GANES
FOCUSED VALUE FUND

APIR GCM0001AU | ARSN 117 119 712

DECEMBER 2020 QUARTERLY REPORT

Portfolio Performance

The fund has recorded another solid quarter with the unit price up 8.3% to $3.53 at the end of December. For the past year the fund reported a return of 10.6%, outperforming the market by 8.9%. Over the longer term the fund has provided a return of 8.9% per annum for the last 10 years and 11.4% per annum since inception. Since the lows in March the unit price has rebounded over 68%.

When I compare these recent results to the March 2020 update, it only reinforces my view that no-one can predict markets.

As can be seen in the adjacent table the fund became a "seven-bagger" during the quarter with each initial $10,000 now worth $71,613. The next goal is to become a 10-bagger.

The positive performance and return to "business as usual" for the fund has been quick and rather surprising. The liquidity injections that governments around the world have provided during the course of this year to bridge the pandemic crisis may still have some unintended consequences. They may have also injected some over-confidence amongst equity investors in the short-term. Lessons are quickly forgotten in financial markets.

While researching companies continues, portfolio activity has dwindled to a trickle with just the addition of one new company to the portfolio and the partial sale of another holding to fund the purchase. Unitholders should note that inactivity is still a decision, it just doesn't keep the brokers or the accountants busy.

Cash remains at less than 5% of the fund.

A distribution of 1.322c will be paid for the half year.

Performance as at 31 December 2020:

	Fund (net of fees)	ASX 300 Accum. Index
3 months	8.3%	13.8%
1 year	10.6%	1.7%
3 years p.a.	8.1%	6.9%
5 years p.a.	9.5%	8.8%
10 years p.a.	8.9%	7.8%
Since Inception (p.a.)*	11.4%	9.0%
Value $10,000 invested since inception	$71,613	$48,239

*Inception date of Fund is 14/10/2002

Unit Prices as at 31 December 2020:

Entry Price	$3.5398
Unit Price	$3.5310
Exit Price	$3.5222

Top 10 Holdings:

Company	Code	Weight (%)
PWR Holdings	PWH	10.8
ARB Corporation	ARB	8.2
Domino's Pizza Enterprises	DMP	8.1
Reece Australia	REH	7.9
Dicker Data	DDR	7.3
MFF Capital	MFF	7.1
Lovisa	LOV	5.1
Magellan Financial Group	MFG	4.3
Audinate	AD8	4.3
Cochlear	COH	4.2

Top 5 Sector Exposure:

Sector	Weight (%)
Consumer Discretionary	33.9
Information Technology	22.8
Financials	19.8
Industrials	7.9
Healthcare	7.3
Cash & Other	8.3

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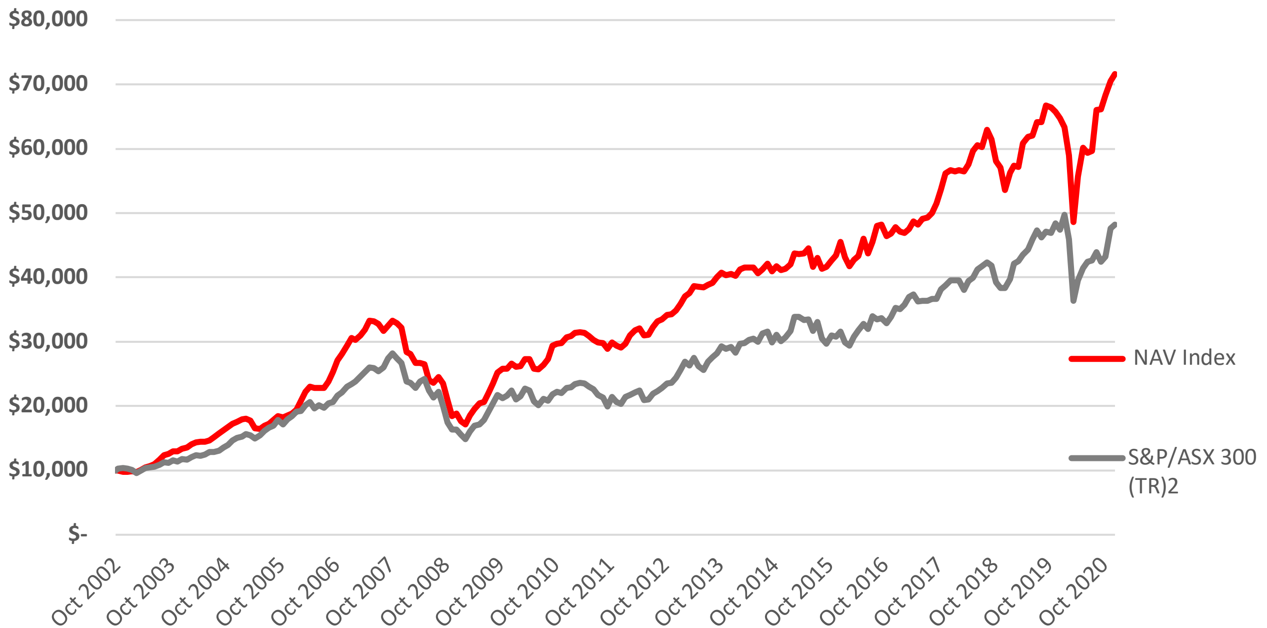
Fund Performance



