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Dear Investors,

Attached, you will find the semi-annual report for the year 2016 provided by our sub-advisor JMX Capital GmbH for the sub-fund „Truffle".

Kind regards,

Investmentaktiengesellschaft für langfristige Investoren TGV

Semi-Annual Report 2016 of the Sub-Advisor

Dear Investors,

The last six months were defined by high volatility in the global stock markets, leaving the price level of the investments within the TGV Truffle on June 30, 2016, approximately at the same level as at the beginning of the year. In the operational business of the companies, only a few notable developments have taken place, and there were no significant changes in the portfolio of the TGV Truffle.

Only with its takeover bid for LinkedIn, Microsoft sprung a bit of a surprise. In my opinion, the acquisition makes a lot of sense for Microsoft. The company is currently switching its product portfolio from one-time license to a subscription model and thereby represents the vision of being the central "productivity partner" for users. Nowadays, an important element of the holistic range of productivity software includes a decent telephone solution. For Microsoft, this element is represented by the Skype product range. LinkedIn is an excellent additional component for Skype, e.g. when upon receiving a call in the call center, the call sign is accompanied by the LinkedIn profile of the caller popping up on the agent's screen.

In addition to the strategic value of the acquisition, I consider especially Microsoft's capital allocation appropriate. The purchase price seems reasonable (even without its association with Microsoft, LinkedIn is a profitable company with strong growth) and Microsoft will finance the acquisition mainly using debt capital, borrowed at the currently extremely low interest rates. In my view, the shares of Microsoft have therefore become a bit more valuable following the announcement of the takeover of LinkedIn.

Measuring and weighing

Analogous to prior reports, please find the most important portfolio and performance data about TGV Truffle in the following table.

NAV as of 06/30/2016 in EUR	86.89
Total number of investments	10
Weighting largest investment	15.1%
Weighting of the top 5 investments	66.3%
Weighting cash / fixed deposit	0.1%

Alphabetical Listing of Top 5 Investments:

Alphabet

Leucadia

Microsoft

National-Oilwell Varco

Rolls-Royce

Period	TGV Truffle	Berkshire (in EUR)	*Difference*	6% p.a. Benchmark	*Difference*
Since 04/01/2015	-13.11 %	-3.54 %	*(-9.57 %)*	7.57%	*(-20.68%)*
Since 01/01/2016	-0.72%	7.27%	*(-7.99%)*	2.95%	*(-3.67%)*

Since the TGV Truffle was fully invested shortly after its launch and there have been no significant changes within the portfolio, I am often asked what I am doing all day. What more is there to do, when all shares are purchased, and all capital is invested? Generally speaking, traditional standards of productivity don't apply to my workday. In most occupations, the traditional definition of a productive workday can be measured by how much output was produced.

A salesperson sells products, a doctor treats patients, and a lawyer writes legal opinions. In all these cases, even an outside observer can get a clear impression how much work has been done in the respective profession. In my profession, however, nearly everything revolves around questioning the original hypotheses behind investment decisions and continuously collecting information that contests these theories.

For me, it is a good workday if I can dispel an investment idea of the past, or have found a creative way to pit one of my key assumptions against reality. During one of his legendary general meetings, Warren Buffett was asked whether his success needed to be put into perspective, since it is essentially based on only a few major investment decisions (which, however, could have been mistakes). Buffett replied that every day he is holding a share, he is making an active decision not to sell it.

After making an investment, it is, therefore, crucial to ponder every aspect of an investment decision continuously. All investments in TGV Truffle share a capable management team of integrity, structural growth trends, sustainable competitive advantages, and an attractive price. The latter attribute can be validated quickly by looking at the share price. Since I do not tend to determine the value of a company to the second decimal place (because that simply would not make sense), I can always roughly assess the criterion of "attractive price". I like to approach this like a swimmer who is testing the water temperature: the exact temperature of the water does not matter. What matters is whether it is too cold or warm enough.

Unlike with the daily pricing of listed companies, for the criteria ”capable management team of integrity" and "structural growth trends" I conduct a much more gradual review of the initial hypotheses. Even though I spend considerable time to get to know the management teams better and to assess their decisions, drastic changes of my assessments are relatively rare. When it comes to my long-term growth assessment, sudden changes or shifts of opinion are equally rare. The growth of Rolls-Royce depends on the inclination of the world's population to do long-distance travel. Google benefits from an ever-higher Internet usage for more and more activities of daily life. Aggreko benefits from the continuously growing need for stable power supply in developing countries. These are all fairly basic factors, but their appeal lies in the almost mundane obviousness of the assumption.

The crux is the criterion "sustainable competitive advantage". Let us take Google as an example: few observers will question the increasing internet use, but an excellent question would be if the products Google is offering are still going to play the same important role in 2025 as today. Therefore, it is not surprising that a significant portion of my day is set aside for the ongoing assessment of the competitive advantages of the companies in TGV Truffle's portfolio.

Why is a sustainable competitive advantage so important?

