decries negative rates for one additional reason: they believe it is "immoral" to reward people for amassing debt, and thus "negative interest rates are difficult to reconcile with Swiss values."

Europe, more than anywhere else, is where interest rates go to die. Not only do trillions in European sovereign debt trade at negative yields, some companies are now able to issue bonds where the holder pays the issuer for the privilege of owning their debt. Crazily, borrowers in Denmark now get paid to incur debt on their homes. Even Greece, a country which defaulted on and restructured its debt in 2015, with a current debt to GDP ratio of roughly 180%, has been able to issue negative rate short-term bills. The European Central Bank (ECB) is essentially pushing on a string; their bond buying program has been so substantial that they may be running out of bonds to buy and are thought to be considering the purchase of equities as well.

Investors cannot know whether ultra-low interest rates have become a permanent fixture of the investment landscape. The too-ugly-to-buy but ultimately too-dangerous-to-short Austria 100-year 2.1% bonds, which over the sweep of time will almost certainly be a poster child for "return-free risk," recently traded at more than double their par value, as speculators bid their price up and yield down to roughly 0.6%. Today's low rates are a shocking aberration by historical standards. But now that they have arrived, will they last indefinitely or only for a short while? And what comes after?

Negative rates have upended several components of long-standing conventional wisdom. Compound interest has sometimes been termed the Eighth Wonder of the World. If so, then what should we call "decompounding" interest? If one of the reasons to save is that your money will grow over time, what if it is certain to shrink? If positive rates reflect "the time value of money," then do negative rates mean there is a "time cost" of money? The logical and behavioral consequences of negative rates are far from fully understood or flushed out. But it seems highly likely that debt instruments that trade at a negative yield will someday fall in price to where they offer positive yields. At that point, those who parted with their cash to accept the certain losses from negative yield bonds may well lack the money or will to average down in price. When you normalize the imponderable, and consider the aberrant to be mainstream, you leave yourself vulnerable to the mark-to-market losses that will result from a return to normalcy. In another complication in this unprecedented environment, it turns out that the widely used Black-Scholes option pricing model doesn't logically hold in a negative rate environment because it assumes capital has a cost. Highlighting another conundrum, some commentators have noted that a "perpetuity" (a perpetual bond) theoretically becomes worth an infinite amount if valued under the assumption of negative rates continuing indefinitely.

Why else might extremely low interest rates matter? The expectation of "lower for longer" virtually compels many investors to find higher-yielding alternatives. In that desperate search for yield, capital has poured into corporate credit. U.S. corporate debt outstanding between 2007 and 2019 doubled to $10 trillion, or a record 47% of the overall economy.

Collateral Loan Obligation issuance has grown eightfold since 2007, while global private credit has grown 156% since 2010. Record portions of the global investment-grade bond market received the lowest investment grade rating, BBB, which now accounts for over 50% of investment grade debt outstanding, up from 30% a decade ago. Through October of this year, the BBB portion of the U.S. investment-grade universe comprised 65% of new issue activity, and since 2010, lowly CCC-rated junk bond issuance has been 2.3x that of the prior decade.

Emerging market corporate junk bond issuance hit a record of $118.4 billion in 2019, double the level five years earlier. In late December, the World Bank warned that developing country debt, now totaling over $55 trillion, left those countries more vulnerable than before the financial crisis, with debt to GDP ratios averaging 170%, a 54 percentage point increase from 2010. The Bank noted that three-quarters of emerging economies have budget deficits, and rising exposure to debt denominated in foreign currencies. An assessment of the true cost of low rates must include the ensuing misallocation of society's resources, as well as the systemic damage resulting from the eventual bursting of investment market bubbles and the resultant investor losses.

Investor exuberance in this period is perhaps best illustrated by the robust fundraising environment for alternative investments. Unprecedented sums have flowed into private equity and venture capital, creating bubble or near-bubble conditions in these markets generally.

