

LUCRI ALPHA NEWSLETTER NR 37

20 October 2023

Dear Lucri friends,

During this agricultural year, we had record levels of beneficial rainfall in the Overberg region. It is now harvest time, and the wheat, barley and canola fields look really promising. I am grateful and glad on behalf of the farming community, but I still think the risk involved in value investing is much lower than that involved in farming.

In this newsletter, we discuss the sovereign debt of South Africa, the inflation monster and we look at an update of the lazy portfolio.

On a lighter note

You know you are truly retired when your dog starts barking wildly at you the moment when you dare to start working. This happened to me a while ago.....

When someone asked Charlie Munger about his plans for retirement, he replied: *"People should not be able, by observing from the outside, to tell whether you are retired or not!"* He then added: *"The problem in businesses is that some workers are retiring without telling you!"*

This happens when you get older...

- I finally got eight hours of sleep. It took me three days, but whatever....
- I remember being able to get up without making sound effects...
- When you do squats, your knees sound like a goat chewing on an aluminium can...
- You hate it when a couple argues in public. You normally miss the beginning and then you don't know whose side you are on!

But, you can always make life more interesting by following these instructions:

- When someone asks what you did over the weekend, you squint and ask: "Why, what did you hear?"
- If you are sitting in public and a stranger takes the seat next to you, just stare straight ahead and ask in a low voice: "Did you bring the money?"

"Doctor, doctor! I think I am shrinking. I need help right now!" Doctor: "I am sorry, you'll just have to be a little patient."

Your geography lesson continues:

- "Where is the best place in Europe to find sharks?" Finland.
- "Where do you find Quebec?" On a map.

Now for your lesson on nature:

- "Why do mother Koalas carry their babies?" Because the babies are too small to carry their mothers.

Someone asked Warren Buffett: “People always ask you for advice, but when you need advice, who do you go to?” He replied: “Well, I usually look in the mirror!”

Yes, Warren may not be too modest, but he admitted earlier that he actually regards his partner Charlie Munger as the one that shows true north without fail. They do not always agree – but they never have an argument. This shows that we can take advice from someone without always being in agreement with that person.

On a heavier note

In October 2020, the sovereign debt of South Africa amounted to R 3 900 000 000 000. In October 2023, it amounted to R 4 700 000 000 000. This is before the announced Eskom bail-out, and before the debt of other state owned enterprises are included. So, the South African government borrowed R 800 000 000 000 in about 1095 days, which is R730 million per day or R30 million per hour! No wonder the overseas holders of our debt are now selling the debt at a faster and faster pace. Who is taking up the debt that they are selling? South African banks, pension funds and local investors! It is already late in the day.....the South African reserve bank recently warned that South African banks are exposing themselves too much to South African bonds.

Quotes

“The value of each share of an individual company is determined by the business model and actions of that individual company to a large extent. The price of each share, however, is determined by market forces driven by emotions. While value normally changes slowly in small incremental steps over time, listed prices can move dramatically with-in minutes. Also, while listed prices are easy to find – it is actually in your face constantly – it requires skill, deep thinking and time to determine value with reasonable accuracy. Value and price are clearly not the same thing – but most investors just assume it must be identical. This explains why true value investors can beat the market.” Simon Streicher, Lucri Alpha☺

“We believe in singing country songs in reverse. If that way, you get your house, your automobile and your wife back.” Warren Buffett

Warren is conveying a very important principle, hidden in this bit of humour. You need to think about life in reverse gear, you need to reverse engineer life. You need to think about the bad things that can happen to you, and what actions or decisions will most probably lead to these bad outcomes. Then you simply AVOID those decisions and actions like the plague. So, if you want to achieve a specific positive outcome, you concentrate and think hard to come up with a shortlist of critical actions that will surely cause you to fail. Then you just stay very far away from those actions.

“The typical big winner in the Lynch portfolio generally takes three to ten years or more to play out.” Peter Lynch

Do not think the market will be quick to see what you are seeing – be prepared to stay the course for many years without obvious price appreciation results. Buy value

and wait for the truth to come out. It may take 3 to 10 years before a position bears fruit.

“Let’s go invent tomorrow instead of worrying about what happened yesterday.”

Steve Jobs

Lucri agrees – we can learn from the past, but we should not spend too much time there. The past is gone – it is the future that matters.

