To the supporters and friends of Social Capital:

This is the fourth of our annual letters in which we discuss our investments, our observations on the year passed, and other ideas on technology, markets, and our mission.

At Social Capital, we know the future is uncertain so we focus on building the things we think will contribute to the future we want. To do so, we partner with entrepreneurs to build useful products that can improve society. Since our founding in 2011, this journey has led us to make investments in technology companies, both public and private, at all stages from incubations, seed, and Series A rounds to growth capital, IPOs, and SPACs.

Through the various wins and losses, the common thread has been to keep learning and apply those learnings to future projects. From our perspective, it makes this the most interesting job in the world.

**The formula to successful technology investing**

Based on more than 10 years of accumulating these learnings, we believe being a successful technology investor is less complicated than many make it out to be: attract and partner with
founders who are, above all else, hyper-focused on finding product-market fit, and then willing to scale this fit with superhuman resilience and persistence, no matter the distraction.

While that may sound glib and obvious, the past decade has taught us that these attitudinal and psychological characteristics dominate the makeup of the most successful founders. And the more time we spend with founders, we’ve become increasingly better at learning how to identify who has it and who doesn’t. Inspiringly, the founders that exhibit these traits exist in every age, color, gender, and sexual orientation imaginable.

Meanwhile, we’ve also learned (the hard way) the price of investing in companies and founders who don’t exhibit these traits. No matter how shiny they may appear from the outside, failed startups and founders uniformly reveal the same shortcoming: they are easily distracted by whatever priority is popular at the time. Sometimes this can be a technology fad, other times it’s the social cause du jour. What is unambiguously clear, however, is that no amount of virtue signaling or focus on non-product issues will make a company successful.

As a result, the level of discipline and focus required for success can make a founder seem, at times, aloof, detached, or even callous to some of their employees. But through a different lens, this hyper-focus can also be invigorating for employees, partners, and customers. For the founder, this often means a tough and even lonely road, but as the saying goes, “smooth seas never made for a skilled sailor.”

To entrepreneurs reading this, you are charting the most dangerous waters I have seen in more than 20 years of building technology companies. Not because of competitive pressures or access to capital – these are nothing new – but the unrelenting distractions and window dressing that try to get in the way of being singularly obsessed with creating value for your customer. In fact, status games and identity politics, especially when doggedly pursued, are usually a reliable signal that a company isn’t focused enough to win big.

Said differently, we may never know if Tom Brady or Michael Jordan could have become the best at what they do if they only practiced four days a week or refused to play unless teammates met arbitrary designations of height, weight, or likeability. But we do know the counterfactual. They were obsessed with winning, they were ruthless with their regimen, and their insane expectations elevated everyone around them. The result? Undisputed GOATs of their respective crafts.

In theory, every company starts with the same potential, but few actually achieve it. Why? Because doing so requires the founder to choose to be obsessed with what their customers want and need, even when doing so will make some of those around them uncomfortable. Ultimately, it’s up to each founder and board of directors to decide what their company stands for and, even more importantly, what it doesn’t stand for. Without this clarity, you will only achieve a shadow of your potential.

My two cents: take the uncomfortable path and choose to be a GOAT.
Inflation is here

With many successive months of high CPI and PPI prints, it's safe to assume that inflation is here. The only question is how persistent it will be and what we should do to address it.

After a decade of free money, quantitative easing, zero interest-rate policy, and an unprecedented bull market, the best party in town ('long' equities) has come to an end. By the end of 2021, we woke up from our hangover to realize that in our drunken haze we had printed an absurd amount of new money (i.e. M2 money supply skyrocketed). And we did so without considering the consequences.

In fact, since 2018, the correlation between the S&P 500 and M2 YoY growth was 0.92! In layman's terms, as “the money printer went brrr,” the stock market went up dollar for dollar.

The problem is that when this quantum of free money is magically introduced into the economy, prices must also increase so that incremental goods and services can absorb these newly printed dollars. Otherwise, asset bubbles form, and the economy would not be in equilibrium.

But as prices first start to rise, the ability for supply and demand to find this equilibrium is both risky and difficult to manage. We are told that raising interest rates is the most effective way (h/t Paul Volcker), but interest rate hikes are not without consequences.