Earlier in 2019, SoftBank, now somewhat tarnished by its high-profile stake in ill-fated WeWork, announced the launch of their second Vision Fund, which, like its predecessor, raised the astonishing amount of roughly $100 billion in commitments. Leonard Green raised its largest private equity fund ever, at $12 billion. Other funds have also been sized-up to effectively compete with SoftBank. Ten months in, 2019 was already a record fundraising year for private equity, according to The Wall Street Journal. And "dry powder" in the hands of private equity recently hit an estimated record of $1.5 trillion, more than double the sum of four years earlier.

Venture capital firms are sitting on a record $276 billion in cash, nearly triple 2012 levels. In 2019, Blackstone closed on the largest ever real estate fund, a $20.5 billion behemoth. And it was recently reported that pension funds have boosted their exposure to illiquid investments to 24% of assets, triple the level in 2006. Dyal Capital, which pursues the eclectic strategy of purchasing stakes in the management companies of private equity firms, recently raised a $9 billion fund, the largest ever by any firm for that strategy.

Unicorns, the most highly valued privately held firms, are the poster children for venture capital success. A Stanford Business School study, "Squaring Venture Capital Valuations with Reality," makes the case that Silicon Valley's apparent success is in part a story of overvaluation rather than business achievement. Because of favorable terms offered to preferred shareholders, the common shares of many of these firms are overstated in value, sometimes dramatically so. A

skeptic could make the case that this preferred-to-common adjustment is merely the tip of the overvaluation iceberg for these high-flying and often profitless upstarts.

Low interest rates inflate valuation multiples in private equity transactions because low rates make debt more affordable. As a result, prices paid in private equity transactions once again hit record highs in 2019 (up from 9.7x EBITDA in 2007 to 10.6x in 2017 and 2018 to 11.1x by mid-2019). Without question, the U.S. equity market's decade-long ascent has made risk-taking seem riskless and has made the private equity asset class seem more attractive than it will likely prove to be over a full cycle of boom and bust.

Financial market excesses can have wide-ranging implications in the real economy. Netflix's lofty share valuation, for example, has propelled the launch of several new streaming entertainment services, creating a potential "content bubble." Uber and Lyft, similarly, could not have dealt a near-death blow to the taxicab industry had their investors demanded a foreseeable path to profitability. As Derek Thompson notes in The Atlantic, "If you wake up on a Casper mattress, hail a Lyft to get to your desk at WeWork, use DoorDash to order lunch to the office, hail another Lyft home, and have Uber Eats bring you dinner, you have spent your entire day interacting with companies that will collectively lose nearly $13 billion this year. Most have never announced, and may never achieve, a profit." While most people see Netflix, Uber, Lyft, and even Tesla as outstanding success stories in today's economic landscape, one has to consider the possibility (even a limited one) that the investment "success" of these companies is in part a mirage – a reflection not of value creation for shareholders, but of tulip bulb pricing driven by nearly limitless inflows of undemanding capital.

The sudden collapse of WeWork, the privately held unicorn, valued for a brief shining moment at $47 billion, highlights the sometimes grim intersection between the real and financial worlds.

In the financial world, WeWork was a rousing success and its quirky founder a frontpage sensation. But when a pending IPO was withdrawn for lack of interest, the company suddenly needed a capital infusion that could be arranged only on onerous terms. The rescue financing by major shareholder SoftBank valued the company's equity at less than $8 billion.

Meanwhile, the company's founder walked away with $1.7 billion in cash, an outcome that instantly made him the epitome of capitalist excess. WeWork is also a reminder of how quickly the lessons of prior financial bubbles can be forgotten. Market cycles can last for a decade or more, but humans tend to experience time in much shorter intervals. This makes it hard for people to remain apart from the mood of the moment, and many investors today haven't experienced market or economic downturns. Just as with many of the wildly overvalued stocks of the late 1990s – early 2000s, WeWork was a prosaic operating business which was branded as a VC-backed, technology-empowered, futuristic innovator with boundless possibilities. Rather than describing itself as an unprofitable office landlord that depends on unusually short leases from its tenants, WeWork thickly laid on the hyperbole in its SEC filings, declaring that it was "a community company committed to maximum global impact … (with a mission) to elevate the world's consciousness." And for a time, such lofty goals inspired a lofty valuation – until the hard truth of business fundamentals finally returned the company to a more demanding reality.

