Dear Investor Friends,

The assets of your Sextant funds now amount to 230 million euros. Much more than five years ago, but much less than we could have with our track record and our management team. This is because we are conservative investors rather than collectors of capital. And because our business model is somewhere between managing our own money and third-party investment. Of course, our first and foremost priority is respect for our clients. The best way we have found to avoid any conflict of interest is to invest with you, in our own investment funds.
In the mail from readers we sometimes find congratulations on this, from investors who know that we could easily raise several hundred million euros in a few months. They are delighted that we stay moderate in size, because they know that this is a guarantee of good future performance. Of course we want to grow our assets under management, so as to keep on investing in a solid team, open some offices abroad in order to maintain our locally based expertise, and thus keep on offering you fine performance. But this growth will take place at a controlled pace.

As you know, our management philosophy is based on freedom of action. The freedom to do everything we want (everything, but not anything, we don't joke, whether with our money, or especially with yours!). That is why we have decided to add a fourth fund to our range. Since 2002, we have seen that not only we knew how to buy shares (and we were convinced of this, placing all our assets on this bet without the slightest fear), but also convertibles, funds[1], hedging products, and even gold. We also, although the opportunities are far rarer, know how to sell shares short when we consider them greatly overpriced. To profit from all this expertise, we need to create a product that is more complex and unfortunately less accessible to the general public, that we shall call Sextant Inc, and which will be more or less a hedge fund (although the term hedge fund doesn't mean much. In fact we shall continue to do our exciting job as investors, with a value and long-term approach, but simply with fewer constraints). We shall tell you about this in greater detail very soon. As we want to control our assets under management, we shall accept only 100 million euros from outside investors. If we find anyone interested, of course!

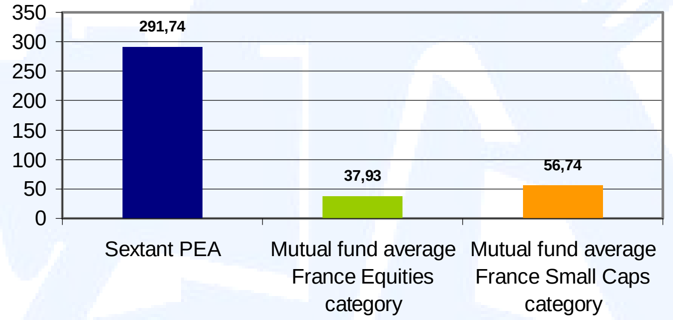
[1] Moneta Micro Cap for France and VEIL in 2003 for Vietnam. A nice stroke of luck to go there on holidays when the local stock exchange was at a low! It must be said that as a result I didn't go to the beach but to meetings with a whole lot of people who couldn't understand what I was doing in their offices in my swimsuit, asking questions about their margins, their turnover growth, the age of the population, the level of education and the communist party. Moreover, since I had come to discover Asia and the local business scene, I had forgotten my beach mat. Wonderful holidays. I also recommend to you Lebanon, from which I have just got back. There's not a soul in magic places like Baalbek, Tyr and Amjar, and there are pretty women in tight jeans in the "terrorist" villages of the Hezbollah. On the other hand, since the Vietnamese communist party is not in power, I bought nothing.

Self-satisfaction

Since 11 January 2002, the date of its registration with the late market regulator COB[1], your Sextant PEA fund has in any case not done badly. Here are the performance figures since then:

	2002[2]	2003	2004	2005	2006	2007 to date
Sextant PEA	**14.72%**	**63.99%**	**29.99%**	**31.41%**	**19.92%**	**14.34%**
CAC 40	**-31.13%**	**16.12%**	**7.40%**	**23.40%**	**17.53%**	**1.67%**

Over five years, the comparison with our little friends is also more than favourable:



We are also very pleased with the performance of our Sextant Autour du Monde fund. Up more than 55.9% since its launch in July 2005, it is one of the very best funds in its category, even the leading fund over one year. Here is a summary of its performance:

	2005[3]	2006	2007 to date
Sextant Autour du Monde	**13.33%**	**24.48%**	**10.51%**
MSCI World AC in euro terms	**10.53%**	**6.57%**	**0.66%**

As regards Sextant Grand Large, it hasn't done badly. Its performance was excellent in the first two years and has been simply satisfactory since early 2006. The reason for this is that in Sextant Grand Large we look for securities offering us a very large margin of safety. Although we have had many ideas and opportunities since the end of 2005, unfortunately over the last two years the markets have no longer offered the many gifts we received until 2004. Sextant Grand Large has always been relatively lightly invested (around 55% on average), and we try to select for this fund only the very rare "gifts" from Mr Market that we manage to detect now and then. That is why this fund did not profit fully from the bull market of these last two years. We remind you that Sextant Grand Large is a fund designed to enable you to increase your exposure to shares without posing you any problem of timing. Personally I have invested in this fund to replace my money-market funds (which I would advise no-one to do!). We shall therefore be always extremely conservative with its management.

