LRT CAPITAL MANAGEMENT

THE VISION TO SEE ECONOMIC MOATS

December 3, 2018

## November 2018 - Performance Update

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

Short-term changes in stock prices tend to be greatly influenced by emotions rather than reason i.e. fundamentals. In such climates, noise is pervasive which in turn produces higher levels of volatility, that can inflict temporary damage on a portfolio. During such times, the conviction of process and a commitment to consistent execution is more critical than ever to long-term portfolio performance, return realization and exceptional performance. This approach enables LRT to step into the market and buy, with confidence, when others are selling from fear. Baron Rothschild, an 18th century British nobleman and member of the Rothschild banking family, is credited with saying "buy when there's blood in the streets." The more recent iteration of that is by Warren Buffet, who said “'Be Fearful When Others Are Greedy and Greedy When Others Are Fearful'. AT LRT, we fully ascribe to that sage advice.

We refuse to be swayed by changes in sentiment, as we are acutely aware that over the longer term it is fundamentals that matter. With over 97% of companies in the S&P 500 having reported their Q3 results, earnings per share have risen by more than 33% over the prior year – an extraordinary performance. Counterbalancing that has been a sharp decline in valuations, as many investors expect earnings to have peaked and a recession to be imminent. At LRT, we are not macroeconomic forecasters and don’t think anyone can accurately and consistently predict the economic cycle. However, with that said, per last month’s letter, we see no signs of a slowdown in the data. As a result, we view the current disconnect between strong corporate performance and investor pessimism as a buying opportunity that positions LRT to generate strong portfolio performance ahead. Consequently, LRT has been net buyers of equities over the past two months.

## We Have Met the Enemy and He Is Us

Study after study has shown that most mutual fund investors realize returns far worse than the average return of the fund. How is that possible? Simple: They lack process and are undisciplined. Most investors try to time the market by buying into the fund after a period of short-term outperformance and they sell after a period of substantial underperformance. Yet as stated above by Rothschild and Buffet, the time to invest is when things look dire and prices are down, not after a big rally has occurred. Investors’ “instincts” i.e, emotions often serve to undermine achievement of investment performance. If you understand the strategy that you are pursuing and what you are investing in, most of the time the right answer is to do nothing. At the end of the day, the biggest risk to investment performance may be onesself.

Our goals at LRT remain consistent: To acquire shares in exceptional business, with moats, growth opportunities and intelligent management teams; and then to hold these positions for as long as our investment thesis remains in place. This requires conviction. We achieve that ability as a result of the considerable careful thought reflective of a rigorous investment process. It is during the holding of an investment when returns occur. It is this crucial aspect of the LRT process, that I focus my discussion.

For LRT, an ideal situation would be to acquire shares in an exceptional but unknown company and hold them long enough to see the government take action against it on antitrust grounds – something akin to owning Microsoft since it went public until the late 1990s. Since its IPO in March of 1986, until Dec 31st, 2000, Microsoft's shares returned 600x – for those that had the foresight to hold them that is.

Recently, I was discussing our investment strategy with an investor who quipped that I am just a "buy and hold guy". He didn't mean it as a compliment, but I took it as a positive. There is nothing easy about holding investments for the long term. Research reveals the one feature that is the basis for substantial wealth creation: Owning very high-quality assets for lengthy periods of time. Usually, these assets were highly illiquid businesses or real estate assets. Along the way, there were always reasons to divest – short term panics, recessions and other concerns. Yet those that persevered and held onto their assets triumphed in the end. In this manner, the illiquid nature of most private businesses and real estate is an advantage as it makes the temptation to sell easier to resist. Yes, the "illiquidity premium" is real!

Public market investors are in effect cursed by easy access to liquidity, which tempts them to sell, both in times of panic and in times of great prosperity on the bogus notion that "nobody ever went broke taking a profit". Taking a profit, when you don't need the cash and the original investment thesis remains in place is a road to ruin because it creates losses from lost opportunities and exposes the investor to re-investment risk. Can the proceeds be re-invested at the same or higher rates of return? These issues are of the most insidious nature because they don't show up directly in the P/L statement. Simply put, while everyone is constantly worrying about losing money on an investment, investors should also worry about the profit foregone, because they sold way too early.

At LRT we employ a business owner's mentality which helps us tune out distracting noise, allowing us to focus on the long-term fundamentals of the business – as opposed to the daily movements of stock prices. Our strategy remains to buy and hold our positions until our reasons for buying is no longer present. We would sell an investment for one of the following reasons:

- A company's business environment is deteriorating structurally, i.e., "it's moat is eroding".
- The company's management changes their capital allocation strategy by doing a "strategic" or "transformative" acquisition, i.e. "diworsification".
- Our investment becomes dramatically overvalued, **and** a substantially better opportunity is available.

Reasons other than those are not sufficient excuses to exit a position. Fears of a recession, a trade war or general market turbulence, are not reasons we would ever sell an investment. Selling something simply because the price is going down is not investing.

Investors are bombarded with news daily. Reasons to fear a market drop and sell your investments are reported ad nauseum. At LRT we have the conviction to stick to our investments in face of the deafening noise of Cassandras and financial news "experts". We do not believe we can dance in and out of stocks at precisely the right time and consistently enough to generate outperformance through market timing. In fact, we have yet to ever meet anyone who can do this. We do not believe that going in and out of the market in the hopes of capturing short term market moves is a sustainable investment strategy or that it is necessary to achieve extraordinary investment returns over the long term. Conviction enables us to remain fully invested holding exceptional companies through perceived "good" and "bad" markets.

## Holiday Cheers

This is my last letter to you all prior to the Christmas Holidays and I want to thank you for all your continued support. Over the past several weeks I have heard from many of you directly and I deeply appreciate your words of encouragement. A wise man once told me that all companies get the shareholder they deserve, and I believe the same to be true for investment managers. I could not have asked for better investment partners. In life and in markets luck often plays a role and I have been extraordinarily lucky. I am especially grateful for all the people who have taken the time to mentor me over the years. I would not be where I am in life today without your help.

This holiday season, my family and I are leaving for Europe in mid-December and returning to the US by the end of the month. To my wife's chagrin I will be taking a stack of financial reports with me, as my list of investment ideas requiring further due diligence remains deep. I will also be taking with me a new book titled "Railroader: The Unfiltered Genius and Controversy of Four-Time CEO Hunter Harrison" – a biography of the late Hunter Harrison, a CEO extraordinaire who ran Canadian National, Canadian Pacific Railways, and most recently was CEO of CSX. I encourage everyone to read it and learn more about his remarkable life story.

This year we welcomed several new investors into our partnership. I want to thank everyone who has referred new relationships to us this year. If you know of others who might share our investing beliefs, I welcome the opportunity to discuss the LRT approach in more detail. I value and respect the trust you have placed in me as a steward of your wealth. Candidly, that perspective is the foundation of my daily commitment to deliver on the LRT promise to each of you. In closing, I appreciate the opportunity to serve as your General Partner and look forward to many good years ahead. I can say unequivocally: "Life is truly rich".

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