Lugarno Fund

INVESTOR LETTER
30 September 2021

18 October 2021

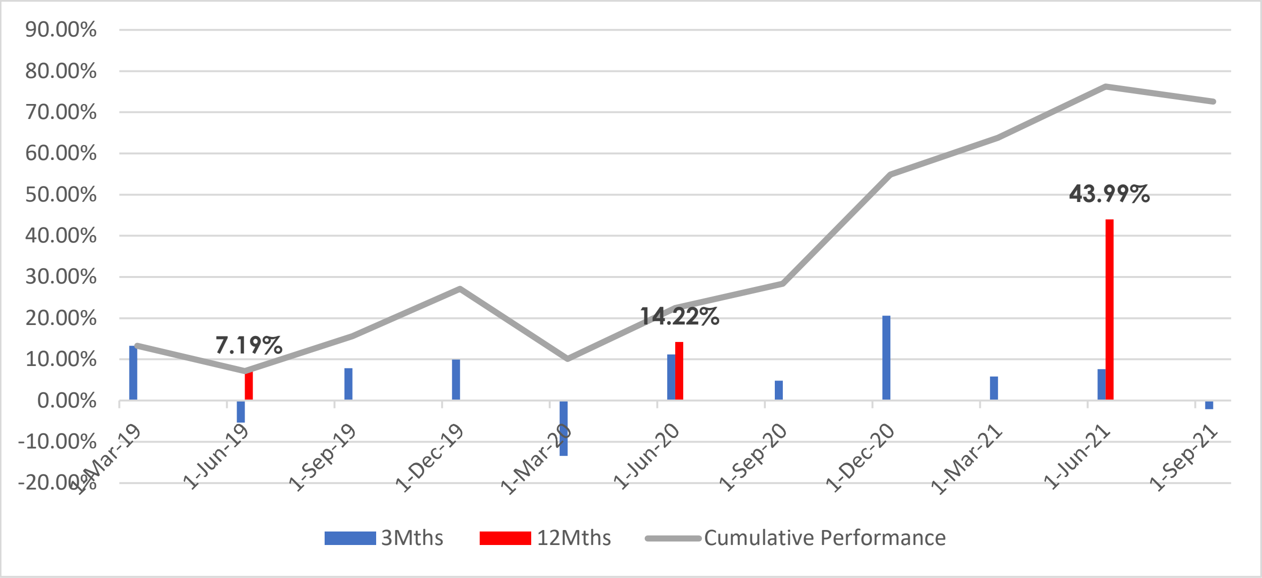
Dear Partners,

The returns for the Lugarno Fund as at 30 September 2021 are as follows:

3 months	12 months	Since inception
-2.12%	**+34.42%**	**+23.10% pa**

The fund began on 15 Feb 2019 and has provided a return of 23.10% pa (after all fees and costs) since its inception. If you had invested $500k in the Lugarno Fund at inception, it would now be worth $862,769.

More details on the fund's performance history is illustrated below.



"The first rule of fishing is to fish where the fish are" Charlie Munger

COMMENTS

Portfolio comments

At the time of finalising this note (mid-Oct), the composition of the portfolio was as follows:

- 7% in cash
- 23% invested in private investments (by carrying value)
- 70% invested in listed companies of differing size and region (by market value)

The fund's five largest investments make up just over 65% of the portfolio.

Significant contributions during the quarter were:

- AMA Group fell 19.5% due to an onslaught of negative press which among a few things questioned the companies ongoing solvency. This culminated in the company raising capital and the share price has since recovered somewhat.

- Litigation Capital Management fell 18% for no apparent reason. The stock has largely recovered so far in October.

- Bailador Technology Investments rose 25.18% and paid a small dividend. Some of the company's larger holdings have received some favourable attention in the press which has drawn more eyes toward BTI. The discount to NAV has largely closed but we are optimistic there will be ongoing increases in the value of their NAV overtime.

- Scorpio Tankers fell 14.5% due to a widespread repricing of companies earmarked as 'reopening' trades. Looking forward, the company still trades at a healthy discount to NAV and we are optimistic that the supply/demand dynamics will see the NAV gap close again. Scorpio's share price has recovered somewhat.

Price matters

In Dec 1999 Microsoft traded at a high of $59.62 but didn't reach that price again for almost 17 years. Adjusting for dividends, shareholders earned a return of just over 1% per annum for 17 years.

One would think this performance is a reflection of a poor business, NO. While they had some challenges, Microsoft's revenues still grew by an impressive 9.6% pa (avg).

Investing is not as simple as buying good companies. Buffett has suggested that paying too high a price for a great company has the ability of the undoing the effect of the next decades worth of favourable developments.