As global economies largely fall short of full employment while experiencing lackluster growth, proponents of a new madness known as Modern Monetary Theory (MMT) have gained some traction. The general idea implicit in MMT is that governments can and should borrow money in sufficient quantities to generate full employment, irrespective of the magnitude of the resulting deficit or debt burden. Historically, debt investors (aka bond market vigilantes) have been paranoid about money printing, fearing for good reason a repeat of the Weimar-era hyperinflation. Running massive budget deficits in a period of strong economic growth puts the U.S. on the road to MMT and money printing without end, in service of a permanent prosperity that has always eluded mankind. MMT, in the hands of astonishingly short-term oriented and self-serving politicians, would raise the risk of out of control inflation, the loss of public confidence in money and, indeed, in government itself, and potentially accelerate the unraveling of social cohesion.

"Anything Can Happen Thursday": Navigating Extreme Uncertainty

On television's long running and highly rated "The Big Bang Theory," the cast of lovable, nerdy scientists created "Anything Can Happen Thursday" to pull them out of their culinary routines. Living under the current administration in Washington is just like "Anything Can Happen Thursday," though "anything can happen" is not limited to Thursdays, and the subject isn't dinner but democracy, prosperity, global alliances, societal institutions, and truth itself. These days, literally anything can happen in foreign policy, immigration policy, cabinet appointments, and White House staff turnover. One day, the president is distracted by the size of his crowds; another day, it's a debate over who said what about the path of a storm or the demand to acquire Greenland from Denmark. But sometimes, the matters are more serious. One day, we are fighting ISIS in northern Syria alongside the Kurds; the next day, Turkey's President Recep Tayyip Erdogan calls Trump and we abandon the Kurds and pull out troops, handing a victory to Russia, Iran, Syria, and ISIS. On January 2, 2020, an actual Thursday, President Trump ordered the killing of Iran's Quds Force commander, Qassem Soleimani, in a drone attack. The longer-term implications of this impetuous act have yet to be felt. The experience of the past three years says we better get used to the turmoil and vicissitudes, but then we realize there's just no way that we can.

With Democrats and Republicans evidently focused largely on preventing each other from claiming victories or accomplishing anything, there is a ubiquitous sense that nothing can get done in Washington. This is enormously damaging to American democracy. Meanwhile, none of the pressing issues that are facing the country are being tackled. Instead, we focus on seemingly peripheral or invented matters. Our most severe challenges – a failing education system, crumbling infrastructure, massive budget deficits, unaffordable entitlements, growing societal inequality, and a planet that is heating up – are problems that only compound in magnitude if left unaddressed.

Even as the president has been impeached by the House of Representatives, he has waltzed toward re-nomination facing scant opposition within his own party. Republicans have been unwilling to stand up to President Trump about much of anything, choosing, in the words of political commentator John Avlon, "Trump over truth." Republicans in the House, for example, have been remarkably incurious about what Trump and his lieutenants were actually up to in

Ukraine. Meanwhile, an unwieldy field of some two dozen Democratic candidates has only recently started to narrow. To some observers (myself included), the president's failure to broaden his appeal and expand his base creates an opening for a centrist Democrat, who might collect votes from Democrats, independents, and disappointed Republicans. As usual, however, the primary process has pulled the Democratic Party to the left, and Elizabeth Warren and Bernie Sanders have regularly polled at or near the top of the field. Their successes had the effect early on of pressuring many of the other Democratic candidates to embrace massively expansive versions of "Medicare for All" and the "Green New Deal" – far left policies best characterized by lack of details, impracticality, and obvious unaffordability. Marginal tax rates of 70%, and the possible imposition of a wealth tax, round out the liberal policy proposal superfecta.

