LUCRI ALPHA NEWSLETTER NR 17

24 OCTOBER 2018

Dear Lucri friends,

It is now four years since I started the Lucri Alpha newsletter. During this time, we had a challenging investment environment in South Africa – and I do not need to tell you that this month has been particularly tricky thus far. While I believe it is deadly serious business to manage other people's hard earned money, let us briefly look at the lighter side of things and smile with a tear in the eye…After that, we shall get serious.

Comparing the USA market to the RSA market

How do optimistic USA investors currently greet one another? "Hi!"

And pessimistic RSA investors? "H'Low!"

This is a summary of the current investment mood in South Africa: While the USA stock market was rising sharply, our market was falling. Now that the USA market is falling, our market is falling like a lead balloon….

It is a well-known fact that Warren Buffett teaches his shareholders to avoid following the crowd, for them to avoid buying into popular investments. So, every year, the Berkshire annual meeting is attended by 40 000 people not following the crowd….

It is not easy to be the CEO of a South African company. They nowadays start their letter to shareholders as follows: "Dear fellow shareholders, I am very pleased to report…….on second thought, let's just say I am kind of pleased to report………well, to be frank, I am actually more relieved than anything else, to report any results at all for 2018…."

Since light travels faster than sound, some people appear bright until you hear them speak…

Risk indicator

The risk indicator remained around 50% last month, but quickly reduced to 47% this month. Investment risk can reduce due to a strengthening of fundamental economic factors, or it can reduce due to the fact that share prices have reduced. This time around, the second reason unfortunately explains most of the risk reduction. After fluctuating between 55000 and 60000 for a year, the RSA all share index moved back to the range between 50000 and 55000 where it spend most of the time since 2014.

But…..strong hands hold on

The South African market is like a tree in a mighty wind – it is moving and shaking. Investors are in the tree – holding on to its branches (shares). The tree keeps on shaking until the weak hands let go, only the strong hands hold on. I am planning to have strong hands, and shall try to explain the logic.

Firstly, let's listen to a few great minds:

"In the middle of difficulty lies opportunity" – Albert Einstein

"The best opportunities come in times of maximum pessimism" – Sir John Templeton

Do not try to time the market: "The only value of stock forecasters is to make fortune-tellers look good'' – Warren Buffett. "There are no market timers on the Forbes 500 list of the world's richest people" – Sanlam Private Wealth, Niel Laubsher.

The facts also support strong hands: From 1996 to 2015, the S&P 500 index returned an average of 8.2% a year. But, if you missed out on the top 10 trading days during those 20 years (0.25% of the time) your returns dwindled to just 4.5% a year. If you stayed out the top 30 trading days (0.75% of the time) your return would have been 0% - or even negative at -2% if you stayed out for the top 1% of the time. To summarise: 1% of the time over 20 years made the difference between -2% a year and 8.2% a year! Stay in – it is risky to try to predict the market.

"You cannot win by sitting on the bench. You have to be in the game. To put it another way, fear is not rewarded. Courage is." Tony Robbins

"No one ever made a dime panicking. If you want to invest wisely, you constantly need to be fighting off your own worst impulses." Jim Cramer

Make sure you have strong hands, hold on to a sound investment plan and focus on your investment goal. If you deviate to plan B or plan C – what makes you so sure that the alternative plans will get you to your destination? It makes sense to stick to trusted principles that had stood the test of time.

Listen to the CEO of a company with extraordinary, durable success over decades: "While our mission and business plan have not changed, the economic and business environment is constantly changing, which brings new challenges to the execution of the company's plans. We have run up against inflation in the 70's and 80's, easy credit, tight credit, the threat of deflation, the threat of inflation again, the real estate bubble of the 2000's, and the "great recession" of 2008 and 2009. Each of the economic challenges has posed a threat to some aspect of our overall business at various times during the past 40 years. But by having a conservative, long-term plan, we knew where to focus our efforts in order to maintain the fundamental drivers of success in our business." As investors, we shall do ourselves a favour if we follow this steadfast example.

Unfortunately, most investors do exactly the opposite. Peter Lynch managed a most successful mutual fund that yielded about 29% per year over more than a decade. He then asked his team to calculate in detail the benefit that investors into this mutual fund were reaping over the years. The shocking answer was a paltry 5% per annum for all the investors on average – from investing in a mutual fund yielding 29% per annum on average! The reason? The investors constantly tried to time the market, jumping in and out of the fund at the worst possible times. They got greedy at the wrong times (market expensive), and then jumped ship due to fear, again at the wrong times (market cheap). So, the recipe for disastrous investing is: Buy on greed, sell on fear, and continue until broke.

Listen to Sir John Templeton: “If you want to have a better performance than the crowd, you must do things differently from the crowd.”

I rest my case on having strong hands.

More John Templeton wisdom

“Bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria. The time of maximum pessimism is the best time to buy and the time of maximum optimism is the best time to sell.”

