MONOCLE

WE LOOK CLOSER

November 05, 2019

Dear Investors,

As at September 30, Monocle (A share) was +6.69% over 2019 and +4.25% on an annualised basis over 5 years.

The breakdown of performance over the quarter is as follows:

Category	Contribution
Bonds	+0.4%
Equity	+0.1%
Hedges	-0.1%
FX	+0.4%
Fees	-0.3%
Total	**+0.5%**

As regards the markets, at the beginning of November:

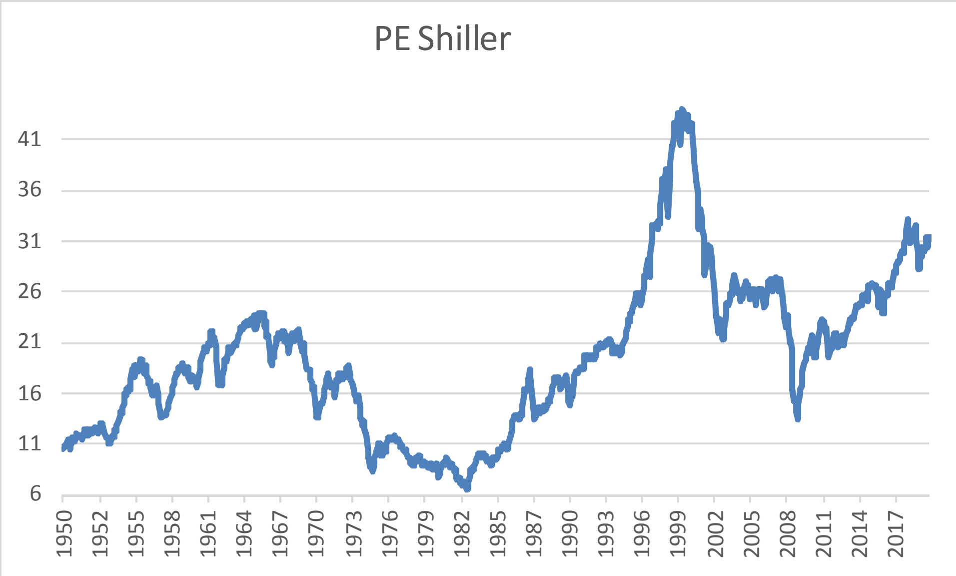
- Equity indices rose slightly over three months: +2.5% for the SP500, +4.0% for the CAC40.

- Long-term rates (10 years) are unchanged: US 1.6%, FR -0.1%.

- Gold is up ($1509, +6%).

- Oil is unchanged ($56 per barrel).

On the other hand, the 3rd quarter results are out (operating results) and they are down (-4% for US equities) compared to last year. This is the third consecutive quarter of decline. Among other things, Amazon is down 15% year-on-year and Apple is down 3% year-on-year. The first one is paid 80 times the results, the second 22 times (compared to 17 times a year ago and 14 times 3 years ago): it is expensive.



The graph above shows Shiller's PE for the SP500 index since 1950. It is calculated by dividing the market capitalization by the sum of the results over ten years, in order to compare, at a given time T, the valuation with the historical results over a full economic cycle. We can see that, except for the 2000 bubble, we are at a historic high: the index has been above 30 for the past two years, i.e. 50% above its average over the period.

For us, this price level is generally prohibitive because, as a minority and passive investor, our main protection is the price we pay. If you agree to pay too much, if everything goes well, you mathematically reduce future returns; if it goes wrong, you significantly increase the risk of capital loss. For the past two years, apart from certain moments of tension such as the end of 2018, we have not found any stocks of correct quality at reasonable prices.

And unfortunately, the observation is the same for other asset classes: the introduction of negative rates by central banks has forced investors to buy riskier assets to earn returns, driving up prices everywhere.

Ray Dalio, the president of Bridgewater, the world's leading hedge fund, wrote it yesterday in a pessimistic article:

« Financial asset prices have risen sharply and expected future returns have fallen sharply, while economic growth and inflation remain sluggish. These strong price increases and the resulting low expected returns are not only true for bonds; they are also true for all other asset classes, although the low expected returns on these assets are not as visible as those on bonds because they are not "displayed" as for bonds. As a result, their expected return is left to the investors' imagination.