"The progressive agenda," writer Richard A. Epstein notes, "assumes that no amount of taking will ever lead to less earning." The left's response to the extremism of Donald Trump may be an equal and opposite reaction of extremism, in the form of an aggressive attack on the corporate sector and the wealthy without concern for the inevitable implications on economic growth and job creation. The Economist perceives two dubious philosophies in Elizabeth Warren's plans for America. The first is her faith in government as inevitably benign and effective, ignoring that it is prone to incompetence, inefficiency, and political favoritism. The second is the vilification of business, characterized by underrating the power of the market to benefit people through the dynamic process of innovation, creative destruction, and enhanced efficiency. The pie (though the far left never seems to acknowledge it) is not fixed in size.

Expanding it and then judiciously redistributing a portion through progressive taxation or tax credits is infinitely better for society than fighting over how to share a smaller bounty. It is increasingly difficult to keep up with the unnecessarily chaotic pace of current events. A country functions on the reasonable assumption that some things are settled: norms, regulations, the rule of law, and proper presidential conduct. But with a president like Trump, nothing is ever settled. And for business executives, government officials, and average citizens, this makes it almost impossible to plan ahead, think long term, or simply keep up. We've unfortunately started to normalize the abnormal – from tweetstorms, to turmoil in foreign affairs, to a remarkable number of falsehoods. This practice of generating a torrent of risible misstatements and outright lies so rapidly that fact checkers simply cannot keep up has had – as perhaps intended – a corrosive effect on our ability to discern the truth. Indeed, as one of my colleagues has noted, the incessant barrage of lies and tweets is effectively a "denial of service" attack on American democracy.

The turmoil in Washington has some parallels in other countries. Beyond U.S. borders, authoritarians have come to power in a number of countries, and polls indicate that substantial numbers of people claim they want "strong leaders" at this moment of heightened uncertainty over the future. Britain has been in protracted tumult over the prospect of a very messy Brexit from its relationship with the EU, though the recent electoral mandate of Boris Johnson suggests Brexit will be set in motion in the first part of 2020. Bitter street protests persist in France, while Hong Kong citizens are bravely and in large numbers standing up to China's assault on their liberties. On one recent weekend, protestors there numbered one-fourth of the island's total population.

America under Trump has become more inward looking, at a time when the world arguably needs more, not less, American leadership and role modeling. Unfortunately, we are squandering our credibility on unimportant hijinks, while alienating many longstanding allies who need our assistance and support in tackling global problems. Under this woeful administration, and at this treacherous time in world affairs, it's disconcerting to face the reality, again and again, that truly anything can happen in Washington and beyond.

The Tightrope That Today's Investors Must Walk

In the face of lax central banks, extended valuations, a buildup of excesses in credit, private equity and venture capital, all combined with extreme political uncertainty, what's an investor to do? The future course of events is always uncertain (although today's risks do seem more dangerous than usual), and forecasting is notoriously difficult. Often, it is not the risks we can identify but the threats that cannot be anticipated that hold the greatest peril for investors and for society. While lofty valuations present risk for investors, extended valuations alone aren't predictive of imminent collapse. If conditions remain generally benign, elevated multiples can be stretched further.

It's particularly difficult to sort today's political challenges into a useful investment framework. Risks seem heightened under the mercurial Trump Administration, which would seem to augur for caution and lower earnings multiples, yet the stock market moves relentlessly higher. A Trump second term, unchecked by the prospect of re-election, would potentially be even more volatile than his first – a rollercoaster ride of unprecedented proportions. On the other hand, the election in 2020 of a far-left candidate in the U.S. would bring new and different risks that would be similarly challenging to manage, including likely tax hikes, new regulations, and a rollout of expensive new government programs.

