LUCRI ALPHA NEWSLETTER NR 10

25 JANUARY 2017

Dear current and future Lucri members,

The Overberg is currently experiencing a dry period, but it is still such a privilege to live in this part of the world – we are grateful for the tranquil surroundings and open spaces. Advice from a wise father to his son (continued): “Before you criticize someone, you should firstly walk a mile in their shoes. That way, when you criticize them, you’re a mile away and you have their shoes.”

Lucri website

The Lucri Alpha website at www.lucri.co.za had a bit of a face-lift lately, but the contents is basically unchanged. I just want to high-light that the website now contains all my past newsletters. In this age of information overload, I am grateful when someone tells me that they read my newsletters, and quite pleased when they indicate that they enjoy parts of it. The biggest compliment, however, is when someone requests me to send all my past newsletters to them. So, it is now available on the website. (I shall now unfortunately not receive that compliment again – please be kind and think of another?)

Risk Indicator

The risk indicator of the all share index is still fluctuating in a narrow band around 63%. The risk is being contained by the sluggish growth in the prices of listed entities while the continued high price to earnings ratios of popular shares does not allow any reduction in the risk at the moment.

The crab-like movement of the all share index that we are experiencing since July 2014 continues – we therefore remain in resilience testing mode. While this is true for the market as a whole, it is sobering to re-visit the table on selected resource shares that was discussed in newsletter nr 7. At the time, the discussion was for one quarter only. A full year has now passed:

Share name	Price 25 Jan 2016	Price 25 Jan 2017	% Increase
Anglo	5419	22850	321%
Assore	8600	28075	226%
Kumba	2911	19099	556%
African Rainbow	4587	12300	168%
Exxarro	4830	10949	127%

This group of 5 resource companies continued to recover at the staggering rate of 280% on average over a one year period. It is important to note that the recovery is not from absolute bottom to top – all 5 has the exact same starting date while they reached their low points at different times. The recovery continues as I am writing today, it has not run out of steam (yet).

What can we learn from this recovery? In newsletter nr 6 dated 25 January 2016, exactly one year ago, you will find the following under the commodity shares heading: “Some commodity shares have now reached capitulation price levels where all investors buying the share over the last three years has lost money (on paper, at least!). When this happens, investors are fearful and do not think rationally about a share – they give away value due to emotional reasons with no sound, rational thought process involved.” Or, more eloquently in the words of Warren Buffett: “Be fearful when others are greedy and greedy only when others are fearful.”

We compared the resource shares in newsletter 7 with expensive, popular shares with a heavy weighting in the All Share index, namely SAB and Naspers. So, let us perform this comparison over a one year period as well:

Share name	**Price 25 Jan 2016**	**Price 25 Jan 2017**	**% Increase**
SAB	98200	79200 (de-listed)	-19%
Naspers	182000	218004	20%
Anheuzer-Bush	200000	141269	-29%

Due to the de-listing of SAB after the successful take-over bid by Anheuzer - Bush Inbev, we cannot do a precise calculation. We can either take the de-listing price of SAB at its last day of trading, or we can use Anheuzer-Bush as a proxy for SAB. If we use the average between the two cases we reach -24%. With an increase of 20% for Naspers, it is clear that the combination of the two popular shares selected (SAB and Naspers) moved no-where over the one year period.

So, in summary: While the all share index of the JSE increased with 13% from 47210 to 53439 over the one year period from 25 Jan 2016 to 25 Jan 2017, the two most expensive, popular shares moved no-where while a group of 5 unpopular commodity shares increased by 280% on average. This must surely be statistically significant. The initial price that one pays for a share investment surely plays an enormous role in the ultimate investment result – this is one of the mantras of value investors. Now, you should not think for a moment that I had not rated the companies (SAB and Naspers) highly one year ago. I actually thought they were excellent, high quality companies with talented management and strong business models – and I still think likewise today. The only reason why I stuck out my neck and put them in a race with unpopular, lower quality companies was to emphasise the role of the initial PRICE paid. I wanted to illustrate that a great company is not always a great investment. Over a longer time period Naspers and Anheuzer–Bush will most likely catch up on the others again – I surely like Anheuzer-Bush at the current price much more than at the R 2000 price one year ago!

Was Lucri smart enough to capitalise on this positive movement of resource/commodity shares over the past year? While Lucri gained strongly over the past year from commodity stocks, one should look at the full investment cycle from start to finish. Lucri could extract benefits from this cycle, but could not get close to reaping the full potential. The value investment cycle described in newsletter nr 9 were at play, causing huge initial losses. I am grateful to state that the full cycle did provide black ink for the majority of Lucri clients.

More confirmation that diamonds are a (value) investor's best friend…..

Please refer to the discussion on Transhex in newsletter nr 4 and newsletter nr 9. In the meantime, the consortium of Christo Wiese and Piet Viljoen received the results of their offer for Transhex at 394 cent per share. The offer was accepted for 16% of the available Transhex shares. The consortium increased their shareholding by 4.46% via the offer to reach a total shareholding of 76.74%. As discussed, they can now approach shareholders with a proposal to de-list Transhex as they own more than 75% of the shares. They cannot perform a compulsory offer for the remainder of the shares – as they need 90% of the shares before they can proceed with such an offer.

