Lugarno Fund

INVESTOR LETTER
31 December 2020

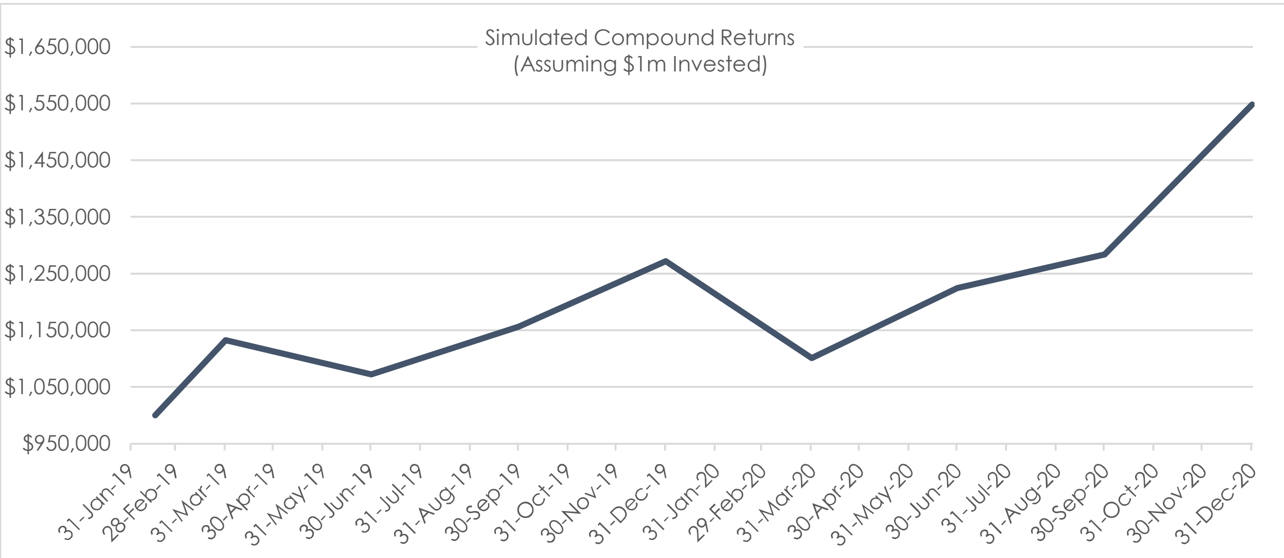
8 February 2021

Dear Partners,

The returns for the Lugarno Fund as at 31 December 2020 are as follows:

3 months	12 months	Since inception on 15 Feb 2019
+20.62%	**+21.77%**	**+26.23% pa**

The fund began on 15 Feb 2019. Since inception it has provided a return of 26.23% pa (after all fees and costs). In other words, if you had invested $1m in the Lugarno Fund at inception, it would now be worth $1,548,401.



"A bubble that is beginning to look like a real humdinger"
Jeremy Grantham

COMMENTS

The portfolio continued to increase in value post the COVID sell-off. We attribute the good fortunes this year to some rational decision-making which was aligned with our philosophy.

While we made investments in line with our investment values, we never expected to achieve returns as large and as fast as we have this year. We can pat ourselves on the back for picking the right horses but count ourselves lucky for the speed they ran.

Most of the portfolio is invested to grow. As a result of some recent selling, at the time of writing this approximately 13.50% of the portfolio was invested in cash and gold. The balance is invested in public and private stocks which we believe (collectively) have very strong prospects of growth from here.

To reiterate the theme of our last note, the low cash balance is unlikely to be a long-term theme. It is a vote of confidence in the underlying stocks in our portfolio – not the overall market.

Notes on performance

Approximately two thirds of the returns this quarter are attributed to a single private investment which was revalued on 31 December 2020. We made this earlier in the calendar year under unique circumstances at a very attractive price.

Since then, the business has performed extremely well and is most definitely worth more than we paid. We consulted with the Trustee on the approach to revaluing this investment very carefully and believe the process, which was run by the Trustee with external assistance, was fair to all stakeholders.

The balance (approximately one third) of the returns this quarter can be attributed somewhat evenly across the balance of the portfolio. Some of which we have sold completely, some we believe there are still solid returns to come.

This quarter's performance will be like most other periods in that a small number of investments will make up the majority of the returns.

