Sextant Newsletter - March 2006

Dear Investor Friends,

For the fourth consecutive year, we have delivered a remarkable performance. After gaining 14% in 2002, 63% in 2003, and 30% in 2004, Sextant PEA added 31% in 2005. That makes a 220% increase over four years, while the CAC 40 has been treading water (up only 6% from 11 January 2002 to 31 December 2005).

Sextant Grand Large joined in as well, soaring 80% in two-and-a-half years. Not bad for a Fund that is 50% invested on average.

And our new Sextant Autour du Monde Fund got of to roaring start, jumping over 20% in six months, already making it one of the best in its category.

So, "Bravo, Amiral Gestion"? Our management team was rated AAA by the London rating agency Citywire, placing it as one of the best in Europe (9th out of over 1,000; we'll try to do better next time). Indeed, Citywire is a clever rating agency, because rather than rating funds, it rates the fund managers. As I said before, your money is not managed by asset management firm X or bank Y, but by real men and women. Therefore you have every interest in getting to know them a bit before trusting them with your savings. And to get to know them, you can read our newsletters, come to our meetings, and, from now on, turn to Citywire.

"Bravo", for the past four years, perhaps. But the future is much more uncertain. Stock market regulators, as well as good sense, warn, "Past performance is not a guarantee of future performance." Right, we are required to tell you that. But there is something much more serious. I recently read a statistical report on the performance of excellent fund managers. Unfortunately, I lost it somewhere amongst the pile of books gathering dust on the right side of my desk and the pile of magazines strewn on the left. So I can only speak approximately, and can't cite the author. But suffice it to say that we are excellent fund managers (why not; after all, it's not rocket science). This report explains that an excellent fund manager, who beats the indices by 5% per year on average, with a low average volatility, should have a horrible performance once every ten years. This seems to imply that the longer we continue to generate good returns, the greater our chances of having a bad year. For example, if we have nine consecutive years of outstanding performance, then one might think that there is a 100% chance that we will bomb in the tenth year. This is false, of course; statistically speaking, each year starts at zero, and an excellent fund manager always has a 9 out of 10 chance of having a good year.
In conclusion, what can we tell you? Unfortunately, there is not much we are certain about in the short-term. Anything can happen. We could have one, two, or even three years of bad performance in a row. But for the long-term, we have solid convictions. Anything can happen, which certainly includes us earning a lot more money together.

2005: How to misfire on all fronts

My comrades have already written summaries for the year 2005 for our three mutual funds. Clearly, we did not perform very well in France last year. Romain Burnand of Moneta Asset

Management, whom I consider to be one of the best fund managers in Paris, noted that in the third quarter of 2005, two stocks, Vallourec and Alstom, contributed one-third of the increase in the Mid 100 Index, and similarly, only two stocks, Nexity and Soitec, comprised 43% of the increase in the Mid 90 Index. We are not out to replicate the indices. And since we don't know anything about high-tech, we passed on Soitec. I have a feeling that those who reaped big gains last year are the same who lost their shirts when the dot-com bubble burst, around 2000-2002.

To bet on Alstom, you have to like betting on restructurings, which can sometimes end in a catastrophe. Except when someone like Patrick Kron is at the lead. There we were not on track, and perhaps we should have seen it. For Vallourec, I'm not sure. I've seen it rated as a "buy" hundreds of times by analysts over the past 20 years, but it has always disappointed. That must have blinded me. With regards to Nexity, I bought a flat in 1990 which I then sold in 1997. I am useless when it comes to property. I didn't even try to understand this stock. So, sorry. More surprising however, is that while we thought we understood the internet fairly well, we were only able to slightly profit from the soar in Hi-Media and ArtPrice. In spite of the fact that we followed these companies closely, and were probably one of their largest mutual fund shareholders in 2004. But we can't know everything, and we didn't realise their considerable earnings potential. On the bright side, I would say we were being prudent; while everyone else panicked over these stocks, we spotted a true safety margin. And when they became fashionable, we sold. Much too early. Our sincerest apologies, especially to these companies' managers for not giving them the trust they deserved.

Take a few hits….

But that is not all. In November 2004, our two biggest investments were in LDLC and Vet'Affaires, which together made up around 20% of the portfolio. We bought them at rock-bottom prices. We went up to 30X on LDLC with part of the holding. One year later, at the end of 2005, these stock prices had plummeted to one-third of their initial value. That's what you call a huge slap in the face. Our results could have been disastrous last year. Sometimes I wonder how we made it through. We seemed to miss on all fronts, except…..

