LUCRI ALPHA NEWSLETTER NR 1

20 October 2014

Dear Lucri members (and others also passionate about investing),

I mentioned to some of you that I have the noble intention to write a Lucri newsletter once per quarter. Well, here goes....the first one, hot off the press!

The time has really flown since I closed the Sasol doors behind me. I am enjoying the new status tremendously - getting up the usual time in the morning, but instead of driving to work, I go for a jog - with the result that I shook off a few kilograms, and are slowly getting fitter (relative term - some will call my "jogging" a fast walk, but I do not mind - I am enjoying it, and feel privileged to have the opportunity.)

You might have noticed that the stock markets underwent a small risk reduction in the months of September and October - if you understand the value investing philosophy, you will know why I call it a risk reduction. When equity prices reduce while the underlying profit and dividend per share are increasing, the inherent investment risk reduces. No-one really knows whether this correction may develop into a full-blown market crash, but I am about to stick out my neck a little bit and tell you that MOST PROBABLY this will only be a mild market correction.

MY SECRET STOCK MARKET RISK INDICATOR

Ok, you want to know what is the big deal, what is so secret about it? Nothing, it is no secret at all, I just added it into the title to get your attention!

I have developed this indicator to help me with overall market risk quantification. You must please understand that my whole purpose was

NOT to predict the next market crash - not at all (I do not believe anybody or any system can really predict or time market crashes - it is often triggered by something out of the blue sky, that almost nobody have predicted or expected - while a few will claim that they did - after the fact!)

BUT I do believe one can quantify the EXTENT of any crash, assuming that it will occur today, at this moment. This provides me with valuable information, as it can be used as a direct risk indicator - if I knew the EXTENT of a market crash at any point in time, I can plan my portfolio composition and increase the cash content in the portfolio accordingly. My stock market risk indicator have five ingredients, namely inflation, the repo interest rate, overall market PE ratio, time lapsed since the previous crash and extent of the market appreciation since the previous crash. I mix these ingredients into a "secret" overall formula and technique to distill a single, overarching market risk indicator, expressed as a percentage. (See, it is a secret after all.)

While I do not claim that the market crash will always be directly proportional to the indicator, I can claim that the indicator has never failed to indicate risk DIRECTION - whether risk is increasing or decreasing. I may go as far to claim that it provided me with more than direction in the past - it helped me to quantify risk with "sufficient" accuracy, so that I never dare to ignore this risk indicator.

When people ask me about the status of the general market, I shall normally reply in robot terms, whether the market is green, orange or red. In terms of my risk indicator, 0 to 33% will translate to green (ignore any market crash), 34% to 66% will provide orange (market crash 10% to 25%) and 67% to 100% will signal red (market crash 25% to 50% or more). Obviously, the market can contract more than the ranges indicated - but if and when that happens, it surely will be BUYING time! I shall provide you with some history on this overall risk indicator, so that you can decide for yourself:

END DECEMBER 2011:	11.3%
	DEEP INTO GREEN, ignore fear about so-called "double recession"
END DECEMBER 2012:	28.9%
	GREEN - ignore market variations
END DECEMBER 2013:	39.2%
	JUST INTO ORANGE, risk increasing, but still buy opportunity
END APRIL 2014:	42.6%
END MAY 2014:	44.4%
END JUNE 2014:	47.6%
END JULY 2014:	44.6%
END AUGUST 2014:	45.4%
END SEPT 2014:	40.7% (correction started already)
END OCT 2014:	Expect lower than 37%
	Back to end 2013 level - healthy correction.

Please refer to the consolidation in the risk indicator from June 2014 to August 2014. The market fluctuated, but the growth pattern changed to a fluctuating Plato - the only reason for the slight risk reduction in July was the continued growth in profits and dividend per share. In Sept 2014, you see the first effect of the market correction, to be continued into October. Profits and dividends per share kept on growing, helping the risk factor to reduce further as time passes.

So, now you know why I am calling the recent market correction a RISK REDUCTION. The risk indicator did not help me at all to predict that the correction may be in Sept/Oct - not at all, BUT when the correction started, in the orange region, I was not too concerned. It will be a different matter altogether when a correction is initiated in the red zone! Even before a correction starts in the red zone, one should be prudent and gradually accumulate cash as you enter the red zone - remember, cash is king just before a crash - but you should not sit on cash for extended periods, as inflation will reduce your buying power with time - this is not a risk, it is an absolute truth under current economic mechanisms.

No, I am not trying to tell you that I shall successfully protect your portfolios in the next crash - but, when you see that the cash content in your portfolios are growing, you can know with absolute certainty that we have entered the red zone indicated above. It will be a gradual increase in cash until the crash hits - the longer the crash will be delayed, the more cash will be accumulated - but also, the more severe the extent of the crash according to my empiric techniques and secret formula!

Mouton magic and Rupert risk reduction

I was impressed with the latest results from PSG - for some time now, one could buy PSG shares in the range R 93 to R 100 per share while the sum-of-the-parts of the underlying PSG investments added up to R 115 to R 119 per share - add the Mouton magic embedded in Zeder, Curro, Capitec and PSG Konsult, with 7 other smaller ideas in the Mouton incubator, it is no wonder that you will notice that I have added PSG to portfolios with cash. Also, Reinet continues to trade at a HUGE discount (36% last week) to the sum-of-the-parts of the underlying Reinet investments. At some point in time last week, the Reinet share price was almost fully covered by BTI alone - with 25 cents to spare. You actually paid only 25 RSA cents for the rest of the Reinet international portfolio, with sum-of-the-parts valued at Euro 6.09! (A trade of Euro 6.09 for 25 RSA cents is not bad in anybody's books, for sure!) But wait - I should not tell you about opportunities X, Y and Z - otherwise, you will stop investing with me and just go out and buy them . It took me some time to uncover these three additional value opportunities, and I must admit, it is getting harder as the market marches higher.

So, in summary: I hope you are still sleeping well at night, and are not too concerned about all the volatility in the stock market. In fact, I am very proud of some of you - who contacted me with additional cash to invest while the correction was underway - it indicates to me that you are true disciples of the value investment technique. The market will always fluctuate - the trick is to avoid fear, and to systematically add to your investments when bad news are exaggerated or being extrapolated too far into the future. Likewise, when good news are extrapolated too far into the future, you should avoid greediness and be prepared to sit on more cash and just wait it out - surely easier said than done.

Kind regards and happy investing,

Simon Streicher