“High multiples on high margins are a recipe for either disaster or mediocrity.”

Christopher Bloomstran

When a company is highly profitable (high net margins) it is difficult to defend it against competition or it is challenging to maintain success. If the profit per share is also translating to a very high share price (high PE ratio or high multiple), the share is priced for perfection. If anything goes wrong, the price will come tumbling down due to lower profits and a lower PE ratio – a double whammy. So, the best outcome that the investor can expect is mediocrity.

Inflation

South Africans that follow local politics are well versed in the term “Expropriation without Compensation”, or EWC. Now, I want to introduce you to the term EWI – “Expropriation with Inflation”. The first, EWC, needs to be performed in the open where everybody can see. If it is implemented in future without restraint, it will surely bring the economy of South Africa finally to its knees because the right of an individual or entity to own private property has been the basic backbone of successful economies through the ages.

EWI, on the other hand, is a stealthy way to take from everybody – from the very poor right through to the very rich. It happens constantly in the shadows of the economy, away from the open where people can see. Therefore, many people do not understand it fully. They do not understand the causes of it, nor the true effect. Governments, like the South African government with lots of debt, actually benefits largely from it, as it constantly eats away at their debt pile. Workers can feel the effect when they try to spend their salaries on inflated goods – but most do not understand why their “above inflation” salary adjustments, that they sometimes fought for very hard, cannot buy the same goods as the years before.

This newsletter is focused on investment – so we shall limit ourselves to the effect of inflation on investments. Investors should be fearful of inflation – as it tends to drive share prices closer to earnings per share. An increase in inflation reduces the share multiple, or the share rating (PE ratio).

Investors in capital intensive stocks should particularly be fearful of inflation. Take Sasol as an example of a capital intensive stock. As inflation accelerates, it will cost Sasol more and more to maintain its vast asset base, especially when equipment components need to be replaced in future. This reduces the free cash flow in the company, cash flow that is needed to pay down debt and to pay dividends.

Compare this situation with a business like Lewis where the asset base is not capital intensive at all – some money is locked up in inventory, but the inventory can be turned around a few times per year. Inventory is actually close to cash. You can also think about a company like Coronation, where the asset base consists of a few desks and computers. There is almost nothing that needs replacement at ever increasing prices into the future. A restaurant franchise business like Spur Corporation that do not own all the Spur restaurants is comparable with Coronation, both have a very low asset base. Inflation cannot hurt them in the same way that it hurts Sasol.

The Lazy portfolio

Five years ago, Lucri constructed a concentrated portfolio for a 10 year period – please refer to newsletter 17. The basic idea was that an investor does not need constant buying and selling to earn a decent return. I therefore offered to box for a full decade with both hands tied behind my back – without any opportunity to make any changes or adjustments at all to a limited portfolio.

On 18 October 2023, the status of this investment was the following:

Name	Rand price	Share count	Dividends Cumulative	Rand value 18/10/2023	Rand value 23/10/2018
Berkshire B	6514	11.80104	0	76871.97	35000
Annheuzer Bush	1013.15	12.56881	1050.61	13784.70	15000
Naspers	3023.30	9.20515	224.22	28054.15	25000
Multichoice	74.34	9.20515	156	840.31	
Prosus	547.24	20.06354	42.72	11022.29	
Reinet	392.56	105.50749	2365.46	43783.48	25000
			Total:	174357	100000

When we compare this result to one year ago, it is clear that we had an interesting year. The lazy portfolio was not lazy at all – it appreciated from R 134576 on 18 October 2022 to R 174357 on 18 October 2023 – a full 29.5% in one year. So, it took 4 years to get the first R 34 576 growth, and one year to get another R 39 781. This provide proof that investment growth does not come in straight lines over time – investors grow impatient with anaemic growth and bails out before they can enjoy the fruits of price that closes the gap to value. So – the fast growth that we have seen was a price correction, especially in the price of Reinet shares that was priced too low for years – we have discussed the Reinet scenario in the Lucri newsletters in the past.

The lazy portfolio had only 4 shares at the outset – but, due to corporate action, Naspers developed offspring in the form of Multichoice and Prosus. Also, the share count of Prosus increased over the past year from 9.20515 towards 20.06354 without any action from my part – is was due to corporate action outside my control. It is important to note that I have not performed ANY investment actions since October 2018.

