THE VISION TO SEE
UNREALIZED VALUE

September 5, 2019

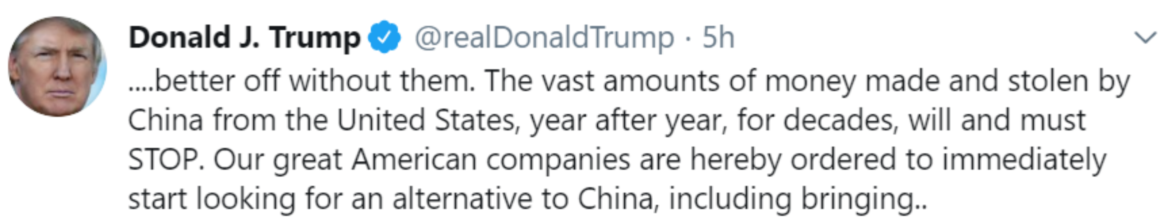
August Performance Update for LRT Global Opportunities, LP

Dear Friends & Partners:

If you are an accredited investor, please contact us for performance information.

August was a volatile month with many ups and downs. Most of the stocks in our portfolio declined, offset by a sharp rise in our US Treasury holdings. Besides our holdings in Treasuries, other notable winners during the month included NVR Inc. and Home Depot. Offsetting these were losses from Union Pacific, Ryanair and Colliers International. Our top equity positions at the end of the month are AutoZone, Inc. (AZO), Ryanair Holdings plc (RYAAY), NVR, Inc. (NVR), Colliers International Group Inc. (CIGI) and HEICO Corporation (HEI-A). Our five largest equity positions account for approximately 26.9% of our portfolio exposure.

August was a particularly volatile month on account of Donald Trump. Unstable policy with respect to tariffs and a cycle of seemingly endless tit-for-tat escalations frightened many market participants. I wish to draw your attention to one tweet in particular. On August 23rd, the US President, Donald Trump, said:

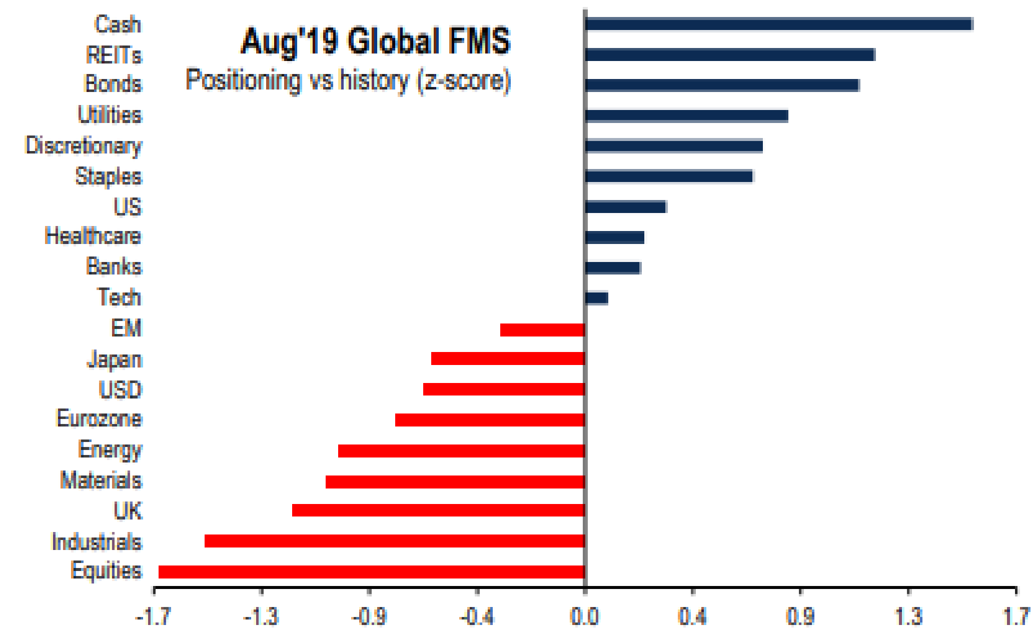


Having been born in a communist country and having seen how government ownership and management of companies affected the economy I find such rhetoric particularly disturbing. The prospect of politicians giving "orders" to private enterprises fills me with dread. The path to prosperity is business for the sake of business, not for the sake of government. Let us never forget that.

Recession Watch

Warren Buffett, in one of his earliest TV interviews, when asked about how to be a successful investor, remarked: "this is not a business where you take polls" – what he meant by this was that what mattered was the underlying value of the investment, not what anyone else thought about it. He was right figuratively, but boy-ohh-boy was he wrong in the literal sense! This sure is a business where one takes lots of polls! One such poll, is the monthly BAML investor sentiment survey. You can see the August results of this survey below.

