

## LUCRI ALPHA NEWSLETTER NR 33

21 October 2022

Dear Lucri friends,

In this newsletter, we shall take a brief look at the value of procrastination (yes, it can have value☺) and a specific investment technique, which Lucri calls the LAPP technique, will be discussed in detail. The performance of the lazy portfolio will also be updated.

### On a lighter note

- (Too) Frequently asked questions...

John: *"How can I improve my financial position?"*

John's friend: *"Under the correct circumstances, if you just sit on your hands (or ass, according to Charlie Munger), your ass sits (assets) will improve.☺"*

John: *"What is the correct circumstances?"*

John's friend: *"For example, when you buy a great company at a fair price."*

John: *"What is a great company and what is a fair price?"*

John's friend: *"Keep on reading your Lucri newsletters diligently, and you will know."*

John: *"Lucri newsletters?"*

John's friend: *"Ok, you win..."*

- How should you dress on a cold day? Quickly!
- What did the tie say to the hat? *"You go on ahead while I hang around".*
- An important announcement for little Peter: *"Your mother just had a new baby!"* So, little Peter immediately responded: *"What was wrong with the old one?"*
- The Eskom version of "the glass is half full": *"You will frequently have power over the next week or two!"*
- In South Africa, we do not drive on the left side of the road anymore. We are now driving on what is left – of the road.

### Quotes

*"In markets, you can have good news and you can have good prices – but not at the same time!"* Anonymous

*“To be successful, the investor must first understand the true definition of intrinsic value, something that drives multiples (PE ratio, Price to Book ratio), not something that is derived from multiples.”* Valuentum team

Lucri agrees fully. The utilisation of pure statistical and mathematical processes to determine whether an opportunity represents a suitable candidate for value investing can be misleading and dangerous.

*“Learn the method of learning. Recognise the good ideas of others and quickly incorporate them into your own life by adopting them and applying them constantly for the rest of your life.”* Charlie Munger

*“If you have a certain conviction or idea, start developing counter arguments against your own idea. Do it until you are better at developing the counter arguments than the people who are against the idea. In this way you develop new insights and in the end can execute an idea with way less risk.”* Charlie Munger

*“Invert, always invert.”* Charlie Munger

Lucri understands this quote in the following way: If you want something, you should look at all the things that will destroy that specific “something” – and then avoid it! Firstly determine what will destroy your goal.

*“I have never met a really rich economist.”* Warren Buffett

*“If you are not a bit confused about what is currently happening in the economy, you do not see or know what is happening. There is a probability that the current printing of money will end very badly. Economists at the Fed are too confident that they know how to control the situation.”* Charlie Munger

### **Cash before the crash**

It can be very valuable to hold cash, but it should not be held for long time periods due to inflation that slowly but surely eats away the buying power of cash over time.

Once we act and commit cash to an investment, we forfeit the option of waiting until new information comes along. As a result, non-acting has value. The more uncertain the outcome, the greater may be the value of procrastination.

Do not invest if you cannot find a compelling reason to do so!

*“I certainly have not got rich by buying stocks at high price to earnings multiples.”*  
Charlie Munger

### **The Lazy portfolio**

Four years ago, I constructed a concentrated portfolio to hold for a 10 year period – please refer to newsletter 17.

On 18 October 2022, the status of this investment was the following:

Name	Rand price	Share count	Dividends Cumulative	Rand value 18/10/2022	Rand value 23/10/2018
Berkshire B	5118	11.80104	0	60397	35000
Anheuser Bush	860.44	12.56881	860.02	11674	15000
Naspers	2238.41	9.20515	224.22	20829	25000
Multichoice	118.01	9.20515	156	1242.30	
Prosus	965.87	9.20515	42.72	8933.70	
Reinet	282.31	105.50749	1713.42	31499	25000
			Total:	<b>134576</b>	<b>100000</b>

At first glance, when we compare the performance to that of a year ago, it is clear that the portfolio had a rather stagnant performance over the past year, increasing from R 131489 to R 134576. The movements inside the portfolio, however, was far from insignificant. Berkshire had a strong surge from R 50688 a year ago to R 60397 now, which provides growth of 19.1% in a rather difficult investment year. In comparison, the all share index of the JSE had growth of 2.9% with dividends included and the S&P 500 had growth of 1.7% with dividends included.

While Naspers and its offspring was still the star performer last year at 53% growth over three years, this investment has now decreased to deliver 24% growth over four years. Berkshire at 72% growth over four years is now ahead of the pack, with Reinet at 26% in second position and Naspers at 24% growth in third position. Anheuser Bush is still the laggard with a loss of 22%, better than the loss of 25.3% of last year. You will notice that the highest conviction investment at 35% initial weight is now the best, while the lowest conviction investment at 15% initial weight is the worst performer. Maybe I am over diversified with four investments and should have dropped my lowest conviction share to have only three share names in the portfolio☺.

We normally also compare the lazy portfolio with the all share index of the JSE, the S&P 500 index in the USA (expressed in rand) and inflation in the RSA:

	23 Oct 2018	18 Oct 2022	Dividend index total	Rand value	Dividend %
All share index RSA	51500	66351	9543	147364	4.4%
S & P 500 dollars	2755.9	3720			
S & P 500 rand	39640	67592	3674	179781	1.68%
RSA inflation index	88.1	107.3	0	121793	

The RSA all share index dropped a little from 67050 to 66351 now, but the dividend from the commodity boost helped the overall index performance higher from R143254 last year to R147364 now. It is also interesting to note that the S&P 500

index dropped from 4545 to 3674 over the past year, but the weaker rand saved the day for the rand version of this index and the value actually increased from R176723 a year ago to R179781 now.