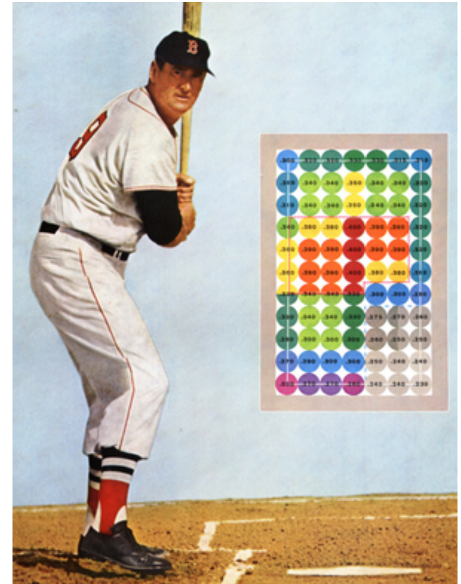
While the table on the first page shows the performance of the fund over various time frames the graph above provides a visual representation of the fund against the ASX300 benchmark since inception.

Most companies within the portfolio have continued to see their share prices rise substantially over the past few months. Notably, Audinate rose more than 40% during the quarter to make its first appearance in the top 10, and Dicker Data and Lovisa similarly rose more than 35% during the quarter. Dicker Data, ARB Corporation and Domino's Pizza all rose more than 50% during the year. Were it so easy to predict these things at the start of the year!

On the downside PWR Holdings fell 5% during the quarter as did Nearmap, and both were down over the course of the year. Another detractor to fund performance was MFF Capital which was down 5% for the quarter and nearly 20% for the year. The strong Australian dollar rising 10% from 70c to 77c (via 61c in February), has been a major headwind for the share price. On a positive note, the manager has been busy investing funds and Amazon has now become one of its larger investments alongside Mastercard and Visa.

A Little Self Examination

I admire world-class athletes and their training methods, particularly those that examine their process to understand their results. Baseball legend, Ted Williams, analysed his game to such an intense degree that he broke the strike zone down into 77 baseball-sized cells and by charting his results determined that he achieved better results when he only swung at pitches in his "sweet spot". And he found that his batting average went down when he swung at balls outside his sweet spot. How does that apply to investing?



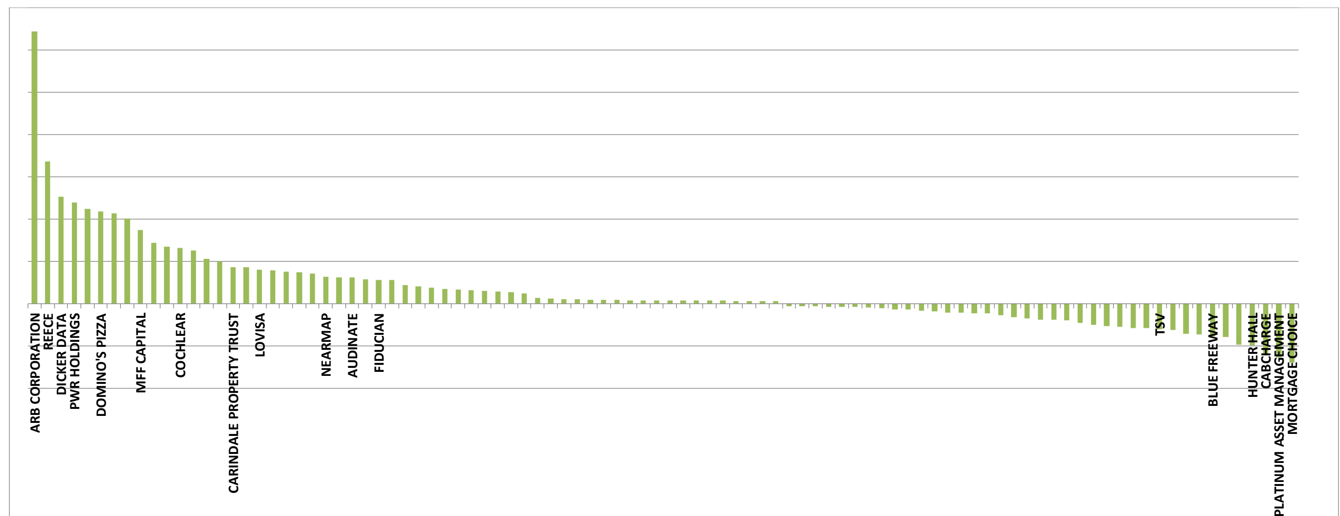
In the chart below I have attempted to do something similar in a very crude fashion. The graph looks at every company owned by the fund since 2002, and the actual dollar return they have provided during that period. So, this represents 18 years of results - not just the latest 12 months that can include both good and bad luck.