Specifically, by the end of 2021, investors had generally concluded that it was time to start being 'short' growth stocks, 'long' value stocks, and 'long' commodities. With 10-year Treasury yields hovering between 2.5% and 3%, we can assume that we are yet to see the bottom of the S&P 500 or the ultimate long-term stable interest rate. As such, stricter monetary policy (interest rate hikes) will continue to be an overhang to the stock market until we bottom and reach the end of the Fed's latest tightening cycle.

At the same time, we've also been changing the goalposts in ways that make measuring inflation more difficult. Perhaps most importantly, our measurement of core inflation has changed to exclude the costs that people feel every day. By looking at inflation ex-food and energy, we (mistakenly) train the financial markets to ignore food and energy costs when they think about the future, despite these being legitimate costs felt on Main Street that eventually flow into labor costs (OpEx) and materials (CapEx).

So why should all of this matter to you? Because we all need to be ready for a new way of doing business.

It’s important to recognize that the response to the pandemic (stimulus checks and corporate bailouts) exacerbated a large and growing employment gap between available jobs (high) and available labor (lower). One way to partially resolve this mismatch is through higher wages that create better incentives for people to return to work.
This is the first implication from inflation. For entrepreneurs, you should expect rising labor costs for your employee base. If you don’t have pricing power to pass these costs to your customers, it will impact your long-term margins because while labor costs are hard-won, they are rarely, if ever, given back. For employees, you will have more bargaining power to demand greater compensation because companies would rather pay you more than see you quit and leave them with uncertain prospects on how to replace you. The positive byproduct is that as wages increase, the working class will accumulate more and more buying power that can be propelled into the economy.

This, however, creates the second major implication. Much like we saw with China’s economic expansion since 2000, when the middle class earns more, they demand higher quality goods and services. They want to travel more, buy online more, and own the latest gadgets and toys.

To meet this “obvious” demand, an entire class of companies has been, and will be, created across a variety of sectors. But our biggest mistake would be to ignore the capital requirements – particularly the supply chains needed (many of which will need to either be upgraded or created from scratch) – to support these hundreds if not thousands of existing and new companies.

Over the past decade, as investors swooned over the Nasdaq, we ignored critical investments in capex and infrastructure. Investors pumped money into technology stocks and startups at an unrelenting pace, but commodities and energy investing became the “ugly stepchild” of the capital markets and were left woefully underinvested.

Put another way, we chose to invest in FAANG over batteries, supply chains, and climate change, and the consequences to our national security, energy security, and resource security have never been more apparent. This time around, we need to invest in the less glamorous, but equally important, parts of our economy so that we emerge from this current phase stronger and more independent than when we started. We need to show the world that we have a resilient supply chain, a well incentivized and motivated workforce, and the strategic resolve to invest in a broad swath of capabilities from AI and semiconductors to natural gas and nuclear power.

*What the hell is going on – 2021 edition*

**The end of U.S. hegemony**

If it wasn’t obvious by the end of 2020, it became clear at the end of 2021 that a number of global actors had seized the opportunity to challenge the U.S.’ political and economic leadership. Even countries that we’ve long counted as steadfast allies have started to hedge their bets.

These global actors have already begun forming their own alliances and, increasingly, the concept of “our enemy’s enemy is our friend” is their modus operandi. We are seeing trade
agreements, defense agreements, lending programs, and all manner of strategic and financial cooperation from countries that were previously thought of as strange bedfellows. Russia and China. China and Saudi Arabia. Iran, Russia, and China. Israel and China. Russia and India.

Why is this happening?

In some ways, this is the latest attempt to undermine the U.S.’ role as the ultimate mediator and arbitrator of conflict and the U.S. dollar’s standing as the reserve currency of the world. At various points in the past, usually during similar moments of volatility, we’ve always been able to rely on the U.S. government as the “iron fist” and the U.S. dollar as the “velvet glove” that could drive resolution of world issues. This is no longer the case.

With our quixotic handling of the pandemic, our botched exit of Afghanistan, our insatiable and growing indebtedness, and our increasingly intractable internal politics, we have whipsawed our allies. As a result, we are left in an increasingly complicated world with fewer friends and a growing list of frenemies.

How do we fix this decay?

