



Measuring Performance

In our industry, current and potential clients are understandably very interested in our investment performance. Given that our mandate from each client differs, ranging from ultra conservative to aggressive, it follows that each portfolio's performance is unique.

Recognising this problem, we decided to introduce a measured portfolio two years ago seeded with our own capital. We term this portfolio our model and it forms the backbone to all client portfolios that have mandate a general equity type structure. The model portfolio is discussed (robustly debated) at least monthly and changes, if any, are actioned immediately, both in the model as well as client accounts.

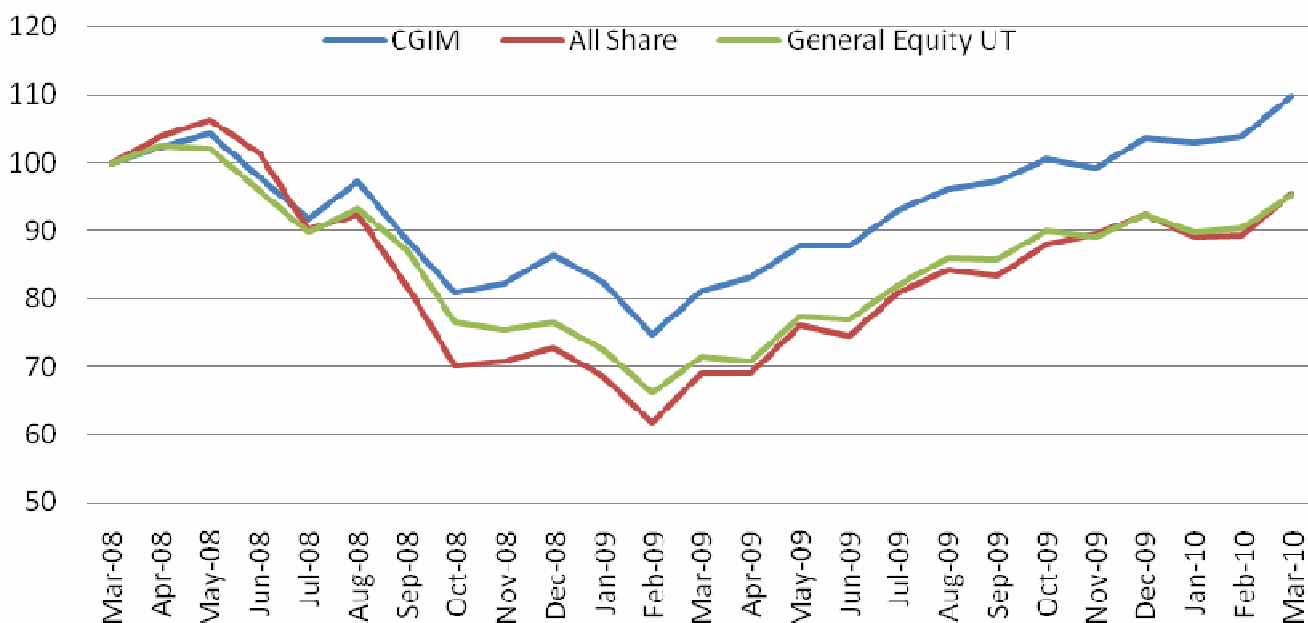
The importance of running a model live is that it enables a constant assessment of the weightings attached to each underlying instrument as well as exact measurement to track performance. It is worth mentioning again, for those reasons mentioned above, that no single client is likely to have an identical portfolio to that of our model.

Almost from the outset our model portfolio was met with a baptism of fire as the global economic meltdown gripped markets worldwide. This is clearly evident in the chart below. Importantly though, we managed to perform better than the market on the way down and while this may be of little comfort, the reality is we lost less than most. Anthony Bolton, the well known and respected portfolio manager from Fidelity stated in his book *Investing Against the Tide* that "The job of the professional investor is as much about avoiding disasters as it is about picking winners."

Since inception, our model portfolio is up 9.9% versus a decline of 4.6% and 4.8% for the All Share and Domestic General Equity Unit Trust respectively. Over the last 12 months our model is up 35.5% versus 38.3% for the All Share Index and 33.2% for the Domestic General Equity Unit Trust Index.

