July 1, 2019

June 2019 - Performance Update

Dear Friends & Partners:

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

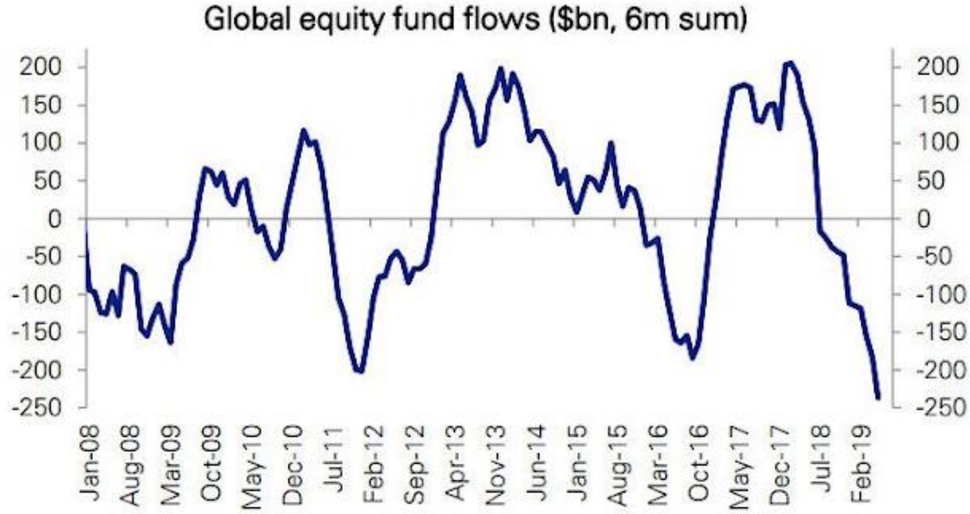
Our investment partnership experienced another positive month driven by strong gains across the portfolio. All of our investment positions continue to perform well with one big exception – Ryanair, a controversial company that continues to face a difficult operating environment. While the current outlook is bleak we continue to expect the company's fortunes to turn around and the stock to deliver handsome gains for our Partnership in the years ahead. Overall, we are happy with the results of the first six months of 2019 but **please, please, please** do not take these returns for granted – there will be some losing months in our future (we guarantee it). During June were net buyers of equities and marginal sellers of bonds. Our top equity positions at the end of the month are AutoZone, Inc. (AZO), Ryanair Holdings plc (RYAAY), Danaher Corp. (DHR), Colliers International Group Inc. (CIGI) and NVR, Inc. (NVR).

Markets rose broadly during the month of June – to the surprise of many professional investors who remain firmly bearish, expecting a recession to emerge soon. The recent Bank of America Merrill Lynch investor survey results speak to the degree of pessimism and defensive positioning amongst investment professionals.

Exhibit 8: FMS investors positioned for low growth & low rates

Source: BofA Merrill Lynch Global Fund Manager Survey

Figure 2: Equity outflows over the last 6 months now the largest on record in dollar terms...



Source : Deutsche Bank Asset Allocation & Delta-1 Strategy, EPFR, Haver

Global investors have been selling equities over the past eighteen months in preparation for a global recession. Should a recession not materialize, large amounts of money will be forced back into the market, as investment managers will chase their respective benchmarks. Most of our portfolio companies continue to report record profits and speak of an incredibly strong economic environment. What we hear from our portfolio companies is in stark contrast to the fears and negativity we hear from the press and other investors. We believe that markets tend to do what will hurt the greatest number of people the most. Given the current market positioning, we believe that the path of least resistance for risk assets is firmly up. An additional 10-15% rise in the US stock market driven by a cyclical upswing in the economy by the end of the year would be a scenario that almost no investor today is prepared for.

Exhibit 30: Net % AA Say they are overweight Equities

Source: BofA Merrill Lynch Global Fund Manager Survey

Stock prices follow corporate earnings. We are comfortable with our exposure to equities because the macro economic data does not support a looming recession. Without a meaningful decline in corporate earnings, we see the stock market as likely to continue its upward momentum. At the same time, investor sentiment remains extremely pessimistic. In simple terms, while we can never fully discard the possibility of a recession, the disconnect between the positive macro data and the broadly negative investor sentiment presents an opportunity for profit. Smart investors should discount the obvious and bet on the unexpected. To us the unexpected means a continuation of the US economic expansion.

How will you feel if the market continues to rise over the next three years without a bear market? We believe a market "melt-up" is ahead of us. Is that a scenario you are prepared for?

A Day at The Beach or How to Think about Losses

Given our strong performance year-to-date the title of this heading may sound strange, but we believe that now, during a period of strong performance, is the perfect time to psychologically prepare for the possibility of losses ahead. Trees don't grow to the sky and stocks don't go up in a straight line. While we remain constructive on equity markets overall and are always focused on the long-term, significant volatility could emerge at any moment. With that in mind, we want to give you a template of how to think about short-term losses.