Looking at the original four shares in the lazy portfolio, Berkshire is now clearly in the lead at 119% growth, with Reinet second at 75% growth and Naspers third at 59% growth. Annheuzer Bush lags with a loss of 8% - much improved from the loss of 22% last year at this time.

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 2023	Dividend index total	Rand value	Dividend %
All share index RSA	51500	72195	12669	164782	4.3%
S & P 500 dollars	2755.9	4373			
S & P 500 rand	39640	82478	4903	220434	1.49%
RSA inflation index	88.1	111.7	0	126787	

We shall use our analogy of the Comrades marathon again to describe the relative performance. Halfway through the comrades race (5 years completed out of 10), we see that the lazy portfolio at R174357 (11.8% compound growth per annum) is now running in second position after passing the RSA all share index, which is now at R164782 (10.5% compound growth per annum). The S & P 500 index of America is clearly in the lead at R220434 (17.1% compound growth per annum). Due to the superior performance in this case, Lucri decided to analyse the result further. The total growth of 220% was delivered as follows: 56% via appreciation of the dollar based S & P 500 index, 12% earned via dividends, and 26% appreciation due to the weakness of the rand versus the dollar. ($1.56 \times 1.12 \times 1.26 = 2.20$). The RSA inflation index is lagging far behind at R126787 (4.9% compound growth per annum) – which confirms my rather bold statements in earlier newsletters that the RSA inflation rate is not being measured accurately. This is a discussion for another day.

With the fast burst forward from the lazy portfolio, we can expect a rather weak performance in the year ahead due to the higher base that has formed. I may be biased, but I still believe the price to value ratio is healthier in the lazy portfolio compared to the expensive S & P 500 index. Having said this, I also believe this American index has provided us with proof that it is extremely difficult to beat the S&P 500 without taking on a boatful of unhealthy risk. So, if you cannot beat them, the rational approach must be to join them! I have added the S&P 500 index in my personal portfolios, and will add it with caution to client portfolios as well. I am currently waiting for a more advantageous entry point, as 120% growth in 5 years is a bit too steep to my liking – I remain a value investor at heart.

On 10 October 2023, 10 days ago, I listened to a Biznews programme hosted by Alec Hogg. He had two guests in this programme, namely Magnus Heystek from Brenthurst Wealth and Piet Viljoen from RECM. Both Magnus and Piet deserves

credit for their achievements. I want to acknowledge Magnus for his timely encouragement of South African investors to diversify their investments overseas – he did this well in advance of the significant depreciation in the rand versus hard currencies. I also want to acknowledge Piet for his consistent application of true value investment techniques in South Africa – I have previously called him the Warren Buffett of South Africa for good reason.

On 10 October 2023, Alec Hogg interviewed these two gentlemen. With Magnus promoting overseas investment, and with Piet promoting value based local investment, these two gentlemen each started an investment portfolio worth R500000 on 1 Nov 2021. The portfolios are independently monitored by Alec Hogg.

On 10 October 2023, after two years, the value of the Magnus Heystek portfolio was R 434 008 (a decrease of 13.1%), and the value of the Piet Viljoen portfolio was R 527 346 (an increase of 5.4%). It is still early days, they agreed to run the portfolios for 5 years before a winner will be declared.

Now, because the lazy portfolio has also been monitored and valued every year late in October, the timelines of these portfolios are overlapping, so that comparison should be in order. On 22 October 2021 (compared to 1 Nov 2021 for the other portfolios), the lazy portfolio stood at R 131 489 as reported in Lucri newsletter 29. Now, on 18 October 2023, the value was reported as R 174 357. Therefore, in the last two years (the first two years of the Magnus/Piet contest), R500 000 invested into the lazy portfolio would have yielded $174357/131489 \times 500\ 000 = R\ 663\ 009$.

For now, the lazy portfolio is running much faster than the other two portfolios at 32.6% growth. Anything can happen in investing, and the moment that you think you are on top of things, you are close to humiliation. Having acknowledged this fact, it is clear that a simple, limited portfolio like the lazy portfolio can hold its own in the investment world. It was at least true for this specific two year period. It will be interesting to continue the comparison with the Piet and Magnus portfolios into the future.

Lucri housekeeping

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

All comprehensive 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 enjoy “lazy” investing,

Simon Streicher