Taking advantage of opportunities is a basic principle of capitalism. If I sell waffles at a market and make a lot of money that way, soon other market participants will appear who want to offer waffles as well in order to tap into my source of net value creation. This results in increased competition, which leads to reduced prices and/or better waffles. The consumer benefits in both cases and the waffle producers achieve an at most average return on the deployed resources. The vast majority of activities in the business world rather takes place at an efficient price, i.e. if a new party enters into the existing market, achieving an excess return is rarely possible in the long run. Peter Thiel writes about this in his (highly recommended) book "Zero to One":

„Tolstoy opens Anna Karenina by overserving: ‚All happy families are alike; each unhappy family is unhappy in its own way.' Business is the opposite. All happy companies are different: each one earns a monopoly by solving a unique problem. All failed companies are the same: they failed to escape competition."

They failed to escape competition – they failed to outsmart their competition. Let us apply this to the example of our waffle vendor: he had no way of protecting himself against competition on the market. The TGV Truffle, however, strives to include only "happy companies". In this context, Warren Buffett is speaking of the concept of "moats" that protects the company against eager competitors.

There are several factors that can create such a moat. Many of these competitive advantages are subject to fairly simple logic. For example, the economies of scale: Mathematically, there can only be very few manufacturers of aircraft engines, as the costs of development and regulatory approval are extremely high. The manufacturer requires a sufficiently large sales volume that makes the development of a new product lucrative in the first place.

Brands are also often a result of economies of scale in the marketing field. Many brands have grown over decades of advertising. Especially in the consumer goods sector, many brands have been known for a long time and have been carefully built up by the brand owner over a long period of time. The effect of scaling is evident when taking a closer look at the economics of the leading medium of branding: television. Until a few years ago it was only possible for a brand to advertise nationally (e.g. at the Super Bowl in the United States or Bundesliga broadcasts in Germany) when the national availability of the products sold was sufficient.

The classic example is advertising for Coca-Cola: since the 1960's, the beverage company has always been able to spend the by far highest budgets for advertising, since the advertising costs per can were low. If a new market participant wanted to place a TV commercial during the Super Bowl, the cost per sold can would be prohibitively high at the beginning of the campaign. For a competitor, it does not make sense to fight the uphill battle against existing competition with high scaling effects in a market that is already split up.

From the 1970's until the 2000's, Warren Buffet has made many investments based on the economies of scale. The success achieved that way was condensed to theoretical concepts by scientists like Bruce Greenwald of the Columbia Business School.

The appeal of these models is their logical elegance and mathematical demonstrability. Like no other, Greenwald has influenced my approach to the analysis of companies. His achievement is the construction of a toolbox with only one tool: the question "Who receives the economic profit?". This makes breaking down the value creation process of a product or a service easy, and often it becomes evident, where there are entry barriers for competitors and where there are none.

As much as I appreciate Greenwald's theses, I currently see many competitive advantages changing. Greenwald's competitive analysis requires the measurability of "mathematically-conditional" competitive advantages (economies of scale, network effects, etc.). Due to the ever-growing Internet, however, a radical change in the measurability of competitive advantage is taking place.

There are two obvious examples of this change: the shift from offline purchase decisions toward e-commerce and the increasing importance of "user experience" and service transparency in purchasing decisions.

Let us first take a look at e-commerce. It is structurally more favorable and more convenient when a parcel service delivers ordered goods directly to the doorstep of 100 households than when 100 households take their SUVs and drive to 30 different stores.

The physical shopping experience will certainly still be appreciated in the future ("looking around in a bookstore") - a substantial part of household logistics, however, is not the consumer's favorite pastime. Nobody enjoys buying toilet paper. Nobody likes having to wait for ten minutes at the checkout. Only very few people enjoy packed department stores the day before Christmas. E-commerce has already taken a considerable market share from stationary trading, and it is safe to assume that this trend will continue.

The infrastructure that is necessary for an e-commerce business differs considerably from existing commerce- and distribution business models. Although many conventional merchants with their existing infrastructure still have the advantage of economies of scale over their current competitors, but in many product channels, a parallel and more efficient new infrastructure in e-commerce is growing. In these cases, it may well be rational for a company entering the market to make significant investments in this new infrastructure. Initially, it was ridiculed by many observers and often observed with malicious glee. Everybody knows the derisive comments about the likes of Amazon or Zalando – "they are yet to make money" – but five years of initial losses could very well be justified if a competitive advantage for the coming decades can be established that way.

Another good example is food delivery services. When I was still going to school, there was a delivery service in our borough that has dominated the entire market. The brand was heavily advertised locally, and there were apparently enough orders to operate ten delivery vehicles. The resulting quality of delivery (max. 30-40 minutes wait), reasonable price (free delivery from EUR 7.00 per order) and brand awareness (delivery vehicles and flyers everywhere) were a considerable "moat" for this pizza delivery service in Hamburg Niendorf at that time. Due to the ever-increasing popularity of smartphones over the recent years, delivery networks have become popular. This spawned the idea of combining an online ordering platform with a system to tie all the restaurants of a city (not only pizza) into this delivery network. The resulting product is clearly better than the pizza delivery service: greater selection for the customer, better utilization of the delivery infrastructure and lower prices, because the orders mean additional business for restaurants and require no extra kitchen infrastructure. The investments that Lieferando, Foodora, JustEat, Lieferheld & Co are willing to make are enormous, and it is not clear, which of these companies are going to survive. There will, without any doubt, be a selection process, and certainly, not every investment in these companies makes sense. On the other hand, at the end of the investment process lies the control over a distribution network, which is worth much more than the old, one-dimensional infrastructure of a pizza delivery service.