Since 2002 the fund has owned 149 companies, currently it owns 21. I have tracked the profits and losses made on each of these since that time to see whether there are "pitches" that I am swinging at that I should leave alone, and see if there are common characteristics for my "sweet spot".

First, the batting average is 70% winners and 30% losers, with a whole bunch of companies that didn't make much or lose much. This is actually about what I would expect. But picking stocks where 70% are winners doesn't matter so much if the 30% of losers were the big bets and the winners were only minor holdings. So, I also looked at the "slugging" percentage (to continue the baseball analogy). Slugging percentage will indicate if position sizing within the portfolio is appropriate.

From the results the largest winner was nearly five times that of the largest loser. And the average profit for the top 10 winners was 3 times the average loss from the worst 10. I don't know if that is a good number or a bad number, but a negative number would clearly be a bad outcome.

The largest winners were ARB Corporation, Reece, Dicker Data and PWR Holdings – all currently owned by the fund and top 5 holdings. There are also a range of relatively new businesses held by the fund that I expect to provide outsize returns in the future but will require time to prove this out – Audinate and Lovisa are on this list. The largest losses were Mortgage Choice, Platinum Asset Management, Cabcharge and Hunter Hall. All financial services companies that were hit hard during the Global Financial Crisis and sold nearly a decade ago.



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Some observations:

Being right about the business mattered more than being right about the price (in the long run): Because my investment style is to be a long-term investor and let compounding weave its magic, being right about the business has a major factor in the investment return, probably more so than the original price paid.

When I look at the larger winners it is also apparent that these companies have a strong bond with their customers. For example, I know both PWR and ARB place their customers first and work backwards from there. This leads to a number of positive outcomes; strong customer retention because the cost of switching and going to a competitor is high, they can set their own prices (higher profit margins), and finally they usually dominate their market. The financial flow-on effect is a high return on invested capital and sales growth – the magic sauce of good businesses and good investments.

It may be a co-incidence, but I don't think so, they also all have a founder who still maintains a high degree of ownership running the business. The company with the highest sharemarket return on the ASX for the past decade is Altium and it would also tick all these boxes.

Patience is required for out-sized returns: There are no truly outsize "home-run" winners in the results, they were sold too early and this is really disappointing. For example, Pro Medicus was sold for 70c and was only held for a year early in the life of the fund (its current price is nearly $35.00 per share). Selling when the share price appears fully priced, but the underlying business continues to grow, can appear a rational decision at the time but have a significant opportunity cost later on.

It appears the results would have been much better if I had let those companies remain in the portfolio. Even at the risk of some short-term underperformance later on if prices fell back to more reasonable levels. Patience and inactivity are very under-rated skills, and my main objective is to improve this. Patience also reduces the reinvestment risk of selling a good business to buy a poorer quality business. Lesson learnt.

Beware hot stocks of the day: The biggest losers were financial stocks in the GFC and even though they were profitable and had a founder at the helm, in most cases this didn't help. Leading into the GFC funds management businesses with high profile founders were very popular with investors and I bought into that. What I should have understood is that financial services businesses are inherently leveraged to markets regardless of how strong their balance sheets are, and they have minimal competitive advantages because of low switching costs for customers. I can see some similarities with the range of Buy Now Pay Later (BNPL) companies that are currently in vogue and are unlikely to all be winners.

Beware story stocks: Most of the other losses came from companies that were newly listed and could be regarded as "story" stocks. They held the promise of a bright future but failed to deliver. The fact that they were only small positions helped, but it also shows that if there isn't a high degree of conviction in owning the business then it probably has no place in the portfolio in the first place. Waiting until the business has an established track record, and lower execution risk, is more likely an advantage than a disadvantage in this situation.

I’m not trying to succeed in my too-hard pile

Finally, investment legend and Berkshire Hathaway Vice-Chairman, Charlie Munger turned 97 on New Year’s Day. Just prior to Christmas he had a question-and-answer session with Caltech via Zoom. Amongst the hour-long session was this quote which I thought encapsulates so much investment wisdom.

> ***“I just try and avoid being stupid. I have a way of handling a lot of problems. I put them in what I call my too-hard pile, then I just leave them there. I’m not trying to succeed in my too-hard pile.”***

Thank you for the kind words during 2020 and I look forward to the future and what 2021 may bring. Feel free to call or email me if you require any further information about the fund.

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