2014

	Return	Participation
T&A P	**15%**	**89%**
S&P	**13.15%**	
T&A P	**-8%**	**11%**
Colcap	**-3.04%**	

2014 Annual Letter

My name is Jean Philippe Tissot Ayram and this is the first annual letter to those of you who have entrusted me with your capital (my sister), and those of you who might be of interest. To begin with I want to make it clear that I am not pretending to be Warren Buffett or Charlie Munger – rather they have become my mentors through reading as much about them and their advice as I could, and in an effort to follow their discipline and teachings I am writing this open letter to lay the rules of my fund, consider the economic environment in which we are investing, and set out a clear picture (to you and myself) of what I hope to achieve.

2014 has seen the beginning of our partnership and my fund, and I hope it will continue for the foreseeable future. I have divided the partnership into two hubs, each one separate from the other; a Panamanian Hub, where international assets are traded, and a Colombian Hub where only Colombian stocks are traded. Based on my opinion on the markets (I have chosen to ignore forecasts as no one can predict the future) I have allocated 89% of NAV (Net Asset Value) to the international hub (Panama) and 11% to the Colombian Hub, each one with its respective benchmark (S&P and Colcap) as shown in the table above.
If I were to compare the initial investment in COP to the mark-to-market total NAV in Colombian Peso with the US Dollar year end rate in 2014, the total return of the portfolio is **45%.** This is largely due to my decision of selling 89% of the Pesos of the original investment and buying Dollars when we saw a surge in the price of the USD in 2014 which reached as high as a 30% increase against the COP. However I do not want to show a consolidated return as the USD are not expected to convert to Pesos in the foreseeable future, and while the decision of having the highest proportion in USD proved correct, I want to show the net results of the asset allocation process, therefore this is the only one time I will show it as a consolidated return.

My decision to allocate 89% in USD is based on the divergence of central bank policy – the Fed is due to increase rates in 2015 whilst many other central banks (BoJ/ECB) remain in a dovish stance. The world has to reflect a dollar where investors holding it will earn yield, therefore under this scenario I prefer to hold USD particularly against JPY and EUR. In emerging markets currencies react abruptly and aggressively when rates in the US are expected to rise, so I avoid holding a large proportion of emerging currencies at the beginning of a tightening cycle. That, combined with my view that assets in Japan and Europe are relatively cheap was the reason behind allocating only 11% to Colombian assets. At the time of writing this I am concerned by

the speed of the USD move – the USD index has moved 20% higher in the last nine months and the Fed has not lifted rates yet. This anticipation of the markets is indeed detrimental to US growth – as 40% of the earnings of the S&P 500 are derived from outside the US and US goods become more expensive versus the rest of the world, demand within the US should be reduced which may impact the beginning of the hawkish cycle further. Currently the market anticipates the Fed to move in September 2015, a month ago the expectation was June 2015, and I would not be surprised if the continued USD strength delayed this again. Consequently I believe the USD has to correct lower before rates can increase.

Although I intend to incorporate a value investment approach (which basically means buying companies for less than they are worth) my main experience has come from trading FX, and therefore the first year of our fund has followed mainly macro views. My passion for value investing started when I read about Warren Buffett, his fellow disciples, and the techniques of value investing developed by Benjamin Graham. This, combined with studying CFA material, has allowed me to network with outstanding people, attend events, and above all become a more rational investor.