…. and come out alive

Super Managers to the rescue

We are very attached to our well-performing investments, but we remain watchful. We suffered in 2005 (Gifi plummeted as well, but we like their managers), but were wise enough to cut back our investment at the first signs of long-lasting trouble. To some degree, it is reassuring to know that you can get yourself out of a tricky situation. And we had some happy endings as well. For example, Toupargel and Aufeminin have incredible employees who do fantastic work. They helped us make it through the year and end it off with success.

Oil, steel, and distant oceans

We have been bullish on oil companies ever since September 2004, and explained some of the reasons why in our April 2005 newsletter. That is part of the reason why we want to invest overseas. We have not been able to find companies in France that would allow us to significantly invest in this sector. Granted, there are oil and oil services companies in France, but none with which we feel very comfortable. We are looking for producers who operate in their home country, because it reduces political risk, and with large or very large reserves, because it enhances visibility. We found Statoil in Norway, PetroChina in China, Petrobras in Brazil, and several companies in Canada with…. between 50 and 200 years of reserves. It's a wonderful investment for us for the next 30 years, or even longer. Now that's long-term, no?

Under the threat of physical violence from my partner Julien Lepage (who is a champion at Badminton, a girl's sport), I ended up buying some of IMS in 2005. Fortunately, Julien stocked-up. It's a nice company that is worth less than its invested capital (which basically means that it would cost more to fit-out the warehouses and purchase inventory than to simply buy the company, with its customer book as a bonus), and one that is indispensable to the country's economy. IMS, we couldn't resist. And it won't disappear, because there is no point in starting-up a competing business; it would be a better investment to just acquire IMS. It is well-managed, and not at all expensive (P/E ratio of 4 in early 2005). We like it and we have a lot of it (almost 8% of the portfolio), and it delivered good returns in 2005.

Camaïeu: bon voyage to our favourite managers!
You can always find something to wear at Camaïeu. The collections are better and better; the sales people are nicer and nicer. And there are more and more of their fine stores, in Poland, Hungary, and even in Spain, Zara's home turf. But we are no longer shareholders.
Camaïeu was Sextant PEA's first investment, making up 10% of the portfolio. That was in 2002. I would have put everything in it at the time, but that is forbidden by the French securities regulators. Too bad; at €23 it was a good buy. In fact, I decided to go into professional fund management because I felt so strongly about this very investment. We bought our last shares at €66 at the end of 2004, when there was a huge seller on the (Mr.) Market. Good times. In early 2005, we kept our shares through the buyout offer for €85, but finally sold them a month ago, during the second buyout offer for €130. We wish all the best to the company's managers during their LBO. The future will be a bit more challenging for the Sextant funds, now that our favourite managers are gone!

2006 – 2026

Bill Miller is one of the best portfolio managers in the world. A brilliant guy. You would do well to listen to his advice. That's what we do. He is a model for us, and we draw inspiration from his decision-making methods and strategy. Most of the time, Bill Miller is right on target. He thinks that the price of oil will fall back to $40 this year. Or at least, that is what he said at the end of 2005. He may have changed his mind since then; I don't know. If he is right, 2006 will be a very bad year for Amiral Gestion. In the short-term, we will take a stiff beating. In the long-term, we will be even richer, and I will explain why in the next newsletter. In the meantime, keep in mind that even Bill Miller can be wrong. He did not buy any oil company stock in 2004, even though the signs were fairly clear. Bill Miller, Warren Buffett, and several others are Gods for us, but once we believe in something, we do not change our minds very easily. We listen carefully to differing viewpoints, try to understand their reasoning, flush out ideologies and preconceived notions (especially ours). But at the end of the day, we remain independent. No one can prevent us from thinking.

I foresee that we will keep some of our investments for the next twenty years. Canadian Oil Sands Trust (COS) for example. We met its management team in September in Calgary (our "Canadian holiday"). The meeting reminded me of a ski run I went down a few years ago, not far from the COS oil fields, with powder snow among the fir trees; the run was named "Better than Sex".

Anyways, we thank you for your trust. A thousand thanks also to all the Super Managers who let us live our passion by betting on their success.

Talk to you again soon,

François