A share price reflects the expected future performance of its underlying business. Great returns will only be achieved if the business performs better than expected. This performance might be due to growing faster than expected or might even be that the business declined less than expected.

Point being, the share price does not necessarily follow revenues or earnings, especially over short and medium time frames.

The share price is the often overlooked element which determines if the investment is a bargain or a rip-off. Paying too high a price leaves us no margin of safety. It leaves us exposed to losses in an all too common scenario where the business performs poorly relative to our expectations.

On the contrary, a low share price might afford us a wide margin of safety to protect us when the business performance is poor. If the margin of safety is wide enough, it isn't uncommon to earn a positive return even when the business performs poorly – so long as its performance is better than the implicit negative expectations.

"This is the cornerstone of our investment philosophy: Never count on making a good sale. Have the purchase price be so attractive that even a mediocre sale gives good results." Warren Buffett

Some might say they are a long-term investor and observe that the Microsoft share price eventually recovered. Some may be patient enough to hold for 16 years poor returns, most wouldn't. In 2009 (10 years later) the stock was down 74%!! One would be forgiven for giving up – no doubt many did around this time.

In 1999, Microsoft's share price implied a multiple of 85x current earnings. A multiple in this region is common these days and to me is an aggressive price for any business. A price in this region assumes almost perfect execution, an impossible benchmark. It is far safer to only pay for what there is today not what we hope for the future. Let the upside be the upside, not the justification for the high price.

What is the stock today most at risk of mimicking Microsoft's performance in the early 2000's? Which of our market darlings will perform below expectations? Impossible to say for sure but I'm fairly confident there will be a few run backs.

Our experience tells us that bad businesses can make great investments and vice versa. Price matters to us. It determines value – the most essential ingredient to our decisions.

Variant perception

"Invert, always invert: turn a situation or problem upside down. Look at it backward. What happens if all our plans go wrong? Where don't we want to go, and how do you get there? Instead of looking for success, make a list of how to fail instead. Tell me where I'm going to die, that is, so I don't go there" Charlie Munger

You invest with us to receive greater than average returns. Our fees are structured to ensure we are only rewarded when we deliver above returns.

Variant perception is just a fancy investment phrase for thinking differently.

It seems logical that in order to deliver above average returns, we cannot invest like the average investor. My practical experience has supported this notion that in order to achieve a different return – we have to invest differently.

We are attracted to the ideas which are unique. The market will often overshoot at its extremes. It makes sense to us that a popular investment idea is reflected in a higher (more expensive) price. Vice versa for unpopular or contrarian ideas where value is often created by an overreaction to the downside.

In our experience, it very difficult to find value in a stock everyone seems to like.

Variant perception can come in two forms.

a) Out-of-favour (contrarian) investments. Investments where the consensus view is overwhelmingly negative. This is usually reflected in the media and a large share price decline.

b) Out-of-sight investments. Investments which are fairly obviously attractive but are outside of the lens of most other investors. Large investment firms generally focus their search on the top 200 – 500 companies in any given stock market. This leaves the overwhelming majority of companies available to us to consider without major competition. Private businesses (especially smaller ones) are also a fertile ground for us because we are often bidding without ANY competition. No competition makes for buyer favoured price discovery.

We are looking for value. It makes sense to us that we are more likely to find them in investments which the market has either hated for some time or hasn't yet found.

Charlie Munger often talks about the importance of inversion. We try to look at mainstream perspectives and take the opposing view to see what is there. A fertile ground for this at the moment is in and around the environmental debate.

Public sentiment and capital flows is heavily against coal and fossil fuels. This is the right call long term but it has created a significant under-investment in coal and oil projects well before what is prudent. You only need to look at the energy crisis in Europe & the UK to see the unintended consequences of sentiment driven investment policy.

The variant perception in the climate debate makes for some interesting investment opportunities today which we are current taking advantage of.

Acknowledgements: Charlie Munger, Warren Buffett.

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 herd-like 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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This update contains information concerning about the Lugarno Fund (Fund), an unregistered managed investment scheme, and has been prepared by Lugarno Partners Pty Ltd ACN 607 035 138 AFSL no. 508934 (Investment Manager) as investment manager of the Fund. DDH Graham Limited ACN 010 639 219 AFSL no. 226319 (Trustee) is the trustee of the Fund. This update is for distribution only to wholesale clients as defined in section 761G of the Corporations Act and to sophisticated investors under section 761GA of the Corporations Act. It contains general information only and is not intended to provide advice to any particular investor, nor take into account an individual's investment objectives, circumstances or needs.

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.