[1] The AMF is the new French market regulator, since 1st August 2003.
[2] From 18 January 2002
[3] From 8 July 2005

There you have it. Without boasting, it can be said that these are good results, don't you think?[1]

The whole truth about efficient markets

For almost half a century now there has been a very amusing controversy about market efficiency. On one side extremely qualified economists who assert that markets are efficient and that it is impossible to beat the index. On the other side, a few investors who think just the opposite and who profit from this to amass huge fortunes.
During numerous passionate discussions in the kitchen[2] of Amiral Gestion we have solved the problem of market efficiency using the models from two of the major fields of modern physics: information theory and the principles of quantum physics.
Here, exclusively on amiralgestion.com, is the whole truth about efficient markets.

Informational Efficiency and Information Theory

The general principle of this theory is not to try to define the concept of information, but to assign to each observation an information value (interesting for the value investor, don't you think?). The idea is that the less an observation is likely, the more information it provides[3]. "For example, when the journalist starts the television news with the phrase "Good evening", this expression, which has a high likelihood, provides little information. If, on the other hand, the first sentence is, for example, "France is afraid", its low likelihood will mean that the listener will learn that something has happened, and will accordingly listen more carefully." (Wikipedia)

Now, here are two official and virtually Nobelized definitions of an efficient market:

> "A market is efficient with respect to a given information set if it is impossible to make economic profits by trading on the basis of that information set…" (Jensen, 1978)

or again:

> "In an efficient market prices reflect information to the point where the marginal benefits of acting on information (the profits to be made) do not exceed marginal costs (Fama, 1991)".

It can be said that the most likely observations for an investor are, firstly, quoted market prices, and secondly, the financial results reported by companies. According to information theory, these observations, which are extremely likely, will have only a very low

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[1] Sextant PEA, over five years, is the investment fund with by far the best performance of all the funds distributed in France since 2002, for all categories combined. "PEA" personal equity savings plans, non-"PEA", real estate, Russia, Brazil, French large and small cap equities.

[2] As we often discuss our ideas with one another, we felt it was better to do so in a peaceful place. A kitchen is more pleasant than a meeting room.

[3] Information Theory is originally the result of the work of Ronald Aylmer Fisher. This statistician formally defined information as equal to the mean value of the square of the derivative of the log of the likelihood function studied. Based on the Cramer inequality, the value of such information is proportional to the low variability of the resulting conclusions. Put more simply, the less an observation is likely, the more information its observation provides (Wikipedia).

informational value. Quod Erat Demonstrandum: they will not make it possible to achieve economic profits by trading (i.e. to beat the index).

But there's nevertheless a slight problem: what about the least likely observations conveying the most information? Information theory does not define the concept of information. In this context, Jensen's definition in particular is no longer meaningful. What "given information set" is he considering? Likewise for Fama, "prices reflect information… ". Alright, but what information is he talking about? The definitions of our economists therefore don't hold up. In a real world, there exists no market in which the operators might have merely a "given information set". To the extent that each operator is an observer, one would have to imagine a market in which all the players would be shut up in a laboratory to be very sure of being able to define this set correctly.

If no endeavour is made to define the concept of information, it is by definition an infinite concept. Therefore EVERYTHING is information. Corporate reporting in the newspaper, of course, but also corporate valuation expertise and techniques, investment horizons, psychological capability for resisting pressure, knowledge of history and the sciences, not to mention personal experience, observations in the stores, product tests, etc. "A market is efficient with respect to a given information set… ". Of course! Except that much information is not available to the general public and is not part of this set. And this unshared information is based on unlikely observations. It is therefore highly valuable and makes it possible to beat the market! In light of information theory, that's obvious!

Bill Thorp, for example, was a mathematics genius who in the 1960s discovered how to beat the bank at Black Jack. Thrown out of the casinos, which are bad losers, he eventually wrote a little book outlining a method for the valuation of warrants. To put it into application, you first had to read this book (a highly unlikely observation, because the book was not a success), but also have powerful computers and sophisticated programs (even more unlikely in the 1960s). The information available to Bill Thorp took several decades to circulate in the market, and this enabled him, through his company Princeton Newport Partners, to earn billions of dollars on the stock exchange.