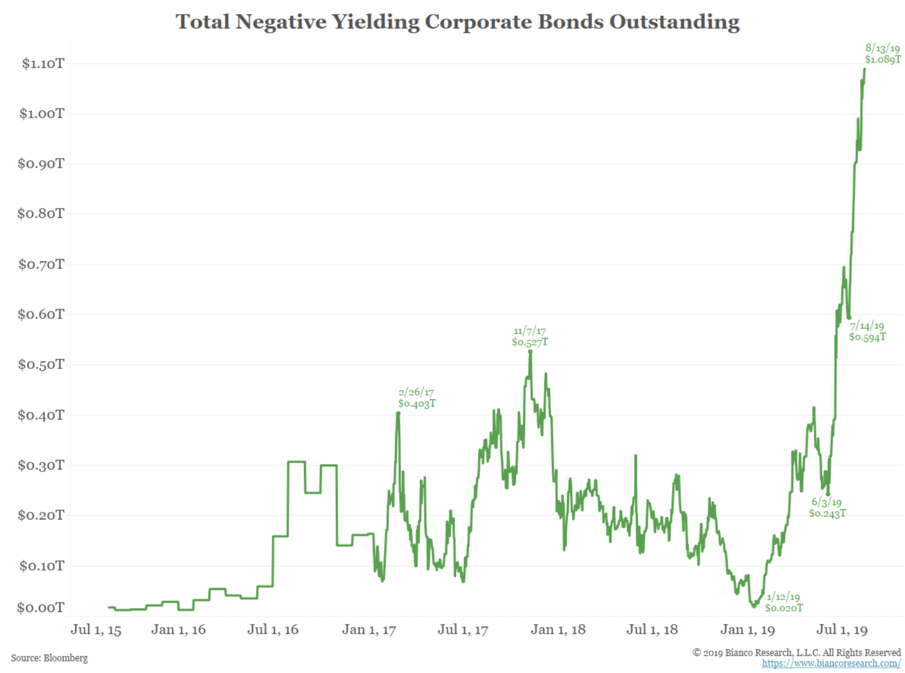
Exhibit 7: FMS investors still positioned for low growth & low rates



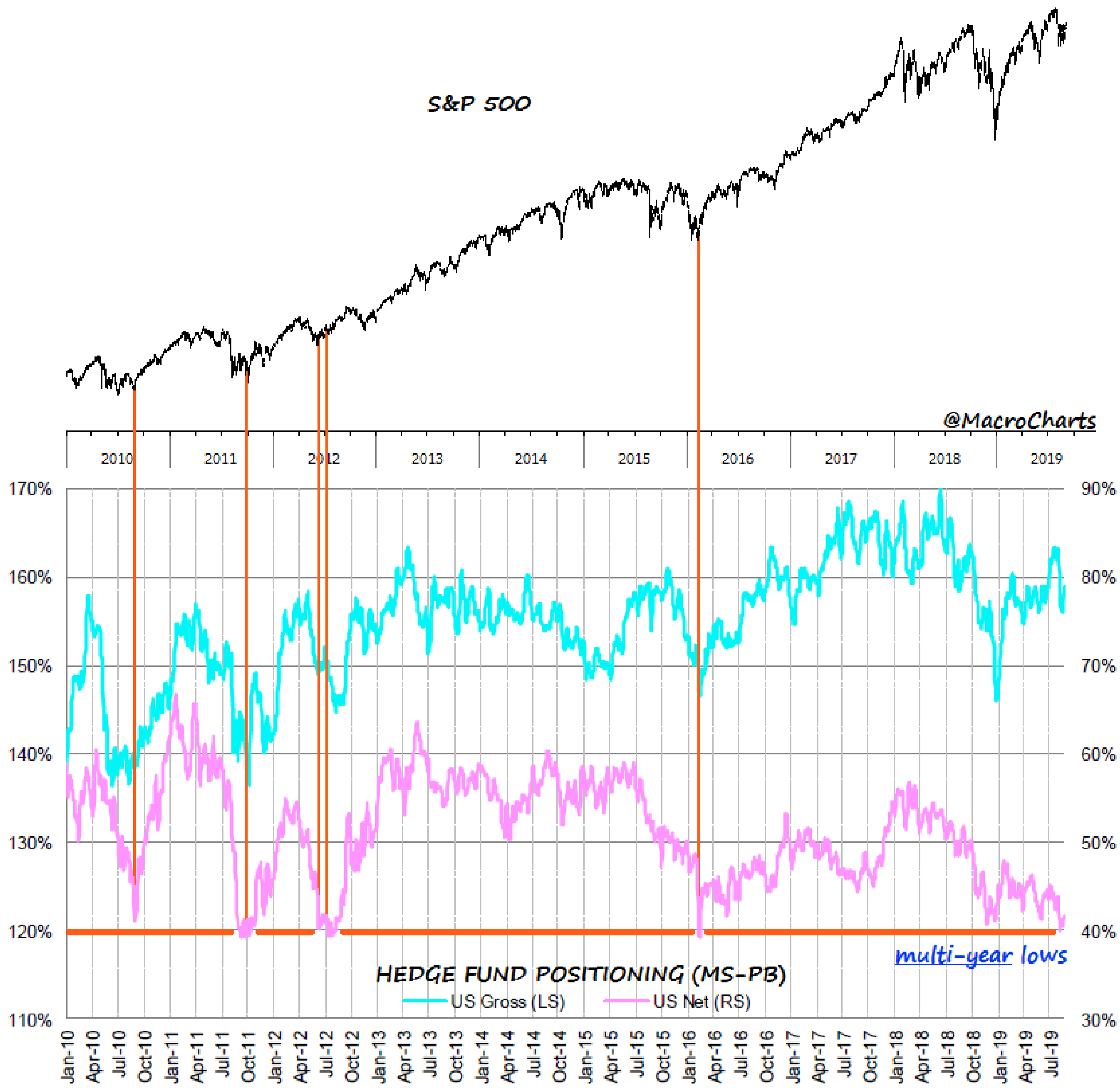
Source: BofA Merrill Lynch Global Fund Manager Survey

