Investmentaktiengesellschaft für langfristige Investoren TGV

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Dear investors

Attached, you will find the annual report for the year 2018 provided by our sub-advisor JMX Capital GmbH for the sub-fund „Truffle".

Yours sincerely

Investmentaktiengesellschaft für langfristige Investoren TGV

Annual Report 2018 of the Sub-Advisor

Dear investors,

Over the past six months, the price development of the TGV Truffle was slightly negative at -1.9%. In the context of declines of 20% and more in many equity indices worldwide, the price development of TGV Truffle in 2018 may paint a calm picture. However, nothing is further from the truth. Over the last 12 months, the performance of the shares in the TGV Truffle has clearly diverged: one portfolio position has halved in price since the beginning of 2018 while another quotes one-and-a-half times higher. It is pure coincidence that the aggregate result across all positions was *minus 1.9 per cent*. I face price fluctuations stoically because what is really relevant is the change in value of the companies. Which was – with one big exception – roughly in line with my expectations in 2018. In this respect, there is little news to report from the individual companies.

The exception: since its launch, TGV Truffle has been holding a position in medical Columbus AG – a small German company. The original business model was the operation of an ordering platform for the German hospital supply market, with three players competing for years. All used similar IT systems but served different hospitals. It was evident that a consolidation in the market was inevitable, meaning that medical columbus would either sell its own operating business or take over the business of a competitor. In the middle of 2018, competitor GHX finally acquired the operating business of medical columbus. The price paid was a good deal for both sides.

However, the real hero of the story is Dirk Isenberg, the founder and CEO of medical columbus. Mr Isenberg has used the opportunity with determination, putting aside the ego that is oh-so-common among CEOs, and paved the way for consolidation in his field. He thus created considerable value for the shareholders of medical columbus and ensured that the stock of medical columbus achieved the second-best performance of all 561 companies listed on the German stock market in the last 12 months. The company (which is still listed on the stock market) now has considerable liquidity from the sale of the operational side of its business. The reallocation of this liquidity is supervised by the new Chairman of the Supervisory Board Dr Mathias Saggau.

Measuring and Weighing

As always, please find the most important portfolio and performance data of TGV Truffle in the following table.

NAV as of 12/28/2018 in EUR	118.70
Total number of investments	10
Weighting largest investment	28.6%
Weighting Top-5 investments	75.0%
Weighting cash / fixed deposit	0.1%

Alphabetical Listing of Top-5 Investments:

Amaysim

medical columbus

Rolls-Royce

Tripadvisor

Tucows

Period	TGV Truffle	Berkshire[1]	*(Difference)*[2]	6% p.a. Benchmark	*(Difference)*[2]
2015[3]	-12.5%	-10.0%	*(-2.5%)*	+4.5%	*(-17.0%)*
2016	+18.1%	+27.5%	*(-9.4%)*	+6.0%	*(+12.1%)*
2017	+17.0%	+6.9%	*(+10.1%)*	+6.0%	*(+11.0%)*
2018	-1.9%	+7.5%	*(-9.4%)*	+6.0%	*(-7.9%)*
Since inception[4]	+18.7%	+31.8%	*(-13.1%)*	+24.5%	*(-5.8%)*

[1] in EUR
[2] Rounding can lead to minor deviations in the differences.
[3] 03/31/2015 – 12/31/2015
[4] Since 03/31/2015

Portfolio Changes

Since the publication of the semi-annual report in June 2018, there have been no noteworthy portfolio changes. Although I have repeatedly used the considerable fluctuations on the capital markets to recommend the change of position sizes opportunistically, TGV Truffle holds the same shares at the end of the year, as it did in June.

Portfolio Concentration

The number of securities included in the TGV Truffle and their weighting usually leads to two types of feedback: Either an observer considers the concentration on a select few securities as unusual and risky. Many conventional funds follow a more diversified investment approach. Others, on the other hand, find the concentration desirable and consider it a fundamental condition for outstanding long-term returns.

None of these views corresponds to mine. Focusing on a few stocks is not an end in itself in my recommendations, but the result of a decision-making process. In the future, the TGV Truffle may become significantly more diversified or even more concentrated – this should not come as a surprise and will – in the light of the following – hopefully be understandable.

In my narrow selection, I regularly follow approximately 50 companies. In those companies, the integrity and capability of management, the quality of the business model, and the growth prospects are excellent. From this list, I recommend the stocks I currently consider the most undervalued, and whose quality the market does not appreciate (yet) for purchase into the TGV. Those are the truffles in the TGV Truffle; often hidden under leaves or covered with dirt, yet discoverable – and without having to pay the premium price of a starred restaurant.

My valuation process is quite simple: I look at possible scenarios for each of the 50 companies – from catastrophic to optimistic – and calculate how much the company is worth in the respective scenarios. Then I assess how likely each scenario is. From these two steps, I deduce a "probability-weighted expected value" – my final estimate of the company value. Updates are conducted every few months or when significant events affecting the companies occur. However, the approach looks mathematically more precise than it actually is and is subject to a certain vagueness. Here, I follow the principle that *approximately right* is still better than *accurately wrong*. So many analysts are virtually desperate to determine when exactly which cash flows will incur at Rolls-Royce over the coming years. My focus, on the other hand, is on whether the assumptions behind the budget figures are plausible and that the stock is currently significantly undervalued compared to a rough estimate of the cash flows of the coming years. Nobody forces me to predict a precise estimate of a specific figure for the fiscal year 2019.