The drumbeat for sweeping political change is hard to ignore. Rising income and wealth inequality are threatening the country's social fabric. The U.S. has gone through a protracted period of recovery from the Great Financial Crisis, and many individuals have yet to fully recover. Central bank policies continue to lead to distortions in the capital markets, including nosebleed valuations in certain sectors. Earnings multiples keep expanding; the trailing multiple on the S&P 500 recently approached 21x, up from 16.5x a year ago. Technological disruption remains a powerful force, relentlessly eroding traditional business models. And the risk of an economic downturn looms large after the longest expansion in modern history, with the decade just ended the first ever that did not experience a recession. Taken together, these issues present perhaps the greatest challenge of our investment lifetimes.

One plausible strategy for an investor facing these risks would be to go to cash and sit on the sidelines. You could argue that this approach wouldn't be unreasonable, given that stocks are generally expensive, and market and business cycles haven't been repealed.

But for myriad reasons, this hyper-cautious approach could backfire. First, it would mean passing on the many compelling opportunities currently available in the markets. While some people are calling this an "everything bubble," in our assessment *everything* is not only *not* expensive but, in select cases, downright bargain-priced. As such, the sidelines are a difficult place to be today if you want to be positioned to generate good returns tomorrow. Many

investments require lengthy lead times to analyze and to build positions. A regular presence in the markets is beneficial for an investor; to separate a truly compelling opportunity from a runof-the-mill investment, it helps to have looked at many companies and securities, and to have your finger on the pulse of the market.

The opposite approach would be to go all-in and hang on for as long as the good times last. As we noted, there are attractive investments out there. But unless the opportunities are truly and historically compelling, full exposure in this environment seems dangerous, given prevailing lofty valuations. Should corporate earnings weaken, record-high profit margins shrink, markets falter, or inflation pick up (driving central bankers to reverse current easy money policies), the downside from here could be quite significant.

Because of their mandate to be fully invested at all times, many investors will feel considerable pressure to buy the best investments immediately available, even if they are fully or over-priced. They suffer from FOMO (fear of missing out) in what is now referred to as a TINA (there is no alternative) stock market. Few have the courage and clientele that allow them to stand apart from the crowd, hold significant cash, and wait patiently for better opportunity.

Short-term performance pressures drive investors to do whatever has been working at the moment – which may mean shunning out-of-favor bargains even as they fall in price while embracing overpriced holdings that daily become more expensive.

As you know, at Baupost our search for mispricings is focused on what is out of favor, highly complex, or undiscovered. Today, amidst a veritable buying frenzy, it makes more sense than ever to find opportunity where, for whatever reason, the crowd isn't focused or able to participate. One danger: when the tide goes out on a generally expensive market like today's, what is out-of-favor can easily become even more disfavored. But, the susceptibility of such assets to underperformance is not a condemnation of them but an endorsement, a recognition of their possible undervaluation and return potential. Having the ability to average down when prices fall also makes a real difference. Owning what others can't or won't is not a panacea, but it is the one strategy that, if well implemented, has historically led to outperformance over time.

How ought one navigate an environment such as today's? With great patience and strict discipline. Every position in the portfolio must offer the prospect of compelling rewards for the risks incurred. One must be vigilant to spot adverse developments and identify flawed theses, and be unemotional in taking appropriate action. One must sell when prices become full, even when there is nothing immediate to buy as a replacement. One must be willing to hold cash, but also positioned to move quickly to take advantage of opportunities that develop. Prudent portfolio diversification is necessary, but there must also be a willingness to concentrate in the best opportunities. One must avoid speculating, or chasing the latest investment fads. An investor must be wired for deep intellectual honesty and self-assessment, determined to get smarter and learn from experience, focused on where an edge is present, while moving out of strategies where one is not.

We believe our bottom-up approach, where the portfolio is built through creative sourcing and deep fundamental analysis, one investment at a time, is superior to a top-down, thematic

approach. We don't presume to know in advance what to own; we search for bargains, and when we find and validate them, we buy. This often leaves us behaving in contrary fashion to market forces, buying when the herd is selling, and vice versa. And sometimes we surprise ourselves with what we uncover in the search, such as when an expensive sector contains an unexpectedly attractive diamond in the rough. This is the essential advantage of flexible capital; we can wait patiently for opportunity to arise, and then we can participate robustly and significantly, because we are well-funded and well-prepared.