Another example: corporate valuation methods. It is clear that financial analysis is not an innate technique written in marble since the beginnings of the New York Stock Exchange. Progress has been made. The initiators of these breakthroughs therefore benefited from a competitive advantage. To claim the opposite would be to claim that financial analysis is of no use. According to information theory, if this analysis is stereotyped (which is inevitably the case for 90% of the analyses produced by brokers, because it is impossible for everyone to be original on everything at all times) and read by all investors, then indeed it is of no informational value. But one who has discovered a new method may possess observations of great informational value so long as his method has not been very extensively shared by other investors[1]. Who would dare to say that Benjamin Graham invented nothing and that his lectures were not a wonderful source of information for many investors (and for himself)?

The investment horizon is also information. Now, everyone prefers to earn money tomorrow rather than in ten years' time. Observing a real long term investor is really highly unlikely!

[1] We shall see later that what matters is not the number of players informed but the mass of capital managed by those informed players.

And that is very valuable. Since most portfolio managers have a short-term horizon, one who accepts the risk of volatility (i.e. who considers it a non-risk) inevitably has a competitive advantage, because he will think differently and far more dispassionately. Even at Amiral Gestion we find it very hard to take a long-term stance, because we know that after a few weeks of underperformance we shall have numerous withdrawals from our funds. But since we are our own bosses and are not obsessed with the size of our funds or our annual profits, we are better armed than most of our colleagues to resist the pressure[1]. What's most amazing is that the market's "disinformation", i.e. its intoxication with the short term, is organized by the very same economists who preach market efficiency. To be able to model their theories, they inevitably had to define risk in the form of equations. And thus reduce it to the concept of volatility. In other words to a short-term concept.

Conclusion: Stock markets, in the informational sense, are inefficient because it is strictly impossible for all the operators to have the same information.

Valuation Efficiency and Quantum Physics

I don't too much dare to tell you what are the major principles of quantum physics. It's a field that is so incredible and fantastic that frankly it's incomprehensible. We are going to make some further efforts, and you are invited to take part. On 17 April we have invited a physicist who is a passionate teacher for a little talk. Starting at 7.30 pm. If you want to come, please confirm this to us; we shall accept only about ten investors with the Sextant label.

The teacher can correct me, I'll have a try at explaining. Quantas and electrons are at once particles and waves and cannot have a speed and a precise position at the same time. From what I've understood, they are waves until the time at which they are observable, i.e. roughly until the time at which they no longer have any speed when they encounter an obstacle. It's no use trying to understand, that's how it is, and that's all. On the other hand, the mathematical equations associated with quantum physics have numerous practical applications which work very well. It's rather like markets. You can always explain what causes a rise or a correction, a speculative bubble or a crash. But it's impossible to understand why and how share prices are generated. As in quantum physics, uncertainty is the master word in markets. A company cannot have a precise value and a momentum. Corporate values are therefore like more or less strong frequency waves (volatility!). In other words, nobody knows exactly where they are. The most interesting thing is that the fact of observing the true value of a company changes its value. We shall therefore prove to you the valuation inefficiency of the market: a market that is too efficient can even cause a stockmarket crash.

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[1] At Amiral Gestion we have a living example of the pressure exerted on managers. Steve was one of our clients when, with Julien, we were brokers at Exane. He did nothing like everyone else and had excellent long-term results. In 2000 he refused to buy France Telecom and other Internet shares. He therefore underperformed for a few months. His boss ordered him to fall into line and track the index. He didn't do so (and why should he have bought shares he thought were far too expensive?), and was fired. Since his fund was not listed, Steve found himself out of work at over fifty years old without a track record. Refusing to stay out of work, after a few months he accepted a back-office job with one of our colleagues. We hired him very recently for the same work. He speaks English fluently, plays electric guitar and understands everything we do. He's a jewel. Steve will perhaps do management again someday, but in the meantime he will have to pay for what was considered his fault. That's how it is, markets are implacable. It's the law of the short term, the law of valueless information. What counts is the noise.

Imagine that in 1890 the market could have understood the huge future success of carbonated beverages and, more precisely, of Coca-Cola. Numerous financiers would then have tried to take over the company, giving it a fabulous value, fabulously greater, in any case, than the capital that would be needed to create a credible competitor. At the time Coca had neither the distribution networks nor the very strong brand which now constitute a great protection against the competition. Thousands of pharmacists and chemists could therefore have invested a moderate amount to launch their own soft drink, in the hope of likewise creating a company that would instantly be worth millions of dollars. In such a tough competitive environment, Coca-Cola would probably not have been able to expand so easily and hence its true value would have been far lower!

