

LUCRI ALPHA NEWSLETTER NR 35

19 April 2023

Dear Lucri friends,

In this newsletter, we shall look at intellectual arrogance, investment tail winds, the results of the recent Lucri year end and we also revisit the investments of Freddie Fiat and Pat Productive.

On a lighter note

When one door closes and another door opens.....you are probably in prison.

Age 60 might be the new 40, but 9:00 pm is the new midnight....

I had my patience tested. I'm negative.

When you ask me what I am doing today, and I say "nothing", it does not mean I am free. It means I am doing nothing!

Quotes

"Patience is perhaps the scarcest – and, thereby, most valuable – commodity on Wall Street. Apply patience to a disciplined and common sense investing strategy to counter the blatant lack thereof in the financial markets." David Waldron

"The weeds wither away in significance as the flowers bloom. Over time, it takes just a few winners to work wonders." Warren Buffett

This quote from Warren Buffett is one of the great secrets of successful investing over long time periods. This tells us that the quality of a portfolio, if left alone over long periods, will automatically self-adjust towards higher quality. We shall illustrate the power behind these words by looking at an example.

You invest R100 000 in four companies, A, B, C and D. Initially, you invest R25000 in each. After a decade, it became very clear that B and C were weeds. The result is as follows after 10 years:

A grew by 100% from R25000 to R 50000.

B shrunk by 90%, from R25000 to R 2500.

C halved from R25000 to R12500.

D is the star performer and grew 400% from R25000 to R125000.

Your portfolio increased by a mediocre 90% from R100000 to R190000 (6.6% growth per annum.)

The weights of the four companies in the portfolio are as follows after 10 years:

A is 26.3% of the portfolio.

B is 1.3% of the portfolio.

C is 6.6% of the portfolio.

D is 65.8% of the portfolio.

The weeds, B and C, are only 7.9% of the portfolio after 10 years. Due to the bad initial choice of including two weeds (50% of the portfolio), the result is rather disappointing. But...if you picked the flowers and watered the weeds (like most inexperienced investors will do), the result would have been a train smash, most likely with a painful overall loss over the decade.

You should not try to be clever by buying and selling constantly – you would have missed out on the full 400%, for example. Warren Buffett is a typical buy and hold investor. If he had jumped in and out of his favourite investments over the years, his returns would have been eaten into by tax. He also might have missed out on big upward moves in the stocks and might have been on the side-lines over dividend payment periods.

The lesson is that you should take your time with stock buying decisions, and only sell under exceptional circumstances. Think like an owner who buys businesses for the long term, not a speculator who picks stocks for short term gain.

“I can calculate the motion of heavenly bodies but not the madness of crowds.” Sir Isaac Newton

Yes, Newton was brilliant in his field, but he got burned while speculating. He bought and sold profitably in the South Sea Bubble, but.....then jumped back in at even higher prices and lost heavily.

“Teach others what you know and learn from others all that you don’t know.” David Waldron

This quote leads us to our discussion on intellectual arrogance.

Intellectual arrogance – a bad habit

“The chains of habit are too light to be felt until they are too heavy to be broken.” Bertrand Russell

So, get rid of bad habits and practise good ones early on before it is too late. Bad habits may not become apparent until it is too late.

Take intellectual arrogance for example. Some of us have the need to show people that (we think) we are smarter than they are.

Rather stretch your knowledge by being open and by soaking up the intellectual wisdom of others. Be smart without being arrogant – acknowledge that you do not know it all. Then seek knowledge from those who may know more than you do. If you are the smartest person in the room, you are in the wrong room (unless you want to invest into others, which is noble and should be encouraged.)

For those of us who are middle-aged (a nice way to say “old”), try to find a reverse mentor – someone younger and less experienced than you are, but who are technologically savvy and hold expertise in a terrain totally unfamiliar to you.

How do undervalued opportunities originate?

Some investors will provide Lucri with buying opportunities when they:

- Extrapolate depressed conditions
- Underestimate future potential
- Neglect assets
- Are forced sellers due to too high leverage
- Are getting tired – plain investment fatigue
- Are seduced by immediate liquidity – they need cash

Tales about tail winds....

When you go out cycling, a tail wind is always welcome – especially at my age.

Now, we also experience investment tail winds and head winds in life. If you analyse various countries in the world, you find that some have prevailing tail winds for long periods – for example the USA. You have surely noticed the recent noise about the end of the dollar. Yes, the USA tail wind may become weaker, but I believe it is still blowing.

When Lucri decide on investing in specific countries, the long-term prevailing investment wind is important for superior long-term results.

