

December 2, 2019

**November 2019 - Performance Update**

Dear Friends &amp; Partners:

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

November was another positive month for our investment strategy with broad gains across the portfolio. Notable winners during the month included Ryanair (RYAAY), UnitedHealth Group Incorporated (UNH), and Fiserv, Inc. (FISV). Offsetting these were losses from AO Smith Corp. (AOS) and The Home Depot, Inc. (HD). Our top equity positions at the end of the month are Ryanair Holdings plc (RYAAY), AutoZone, Inc. (AZO), NVR, Inc. (NVR), UnitedHealth Group Incorporated (UNH) and Colliers International Group Inc. (CIGI). Our five largest equity positions account for approximately 27% of our portfolio exposure.

We continue to welcome new investment partners to our fund and increase our assets under management. We highly encourage all investors to review our “Investment Philosophy” found at the end of this letter. Since the beginning of the year, **AUM has more than doubled** and we have a robust sales pipeline. On November 11<sup>th</sup>, we were featured in an [interview with Matthias Knab on Opalesque TV](#)<sup>1</sup>. This extra publicity, coupled with strong performance, and winning the [Context 365 “Best Emerging Manager”](#)<sup>2</sup> award has led to strong inbound interest from prospective investors. During the past three months we have engaged in a large number of very productive conversations with foundations, family offices, and some of the largest and most sophisticated institutional investors in the United States. For more information, or to schedule an introductory call, please reach out to Ben Turk – Head of Business Development at [bdt@lrtcapi.com](mailto:bdt@lrtcapi.com).

We are continuously reinvesting in our business, and with asset growth has come personnel growth. During the month of November, we welcomed to our team Gulseren Mutlu as a new investment analyst. Prior to joining LRT Capital, Ms. Mutlu conducted academic research in economics, was published in peer-reviewed journals such as Strategic Entrepreneurship Journal (Financial Times top 50 journal) and Economics Letters, and has more than 10 years of experience teaching economics classes at universities all over the world – including Stern School of Business, McCombs School of Business, City University in Hong Kong, and Bogazici University. Ms. Mutlu holds a Ph.D. in Economics from New York University and a Bachelor of Arts in Business Administration from Bogazici University.

For those of you keeping track, the LRT Capital team has now grown by +200% this year 😊. We are also currently interviewing for an additional investment analyst and CFO position. We expect to welcome two additional team members in the next few months ahead. If you would like to be considered, or know

<sup>1</sup> <https://www.opalesque.tv/hedge-fund-videos/lukasz-tomicki/1>

<sup>2</sup> <https://www.prnewswire.com/news-releases/context-summits-announces-winners-of-annual-365-awards-300932929.html>

someone who would potentially be a fit, please have them submit a resume and cover letter to [careers@lrtcapiatal.com](mailto:careers@lrtcapiatal.com).

Finally, due to multiple requests from both current and prospective investors, we are launching a second strategy – the **LRT Market Neutral Strategy**. The strategy will have a very low net dollar exposure (10-15%), and zero beta exposure to the S&P 500. The Market Neutral Strategy will feature a similar asset selection process to that employed by the LRT Economic Moat Strategy, but a different portfolio construction approach, focused on minimizing volatility and market correlation through index-based hedging and optimization techniques. It is important to note that because the long positions will be similar to the LRT Economic Moat Strategy, there will be absolutely no negative impact or drag on the flagship strategy / fund – requiring no additional time from our investment team. Also, the same portfolio construction process will take place via our proprietary allocation system – only using a different hedging strategy to optimize for a market neutral portfolio. If you are concerned about the extended bull-run of the stock market, or simply want a low-net exposure strategy, we believe the LRT Market Neutral Strategy may be for you. We expect the strategy to deliver a Sharpe ratio close to 3 with extremely low volatility and no broad market correlation. The strategy is launching on January 1<sup>st</sup>, 2020. Stay tuned for live trading results starting with our January update. Should you be interested in more information on the LRT Market Neutral Strategy and reviewing our simulated results, please contact Ben Turk, at [bdt@lrtcapiatal.com](mailto:bdt@lrtcapiatal.com).

## The Road Ahead

With the US stock market at all-time highs, now is the time for caution and a reflection on the topic of risk. Recent weeks have been particularly calm, but volatility can return at any moment. There are clear signs of exuberance and excess that are being largely ignored by investors at the moment, but which could quickly cascade into a larger issue. We would like to flag just a few for your attention:

- The ongoing trade dispute with China<sup>3</sup>
- The global manufacturing slowdown<sup>4</sup>
- Obscure repo financing problems<sup>5</sup>
- Greedy venture capitalists<sup>6</sup>
- The flops of major IPOs – Uber, Lyft, WeWork<sup>7</sup> ([see our video on Uber filmed prior to the IPO](#)).