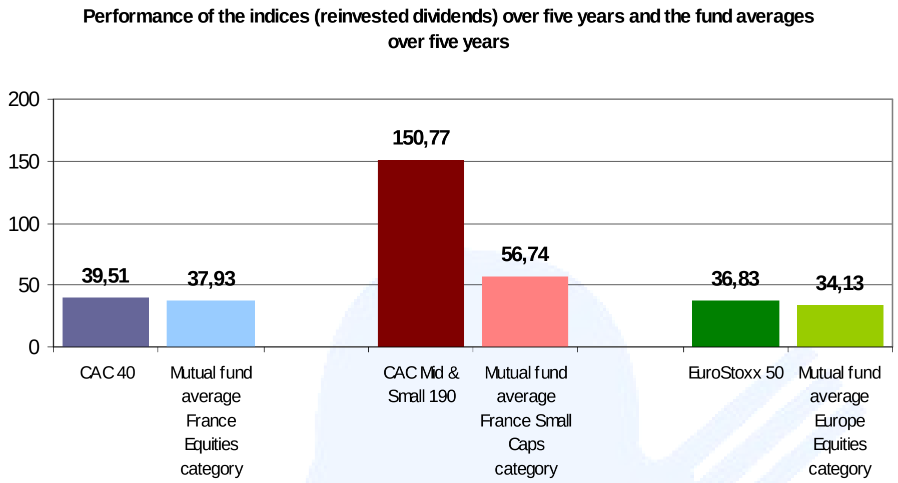
Very serious investors have made their fortunes on this principle: when the market gives too precisely a value to a group of companies, i.e. extreme market prices, very high or very low, at the same time it changes their true value, by directly influencing the competitive environment of these companies. A very high price, and numerous competitors will appear. If on the stock exchange a factory is worth ten times its cost of construction, everyone will build factories financed by the markets. A very low price, and the competitive environment will become healthier, because it will be more advantageous to buy listed companies than to build new capacity.

In the same way, in the 1920s, the market suddenly recognized the great value of growth companies, perhaps, moreover, partly due to the emergence of financial analysis! In light of the 2007 market prices, the market at its 1929 peak was rather efficient, offering until today a very respectable return on investment, far greater than that of risk-free rates. All the same, it is interesting to note that whenever the market has moved too close to ex-post valuation efficiency (i.e. if one considers the historic market prices that have followed over the very long term, 10, 50 or 100 years later), there has been a crash.

In conclusion, stock markets are by nature inefficient, because changes in share prices are capable of changing the very value of companies.

Why are managers beaten by the index?

Markets are inefficient, in other words it is possible to beat the index by means of unlikely observations of strong informational value. But if all the observer-investors had access to these observations, they would become highly likely, and hence of no value. By definition, there can therefore be only a small number of investors who could beat the index. Moreover, the average performance of investment funds over five years is there to prove it:



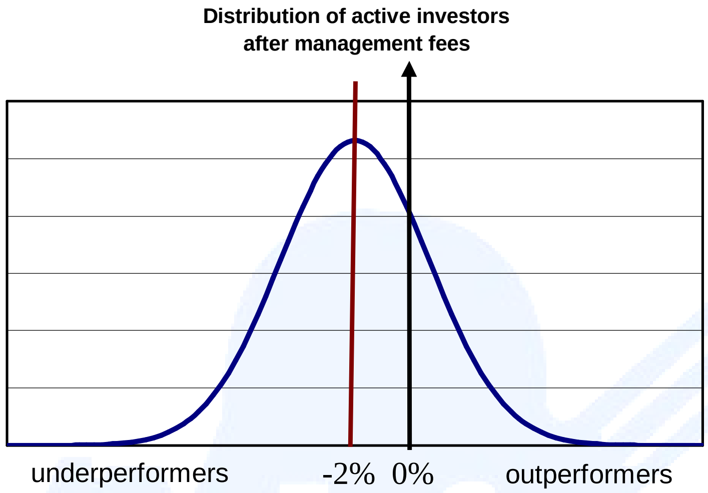
Surprising, isn't it? The managers on average did less well or much less well (almost 100% performance differential!) than the index. And this will always be the case. Here's why.