When using conventional methods for the analysis of competitive advantage, my concern is the missing focus on the revolutionary changes, triggered by the parallel and more resilient infrastructure that is growing alongside the existing economies of scale. This topic is particularly important because so much business is shifting toward e-commerce.

Another – and potentially even more far-reaching – change for the evaluation of competitive advantages the increased transparency of the product quality and the increasing importance of user experience ("UX"). While it has always been an advantage when customers received good service, the product was easy to use, and its operation was intuitive. Completely new, however, is the opportunity to sell many products as an app or website directly to customers. There is a broad shift from a closed infrastructure (e.g. phone calls via mobile phone / landline, television via TV stations, taxi driving a taxi office) towards an open infrastructure (e.g. phone calls via Skype, TV via Netflix, and mobility via Uber). Unlike in the past, in many cases, people are no longer restricted by the corset of a provider, but can book tailor-made solutions over the internet. Therefore, UX is gaining importance, as alternatives are more accessible, and quality differences are much more transparent.

The success factors of good UX are scalable, agile IT infrastructure and a culture of testing as well as effective and simple customer service. In particular, the latter sounds quite mundane, but for many established businesses (and in particular their IT-environment) it is impossible to accomplish. My favorite example is the customer service at Deutsche Telekom. I am "Quad-Play" customer, purchasing mobile phone, landline, Internet access, and TV via Telekom. In fact, there are three service hotlines for these four products. The call center for my mobile phone can see neither my landline data nor patch me through to their colleagues there if I have a problem. I get two invoices that are charged to my account separately. So far, I was able to discuss the situation with some friends who work within the IT-organization of Telekom. The unanimous answer was that merging the IT systems would take six to eight years. By comparison, WhatsApp, the world's most widely used Messenger platform has grown from zero to more than one billion users in six years due to brilliant UX.

The key consequence for investing is that in my opinion, in the next ten years, companies with a UX-centric culture will be among the big winners of the economy. UX is increasingly a customer magnet, which results in low customer acquisition costs and high customer loyalty. Even in the future, many products can only be marketed through widespread advertising. The chances are that even in 20 years, butter, shampoo, and beer will still be primarily marketed through mass advertising. However, especially when it comes to products or services that require interaction between customers and suppliers, the value of excellent UX should become more and more apparent.

I am currently running a small research project in, for which I track down businesses, which have enjoyed vigorous growth with almost no marketing costs. These companies are rare, as most businesses naturally have to inform their customers about their products. Nevertheless, there are a few examples of extremely successful companies that have spent virtually no budget for marketing at all. My current interim conclusion is that strong growth with minimal marketing is only possible if there is either a price advantage, which is shared with the customer (Aldi, Costco, Fielmann) or the UX of the product is outstandingly better than that of the competition (Google, Apple, Tesla, Uber, Airbnb)[1]

While in the 80s, the key figure was "brand value", today, in many cases, it can be replaced by figures such as Net Promoter Score (NPS). NPS measures the ratio of very positive to very negative customer reviews of a certain product and is a good indicator for the customer's UX perception. An NPS of -100 says that all reviews are extremely negative, while NPS 100 means that all recommendations are extremely positive. The comparison of NPS figures within a product group is particularly meaningful.

[1]. At this point, companies that are virtually the only supplier for a customer group due to a license (e.g. pharmaceuticals) or as a result of local monopolies (e.g. cable networks) are excluded from consideration.

One investment of the TGV Truffle, for example, is operating in an industry with generally very negative NPS: mobile telephony. Hardly anyone loves their supplier, and the customer points of contacts are usually caused by negative experiences such as outages or incorrect invoices. The company in question has an NPS of 73, which is unheard-of in its industry. The corporate culture behind the high customer satisfaction is difficult to replicate and represents a real value, which, however, is hardly reflected in the figures of the company (yet).

For me, as an analyst, this is an excellent opportunity, because the concentrated number of companies on my watch list allows me profound thoughts about corporate culture, have the necessary conversations, and invest resources for customer surveys.

„Not everything that can be counted counts, and not everything that counts can be counted."

It is summer again, and if you are still looking for a good book to read on the beach, I wholeheartedly recommend "Tubes" by Andrew Blum[2]. Exciting as in a crime novel, Blum is tracking the physical infrastructure of the Internet. If you have always wondered how a submarine cable is laid or how our data travels through cyberspace, you will find many exciting answers in Blum's book.

On that note, I am wishing you a relaxing summer and thank you for your trust.

Kind regards,

Jan-Hendrik Mohr

JMX Capital GmbH

[2] „Tubes – A Journey to the Center of the Internet", Andrew Blum, HarperCollins, New York, 2012