PALM CAPITAL

Q2 2020

August 2020 | Mahomed Ibrahim

At Palm Capital, we look for businesses with durable competitive advantages run by exceptional managers. We patiently wait to invest when their prices are less than we think they are worth, aiming to benefit as they compound economic value over time. We only sell if fundamentals deteriorate or we find others offering potentially better after-tax returns.

Our performance

Over the three months ending 30 June 2020 our portfolio increased by 18.6% after management fees & trading expenses. Over the same period our benchmark, the MSCI World Index, increased by 18.8%.

Since we started, two and half years ago, our portfolio has returned 29.5% in US Dollars cumulatively after management fees & expenses. We have outperformed our benchmark by 23.7%.

Period	Q2 2020	Since inception
Our Return$^{\lambda}$	+18.6%	+29.5%
MSCI World	+18.8%	+4.7%
Outperformance	-0.2%	+23.7%

$^{\lambda}$after management fees & trading expenses

"Markets make no sense at the moment"

This is a comment we've heard repeatedly over the past few months. "The economy has been devastated but markets are soaring – it's illogical" – or so the comment goes.

As investors who actively look for opportunities, our approach is centred on a belief that markets are inherently inefficient. So, markets "behaving irrationally" come as no surprise to us. In the short term, markets move randomly. They seldom "make sense".

They only appear to make sense because we have a habit of fitting simple narratives to them. For example - a global pandemic sends economies into shutdown and as a result markets crash. It sounds like a completely cogent and rational argument. But we could just as easily fit other simple narratives to justify why markets should be rising:

- A few businesses are doing very well because of the pandemic. They are powering the markets.
- Being forward-looking, markets are looking beyond the current collapse.
- Extremely low bond yields are forcing investors into equities.
- Sports betting is closed, so individuals are now speculating on stocks.

As you'll notice, these arguments also make sense. They are the usual types of explanations given by news networks, market commentators and sell-side analysts.

But it's never so simple. Markets are much more complex and unpredictable in the short term. And these arguments are all examples of narrative fallacies. As humans, we love stories and explanations. And, when it comes to our savings, we need these explanations to sleep well at night. We wouldn't be comfortable to hear that there's no explanation for their day-to-day movements.

At Palm Capital, we don't spend our time trying to understand or explain short term market movements. Trying to rationalize randomness is a fruitless exercise. Instead, we choose to spend our time focusing on what we can understand and have a greater chance of getting right – how strong a company's advantages are and how long these are likely to last.

Our activity

Over the past quarter, we sold our entire holding in AIA – a company headquartered in Hong Kong and one of our very first investments. The new security law imposed by China on Hong Kong is concerning. It brings into question its rule of law and freedom of its courts. This creates many unknowns around the rights of businesses and shareholders, which increases our likelihood of capital loss to an uncomfortable level.

We also trimmed many of our holdings, 'taking profits' as they approached and exceeded our estimate of their fair values. The speed of the market's rally in the early part of the quarter caught us by surprise and we repeated a mistake we have made in the past – being quick to trim.

We regard it as a mistake, not because the prices of these businesses continued to rally, but because subsequent financial results revealed what we expected – that these business grew in worth as their market shares expanded and advantages strengthened over this extraordinary period.

Our experience has shown us that when we are quick to sell exceptional businesses, we seldom get the chance to invest in them again at prices similar to those we initially paid. It ties into another problem now that we have so much cash – having to wait for good businesses to trade at conservative prices.

However, given all the uncertainty and our above-expected returns so far, it's a problem we don't mind having.

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Performance figures are quoted after the deduction of all costs (including manager fees and trading costs) incurred within the fund. Annualised performance figures represent the geometric average return earned by the fund over the given time period.

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