To be sure, today's trend-following environment has left Baupost looking flat-footed, as some of the publicly-traded bargains we identify and accumulate drift relentlessly lower – even as we believe they demonstrate their underlying value in several ways. Companies we own are generally delivering on our expectations regarding their bottom-line results. And our valuation estimates are validated again and again by private market activity – asset sales and takeovers of comparable firms – that highlight the significant undervaluations that can be found in today's public equity market.

We believe our portfolio today is particularly attractive, both based on valuation and because many of our holdings have catalysts in place to drive realization of underlying value. Some of these catalysts involve announced corporate actions, such as asset sales, share buybacks, and reorganization plans. Others involve business catalysts: a new management team, a strategic review on restructuring, or a synergistic merger. As bargains drift lower, as the timing of catalysts draws nearer, it feels to us as though our portfolio is well positioned for performance, whether the markets are up, down, or sideways.

The Sweetness of the Twisted Apple

"In the fall one walks in the orchards and the ground is hard with frost underfoot. The apples have been taken from the trees by the pickers. They have been put in barrels and shipped to the cities … On the trees are only a few gnarled apples that the pickers have rejected … One nibbles at them and they are delicious. Into a little round place at the side of the apple has been gathered all of its sweetness. One runs from tree to tree over the frosted ground picking the gnarled, twisted apples and filling his pockets with them. Only the few know the sweetness of the twisted apples."

– "Winesburg, Ohio" by Sherwood Anderson

Sherwood Anderson's description of the twisted apples of Winesburg, Ohio remind us of our own portfolio. Most people only know or want perfect apples, which, naturally, are pricy, as they enjoy deep and steady demand. Anderson reminds us that the twisted apple – the forgotten, neglected, overlooked, out-of-favor apple – contains its own special, and even superior, sweetness.

We love this metaphor. Over the years, Baupost has benefitted from holding a diverse portfolio of twisted, damaged, blemished apples. These are businesses or assets gone wrong or challenged by a turn of fate, assets in some cases that are literally misshapen, or imperfectly built, securities that seem relentlessly out of favor. And sometimes, at the proper price and at the right time, the twisted apples turn out to be the best and sweetest investments of all. Twisted apples are of

interest because so many pickers hardly give them a second look, so they have few buyers. They remain on the trees, there for the taking, if you are patient and know where to search.

Only a value investor can fully appreciate the market inefficiency of the twisted apples. From our perspective, debt securities in Lehman, Enron, and more recently Steinhoff International, were all strangely twisted fruit. These business debacles were reflected in market price carnage, as bonds plummeted, claims proliferated, and uncertainty dominated. So were structured investment vehicles, which few knew even existed. So are many of our public equity, private equity, and real estate holdings, which are not the investments sought by the marquee funds with the most capital, but by investors with a long time horizon and a consistently small ego. Half-built structures, properties in disrepair, and those needing fresh investment and strategic repositioning, are a particular sweet spot in our real estate activities. The apples we seek out are treasured by us not for what others will think, or how popular they might become, but for the sweetness they will deliver. Ours are typically eating apples, the sweetness accruing to us and not to someone else (though occasionally, our twisted apples are reformulated into apple juice, apple sauce, or apple pies that others can fully appreciate).

While we are not the only afficionados of the twisted apple, we believe this cohort is becoming smaller. Giant institutions can only invest in enterprises with huge market capitalizations – they need apples by the ton. Index funds and ETFs seek only the most conventional fruit; to them, stocks, like shiny apples, are mere interchangeable commodities.

And fewer and fewer investors can today accept the illiquidity of buying something that does not have a daily price quotation or an immediate, ready market for resale. This suits us well, as we search the trees not for the perfect apples but for the twisted ones, for the bargain element and also the extra sweetness that we know is there and that we can anticipate savoring and enjoying.