The results are clear: investors are massively overweight cash, bonds, REITs and Utilities, while being underweight overall equities, the UK and other cyclical sectors. Simply put, most investors are positioned for a recession. Despite the equity market in the US being close to all time highs, the majority of global investors are behaving as if a recession was just around the corner. The extraordinary rise of anything offering a yield, but especially long-term government bonds, during August is an indication that investors are preparing themselves for a sharp global slowdown in economic activity. Investors are seeking safety over growth.

In our July letter, we showed a chart of negative yielding global debt, which at the time stood at approximately $12 trillion dollars. During August, the stock of negative yielding debt has expanded to $17 trillion dollars. The sovereign debt of Germany and Switzerland offers negative yields at all maturities. Want to lend money to Germany for 30 years at -0.15% per year? Switzerland at -0.53%? But wait! There's more! Not only is there $17 trillion in negative yielding debt out there. There is now over $1 trillion negative yielding corporate debt! Ever wanted to pay for the privilege of lending money to corporations? Now you can.



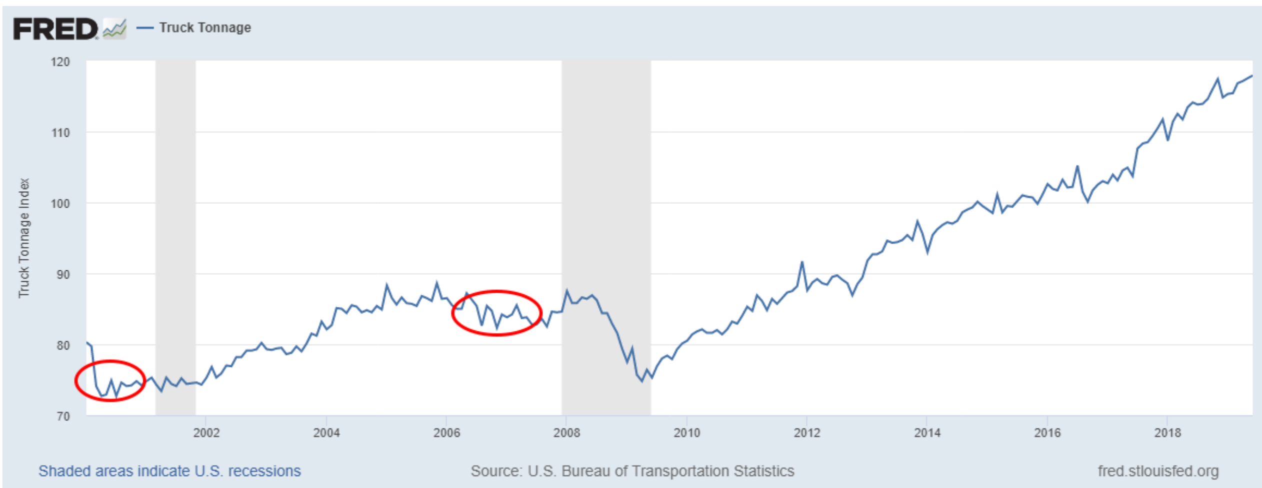
Confirming all this pessimism and negativity is hedge fund positioning which currently stands at the lowest net exposure in years – an exposure level that has historically marked market bottoms. Investors have sold positions, put on hedges and are bracing for a market decline. When positioning is extreme, as it is now, the markets are vulnerable to sharp and sudden reversals as sentiment shifts. To us that means a decline in long term bonds, a steepening of the yield curve, a selloff in interest rate sensitive stocks and an overall stock market rally. We believe that current market sentiment is extremely negative, despite the S&P 500 being close to its all-time high. Furthermore, we believe sentiment is a contrarian indicator – if a recession and a sharp fall in corporate profitability does not materialize, we expect money to flow back into the stock market pushing up prices between now and the end of the year.