Many investors, often mathematically trained in their education, turn companies and their stocks into a pseudo-exact science. In my opinion, this approach is divorced from reality, because the day-to-day business of a company can rarely be modelled with precision. An extensive Excel model is not crucial to investment success: including ever more complex information does not necessarily lead to better decisions, but sometimes rather worse decisions, all the while believing in a higher quality of the basis of these decisions.

I place much greater emphasis on the robustness of the estimate and the general predictability of the company. It is vital that I limit myself to those companies that *are reasonably assessable*.

I am confident giving such an assessment for the currently 50 companies on my list. The size of the list, however, is not rigid. Since some of the companies may be taken over, or things change to the negative, I consider it difficult to increase the number. I estimate that there may be two or three new companies added each year. There are just not that many excellent companies, which I am comfortable assessing.

In an ideal world, these 50 companies are all trading below their fair value at the time of portfolio construction. Then I could issue evenly weighted purchase recommendations for all the companies on the list. In this case, the company-specific risk (e.g. "factory burns down", "management team is full of crooks") of the individual positions would be distributed across fifty companies and therefore low. Under the premise of correct analysis, outperformance would then be a virtual given. The main risk would lie in the so-called systematic risk: i.e. changes in the interest rate level, macroeconomic development, taxation of companies, etc. – however, these risks affect all equity investors equally. In this respect, there is generally little to object to diversification across many positions.

However, two practical factors usually hinder the realisation of this goal.

First, of the 50 companies, some are always expensive, some cheap, and most roughly valued fairly. From the existing pool of 50 companies, only a handful are attractive as an investment at any given point in time.

Second, the reduction of company-specific risks and the sole exposure to systematic risk are not always desirable. In recent months, for example, I have felt more comfortable with the assessment of specific corporate risks than with the evaluation of whether and when the next economic downturn will occur. The risks in the TGV truffle are currently due to whether, e.g. Tucows can successfully implement the fibre-optic expansion in small cities, Rolls-Royce can facilitate the increase in engine production, or the Majestic Wine subsidiary "Naked Wines" will prevail in the US market. Whether or not there will be a recession in 2019, is of secondary importance to these companies.

However, in other future market situations, it may be useful to diversify more broadly and run more systematic risks. For example, in the upswing following the financial crisis of 2008-09, it would have been beneficial to focus relatively widely on indebted and cyclical companies that benefited most from the subsequent stock market rebound.

Another critical dimension in the portfolio concentration debate is the general regulatory equal treatment of all securities, notwithstanding the economic background. Each country in the world has different rules on the diversification of investment funds, but (completely arbitrarily) capping individual portfolio positions to10% of the portfolio is rather standard. In my opinion, such a rule only purports a false sense of security: the value of a portfolio made up by ten biotech start-up stocks, weighted at 10% each, can be erased very quickly because the inherent risk of each company is very high. At the same time, an investment into a large debt-free company with many different businesses is so unlikely to be entirely devalued that a 10% weighting seems perfectly sustainable to most investors.

In the regulatory practice, however, it is irrelevant which share is weighted at 10%. Example TGV Truffle: Tucows and Rolls-Royce together account for approximately 50% of the portfolio, all the while both companies have multiple different segments, some of which have nothing to do with each other. For example, Tucows is a de-facto holding company, active in the field of Internet domains, fibre optic telecommunications, and mobile communications.

All three segments are lumped together under the description "other communication", but the corporate purpose of each segment is almost entirely unrelated. Following the regulation that applies to most funds, it would be perfectly reasonable to invest 10% of the fund each in three individual stocks representing each of the three segments of Tucows. However, investing 30% of the capitalisation of a fund in Tucows alone is prohibited for many funds. TGV Truffle, on the other hand, can invest this way.

A word of caution: many of the best investors have kept their portfolios focused on the very best of ideas. For example, 90% of Berkshire Hathaway's outperformance under the management of Warren Buffett can be traced back to ten decisions within the last 50 years. Unfortunately, quite a number of colleagues, who at some point made a big bet, are buried in the cemetery of the failed investors. Humility is mandatory here.

I know colleagues who speak with great admiration about high-concentration funds, considering their fund managers particularly "brave" or "confident". In my eyes, however, this “bravery” is dangerous and not my goal at all. There are no awards for the most daring investors or the most dramatic way to achieve a performance. Concentration or diversification in the TGV Truffle are always the result of the available opportunities and circumstances, and never an end in itself. Of course, it is the dream of every investor to make a big bet on the perfect opportunity and then be rewarded, but you have to make sure that you actually stay in the game so you can take advantage of this opportunity.

Recommended Reading

As an investor, I read many books, and while many of these books are good, only a few of them are excellent. This past autumn, my wife Isabelle and I read an outstanding book that we both subsequently sent to various people (something that has never happened before), but we mean business:

I am talking about "Factfulness" by Hans Rosling. The author describes hilariously how, in the Western world, some stereotypes about the "rest of the world", which have either always been wrong or obsolete for decades still prevail. Keyword "the rest of the world": there are currently four billion people living in Asia, and one billion in each Europe, America, and Africa. By the year 2040, the number of people in Asia and Africa should increase by one billion each while the population growth in America and Europe stagnates. This raises the question who the "rest of the world" really is. I strongly recommend "Factfulness"!

Outlook

The Investmentaktiengesellschaft für langfristige Investoren TGV would like to kindly invite you to our next investor meeting on 29/06/2019 in Bonn on the Godesburg. All TGV investors and their families will soon receive an official invitation. The steady increase in the number of participants over the years is fantastic. I am confident that all your questions will be answered in an informative way again – otherwise, the chocolate will surely be comforting!

Kind regards,

Jan-Hendrik Mohr

JMX Capital GmbH