The Baupost Team

Our investment professionals worked diligently throughout 2019 to uncover and analyze new investment opportunities and drive outcomes, while exiting fully-priced holdings. As investors, it’s our job to gather facts, make judgments about which information to trust, and develop hypotheses. In a world that sometimes seems to have tilted off its axis, we continue to pride ourselves on our rationality, teamwork, process, and discipline.

I continue to lead the firm as CEO, while spending the majority of my time on portfolio management. In this role, I meet regularly with all the partners and analysts, and approve all investments entering or exiting the portfolio, including hedging decisions.

Jim Mooney, Baupost’s president, oversees the management of our investment team. He continues to drive the ongoing refinement and improvement of our investment process. Jim’s experience and acumen add value in our investment conversations, and his efforts continue to advance the investment team and strengthen the organization.

In his role as head of Public Investments, Jim oversees partners Greg Ciongoli, Josh Greenhill, Rob Bralower, and Michael Sperling, and managing directors Rich Carona, James David, Jianshu Dong, Ryan Dow, and Andy McElaney, who play key roles in our public investment

effort. This group oversees and directs our analysts in their scrutiny of potentially interesting investment ideas. Effective January 1, David Plon and Greg Rudin were promoted to principal.

Partner Tom Blumenthal leads our Private Corporate team assisted by newly promoted managing directors, Ryan Duffy and Patrick Cook. Together, they oversee a growing team of principals and analysts who diligently source, analyze, and manage the firm's private equity investments.

Also effective January 1, Wills Begor and John Gwin were promoted to principal. George Rizk oversees U.S. Real Estate and Asset Management and Mark Tsocanos manages International Real Estate; both are partners in the firm. The real estate teams source and manage our real estate investments around the world, while building relationships to grow our network of operating partners.

George and Mark oversee the managing directors on the real estate teams: Nick Azrack, Hunt Doering, Scott Dunn, David Freibaum, Adam Golebowski, JJ Lenhart, Bill Musto, and Brian Zilla. In addition, Taylor Banks and Charlie Humber were recently promoted to managing director. Managing Directors Gianpaolo Burigo and David Drubner maintain their focus on development and sourcing efforts for both the Real Estate and Private Corporate teams. Also, effective January 1, Monica Choi and Toni Elias were promoted to Principal.

Sam Plimpton, Partner Emeritus, continues to help us ferret out real estate investment opportunities and provide mentorship to the team. Barbara O'Connor, Partner Emeritus, continues to work with Jim to enhance and expand our internal portfolio management reports.

Our Trading team of five, led by Managing Director Scott Haig, does a sterling job of executing buy and sell decisions across time zones in transactions that, in many cases, have become increasingly complex.

In 2019, we successfully grew our teams to fill key needs but also, opportunistically, based on the availability of talented individuals. In total, three new members (including one managing director) joined Public Investments, five (including one principal and one managing director) joined Real Estate and two joined Private Corporate, enhancing our already deep, talented, and hardworking investment team. Five new analysts have agreed to join Baupost in 2020 and two new analysts have agreed to join in 2021. During 2019, five analysts left the firm.

We believe our ability to recruit and retain exceptional people remains a significant competitive advantage for the firm.

The implementation of our investment ideas relies heavily on the skills of our legal, operations, and administrative teams. Fred Fogel, Baupost's general counsel and partner, leads our Legal and Compliance functions. Along with Fred, Chief Compliance Officer and Senior Regulatory Counsel Jack Cohen, Assistant General Counsel Rosemary McCormack, Senior Investment Counsel Collin Beecroft, and Senior Tax Counsel John Harvey provide leadership to a team of 13 people who work within our legal functions. Baupost remains deeply committed to establishing and meeting the highest standards of compliance. Fred continues to bolster our

activities in this realm in an era of increasingly complex regulatory requirements.