This brings us to the question about the real economy: is a recession in the near future likely? If so, how might it unfold and which sectors will be high the hardest. There are currently two competing narratives about the economy. On the one hand, the US domestic economy is booming with very strong consumption growth. On the other, global economic growth is weak, US manufacturing is weak and US exports are even weaker. Which one will win out? Will the US enter a recession in the next twelve months?

Manufacturing in the United States is not a significant component of GDP, despite the disproportioned attention it receives from politicians. In 2015-2016, US manufacturing contracted, but it did not cause a recession – rather just a temporary decline in the rate of GDP growth. We believe the same will be true this time around. Furthermore, trade as % of GDP is approximately 15% of US GDP – the lowest of any country in the OECD. It is 30% in the UK, 42% in South Korea and 46% in Germany, and (coincidentally) 46% in the European Union as a whole. No wonder that the current global slowdown is affecting the EU much more than the United States.

When it comes to the US domestic economy, trucking tonnage is an indicator worth watching. If the volume of goods being shipped across the country declines, it is a good indication that businesses are seeing slowing demand. Is truck tonnage slowing? No, it is not. There is absolutely no sign of a slowdown. Until truck tonnage slows, we expect the economy overall to keep on trucking (pardon the pun).

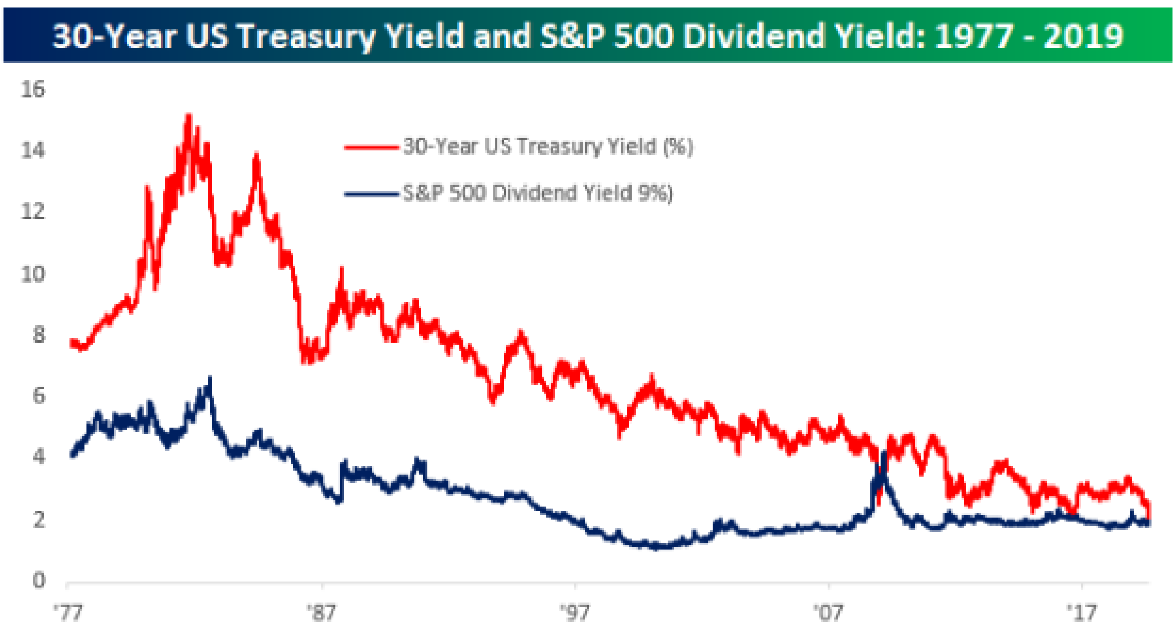


Finally, to demonstrate how strong the US domestic economy is, let's take a look at recent comments from US companies:

- Steve Bratspies, Chief Merchandising Officer, **Walmart (WMT)**, Barclays 2019 Global Consumer Staples Conference (9/4/2019): *"One of the things that we really focus on at Walmart and try to stay incredibly close to is the customer and really understanding their pulse and how they feel. And the good news is, right now all of our data and all of our surveys with our customers are saying that they feel pretty good about the economy and where they are."*
- Brian Cornell, Chief Executive Officer, **Target (TGT)**, Q2 2019 Conference Call (8/21/2019): *"On the topline, our business delivered second quarter comparable sales growth of 3.4%, driven primarily by traffic. This growth was on top of unusually strong comp growth of 6.5% in the second quarter last year, meaning that our comp sales have increased about 10% since 2017, our best two year stack performance in well over a decade."*
- Laurans A. Mendelson, Chief Executive Officer, **Heico (HEI)**, Q2 2019 Conference Call (8/17/2019): *"Business conditions and end markets we serve continue to be strong. While we haven't completed our budgeting forecast and process for next year, current business conditions at HEICO remain excellent. I mentioned in the last call that I had never seen business conditions stronger, and that has followed through in the third quarter, and we're very optimistic for the future."*

The US economy remains strong and we see a recession in the next twelve months as unlikely. Having said that, there are of course risks – but there are always risks. The question is: are you being compensated for taking those risks? We believe we are. In last months letter I mentioned that the S&P 500 was offering a forward earnings "yield" of 5.65%, which compared favorably with the 10 Year US Bond yield of 2.1%. Since then, the premium offered by stocks over bonds has increased further. The S&P 500 currently trades at an earnings yield of approximately 5.7%, while 10 Year US Bonds offer only 1.5% - a very large equity risk premium from a historic perspective. Such a high premium offered by stocks over bonds is unusual and has historically not lasted long. One of three things will likely happen soon: corporate profits will fall (unlikely without a recession), interest rates will rise (unlikely with central banks around the world all cutting rates), or stock prices will go up sharply.

From where we sit, the current market resembles 1998: emerging market concerns, FX issues, a mild yield curve inversion. During that year there was plenty of volatility, followed by the Fed offering a "midcycle adjustment", after which the international issues were resolved, and the stock market exploded higher. We can never be certain how things will play out, but we firmly believe that "risks" are currently to the upside.



Finally, let me leave you with one chart: the yield of the US 30 Year Bond compared to the dividend yield offered by the S&P 500. During August, the yield on the S&P 500 rose briefly above the 30 Year Bond Yield. The last time this happened was in March 2009. **The last time this happened, the S&P 500 rose by over 65% in the following twelve months.**

As always, I look forward to answering your questions.

Lukasz Tomicki
Portfolio Manager
LRT Capital

Appendix I: Investment Philosophy

In the past eighteen months we saw a large increase in the number of LRT Capital partners (the term we use to describe our clients). With so many newcomers, it is important that we write about our investment philosophy again.

Here are the key points:

- Exceptional stock returns come from exceptional business returns on a **per-share** basis.
- We seek to invest in high quality companies, i.e. those possessing sustainable competitive advantages (moats), the ability to grow and reinvestment capital over time, and management that excels at capital allocation.
- We only purchase companies whose shares trade at a discount to our assessment of their intrinsic value.
- It is futile to predict short term market movements. We seek to hold our investments for as long as possible.
- The financial markets are dominate by short term traders who see stocks as casino chips. This occasionally allows us to purchase shares in great companies at large discounts to their true worth.
- If we are right about the trajectory of the businesses we invest in, over time we will be right on the trajectory of their stock prices.

We view stock market volatility as a source of opportunity. Volatility allows us to profit by acquiring shares in superb businesses at attractive prices. The more that markets (the "other" participants) are irrational, the more likely we are to reach our ambitious performance objectives.

Over the long run, stocks are the best investment asset class, but our experience has taught us that our investment process will not generate linear returns. In some years, our portfolio will outperform and in other it will generate a below average return. This is a certainty that we must accept. We are long-term investors and we do not try to dance in and out of the market.

In summary, our investment strategy can be summed up in three steps:

- Only seek out high quality companies.
- Do not overpay.
- Do nothing – patience and discipline are the keystones to success.

Disclaimer and Contact Information

Past returns are no guarantee of future results. Results are net of a hypothetical 1% annual management fee (charged quarterly) and 20% annual performance fee. Individual account returns may vary based on the timing of investments and individual fee structure.

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