October 2022

Dear Investor,

THIRD QUARTER OF 2022

Hide and Seek

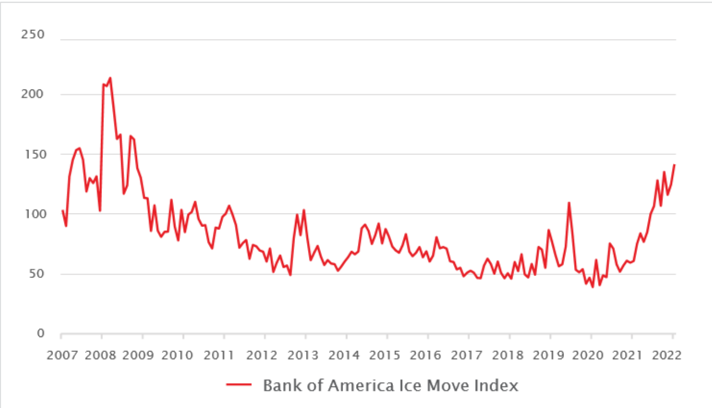
We all remember playing some form of hide and seek when we were children. All towns have different versions of the same principle: you want to be last to be found. But you do want to be found.

I remember playing our version of hide and seek (called Five Fingers) as a child. One day, I hid very well and sat dead still – they would never find me! And they never did. Eventually, I was bored and lonely and emerged from hiding. I found that nobody had been looking for me for a very long time and that the party had moved on, past cake and past pool time. In fact, the party was almost over. I hid so well that I had missed it.

When we hide, we must ultimately choose between time at the chaotic party or calm solitude. Investing is no different.

Consider the following charts, which all represent a gauge of emotions in financial markets. As the collective picture shows us, there is currently plenty of emotion in the market. The party is indeed chaotic.

<u>The USD bond volatility index</u>



Source: Bloomberg

Volatility indicates how quickly and to what extent people change their minds. Higher volatility means there are many hot heads and pumping hearts in the market. The current measure is getting closer to the levels last seen in the Great Financial Crisis of 2008/9.

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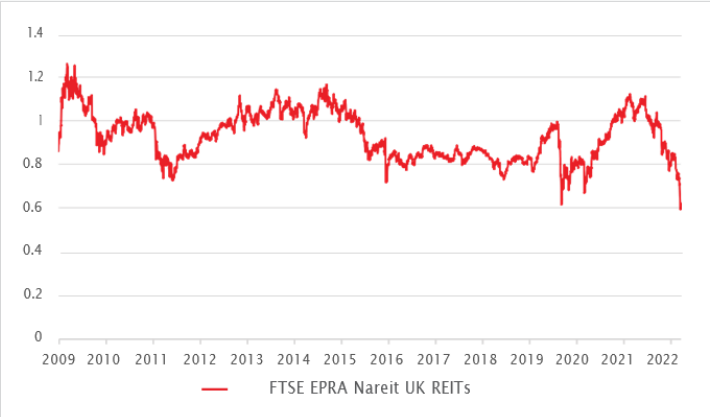
Property price-to-book ratios in the UK



Source: Bloomberg

Listed property companies are valued annually by external valuators. Their share prices move around these pinned values. Currently, the market believes that valuators have horribly overestimated true property values. A couple of years ago the market thought these same valuators were horribly underestimating property values.

Howden Joinery Group price-to-earnings ratio

Source: S&P Capital IQ

The price-to-earnings ratio is a comparison of a company's share price to its profits. It gives us a simple relationship on one chart: what am I paying, and what am I getting? It does not tell you how much you should be paying but it certainly tells you that people have very different views on what that price is at different times. Currently, you don't have to pay much for a UK business that grows profits by double digits, generates high free cash returns on capital and has a long growth runway. We are buying more.

Broadly, all these charts tell the same story: there is currently a stampede out of risky assets to cash. Cash rates have increased, while risky asset prices keep falling. Running to cash seems perfectly rational.

We too could hide in cash and shield ourselves from market pain. But by the time we emerge from hiding, the cake could all be gone. We are therefore not hiding in cash. In fact, we are investing in the asset classes that are being dumped by the great escapers. For your portfolio it means we are buying equities, mostly in the UK and the out of favour corners of the US.

It is not the first (and certainly not the last) time that people dump and run for cash. But it does not happen very often. So when it does, make sure you are a buyer because the cake is big and most of the eaters are hiding when it is served. Short-term pain for longer-term gain is simple, but not easy.

Portfolio Updates

There were no new businesses added during the quarter. Neither did we exit any of your holdings. We continue to selectively add to the areas where we see the most future potential given the currently depressed share prices. These include Howden Joinery and certain of the semiconductor companies we have previously written about. The rest of our time is spent reviewing the investment case in our current holdings, as well as searching for new ideas. Our wish list keeps growing.

In our view, the current share prices of many of the businesses in the portfolio fail to reflect the long-term optimism we feel by including them in the portfolio. As a result, your cash allocation has reduced to the lowest level since inception of the portfolio. We cannot predict how share prices will move over any short period of time, but we have high expectations that the portfolio as a whole will be more profitable and valuable in a few years' time.

Several investors have recently added to their accounts to take advantage of the current share prices. We have similarly done so. Please contact any of us should you wish to do the same.

Conclusion

This letter should be read in conjunction with your quarterly investment statement which contains all the financial information relevant to your account.

It continues to be a pleasure and a privilege to manage your capital. As always, we invite you to contact us if there is anything you would like to discuss. We find that there are valuable learnings in portfolio discussions, especially when clients take opposing views.

Your partners in long-term value,

Alex, Catherine, Henno, Paul, Phila and Simone

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