So, the athlete in front (we are using road race analogy) after 40% of the comrades distance has been completed, is still the S&P 500 index followed by the all share index of the RSA and the lazy portfolio in the third position. The athletes have not changed position over the past year. The laggard, namely the RSA inflation index, has caught up a bit with the others and improved by 8.2% while the others performed in a narrow band from 2.9% to 1.7% growth. So, there was little action over the past year in this race – it was a bit like watching paint dry on a wall. We shall revisit this race in a year's time.

### **The LAPP technique**

LAPP stands for Lower Average Purchase Price – you will soon see Lucri is actually using a weighted average purchase price in this technique, but “lower weighted average purchase price” sounds way too long and complicated.

The success of this technique is based on a simple formula and unwavering discipline, with absolutely no special market timing needed for buying and selling. The principle and aim is to lower your weighted average purchase price with each and every future transaction, irrespective of buying or selling transactions.

You initiate this technique by buying a share at or below value. This will reduce the risk, increase the probability of success and shorten the time before you show a profit. You should have success even if you start buying above value, but I cannot recommend it.

You calculate your initial average total purchase price per share by dividing the cost of the purchase including all brokerage cost by the amount of shares purchased. You also account for the time value of money by adding interest to the purchase cost over time. You also account for dividends received minus dividends tax and take capital gains tax into account when you sell. In short – you should take all cost factors into account. Due to the interest charge, your average purchase price per share will increase over time. If it takes a long time to achieve success, the average purchase price will grow significantly. By taking all the factors into account, you have a very accurate measure of the true average purchase price per share at any given point in time.

When the prevailing market price of the share drops about 10% below your calculated average purchase price, you buy more shares. This will immediately drive your (weighted) average purchase price lower – you just take the total cumulative cost and divide it by the total amount of shares after the new purchase. I am sure Lucri readers have performed this technique previously – the total capital outlay increase to a lesser extent than the share count with the result that the average purchase price decreases. You have reduced the average purchase price by buying more shares. Repeat if the price drops another 10%.

What do you do when the prevailing share price increases to a point about 10% above your time value (interest added) adjusted average purchase price per share? You simply sell a portion of the shares and subtract the net proceeds after brokerage cost and capital gains tax from your capital outlay. In this case, the capital outlay will reduce to a larger extent than the total share count – resulting in a lower average purchase price again. Repeat if the price increases another 10%.

Yes, I know this is obvious (and boring) for people with natural mathematical talent, but I also know some people need to think a little about this – so please take the time to calculate an example for yourself so that you are comfortable with this idea. It is only  $A$  (total cost) divided by  $B$  (total share count) – but you should understand why the reduction in  $A$  is more in % terms than the reduction in  $B$  when you sell. So – you have reduced the average purchase price AGAIN by selling in this case.

Why do I refer to unwavering discipline? The most difficult part of this technique is to do NOTHING when the share price remains with-in about 10% from your average purchase price. You should not act when the prevailing price is too close to the average purchase price – as you will incur brokerage cost and the overall reduction in average purchase price will not be worth your while.

Because you are adding an interest charge, it helps if you receive dividends that you can subtract from your capital outlay to reduce the average purchase price. You also want a share that is a bit volatile from time to time – I have repeated (maybe too often) that price volatility is not risk, it is actually signalling opportunity. This technique will bring that point home strongly – the higher the share volatility, the faster you will drive the average purchase price lower – especially when the volatility results in movements of more than 10% higher and lower than your average purchase price.

Ok, so how do I know that this technique can add value? On 21 August 2020, I initiated this technique by buying BTI (British American Tobacco) at R577 each. I adhered to the first rule – by buying below value. I calculated the value to be about R600 per BTI share at the time. I was quite confident in this value calculation, as the tobacco industry (and the competitive forces in tobacco) is changing very slowly over time – the slower the rate of change in an industry, the easier it is for me to calculate a value per share with high conviction.

In the first year, I could only find buying opportunities and manage to lower the average purchase price to R559 by 19 August 2021. Remember, I had to add interest to my purchase cost the whole time, and subtracted the dividends after tax. The progress was slow, but the resultant average purchase price drifted lower.

In January 2022 I found my first selling opportunity, and by 16 May 2022 the average purchase price was reduced to R513 while the prevailing share price was R680. On 9 September 2022, I could manage to drive the average purchase price to R503 with the prevailing share price at R707 – 40% above my (all costs included) average purchase price.

How do I know this technique was adding more value than simply timing the market for excellent buying opportunities? Assuming than I had excellent market timing

talent (nothing can be further from the truth – I am NOT a good market timer), I could buy all my BTI shares on 4 October 2021 at a price of R514 per share. This will be almost impossible, even for someone that claim to have some knowledge of the future. Do you see that my average purchase price of R503 on 9 September 2022 is much better than that what the best possible market timing can provide – as R514 was the low point in the price cycle? Also – by paying R514 on 4 October 2021, the average price with interest added to account for the time value of money over the 11 month period will result in a price of R542 per share on 9 September 2022 at a 6% interest rate. This LAPP technique beat the best possible market timer by about 7%.

By beating the best market timer over this period, I believe this technique does add value. It is very simple if you think about it, but you need to add all costs to ensure that you have an accurate average purchase price available at all times. Then you just add a good dose of discipline and ONLY act when the prevailing price deviates about 10% from the weighted average purchase price, and repeat the exercise if the price keeps on moving significantly in a certain direction.

### **Lucri housekeeping**

Please always remember to tell me via SMS, WhatsApp or e-mail when you move cash in or out of your account.

All Lucri communication is only via e-mail. If you send an e-mail to [streicher.simonj@gmail.com](mailto:streicher.simonj@gmail.com), I promise to answer in a few days.

Kind regards and enjoy your LAPP investing,

Simon Streicher