ALVIA

ASSET PARTNERS

The Pending Growth Trap

Alvia Asset Partners Investment Team Insights

September 2020 Quarter

Introduction

Those who are old enough might remember in 1999 that companies with websites were illegitimately described as having a competitive advantage (not joking) and whilst this sounds absurd, today we are hearing the same unbelievable creativity being used in 'analytical' circles.

Why? Well simply when traditional methods to value companies (such as using cash flows) result in negative values and you want to own something to join a jubilant crowd, you simply must be creative. When the only net positive number you can find is sales then you simply start valuing based on sales. Our personal favourite currently being used is based on the 'total addressable market', which is a largely irrelevant curated number which only works because its big and produces the desired 'analytical' result. Remember if you want to justify owning something to someone then the higher the number the better – just attach a nice story to it and away you go.

At present we would divide investment markets into three segments:

The first being great businesses trading at expensive prices – we love these but just want to own them when the market gets bored with them. Quality is not the only factor that matters. The price paid is also very important and history has taught us this repeatedly.

The second segment represents a viperous pit of speculative mania which we believe consists of very few ultimate winners and a lot of complete zero outcomes that only survive currently based on easy capital markets and a good visionary story. **Nikola which we wrote about last quarter in "Death of value…ation"**, has since been outed as a fraud and likely a zero.

The third and final segment which thankfully is quite large are companies that mania has completely disregarded, and which are priced quite reasonably, with many high-quality characteristics that have been totally neglected. This is where we like participate and will always do so.

What about Amazon?

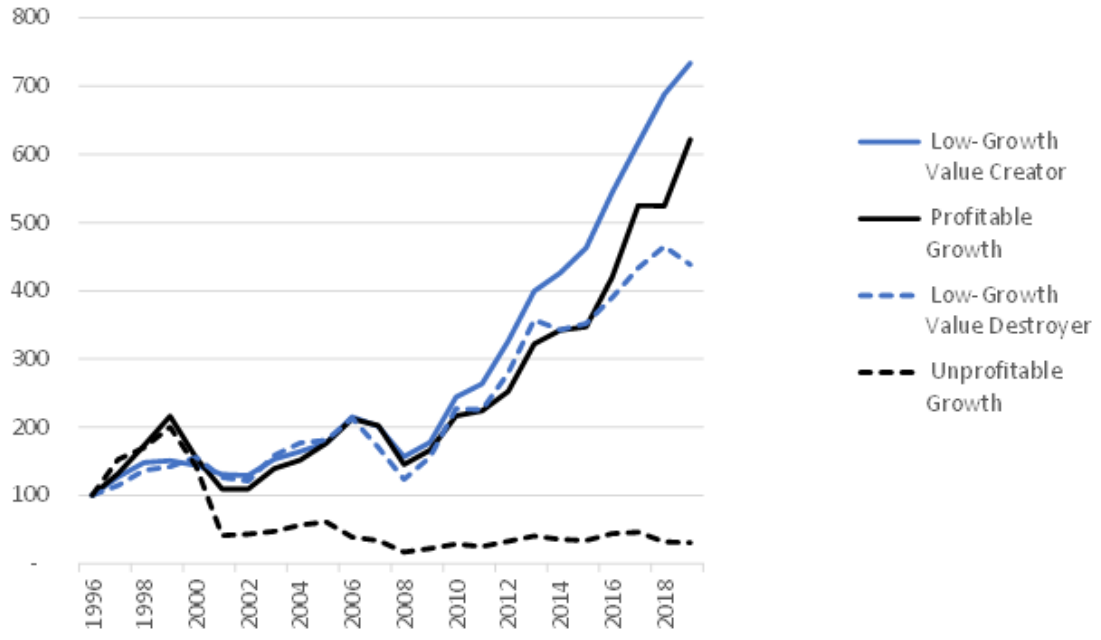
But what about Amazon? This is a company that generated revenue growth year on year and is only now producing profits, having become one of the greatest investments of all time. This is a narrative that we notice has become prevalent in recent times. All we can say is that for every Amazon there are **thousands of failed Amazons** that have purchased revenue and never been able to finance themselves internally and thus failed.

A classic example of this is the recent electric scooter fad, with these eyesores littered all over the Brisbane CBD. These companies produced astronomical revenue growth but this growth never amounted to a sustainable earning rate greater than the cost of capital required to fund the growth. It costs a lot to buy and maintain scooters after all.