I’m generally of the opinion that in moments when the cards are not in our favor, it’s critical to “speak softly and carry a big stick.” Specifically, this means getting our domestic house in order. To return our balance sheet to health, to invest in critical infrastructure that renders us allies with, but not dependent on, any other country, and to strengthen the next generation of our military – which is less about “big iron” tanks and aircraft carriers and more about non-obvious weapons like hackers, satellites, and drones.

Not only would this be a good strategy, it’s good policy and would be stimulative to the U.S. economy. If we really want to “build back better,” the U.S. government should be the capital allocator that it is best designed to be. One that makes meaningful investments in long-term strategic priorities that the private sector is not as well positioned to fund, whether due to the massive capital requirements or time demands on return on investment.

It’s possible that one day there will be an end to U.S. supremacy, but I believe that it’s our responsibility to do everything possible so that it doesn’t happen on our watch. As most parents will tell their kids, we should strive to leave the world a slightly better place than we inherited.

The U.S. demographic time bomb keeps ticking

“Simply put, the U.S. has too few births, too many deaths, and not enough immigrants.” – Derek Thompson, The Atlantic

An important part of fixing the decay in the U.S. is addressing our “human” balance sheet. Last year, the U.S. population grew at its slowest pace in history. Initially, this may seem like an anomaly – we suffered a global pandemic in which nearly 1 million Americans died over the past
two years – but this has been a worsening trend largely driven by years of bad policy decisions and xenophobic ideology.

When thinking about population growth, there are three primary factors: deaths, births, and immigration. According to the latest U.S. Census data, in 2021, the number of deaths exceeded births in more than 73% of U.S. counties. And even after accounting for pandemic-related deaths, population growth would have still neared all-time lows.

Thus, the problem occurs when there aren’t enough new people born to offset lives lost. When this happens over years, economies contract, the old become the burden of the young, and we lose dynamism. The problems only compound as fertility rates continue to fall and people have fewer and fewer babies. If you are curious about a real world example of this playing out, look no further than Japan and their last few decades of stagnation.

This brings us to the swing factor – immigration – that can help get our balance sheet in order. While some may think that we have a net immigration problem, it’s actually the opposite. Over the past five years, net immigration has fallen 75% overall, including by 50% in traditionally migrant communities like San Francisco, Los Angeles, New York, and Miami.

For a country founded by immigrants, where almost half of all new companies are founded by immigrants, it is astonishing how quickly we’ve forgotten that immigration, when done well and appropriately, can be a critical value-add to creating a vibrant economy.

In order to be the envy of the world, people have to actually want to come here, and to reap those benefits, we have to actually let them in. Instead, on the heels of a Trump presidency fueled by anti-immigration rhetoric and a Covid moratorium at our borders, we have done very little to make the U.S. an attractive place to come learn, build, innovate, and grow.

The convergence of these three things – deaths, births, and immigration – leave the U.S. vulnerable. And as we attract fewer and fewer of the great minds born around the world, we would be even more foolish to assume our rivals are not doing everything they can to acquire or retain those assets.

To use another sports analogy, the best path to winning championships is the combination of a deep farm system, a strong draft, and the strategic use of free agency. Whether a sports team, startup, large company, or country, you are only as good as the people doing the work, so talent acquisition and defusing our demographic time bomb should be a priority.

The curious case of boomers

Rising inequality is most commonly – and perhaps obviously – attributed to the unequal distribution of wealth between the rich and poor. Whether it’s corporations vs. the people, haves vs. have nots, or coastal elites vs. middle America, there are deep rooted assumptions that the system is rigged and that the vast majority of people aren’t able to get ahead. This
entrenchment has underpinned the political divide for decades, and it’s never been more obvious than during the more recent election cycles.

But as millennials and Gen Z increasingly dominate the workforce, there is another important trend worth noting.

Take for example the education sector (courtesy of Eric Weinstein). Since the late 90s, boomer academics, teachers, and faculty have thrived in a system that prolonged their careers through the implementation of peer review systems and teacher tenure. As a result, by 2021, the proportion of faculty over the age of 70 at U.S. universities has skyrocketed.

