The Incredible Mr. Market

Dear Investor Friends,

We currently manage almost €21 million of assets in our Sextant PEA and Sextant Grand Large Funds. As soon as our webmaster is kind enough to return to work after his holiday, you can view each Fund's unit price and net assets under the "Performance" section of our website, www.amiralgestion.com. Meanwhile, I will give you the prices here; at 22 August, Grand Large stood at €103.54 and PEA at €1593.01.

World Champion

According to the Boursorama website, as of 22 August 2003, Sextant PEA was the best-performing fund in the world over 1 year, with a 52% return!!! We outperformed funds specialised in gold, Thailand, new technologies, old technologies, companies ripe for a takeover, scrap values, as well as fixed income funds, indexed funds, small funds, large funds, etc. However, we will keep our egos in check by reminding ourselves of one of Benjamin Graham's favourite sayings, borrowed from Horace, "Many shall be restored that now are fallen; many shall fall that are now in honour." (Granted, Horace probably said this in Latin.)

How does it work?

We are not the only one surprised by Sextant PEA's outstanding performance. It has beaten the CAC 40 by almost 85% since January 2002. Let me try to explain….
At the time, I estimated the Fund unit's intrinsic value to be €1,850. So at a price of €1,000 (on 18 January 2002), this represents a potential gain of 85%. The CAC 40 lost 30%, Sextant PEA rose 59%, and there you have 85%! This intrinsic value has changed with time (the more time passes, the higher it gets, thanks to the magic of discounting), with portfolio rotation (we replace correctly-valued securities with undervalued securities), and, in particular, with the progress of the companies we invest in. Of course, there can't be any rotation in the latter, which makes things much less tiring and much more profitable (we never sell, even if it keeps rising). Indeed, after "He who loses, wins," we have invented a new financial theorem, "With good managers, you always get good surprises." We are shocked that we haven't yet been contacted by the Nobel jury. If you know anyone on the jury, don't hesitate to mention us. (People have told us this theorem has already been invented. Perhaps, but has it been published?)

The much-anticipated backfire

We are still very confident in the long-term. The investment philosophy that we borrowed from American gurus has been working for over 80 years. But surprises may still lie waiting for us in the short-term. So when will it backfire?

1. <u>Absolute performance</u>

Dips in stock prices don't bother us a bit, provided they are not related to a poor valuation on our part, or an event that undermines our conviction. In fact, it is just the opposite; we enjoy taking advantage of these recurring cycles to strengthen our positions in our favourite investments. This is why we hope to benefit as soon as possible from a good "backfire"!

2. Relative performance

Your Fund may one day find itself in the pits of the Boursorama short-term rankings (short-term meaning 1 month to 2 years). This would also be good news, as it would mean that the securities we track have been forsaken by the markets, and are probably significantly undervalued with excellent rebound potential. Our management style is well-suited to averaging down; lower stock prices only serve to boost our safety margins and therefore our convictions. However, in a moment, we will introduce you to a good friend who doesn't respond in quite the same way….

3. The true backfire

The true backfire would be from making bad bets on poorly managed companies that are worth very little, if anything at all. It is our duty to remain vigilant and prudent, to verify everything we are told, to invest with a high safety margin, and, if worse comes to worst, to bear in mind "that which doesn't kill us makes us stronger" (a quote from Nietzsche that I read in Elle magazine). Unfortunately, we will make (more!) mistakes eventually. And the ground could cave in, and we will suffer along with everyone else. "We must recognize the difference between those things that are in our power and those things that are not in our power" (a Stoic principle first stated by Zenon, later adopted by Marcus Aurelius, and most recently rediscovered by the Ragagnon family).

The Incredible Mr. Market

These past few weeks we have been acting like "sitting ducks on a rising pond" (Graham or Buffett, I forget exactly which); not getting too excited, letting prices climb, rebuilding cash (through subscriptions and some sales). We have a wonderful friend that we would like to tell you about, the incredible Mr. Market. Warren Buffett introduced us to him, so let's listen to the teacher as he makes the introductions.

"Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favourable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behaviour, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him or to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, you're the patsy."1

Since 2000, Mr. Market has been offering his friends truly astounding prices. Thank you Mr. Market!

Talk to you soon, and best wishes for back-to-school,

François

[1] Warren Buffett, "Chairman's Letter to the Shareholders of Berkshire Hathaway Inc.", 1987.