Not all losses are equal. If one pursues a short-term trading strategy, where every lost or gain is independent of each other, then every dollar lost must be gained back according to the same strategy. In such a strategy, losses are very painful because every loss requires a larger gain to follow it just for the investor to break even. A decline of 20%, for example, requires a 25% gain to break even. A 33% decline requires a 50% gain to break even. A 50% decline requires a gain of 100% just to get back to break even. Every loss decreases the actionable conviction that an investor has in their strategy. Furthermore, every loss reduces the investor's bankroll and his ability to take risks. But this is not our strategy. We are not short-term traders but long-term investors in businesses. For us, volatility is not risk, but rather a source of opportunity.

We focus on company fundamentals. Each day the value of our portfolio companies grows a little. The stocks of our companies jump around much more than the underlying value of the businesses, but over the long-term stock prices follow the intrinsic value of companies closely – however measured: by earnings, cash flows or hard assets. During a period like we experienced in Q4 2018, when we believe the intrinsic value of our portfolio companies rose, but their market value fell, the probability and magnitude of future gains in stock prices increases. Fundamental investing in companies is like playing with a beachball in the ocean – the harder you press it under the water, the greater the strength with which it will rebound. You can hold the ball under the water for some time but as the tide (intrinsic value of the companies) rises, so does the force with which the ball will rebound. In other words, periods of gains and losses are not independent. The tide rises steadily, while the beachball (stock prices) often bobs around dramatically, but over time the rising tide lifts any buoyant object. The strong results we experienced in the first half of the year are partially a result of the poor performance during the last quarter of 2018.

Losses are never pleasant, but they are a part of life when it comes to investing. You should not fear short-term losses but rather expect them to occur occasionally and see them as a source of opportunity: an opportunity to invest more at bargain prices. Savvy investors increase their commitments during periods of short-term volatility. If the investment strategy you follow is sound and consistently executed, you can be sure that losses will be made up by strong gains in the months ahead. While we can never predict the future, a consistent and rigorous execution of our investment strategy is something that we can promise you. Our results over the past year reflect that.

We thank you for your continued interest, trust and the opportunity to managed some of your hard-earned savings.

As always, I look forward to answering your questions,

Lukasz Tomicki

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 reinvest 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 dominated 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 others 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.

Appendix II: The Bubble Basket

We began our Bubble Basket experiment on 3/1/2019. See our February 2019 letter for more information. We assume an equally weighted portfolio and will update the portfolio's hypothetical performance each month. We posit that investors are paying too much for the glamour of fast-growing SaaS businesses and will earn subpar returns as a result. We expect the portfolio to underperform the S&P 500 over the next three years, with significantly higher volatility. We removed Ultimate Software, Inc. (ULTI) from the basket due to a takeover and replaced it with New Relics (NEWR).

The companies in the Bubble Basket are: Benefitfocus, Inc. (BNFT), Box, Inc. (BOX), Coupa Software Incorporated (COUP), salesforce.com, inc. (CRM), Cornerstone OnDemand, Inc. (CSOD), Tableau Software, Inc. (DATA), DocuSign, Inc. (DOCU), Domo, Inc. (DOMO), Eventbrite, Inc. (EB), HubSpot, Inc. (HUBS), Instructure, Inc. (INST), LogMeIn, Inc. (LOGM), Medidata Solutions, Inc. (MDSO), New Relic, Inc. (NEWR), ServiceNow, Inc. (NOW), Anaplan, Inc. (PLAN), Qualys, Inc. (QLYS), RingCentral, Inc. (RNG), RealPage, Inc. (RP), Rapid7, Inc. (RPD), Splunk Inc. (SPLK), SVMK Inc. (SVMK), Atlassian Corporation Plc (TEAM), The Trade Desk, Inc. (TTD), Twilio Inc. (TWLO), 2U, Inc. (TWOU), Veeva Systems Inc. (VEEV), Workday, Inc. (WDAY), Wix.com Ltd. (WIX), Zendesk, Inc. (ZEN). The bubble basket is not rebalanced.

	Bubble Basket (1)	**S&P 500 Total Return (2)**	**Difference (1-2)**
March, 2019	+0.63	+1.81	(1.18)
April, 2019	+5.03	+4.09	+0.95
May, 2019	(4.37)	(6.38)	+2.01
June, 2019	+3.45	+6.44	(2.99)
Since inception	+4.56	+5.98	(1.41)

	Standard Dev	**Sharpe ratio**
S&P 500 Total Return	19.34%	0.27
Bubble Basket	14.30%	0.26
Risk free rate	2.50%	
Months	4	

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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