

LUCRI ALPHA NEWSLETTER NR 3

5 MAY 2015

Dear current and future ☺ Lucri members,

At this point in time, the Streicher family has properly settled down in the Overberg – more specifically, in the Ruggens area. We love the farm and the farming community. We grow our own veggies and enjoy the open space and tranquil surroundings.

Newsletter nr 2

When I wrote newsletter nr 2 at the beginning of February 2015, various factors were balancing the risk indicator (referred to in newsletter nr 1) in a narrow band around 40%. In the last quarter we have experienced a steady risk increase up to 51.3% at the end of April 2015. Share prices are increasing faster than the underlying profits. We have now crossed the midpoint of the orange range – the orange are getting a slight red tint. While the colour gets rosy, it does not paint a rosy picture.....more about this later.

Mouton Magic, mentioned in the first two newsletters, continued with the PSG share price crossing R 200, up sharply from R 100 (newsletter nr 1) and R 134 (newsletter nr 2). As an increase of 100% in a 6 month period is a rare occurrence, one needs to investigate the future merits of such an investment opportunity very closely after the happy event. The PSG SOTP (some of the parts) value has increased to R198.83 per share today, at 5 May 2015. So, the share price has completely closed the gap to the SOTP value – a sign of hype in the share price.

Those of you that is following my value investment approach, will know that risk increases when a share price increase outruns an increase in value per share. While the value of the PSG share has increased sharply over the same time period, I do not believe that the value per PSG share has doubled in the last 6 months. So, you will find less PSG shares in your accounts by now. **Slow rotation of a portfolio into value all the time, is the cornerstone of long-term market outperformance.**

Do I predict a sharp fall in the PSG share price? Not at all – as mentioned previously, I have no idea what share prices will do into the future – it is therefore possible (but not likely) that the PSG share price will double again before it falls. I want you to understand this clearly – I am simply rotating into value to reduce risk and to provide a solid base for future growth. I do this by increasing the value of the total portfolio gradually over time.

The Sasol share price approaches value again after wide (and even wild) fluctuations. You may recall my 2014 Sasol share value at R 495. After the March 2015 results, this value slightly increased to R 518. You may be surprised that the value **increased** after weaker results were announced. The answer lies in the Sasol balance sheet – the equity per share is still increasing, as Sasol (on average) is constantly saving money, even at times when the oil price is down.

Lucri Advantage, introduced to you in newsletter nr 2, attracted limited interest. This indicates that the majority of Lucri members prefer a pure performance driven, value sharing model. I also like this approach, as our interests are fully aligned (and my compensation is also way above the 0.25% on average!)

Numbers.....

11.4

This is the growth in the all share market index in percentage terms over the past 12 months to end April 2015. While still a commendable growth relative to inflation and interest rates, the bull is getting a bit tired, it seems.

1427

This is the ratio of the 2014 dividend of Coronation to the 1994 dividend of Coronation – a straight-line growth of 142700% over 20 years. This company shoot the lights out over the last 20 years. (one of the reasons why I could dare to retire from a formal occupation at age 51). Last week, Coronation warned about a drop in profits for the last six month period, and the share price decreased. So, the share started appearing in some of your portfolios.....again, the value approach.

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This is the amount of consecutive dividend years that was needed to equal the share price of Kumba about a month ago. The Kumba dividends of 2011, 2012, 2013 and 2014 was sufficient to buy a Kumba share in March/April 2015 – indicating a historical dividend of 25% over the 4 year period, based on the April 2015 price. This signals the extreme cyclical nature of our resource stocks – after years of strong cash flow, the iron ore price dropped off a cliff, hurting the Kumba share price severely (and some of your portfolios, unfortunately). Kumba recovered strongly over the last two weeks.

Lucri Alpha report for 2014/2015

All Lucri Alpha members (except those being members less than a month or so) received reports on their portfolio performance for the financial year up to 28 February 2015. Firstly, please allow me to thank you all for paying your invoices promptly and in full – I experienced zero bad debts in my little business.

Statistics:

I issued 29 reports to Lucri members that have been members up to 3 years, and included cases where I inherited existing portfolios more than one year ago. 21 of the 29 reports indicated market beating results, with an average Alpha of 6.28% for the 29 reports.