Leading Indicators:

	1mth % ch	3mths % ch	12 mths % ch
JSE	7.4%	3.8%	36.0%
S&P	6.4%	4.2%	41.0%
Nik- kei	8.8%	3.3%	27.2%
Oil	4.4%	3.7%	71.5%
Gold	0.3%	1.0%	18.8%
R:\$	4.7%	0.3%	26.4%
R:£	6.3%	6.4%	22.0%



...And a few lessons from Warren Buffett

Reading is critical when it comes to finding the best investments. From understanding broad economic trends to micro company issues we try hard to wade through the right material. Of course this information only gives us the ideas. The principles of how to invest are another thing altogether and arguably more of an art than a science. In this regard we are avid Buffett fans and his annual newsletters extending back many decades make for excellent reading.

“Lethargy bordering on sloth remains the cornerstone of our investment style.” The reality is, to achieve superior returns inactivity often leads to success. “Most investors cannot resist the temptation to constantly buy and sell.” Buying for short term gain (a mugs game at best) typically results in buying high and then selling low as capitulation unfolds. Buffett’s teachings are simple: If you buy for the right reasons at the start and the share price then starts declining you should welcome this situation to acquire even more of a good thing at a better price. Simple stuff but often forgotten when the heat is turned up!

And Buffett’s take too on earnings is simple but logical. We often see boastful comments from management about achieving record earnings. He contests achieving this feat is easy - just keep all the capital in a bank account! “The primary test of managerial economic performance is the achievement of high earnings rate on equity capital employed.” And so, record earnings year after year (with capital in a bank account) should be seen against the paltry return on capital.

Earnings can also be very misleading driven by accounting issues – what actually counts is real earnings for the owner/ investor. Has the investment improved the purchasing power of the investor? Buffett’s take on this is as follows: If you forego 10 hamburgers to purchase an investment, receive dividends while holding the investment to buy 2 hamburgers and then receive after-tax proceeds to buy 8 hamburgers upon sale of the position you have had no real income from your investment no matter how much it appreciated. “You may feel richer, but you won’t eat richer.”

Buffett also has plenty to say when it comes to acquisitions – something that all too often gets the market very excited and hooked into buying a share. Placing too much emphasis on the impact of an acquisition on future earnings is a folly particularly when it comes to the use of shares as the method of payment. The deal may result in improved earnings but could be instantly value destroying for the acquirer. His point is the acquirer’s management “might sharpen their thinking by asking themselves if they would sell 100% of their business on the same basis they are being asked to sell part of it.”

Anyone who reads up on Warren Buffet will know he often refers to intrinsic business value, his true measure of the value of a company. What is intrinsic value? It is an economic concept, estimating future cash output discounted to present value. This differs from book value, which is an accounting concept, measuring the accumulated capital injections plus earnings. “Book value tells you what has been put in; intrinsic business value estimates what can be taken out.”

And finally (for this round) I thought you, our valued client, would appreciate that we, like Buffett, will always be candid in our reporting to you, emphasising both positives and negatives. This is something we value and monitor closely when it comes to our dealings with company management and can happily report that we have acted on all cases where we have felt unease around transparency. Like Buffet, “we believe candor benefits us as managers: the CEO who misleads others in public may eventually mislead himself in private.”

The Future Titans Fund

As you are aware we launched the ClucasGray Future Titans Fund six months ago. The fund invests only in non top40 shares, a sector of the market that has yielded superior performance relative to the All Share over a long period of time.

The fund has a flexible fund mandate, enabling Brendon – the primary portfolio manager of the fund – to decide on the asset allocation within the fund between equities, cash, offshore and bonds.

Our investment methodology is both top-down i.e. looking for macro themes that we think will play out over the next several years as well as bottom-up i.e. looking at which companies will benefit from specific macro trends. Our bottom-up research is rigorous and thorough, ranging from soft issues such as management and valuation to black and white facts like cash flow and balance sheet strength to tangible knowledge from company/plant visits.

We believe that it is fair to compare the performance of this fund to the Domestic Flexible Fund Unit Trust index as well as a blended index of 50% of the mid cap index + 50% of the small cap index. As you can see from the chart below, the fund has got off to a reasonable start, rising 15% from 3 September 2009. We are cognisant of the fact that it is still early days, but we are proud of our performance so far.