In the USA, you will experience extended periods with a tail wind. This tail wind will not blow constantly, and sometimes you may experience wind-still conditions or head winds. But, over one or more decades, you can expect to enjoy the benefits of the American tail wind as an investor.

South Africa also experienced a (mostly) prevailing tail wind for many decades – but over the last decade, the investment tail winds and head winds were often balanced – with the result that superior results could not be achieved.

In China, investors experienced a hurricane tail wind for the last 2 decades. While investors experienced an uncomfortable regulatory induced head wind over the past two years or so in China, the probability for the investment tail wind to re-appear is high in my opinion. The business related tail wind is still blowing in China, although it weakened significantly lately.

So – Lucri has reduced investment in South Africa and has increased investment in the USA and China. The future will tell whether this re-allocation of investment capital will bear the fruits that we are hoping for.

Unfortunately, Lucri cannot move towards the USA in specific share investments like Berkshire for clients with exclusive local share accounts. Yes, an index investment into the USA and China can be done via a local share account. In terms of China, Lucri will be very cautious and prefer only index investment, as the Chinese market is still an unknown to me to a large extent.

Freddie Fiat and Pat Productive

Please refer to newsletter 27 for the back-ground to the two characters mentioned above. Last year, Pat was sitting on R118 575, versus the R104 751 of Freddie. Over the past year, Freddie could invest at 6%, taking his portfolio to R111 036. Let's take a look at the portfolio performance of Pat over the past year, measured on 18 April 2023:

Name	Share count	Start price per share in cent	Start value (Rand)	Dividend received past year (Rand)	End price per share in cent 18 April	End value dividend included (Rand)
British American Tobacco	92	62623	57613.16	4021.32	63846	62760
Lewis	411	4670	19193.7	1697.43	3850	17521
Nuworld	680.57	3250	22118.52	1019.49	2149	15645
Coronation	228	4299	9801.72	880.08	2930	7560
Indluplace	3100	315	9765	992	334	11346
TOTAL			118492	8610.32		114832

It is immediately clear that Pat had a weak year, with 3 out of 5 shares falling significantly in price. The overall value declined from R118 492 to R114832, even after dividends to the value of R8610 was received.

It remains interesting that, even after a bad year, Pat is still ahead at R114832 versus the R111036 of Freddie. Also, at 6% interest, Freddie earned R6285 in cash flow while Pat earned R 8610 via dividends. So, on total value as well as on cash flow, Pat remains ahead.

Freddie visited his local bank branch and decided to reap the benefits of the high prevailing interest rates. He invested the R111036 at 8.78% for the new 12 month cycle. Freddie smiles and think to himself: "Let's see if Pat can beat my R9749 interest that I shall earn in the new investment year."

Pat decided to sell the 3100 Indluplace at 334 cents each, as the controlling interest that is held by Fairvest will be sold with-in a few months, and Indluplace will be delisted. He decided to invest the proceeds (R10250 after brokerage cost) plus the R8610 earned via total dividends to increase his shareholding in Lewis, Nuworld and Coronation at the prevailing prices on 18 April 2023. After brokerage fees, he manage to increase Lewis from 411 to 668.17, Nuworld from 680.57 to 884.69, and Coronation from 228 to 377.71.

Due to the friction costs of buying and selling, the total value of the portfolio drops slightly from R114832 to R114542.

So, Pat starts the new investment year with only 4 shares, but 3 of them have an increased share count. Freddie starts the new investment year with higher interest at 8.78% in the bag. We shall revisit the two gentlemen in April 2024 and ask them about their performance.

Feedback from the Lucri year-end

Over 2022/2023, from 25 February 2022 to 17 March 2023 (17 March was communicated in the January 2023 newsletter already), 88 out of 92 portfolios created positive alpha, representing a success rate of 95.7%. This is higher than the already high 81% of last year, 68 out of 84. The same trend that prevailed last year, also helped Lucri towards outperformance this year, namely that strong historical growth rates caught up with the market and the market struggled to produce growth on the high baseline. This was especially true for the S&P 500 index in the USA – Lucri had to run against a declining market in the USA. So, no wonder that the slow tortoise was catching the hare, as the hare was running backwards!

Shrewd readers will also notice the increase in the portfolio count from 84 towards 92 over the past year. The growth in the portfolio count is purely due to word-of-mouth exposure, there is no advertising at all.

As Lucri wants to protect existing clients against the dilution of focus towards their portfolios, Lucri has decided to stop accepting new clients. So, it is expected that the portfolio count should gradually wind down with the passage of time.

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, I promise to answer in a few days.

Kind regards and happy tail wind investing,

Simon Streicher