To start with, in our approach we do not speculate – whilst speculation is sometimes necessary to balance markets I do not wish to see the daily swings in the value of our portfolio. Also my work deals daily with speculators and I have yet to see the positive results of this technique, however as a matter of discipline 10% of the value of the portfolio can be used for speculation purposes if the opportunity arises. (This was not used in 2014 and I do not see any trigger in the short term for this to change). For clarification purposes I consider speculation to be any of the following; any position which is leveraged, use of derivatives, FX trades (as they are highly leveraged), trading in new technology or new companies. As Buffett says, I want to trade in companies I understand, companies with a competitive advantage, with management we can track and feel confident in, with a history of consistent increase in earnings and an attractive price. It's important to mention if I have a view in a market which I do not fully understand (for example Japan) I would trade an ETF, as I would rather sacrifice a few points and go with the market, and avoid hours of wasted research. ETF's are also a wonderful resource if I want to currency hedge my position at a very low cost, therefore I expect to invest in ETF's when a) I want to hedge the FX and b) when I have a macro view but I do not understand the intrinsic technicalities of the equity market of a particular country, otherwise I will tend to avoid them. I expect my circle of competence to increase as I study more. I want to mention that I admire some asset managers very much, actually have learnt a lot from some of them so do not be surprised if any of them also help us managing a part of our money, essentially placing a portion of our money in a value investing fund.

For the International Hub, our main allocation by far is in Japan, in a trade that has been on the books since inception of the partnership and will remain there for the time being. Japan continues to be the exception to the rule that "equities are always positive in the long term" - the Japanese market touched a high in 1989 and since then has not been able to recover. The reason of this is deflation, which is extremely dangerous for an economy as a central bank has limited tools to fight against it - theoretically interest rates cannot go below zero, (yes, now Europe is the exception of this as for the first time we are experiencing negative interest rates) and salaries cannot easily be adjusted downwards, so a country in deflation is unable to grow. On top of that

Japan has the highest household saving rate in the world, currently around 20% - this makes sense in a deflationary economy as consumers store money in the hopes they will be able to buy more goods and services in the future. A trigger to start generating inflation is needed to change this, and this can only happen with an extreme boost from policy makers. In late 2012 I firmly believe Abenomics was the solution the Japanese economy desperately needed.

I am not going to explain the technicalities of Abenomics here but I can say that every button has been pushed to bring inflation higher: bold monetary easing, flexible application of fiscal stimulus and encouragement of private investment, the so called three arrows of Abenomics. I firmly believe this will trigger better results for Japanese companies, generating higher earnings and ultimately higher stock prices. Late in 2014 we saw the change of the allocation policy in the GPIF (the public Japanese Pension fund and also the second biggest pension fund in the world) where it reduced its allocation in bonds and increased its allocation to local and foreign equities, providing a particular higher allocation to local ones. Many smaller pension funds followed with a similar approach and this has been reflected in the valuation and results of Japanese companies, however I still believe the price is cheap and earnings will continue increasing, therefore we keep supporting Japan with no view to selling in the near term as of time of writing. As this policy requires a weaker Yen, I entered into a currency hedged (against the USD) ETF tracking the Japanese market so that if the USDJPY goes higher we are happy. The price of the USD against JPY has increased 20% since we bought the ETF benefiting our overall result.

We also took a macro view on the US economy in 2014 and we were long an ETF which tracked industrial companies, especially ones which benefit from lower interest rates and higher government spending. The ETF was sold in 2015 to buy stocks following the value investing method, so we closed the position with a net result of +12%.

The approach of the fund has changed considerably with a much larger proportion of it in value investments so let's understand the following points – we like markets to fall as my interest in companies increases – companies with wonderful prospects have lower prices and therefore become invest-able to us. Generally we are confident in the long term prospects on earnings and very likely will be net buyers for a long period of time, therefore we are immune to short term price swings as it's only the longer term fundamentals which matter to us. We should ignore at all times market noise and researcher forecasts. Having said this, we do care about the company fundamentals changing, and if they have deteriorated then we need to be professional and sell if the analysis dictates it. Another reason that companies are sometimes mistakenly sold off is the irrational pessimism of the market or when overbought would be irrational optimism, which Benjamin Graham taught us is always present. It's important to mention as well that we will not forecast what the market would do next, instead we find cheap companies trading at a discount and expect that the share price will encounter its intrinsic value at some point in the future, therefore ultimately we should be prepared to face at any moment a fall of 50% of the entire fund - as we have seen the market has crashes (1929 -2000 – 2008, among others) and will continue to have them, but our margin of safety will enable us to remain patient and calm when these situations occur. In summary remember Buffett's rule number one: never lose money and rule number two: never forget rule number one.