So, if the late sir John Templeton could evaluate the market in South Africa today, he would most likely conclude: **“The next bull market is currently being born!”**

In optimistic markets, higher prices create their own demand for a period – until the price implodes.

“A major cause of higher prices is higher prices; but when the trend is reversed, then lower prices lead to still lower prices. To buy when others are despondently selling and to sell when others are avidly buying requires the greatest fortitude and pays the greatest ultimate rewards.”

“Despondently selling” is an accurate description of the stock market in the RSA currently!

When asked to summarise his investment advice in one word, sir John replied: “Patience”

Optimism – in this pessimistic market?

Yes, I am optimistic. You may find it slightly insane and hard to believe in the current market, I understand that – I also understand very well why most of you may feel down and outright negative about investment and particularly investment in stocks at the moment. Let me explain what my optimism mean. Real optimists do not believe that everything will be great. That is complacency. Optimism is a belief that the odds of a good outcome are in your favour over time, even when there will be setbacks along the way. I believe most people wake up in the morning trying to make things a little better, day by day.

It help me a lot to look at fundamentals. Companies are like living organisms – they adapt to a changing environment. When circumstances gets more hostile, they take measures to protect themselves – they get more lean and streamlined when the headwinds are stronger. The result is that debt loads are reduced, cost efficiency will improve and cash will be preserved. This more often than not will lead to an increase in equity, which increases the intrinsic value per share. Some companies will fast track intrinsic growth per share by buying back their own shares at prices far below value. Over time, the value of the companies increase while the share prices keep on dropping. This is probably the main reason why I can stay optimistic – if I only had the dropping share prices to look at, I would feel extremely negative to say the least.

So, you see, I am not that insane after all!

The lazy portfolio

In this newsletter, I am going to do something that may not be very prudent. I am going to construct a concentrated portfolio that we can follow in future newsletters. Yes, it can develop into a stick that people can use to hit me with – that is why it may not be very prudent. Given that fact, I still want to proof that investing does not need to be complicated. I want to proof that a little, limited, listed, lazy, latent portfolio can be lucrative, liberating, logical and low risk over the long-term. Yes, my mind got stuck in the L range….☺

I shall use only 4 shares, 3 are listed in South Africa. All the shares are listed overseas. No market timing will be used, all the shares will be bought in one session. The portfolio will have an international focus, include the largest economies in the world and will have defensive characteristics. We shall pretend that the market is totally closed for 10 years – so, we cannot make any change to the portfolio for ten years. The aim will be to increase the investor's purchasing power over time. We shall measure the portfolio performance against the All Share index in South Africa as well as the S & P 500 index in the USA (converted into rand) just for fun – yes, the portfolio shall fight like a boxer with both hands tied behind the back for a full decade.

While I hope to beat inflation (increase purchasing power), the portfolio may not beat the indexes mentioned. I surely hope to provide worthy competition to the indexes, though!

The prices was taken yesterday morning, 23 October 2018, at 09:30. The indexes were taken at the same time. Purchasing power will be calculated from future inflation numbers in South Africa.

Lazy portfolio on 23 October 2018:

R/$: 14.384

All share index: 51500.8

S&P 500 index: 2755.88 in $ or 39640.58 in Rand

Date: 23/10/2018			
Name	**Rand price**	**Share count**	**Rand value**
Berkshire B – brk.b	2965.84	11.80104	35000
Anheuser Bush - ANH	1193.43	12.56881	15000
Naspers - NPN	2715.87	9.20515	25000
Reinet - RNI	236.95	105.50749	25000
TOTAL:			**100000**

I have discussed Berkshire, Naspers and Reinet in previous newsletters. You will notice that I have allocated a high weight to each. The other one, Anheuser Bush Inbev, is the largest listed beer company in the world.

The idea is to evaluate the performance from time to time, but at least every year in October, to see whether this portfolio is living up to the challenge or not. We shall compare it to R100000 adjusted for inflation, as well as to the indexes mentioned. Due to no trading, the broker cost will be limited to the initial buying – negligible in percentage terms over 10 years. Dividends will be accounted for.

Recipe for outperformance

I shall now discuss the third item under "What to buy" namely – Diversify seed capital: I cannot be 100% correct 100% of the time. (Please refer to newsletter 14.) According to sir John Templeton: "The only investors who should not diversify, are those who are right 100% of the time." Be humble enough to realise you may be wrong. Reduce the impact of a wrong move. Also, diversify over time – repeat buy orders at different time periods to include a variety of value opportunities. Mortals like us should accept that we may be wrong in some decisions and need to diversify to a point in order to counter investment risk. In a future newsletter, I shall discuss concentrated winners – how the highest financial success is being obtained by concentrated investments that fly in the face of investment theory. Naturally, total failure and collapse of wealth can also be contributed to concentrated investments - ask dr Christo Wiese!

So, I hope this newsletter will help you to have a strong hands approach to investing during trying times.

Kind regards and strong hands investing,

Simon Streicher