Because investors have so much money to invest and because of the past successes of the shares of revolutionary technology companies that are doing so well, there has never been so much of companies, except during the Internet bubble, that do not need to make a profit or even show how they will make a profit in the future to sell their shares».

To be precise, over 2018, 16% of US IPOs were profitable. The only two years where this figure is lower are 1999 and 2000 with 14%. Even in 1998, 36% were profitable. And this figure has deteriorated recently: it was still 29% in 2016 (source: Ritter).

As a result, we find ourselves with players who hold riskier assets than in the past at higher prices. Already, mathematically, we are reducing future returns by paying more today. But more importantly, what will happen in the event of a recession? In 2007, Chuck Prince, the head of Citigroup, said: "When the music stops, it will be complicated, but as long as the music continues you have to dance. Right now, we're still dancing." Two years later, the Citigroup share had lost 90% of its value and it never recovered.

For our part, we prefer to wait for better days. We don't know how long it will last, but I think we're closer to the end now. Wework is the first of the stars to have fallen apart in October, with the cancellation of the IPO which was planned for a value of $80 billion and refinancing for a value of $8 billion a month later, a decrease of -90%. I think others will follow.

In March 2000, the Wall Street Journal headlined "The Nasdaq takes off and sets a new record". It was time to sell, not buy. The title of the newspaper today: "American indices at their highest".

Thank you for your trust and kind regards,

Review of operations

1) Barrick Gold (closed line, contribution for the quarter : +0.1%)

At the end of July, we closed our Barrick line, selling the last ones at +55% above our entry price a year earlier. In the meantime, gold has certainly taken 20%, but Barrick's operational performance has deteriorated and the merger with Rangold has made reading more complex.

2) Brembo (closed line, contribution for the quarter : +0.3%)

Brembo is an Italian company, world leader in braking. The stock had dropped to an attractive purchase level by mid-August when we returned. It bounced back quickly with the rest of the automotive sector, recovering 15%, without any fundamental elements. The automotive market has been driven by China in recent years, but this growth is now behind us (2019: -12% in volume). So we preferred to be cautious and take our profits.

3) Gam (closed line, contribution for the quarter : -0.3%)

We closed our GAM line at the beginning of July. If the decline we expect in the equity markets materializes, it will be more appropriate to come back after this.

4) Gamestop (closed line, contribution for the quarter : +0.1%)

The Gamestop shares reached a low of $3.20 on August 15. At this level, we have strengthened the line, considering that the 60% decrease since the announcement of the dividend cancellation was exaggerated. The stock resumed 40% in the following month, allowing us to close the line at a more reasonable level.

5) Bond DIA 1.5% July 2019 (closed line, contribution for the quarter : +0.1%)

Our DIA bonds were repaid at maturity on July 22nd at a nominal value of 100. We bought DIA around 70 in December. The impact on the quarter is small because the bond was already valued at 98 at the beginning of the quarter.

6) Bond Tesla 5.3% August 2025 (closed line, contribution for the quarter : +0.1%)

Our long-term view of this bond has not changed: we believe that the risk is low. But as explained above, we believe that the fall of Wework may lead to tensions in the credit market for companies that consume a lot of cash, such as Tesla. So we preferred to take our profits ($600,000 in 4 months), to be able to return if the price becomes attractive again.

Custodian	Credit Suisse
Auditor	Funds : Grant Thornton
Class A - standard share	ISIN Code : LU1116040533
Maximum fixed management fee	0.95% including VAT of net assets
Class B – retail share	LU1500599094
Maximum fixed management fee	1.50% including VAT of net assets
Performance fee for A & B units	10% above European inflation + 1%
Minimum initial investment A share	€ 100 000
B share	€ 1 000
Minimum subsequent investment A share	€ 10 000
B share	€ 1 000
Net asset value	Weekly, every Friday ("Valuation Day") or the previous Business Day if this Friday is not a business day in Luxembourg

* since July 21, 2015

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