It is clear that the investors in Transhex are mainly value investors who understand and know the value of the company. Therefore, 84% of them did not accept the offer. This seems to be a wise decision, as Transhex is trading on the JSE in a range of 500 cent to 555 cent as I am writing this newsletter, 27% to 40% higher than the offer of only two months ago. I am watching the scene with keen interest.

Investment Olympics: Gold for South Africa

I promised to continue the discussion on real investment growth in South Africa over 108 years in this newsletter. You may recall that South Africa was on the podium, in third position on real compound annual growth rate over 108 years. As South Africa is mostly resources driven, you may not be surprised to learn that South Africa do take the ultimate honours from time to time over certain decades when the world experience a resources boom.

In the decade 1998 to 2008 South African listed equities earned pure Gold on compound global return measured in USA dollar:

South Africa:	13.8%
Canada:	6.9%
Australia:	4.9%
France:	0.8%
Japan:	0%
Germany:	-0.2%
World median:	-1.5%
USA:	-2.9%
UK:	-3.7%

All South Africans who invested offshore in this particular decade diluted their overall investment performance. Offshore investing does not guarantee outperformance versus local investors. However, offshore investing is most useful for diversification – one cannot buy Berkshire Hathaway and Alphabet (Google) in South Africa.

People sometimes expects a tapering off in real growth rates over ultra-long periods like a century. Over the 108 year period from 1900 to 2008, the decade by decade real compound growth rate performance for South Africa is as follows:

1900 to 1909: 9.2%

1909 to 1919: 0.7%

1919 to 1929: 6.7%

1929 to 1939: 14%

1939 to 1949: 5.1%

1949 to 1959: 2.9%

1959 to 1969: 13.1%

1969 to 1979: 5.9%

1979 to 1989: 8.9%

1989 to 1999: 4.6%

1999 to 2008: 13.6% (not a full decade)

When one study the performance over time, it is clear that the growth rate does not reduce or increase over decades in the last century. It rather moves in cycles, with the second strongest growth in the last period. It is true that strong decades will most likely be followed by weaker decades, 9.2% is followed by 0.7%, 14% by 5.1% and 13.1% by 5.9%. Likewise, weak decades are likely being followed by strong decades – 13.6% follow on 4.6% and 13.1% follow on 2.9%. This all indicates the cyclical nature of a resource based economy. We should also expect a weaker decade from 2009 to 2019 – at the beginning of 2017 this seems quite possible after low real growth from 2014 to 2016.

Rupert insult

The continued low rating of Reinet shares is interesting. After Johann Rupert had established a stead-fast investment track record over multiple decades, investors are currently insulting him with an insane low rating on his investment skill in the Reinet international portfolio. Johann has initiated this portfolio 8 years ago and has developed the portfolio into a respectable, low risk portfolio with growth momentum. For all his effort investors are currently placing zero value on this portfolio (even slightly negative some days!)

The tobacco interests of Reinet is packaged in British American Tobacco listed in London with share rights listed on the New York stock exchange. This comprises 2/3 of the Reinet company investments. The other 1/3 is being represented by the international portfolio discussed above. The current price of Reinet shares only reflects the tobacco interests – the investor in Reinet does not pay for the 1/3 of

Reinet assets represented by the international portfolio. While the management fee charged by Reinet for managing the assets does subtract from the value (you may recall my negative sentiment on costly portfolio fees), the discount is clearly being carried way too far.

I am going to illustrate to you how insane this situation really is: If Johann Rupert decides to sell the British American Tobacco portion of the Reinet portfolio (quite possible as it is a small fraction of the total issued shares of British American Tobacco) and utilise the proceeds to buy back Reinet shares, be can basically buy back all the issued shares in Reinet at the current market price. In this way, the total international portfolio can be concentrated onto one issued share, driving the value per share close to infinity. (Johann will ensure that his family trust owns that one share!) The Rupert family trust owns about 25% of the issued Reinet shares – so, in reality he will only have to buy back 75% of the shares to concentrate the full international portfolio onto the Rupert family trust Reinet shares. (He will have ¼ of the current British American Tobacco shares remaining in Reinet plus the internasional portfolio). Will one of you please whisper this proposal into Johann's ear when you have your next braai with the Rupert family? Just remember to firstly buy a few Reinet shares (and refuse to take the buy-back offer!)

Lucri year-end 2017

Due to the fact that the 28th of February falls on a Tuesday this year, I shall need to close out the books on Friday 24 February for benchmark comparison purposes. This will provide me with sufficient time for calculations before the market opens again on the Monday. As indicated earlier, the comparison remains pure as long as one avoids any overlapping between subsequent performance periods, and continue to compare identical periods.

Just to remind you that estate planning should be performed with care, the following has been experienced by estate executors: "Where there's a will, there's a relative!"☺

I hope you are enjoying the investment journey with Lucri. It is a journey with alternating headwinds and tailwinds – we should advance to the best of our ability irrespective of the wind direction.

Kind regards and Sans Souci investing,

Simon Streicher