![Faculty Over Age 70 By School Type](image)

*Source: American Law and Economics Review (2021)*

We see a similar trend at our research institutions. Data shows that most Nobel Laureates are recognized for work accomplished in their 20s, 30s, and 40s, but currently, all but two of the U.S.’ leading research institutions are run by such individuals.
Take yet another example. In this case, the average age of CEOs (courtesy of Paul Millerd). From 1980 to 2001, the average age of a CEO, at hire, got younger by four years. But since 2005 and through 2019 (i.e. 14 years), the average age of a CEO at hire increased by...14 years! To quote Millerd, the best chance of becoming a CEO now is to be a baby boomer.

And it’s not just education, research institutions, or corporate America. The public sector, specifically our elected officials, are among the oldest workforces in the country. In Congress, the most represented age group is 60 to 69 years old. Half of the U.S. Senate is over the age of 65. On average, the 117th Congress is the oldest of any Congress in the past two decades.
What does this lack of churn in the workforce mean? What are the consequences of a large, sticky demographic cohort of 70 year olds occupying all the important jobs and decision making bodies of a society?

Irrespective of where one stands on the issue, I suspect we will spend more time studying these dynamics over the next few years as part of our desire to balance the inequality that many (i.e. younger) people feel.

On markets

The beginning of 2021 got off to an incredible start with one of the most interesting David vs. Goliath battles of recent memory. The GameStop saga made YOLO traders out of all of us – but it also highlighted a number of themes that the financial markets will need to grapple with in order to create more equality and fairness, while also ensuring a stable and reliable financial system going forward.

These themes were further exacerbated with the fiasco surrounding the Archegos family office. In that saga, several banks were responsible for helping a single family office put on excessive risk through the use of undisclosed derivatives which, in totality, had the ability to drive meaningful volatility in the equity markets.

Finally, by the end of the year, it was disclosed that the U.S. Department of Justice and the SEC had been conducting a long-running investigation into short sellers – essentially building a case that these investors would buy volatility in a stock (using options) and then, using their First Amendment rights to write short cases on those stocks, try to create volatility that could then earn them a profit on the options they held.

Whether it's GameStop, Archegos, or short sellers, it's clear that there is a hole in the regulatory framework to maintain fairness and transparency. In my opinion, this hole could be filled relatively easily by a real-time reporting framework.

Currently, with the right tools, every market participant has the ability to understand their risk in real time. At the click of a button, one is able to determine which instruments they are long, which they are short, and what their “factor risks” are. That said, while this reporting is technically available to each of us, there is no systematic requirement to share this data with a central clearinghouse.

Why could this be valuable?

Because it would allow regulators to have a broad system of checks and balances to ensure excessive risks are appropriately managed. Let's use the three above examples to demonstrate the value of such a system.
1. Archegos. In the Archegos case, its traders were able to put on derivatives trades to synthetically ‘go long’ a stock without actually buying it – and to do so with several banks, one after the next. Because one bank had no idea what the other was doing, it served to artificially drive up the stock of that equity until it all unraveled, at which point these banks panicked, causing a crash in the same stock, and almost the entire market. However, if a clearinghouse could track these activities and identify that the same counterparty (in this case, Archegos) was involved in similar derivatives transactions across different banks, they could alert each bank and prevent the buildup of excessive risk.

2. GameStop. This same clearinghouse could identify when a stock is reaching dangerous levels of shorting and prevent it from being shorted in excess of the shares outstanding (essentially what happened to trigger the GameStop phenomenon).

3. Short selling. A clearinghouse could require market participants to publish their long positions and their short positions on a more frequent basis, which would allow the markets to more efficiently process price action and behave with less volatility.

All of these things seem pretty obvious, so why don’t they exist? Especially given that parts of this proposal, specifically a clearinghouse, do exist for interest rate markets like credit default swaps.

Like most common sense regulations, incumbents and special interests fend them off at all costs to protect their advantage. Relevant market participants would claim this framework would reduce their edge and lobby against improved disclosures.

But I suspect that the opposite is actually true. Such improvements would just expose the fact that most equity market participants today employ index-hugging strategies – in which case those that charge the least fees should win. At the same time, it would make it easier for the outliers who actually deliver alpha to separate themselves from the pack. Lastly, it would strengthen the incentive structure for potential new investors to focus on long-term investing due to the fact that less volatility is better for this class of investors.

In the absence of these reforms, the markets will remain a closed bastion of insider organizations who can manipulate markets, create volatility, and then profit from the confusion that ensues.