Active Investors vs Passive Investors

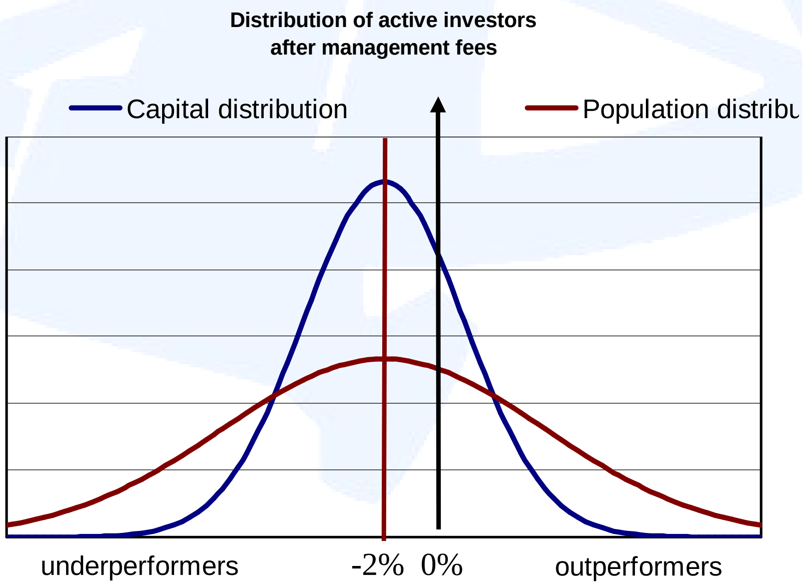
Imagine there exists a world index and an associated fund that tracks precisely the performance of all the shares in the world. And that all investors can be divided into two categories. On the one hand Passive Investors (population PI) who merely buy this fund and replicate the index. On the other hand, all those Investors who believe they are sufficiently clever to beat the market. We shall call them Active Investors (population AI).
The Passive Investors replicate the index, of course. But, what is more surprising, the Active Investors also replicate the index. Because the two populations PI and AI represent all the operators, and since PI replicates the index, the same is obviously true for AI. Otherwise, the whole population, i.e. the market, would not equal the performance of the market itself.
But since the Active Investors pay far more fees than the Passive Investors, on average 2% more, then it can be said that the Passive Investors achieve a better performance than the Active Investors. For a private investor, this means that he must really think seriously before buying anything other than an index fund!

The active investor population

This small demonstration was imagined by Bill Sharpe, Nobel Prize in economics and an ardent defender of the efficient market theory. It simply proves that the market cannot beat itself. But the way in which he presents things is extremely interesting, and has led us to the following thought: if the Active Investors replicate the market (-2% per year!), then they could be distributed, like any population, according to the following bell-shaped curve:



How to become positioned on the right side of the bell
The bell is all the same very worrying, because it shows that very few managers significantly beat the index. Knowing that part of the outperformers achieve this probably through luck, there remains very little room for high-performing investors. Which leaves us rather little hope of forming part of the happy few, knowing the genius of guys like Buffett and a great many hedge fund managers. Fortunately, this bell is also false. In reality one should not speak of the distribution of people, but of capital under management. Remember: the market cannot beat itself and active investors as a whole replicate the index less fees. But it is the capital they manage that all together replicates the index! Now, it is clear that there are huge amounts of capital that are managed by very few managers or management teams. And that there are a huge majority of investors who manage very small amounts of capital. Here then is our new bell:



More reassuring, this curve shows us that the more capital you manage, the more you are likely to come closer to the average underperformance of -2%. And the less capital you manage, the more chance you have of being positioned on the right-hand part of the curve. It is obvious that even Warren Buffett cannot position the capital managed by Berkshire

Hathaway on the extreme right-hand of the curve. On the other hand, give him just 1 million dollars and he will provide you with a return of 50% per year. In any case that's what he claims, and we are convinced that he would do even better in the first few years.

That is why we want to see controlled growth in the size of our funds, and why we shall never convert our company into a machine for raising capital.

Sorry to have written such a long and boring letter, and congratulations if you have managed to read it through to the end. In truth, this efficient market story is nevertheless rather alarming, because it implies that we could merely have been lucky until now. That is why it was important for us to wring its neck for good. It is still very widely taught in our universities, which is sad because it encourages young people not to think. The problem remains that very few managers actually beat the index over the long term. We shall do everything to be among the happy few, without scruples. Even cheating:

- by refusing to manage too much capital;
- by spending less time doing sales work;
- by observing heaps of things that are unlikely and not always clean such as factories, warehouses, suspect websites, backyard garages, oil wells, etc.;
- by reading piles of books which are apparently completely irrelevant, on history, science, and even investment!
- by choosing a longer investment horizon and thus accepting more volatility;
- by travelling the world to uncover nuggets, understand other cultures and keep an open mind.

Yours truly, and I hope very unlikely

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