Morgan Housel writes in *Psychology of Money* that since 1980 effectively all the returns from the Russell 300 index came from 7% of the component companies. He also notes that Warren Buffett has owned 400-500 stocks during his life and made most of his money from 10 of them. We expect our portfolio's long-term returns to exhibit similar characteristics.

Principles

If I sound like a broken record I am pleased. I hope to be referring to the same old concepts we use to guide our decisions for many years to come. While every market cycle has its own characteristics, the one constant is the same human folly willing it on to extremes (in both directions).

A simple and very common example involves investors adjusting their perspective from bearish to bullish as the market is rising. The stock-market is one of the only marketplaces where a crowd gets more excited and more inclined to buy as the product get more expensive.

We are all influenced by emotional biases, especially during times of exuberance. Our principles are based on timeless concepts which over the long run have helped the most successful investors protect capital and achieve strong returns.

During this time of excess, I thought it would be worthwhile to discuss our foundation investment principle.

Margin of safety/room for error

Most decisions have a range of uncertain outcomes. Forecasting accurately on a consistent basis is impossible. The COVID pandemic is a great reinforcement of that. Very few predicted it, no one was fully prepared.

Incorporating a margin of safety (or room for error) is the conservative approach to deal with unpredictability. There is always a range of possible outcomes and as humble investors we cannot know for sure which one will come.

Some may read this and think that due to our conservative nature our fund has low expected returns. We disagree. We are searching for opportunities to pay 30c for assets we believe are worth at least $1.

Successful application of this search significantly reduces the likelihood of losing your capital permanently and in the process gives a decent chance of solid returns.

Our process requires discipline and patience. It sounds like a simple method, but it is a difficult one, mainly because it requires a perspective that is against the tide of the rest of the market. It is a little lonely at the moment, but we are comfortable with that.

THE FUND

We believe in the concept of skin in the game – we eat our own cooking.

This fund serves as the primary investment entity for my family's wealth so you can be confident we are treating your investment like it's our own.

This fund exists to generate solid returns and if we fail to do so we do not deserve to be in business. We do not charge a management fee and only earn performance fees if we achieve returns of greater than 6%. This fee structure is a clone of Warren Buffett's early partnership.

We believe that the easiest way to grow capital is to avoid losing it. In practice this means that investments require a large margin of safety between what we pay and the value we believe we are receiving. We also prefer companies with substantial tangible assets to protect us should things not go to plan.

Good investment opportunities are rare so when they come along, we are willing to invest significant amounts of the fund's capital to maximise the investor's benefit. Conversely, we are content holding substantial cash in the absence of valuable opportunities.

In order to consistently make good decisions, we cultivate a sceptical and contrarian mindset. It is statistically impossible to generate great returns by investing with the same lens and conventional wisdom of 'Mr Market'.

Our investment strategy looks to capitalise on two main elements of the investment market place.

- Inefficient distribution of information: This is where under-researched companies are much less understood by the broader market
- Over-reaction tendency: This is where investors act in herdlike behaviour by over-reacting to negative news on otherwise quality investments

Well known opinions are usually priced into stocks and so we find that ideas are only valuable if they are contrary to consensus.

Internally, we judge our performance over periods of at least three years and we ask you do the same. While we strive to identify near term catalysts for our investments, 'Mr Market' rarely agrees with our perspectives as fast we would like.

We believe wealth gives people the freedom to live their best life and we are immensely proud to get to work every day helping you with that.

FUND PARTICULARS

Trustee	DDH Graham Limited
Investment Manager	Lugarno Partners Pty Limited
Administrator	DDH Graham Limited
Auditor	Findex
Min investment amount	$250,000
Min investment term	2 years
Redemptions	90 days notice
Ongoing fee	Zero management fee
Performance fee	Performance fee of 25% above a hurdle of 6% subject to a high watermark
Buy/sell spread	0.5% of applications and redemptions
Fund operating expenses	Capped as the higher of $50k or 0.5%

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Returns shown are net of all fees and costs. Past performance is not indicative of future performance. This update also contains statements about the estimated future performance of the Fund, which are based on a number of assumptions that may not prove to be correct or appropriate. Actual performance may vary from estimated or forecast performance. Neither the Investment Manager nor the Trustee give any representation, assurance, guarantee or warranty that the estimated return or any projection, forecast or assumption contained in this document will actually occur.