**Our performance**

“Rule number one of investing: never lose money. Rule number two is never forget rule number one.” – Warren Buffett, GOAT
While this mantra is theoretically correct, it is not always feasible as markets can move wildly and in very short periods of time. What it implies more importantly, though, is the need to constantly and actively manage your portfolio. For Social Capital, this translated into a more dynamic need to manage risk in 2021 where we were constantly reunderwriting what we owned during a period of meaningful volatility.

Entering March 2021, the markets had witnessed an incredible bull run that had disproportionately benefited the technology sector in the period before it. But from March through the end of 2021, however, the market grappled with a growing sensation that inflation was around the corner, that quantitative easing was over, and the world needed to get back to a pre-pandemic status quo. No matter how you cut it, we were entering a risk-off phase that would not benefit growth and technology stocks.

While our performance remained positive in 2021, we were still faced with a difficult dilemma. Discipline vs. instinct. If managing risk had to be the priority, we had to commit to a test of attitude and character. To prioritize risk management, without a doubt the most important and primary responsibility of a capital allocator, I had to exercise real discipline in generating liquidity and passing on opportunities my instincts would have otherwise driven us to pursue.

The effect of this active decision was a direct constraint on our investment capability. While we continued to invest in deals that we had committed to, it became imperative to manage our risk by limiting our exposure in public equities. From March through EOY 2021, this translated into a methodical program of increased selling to generate liquidity and a decrease in new investments made.

Essentially, in coming to terms with Buffett’s mantra, I also had to come to terms with another one: “You cannot bite off more than you can chew.” In investing, what this meant was to focus on having enough liquidity and be able to strictly prioritize “must own” from “nice to own” investments. While the former always has a place in our portfolio, in moments of volatility, we learned how to sell the latter for cash and wait patiently.

New investments

Since our founding, we have always sought out founders who are maniacal about solving problems that have the opportunity to have an outsized impact on society. These days, this lens has led us to focus on private investments in areas such as battery technology, climate science, life sciences, and crypto. Some examples of new investments in 2021:

- **Palmetto** aims to – starting with residential solar – enable energy independence at a local level. By removing many of the soft costs associated with the legacy solar market (design, construction, sales, installation), they are able to bring an affordable product to market with operating margins that resemble that of a software business. Palmetto’s goal is to eventually build a clean energy marketplace for power generation, storage, and
utilization.

- **Mitra Chem** is attempting to build the U.S.’ domestic battery manufacturing capability. With the overwhelming majority of lithium-ion battery production taking place in China, it’s critical to our national security and energy security priorities to reshore these efforts. And Mitra is doing this using a process that shortens lab-to-production timelines by >90%, potentially giving the U.S. a competitive advantage in this vital area. No amount of solar, wind, nuclear, or other sustainable energy source will matter without high quality battery storage.

- **Perimeter** is rethinking the approach to remove cancerous tumors from the body. Because of suboptimal imaging techniques, approximately 25% of breast cancer lumpectomies fail to remove all of the cancerous tissue, so patients must undergo a second or sometimes even third surgery. Perimeter’s device provides real-time, ultra high-res imaging in the operating room to help guide surgeons to better outcomes – making this a potential game-changer for breast cancer, as well as for many different kinds of cancer surgeries in the future.

- **Syndica** is doing for Web3 what AWS did for Web 2.0. They are building strong, scalable developer infrastructure, starting with Elastic Nodes, observability tools, and index APIs initially for Solana.

As we’ve experienced with many of our past investments, these can be long and sometimes unpredictable paths but we’re always excited to be partners with great founders and teams.

**One more thing…**

In years past, this annual letter has compared our annual returns to Berkshire Hathaway. While Berkshire has been, and will always be, a symbol of a company that has inspired my personal and professional identity, Social Capital has now sufficiently evolved to a place where it has its own clear perimeter and goals.

As we center our attention on technology-driven companies and are becoming increasingly invested in climate resilience, biotech, and crypto, among other areas, I am of the belief that it makes less sense to compare ourselves and our performance to companies that differ in markets and mission.

This does not change my view that Berkshire, and its founder Warren Buffett, is the highest example of success and long-term execution. And while they will continue to be an inspiration, I have decided it’s time to focus more absolutely on our own path and let our absolute returns speak for themselves.

Respectfully,
Chamath Palihapitiya
Founder
April 25, 2022
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