For the Colombian partnership, we are very happy buying positions on two companies who we think have great fundamentals and strong earnings power, but are valued very cheap given the macroeconomic Colombian environment. We will continue buying through 2015/16 and if the price remains subdued through 2017 as well, though do not expect positive returns in the short term in the Colombian hub. For discipline purposes I will not disclose the stocks, once I sell the position a full review will be expressed.

We are lucky enough to encounter a market full of pessimism on the oil industry today, I will expand about this in next year's letter as positions in this industry have been acquired in 2015, but our partnership has encountered great opportunities in the oil sector. The oil industry is a very cyclical one. The world has had many oil shocks in the last century, this one is due to the increased supply of the US shale industry, as I will elaborate next year, but just a thought: under shale formations the decline rate of a well is very rapid, in 1 year the well is depleted approximately 75% and in 3 years is practically empty. This year the decrease in CAPEX in the oil industry is estimated to be around USD100 billion, and that's not including the decrease of drills, companies and analyst valuated oil companies assuming cash flows with an oil price at 42/50 range. How could anyone fail to see a marvelous opportunity here?

So what concerns me? The Chinese boom for a start – while the Chinese economy is growing at a rate of around 7% the stock exchange has doubled in the last year, and whilst there is no doubt there are a lot of opportunities here, I want to share some points to think about. In China the aggregate debt to GDP has quadrupled over the past decade, domestic credit has risen at twice the rate of money GDP growth, which only implies the Chinese are highly leveraged. An example of the dangers of this market is the unexpected plunge of 42% in one day of the stock of Hanergy Thin (there are more examples) or the collapse of almost 7% in one single day of the Chinese index without any major news at the end of May. The Chinese market is just a few years old, and people there have not experienced any major crashes. It was not around in 1929 or in the 1970's, and barely established in 2000, so it's any surprise they are overly optimistic with share prices climbing so quickly. I do not count the Chinese market in my circle of competence so I do not wish to involve it in our fund for now. Note that just the GDP growth of their economy during the last two and half years is equivalent to the entire output of the UK economy, so the market is full of opportunities – I just do not understand it well enough and dislike leveraged markets so for the time being am very happy not to include it in our fund.

Another concern is activists pushing for short term returns - a lot of companies in the US are being forced by activists to deploy money for an increase of dividends and/or share buybacks. This sometimes is the correct thing to do especially when the stock is trading below intrinsic value, however this practice cannot become fashion and sometimes is very dangerous as the stock can be trading way above intrinsic value and the money would be most needed in capital expenditures so the company can grow. On many occasions these activists are hedge funds pressured for the short termism of a higher stock price forcing the company to buy back shares, diverting the attention of management to this issue instead of running the operations of their company, which in the long term can be very dangerous. NB For more discussion on this issue I recommend you read Laurence Kink (Blackrock CEO) letter to S&P 500 CEOs).

My last concern is to be aware of new well known tech companies such as Uber, Xiaomi, Airbnb etc; if you do not find them overpriced then I wish you good luck. Uber's latest valuation was USD46 billion, the real equity funding was USD1.4 billion giving a valuation to funding multiple of 32.9. I just want to remind of the over optimism and speculation as Prem Watsa from Fairfax wrote in his letter to shareholders (actually this data is taken from his letter), this can only end as most speculations have ended and we know how that is.

I hope you understand how our partnership is run, be patient and I am pretty sure we will have a great result in the long run.

"Someone is sitting in the shade today because someone planted a tree a long time ago. "
-Warren Buffett

I think this tree was originally planted by Benjamin Graham and Warren Buffett, and we are here to enjoy the shade if we stick to their principles.

Jean Philippe Tissot Ayram