Our exceptional operations team is led by Chief Operating Officer and Partner Elaine Mann. Our diverse and complex investment portfolio imposes a host of complicated demands on the firm's operations departments, and our talented group of leaders under Elaine consistently provide operational excellence. Our operational and administrative department heads are: James Conz, Information Technology; Diana DeSocio, Corporate Communications; Beth Mills, Investor Services; Lucy Tshuka, Human Resources & Administrative Services; and finally, Jason Price, CFO and newly promoted partner, who oversees the firm's complex financial operations. Jason's team heads include: Frank Seyboth, Tax Reporting; Tim Cook, Portfolio Valuation, Accounting & Reporting; Amos Pike, Management Company Accounting & Reporting; Jen Lin, Custody & Treasury Operations; and Jason Gorer, Private & Trading Operations. These leaders work with a top notch team of strong contributors who perform a variety of complex operational tasks that help Baupost run efficiently and effectively.

With Our Appreciation

We remain fortunate to have access to the collective wisdom of Baupost's astute Advisory Board: Baupost Founders Bill Poorvu and Howard Stevenson; Jane Mendillo, retired president and chief executive officer of Harvard Management Company; Bill Helman, partner at Greylock Partners; Paul Gannon, former chief operating officer of Baupost; Seth Alexander, CIO of The MIT Investment Company, which oversees that university's endowment; and Ben Gomez, managing director of Pilot House Associates, a family investment office. Kim Sargent, Chief Investment Officer of the Packard Foundation, joined our Advisory Board last month and will undoubtedly make a significant contribution to our thinking in 2020 and beyond. Jay Light and David Swensen completed their Advisory Board terms at the end of 2019. We thank them for their sage advice and valuable contributions over many years. The board offers us a trove of valuable experience and acumen, and its members regularly deliver important insights regarding both investing and the business of running an investment firm.

We also appreciate the valuable long-term relationships that Baupost enjoys with Ropes & Gray LLP, our corporate counsel, as well as with Ernst & Young LLP, our auditors and tax professionals.

It is a privilege for us at Baupost to oversee the assets of a limited number of families and institutional investors. Our limited partners are truly long-term oriented, and that makes it possible for the firm to incorporate the necessary multi-year time horizon in our investing. The trust and support bestowed on us by our clients continue to reinforce our resolve while boosting our spirits as we navigate challenging and increasingly frothy markets.

We are pleased to express our sincere gratitude to our clients for your confidence and support. Please let us know if you have any questions or comments.

We hope you have a healthy and prosperous New Year!

Very truly yours,
Seth A. Klarman
CEO and Portfolio Manager

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Any investments discussed in this letter are largely held across the Baupost partnerships, and the investment information generally is provided on a consolidated basis across Baupost partnerships. Please consult your partnership's reports for partnership-level information. Allocation to a Baupost partnership of any particular investment, as well as the concentration of an investment for any limited partner, will vary depending on several factors, including: (a) differences in allocations of purchases or sales among participating partnerships for a variety of reasons in accordance with Baupost's Trade Allocation Policy, and (b) participation in "Restricted Investments" (as defined in the applicable Agreement of Limited Partnership). The data contained in the letter may not have been audited.

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Partnership performance referenced in this letter reflects estimated and unaudited total return (excluding the capital on which fees are waived in whole or in part, such as on the accounts of current employees, certain former employees, founders, and certain related parties of the foregoing), net of profit sharing allocation and of partnership expenses, including management fees, brokerage fees and custodial fees. This return reflects the reinvestment of dividends, interest and other earnings. Additionally, this return includes any unrealized performance on illiquid assets, with any changes in unrealized appreciation, write-downs and realized results generally reflected in the last month of the quarter. Final unaudited total return provided to limited partners and their representatives or advisors subsequent to this letter may differ from any estimate referenced herein. Further, the return of individual limited partners will vary depending on several factors, including the timing of limited partner capital contributions/withdrawals and the participation in Restricted Investments and/or new issues, as applicable.

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