I also issued 8 reports to members where I inherited existing portfolios less than one year ago. Only one portfolio had a positive Alpha, with 7 portfolios lower than the market. The average Alpha was a **negative** 9.44% (Overall, for the 37 accounts, Alpha was still positive at 2.88%)

Conclusions:

- My performance on a clean sheet portfolio seems to be much better
- I was not aggressive and fast enough in transforming the existing portfolios
- The existing portfolios were struggling in one way or another on average – this should not be a surprise, as one can assume that highly successful portfolios will most likely (but not always) stay under control of the owner.

Market psychology and risk

One usually finds the following emotions/phases just after a significant market crash had run its course, and the markets starts increasing again:

Hope – initial market turn

Relief – increase in trend now clear

Optimism – further increase possible

Excitement – on further increase “I am making good money.”

Thrill – on yet further increase “Wow, I feel great about this investment.”

Euphoria – on strong upwards drive “This time it is different – I am getting rich!”

Then, when the market turns negative, one usually experiences the following:

Anxiety – “I am a bit worried”

Denial – on further decrease “This is a temporary setback. I am a long-term investor.”

Fear – on further decrease

Desperation – on further decrease

Panic – market reaches a fresh new low

Capitulation – on further decrease “Maybe the markets just aren’t for me.”

Despondency – when the market reaches another new low

Depression – when the market are extremely low, but is moving no-where for a period

I am sharing this rather depressing sequence with you, as my risk indicator has crossed the mid-point last month. Remember, this risk indicator does not predict the timing of a crash, but it does indicate the extent of a crash, should it occur today. All that we can deduct from it, is that the risk is increasing steadily while we are still in the orange region.

Risk Tolerance

At this point, I need to ask you to please perform some self-examination to determine your own risk tolerance. If your risk tolerance is low, you will most probably do “stupid” things during the panic and capitulation phases described above. Instead of increasing your exposure to shares at bargain prices, you will most likely be the one dumping shares on the market, literally giving away value to the cool-headed value

hunters. (A Lucri Alpha member can fire me with-in minutes and sell their portfolios – this scenario is therefore quite possible.)

Ask yourself the following questions:

- To what extend will the gain of another R 10 000 make me happy?
- How painful will loosing R 10 000, that I have already gained, be?
- Will my personal circumstances allow me to withstand an extended period of falling share prices?

Normally, the happiness versus pain for the first two questions are not symmetrical – it is quite normal to experience more pain on a loss than happiness after a similar gain. But, if you find yourself to be extremely prone to pain, you have a low risk tolerance – especially if your answer to the last question is negative.

A bird in the hand...

For people with a low risk tolerance, a bird in the hand is really worth more than two in the bush. In order to protect their portfolios, they are prepared to lose out on opportunities while the share market reaches one high after the other. This is the price of the insurance that they are buying when they opt for lower risk. For them it is the rational thing to do – and they should signal to me to decrease their risk.

Feedback

I therefore please need your feedback on your risk tolerance. Just indicate your risk tolerance as low, average or high on an e-mail. If I receive no feedback from you, I shall assume that you are happy with your current share exposure.

While it is true that I shall lose my opportunity to beat the market and earn management fees on the lower risk portfolios, I shall prefer honest feedback especially from the low risk tolerance customers to avoid extreme pain during a market crash. While we shall be under-performing while the market grows, we shall be over-performing after and during a market correction.

My own risk tolerance

I have analysed my own risk tolerance and found it to be much higher than average. I have lived through the 1987 crash, the Asian Tigers correction, the dot-com bubble and the 2009 credit crunch, without sleepless nights or any serious concerns. My approach was to stay invested, and not to try market timing. This approach is to swim the best you can, with or against the current, all the time. While this has worked well for me, it can get to you if you have a low risk tolerance. I recommend that you watch the following documentary on YouTube: “1929 The Great Crash – a video about the stock market crash in 1929.” This happened many years ago, but human nature has not changed, and we have cheap credit available just as in those years.

I believe it is healthy to think about the next market crash while we are experiencing high growth rates – it reduces the thrill and euphoria, and help us to avoid over paying for already expensive stocks.

I hope you are enjoying your investment experience with Lucri. I remain passionate about investment, and really enjoys the challenge involved in uncovering the next value investment ideas.

Kind regards and happy investing,

Simon Streicher