In isolation none of these would be a major worry but taken together and coupled with the market making new all-time highs, they are a cause for concern. Investors appear to have thrown all caution out of the window. Managers who have been underweight stocks all year are throwing in the towel and chasing the market indexes.<sup>8</sup> This, of course, should come as no surprise to careful readers of our investment letters as we wrote in our June update to you that we believe a market “melt-up” is ahead of us.<sup>9</sup>

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<sup>3</sup> <https://www.theguardian.com/business/2019/nov/08/trump-quashes-hopes-of-early-resolution-to-us-china-trade-dispute>

<sup>4</sup> <https://www.wsj.com/articles/global-trade-set-for-weakest-year-since-crisis-11569924455>

<sup>5</sup> <https://www.cnbc.com/2019/10/22/fed-repo-worries-continue-over-the-efforts-to-fix-funding-issues.html>

<sup>6</sup> <https://www.cnbc.com/2019/10/06/bill-gurleys-plan-to-move-from-tech-ipos-to-direct-listings.html>

<sup>7</sup> <https://www.businessinsider.com/wework-ipo-fiasco-adam-neumann-explained-events-timeline-2019-9>

<sup>8</sup> <https://www.bloomberg.com/news/articles/2019-11-08/get-ready-as-beta-chasing-stock-managers-try-to-make-up-ground>

<sup>9</sup> <https://www.lrtcapiatal.com/wp-content/uploads/2019/11/2019-06-June-Performance-Update-Public.pdf>

Our extremely strong investment performance during the past twelve months should not be extrapolated into the future – our long-term track record is excellent, but it is comprised of a mix of great, and not so great, performance periods. Do not panic or lose faith if the next twelve months are not as good as the previous twelve. Instead of market timing, we believe that investors should identify a sustainable, repeatable, and predictable investment strategy, like the one we employ at LRT – and stick to it. We are constantly monitoring our portfolio to proactively identify threats to our continued performance.

With that in mind, and since this is the last time you will hear from us before the end of the year, we want to give you our perspective on how to think about risk in investing. It is important to distinguish between risk and uncertainty. Uncertainty refers to a set of unknown outcomes with unknowable probability distributions, while risk refers to future outcomes where the probability distribution can be established. At LRT, for example, we believe that most macroeconomic variables such as currency prices, commodities and future interest rates are completely unknowable. By contrast, while investing in individual companies is “risky”, we believe we can develop estimates of the future profitability of many companies by anchoring our reasoning in a number of key variables that are likely to affect future corporate performance. Furthermore, we believe that our understanding of industry and company dynamics gives rise to well-bounded forecasts and future estimates. By focusing on **knowable information**, such as the value of products to customers, competitive industry dynamics, and the degree of supplier concentration we can make reasonable judgements about future levels of profitability. This information is both knowable and forward-looking, and thus more useful than even decades of historical data, especially when industries are undergoing changes. As we like to say at LRT, information is about the past, insight is about the future.

We believe investors focus too much of their attention on variables that are truly unknowable – next quarter’s EPS or future interest rate policies, while spending too little time on projections that are subject to risk but derivable from knowable information that can be obtained from industry participants and public sources. Barriers to entry, business operating leverage and the degree of industry consolidation are all important variables that help inform our analysis of companies and industries. We believe that it is on the understanding of these crucial facts that investors should spend most of their time.

Secondly, while we spend most of our time on identifying qualitative insights about businesses, we do not ignore the quantitative aspect of risk management. At LRT, we employ a unique combination of discretionary and qualitative asset selection with a quantitative and systematic risk management process. We execute our risk process using a set of proprietary tools we have developed internally over many years. By utilizing US Treasury bonds as part of our risk management process, overweighting lower volatility securities, and determining the position sizes based on systematic risk factors, we have managed to achieve a very high Sharpe (risk-to-return) ratio in our Economic Moat Strategy. We recently produced a video showing in detail the proprietary tools that we utilize – please contact Ben Turk ([bdt@lrtcapi.com](mailto:bdt@lrtcapi.com)) if you would like more details about this process or would like to view the video.

Finally, we want to thank you for your continued trust, support and the opportunity to manage your hard-earned savings. We wish you a warm Christmas Holiday Season and a prosperous year ahead. And, as always, we look forward to answering your questions.



**Lukasz Tomicki**  
Portfolio Manager  
LRT Capital

## Appendix I: Investment Philosophy

In the past twenty-four 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.

## **Disclaimer and Contact Information**

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