Value creators and value destroyers

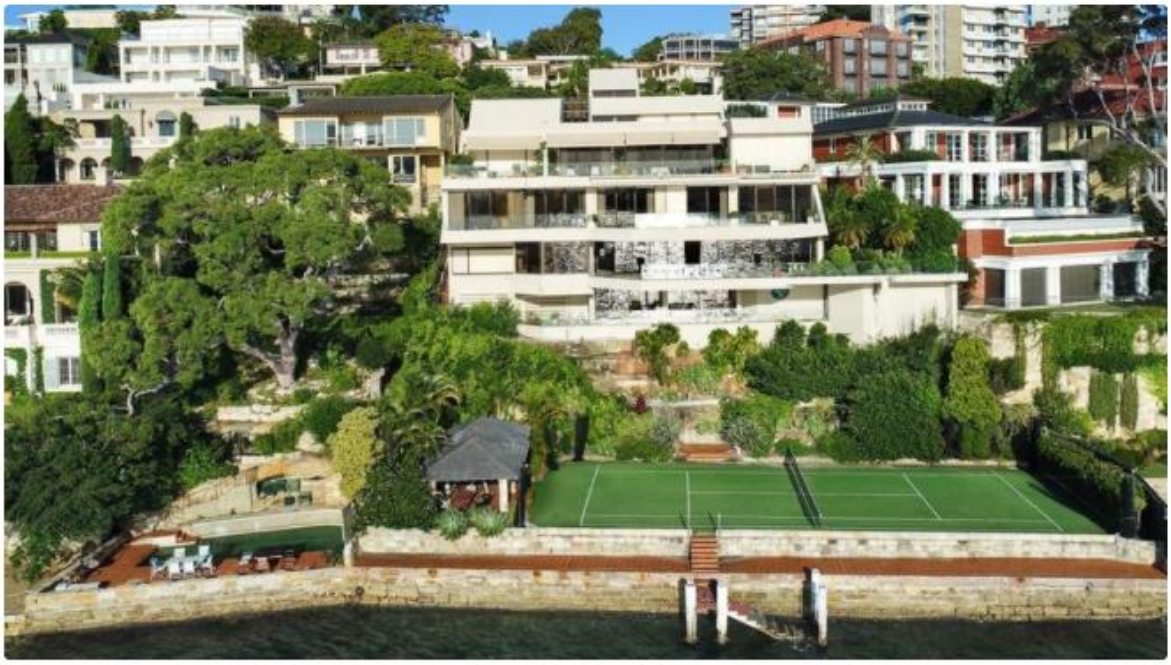
Our preference is for steady growers and the data supports us – see below.

The average total return of low growth value creators is the highest. The difference is the multiple (price paid) – much of the return is generated from a multiple re-rating. Simply put, not paying too much for growth, which is very hard to forecast correctly, is important.



Source: Verdad investments

$95 million sale on the harbour



No. 92 Wolseley Rd, Point Piper, has sold for $95m this week.

There was an amazing story in the paper recently about a trophy home in Sydney that sold for $95 million after being purchased for $5 million in 1985. What an amazing return… or is it?

Annualised its 8.8% per annum (not bad at all), during which time the S&P 500 index generated 11.3% per annum. The moral of the story is to let compounding do the hard work for you. Invest and stay invested and start as early as humanly possible.

The difference of 2.5% per annum over this period equates to an effective sale price of $212 million – even better 😉.

Fed/RBA watch

Its apparent that monetary stimulus will be around for a while. The subtle change in language from the Fed is meaningful. It basically allows them to run over their target for a period. Noticeably the RBA suggested flexibility on their range as well.

- *The Fed has adjusted its inflation target from "2%" to "an average of 2% over time"*

Inflation watch

An easy trick a bond trader taught me to check expectations is to subtract the yield on the 10-year treasury inflation protected securities (TIPS) from the nominal 10-year yield to get a gauge of investors view of inflation.

It jumps around a lot but at the start of the year it was 1.8% - it dropped to 0.60% in the heat of Covid and now sits at 1.6%.

With all the stimulus and having paid to attend an Emergency Department lately – we think 1.6% in 10 years feels a tad light on.

Alvia high level asset allocation tilts

- Low inflation expectations and extremely low bond yields have underpinned the outperformance of growth over value in recent years.
- However, the value factor is starting to perform.
- UK stocks look interesting trading at a large discount to peers. This could close based on a broader rotation out of growth stocks into more cyclical value names.
- Similarly, value in emerging markets, in particular Asia and its related value factor segments deserve a consideration.

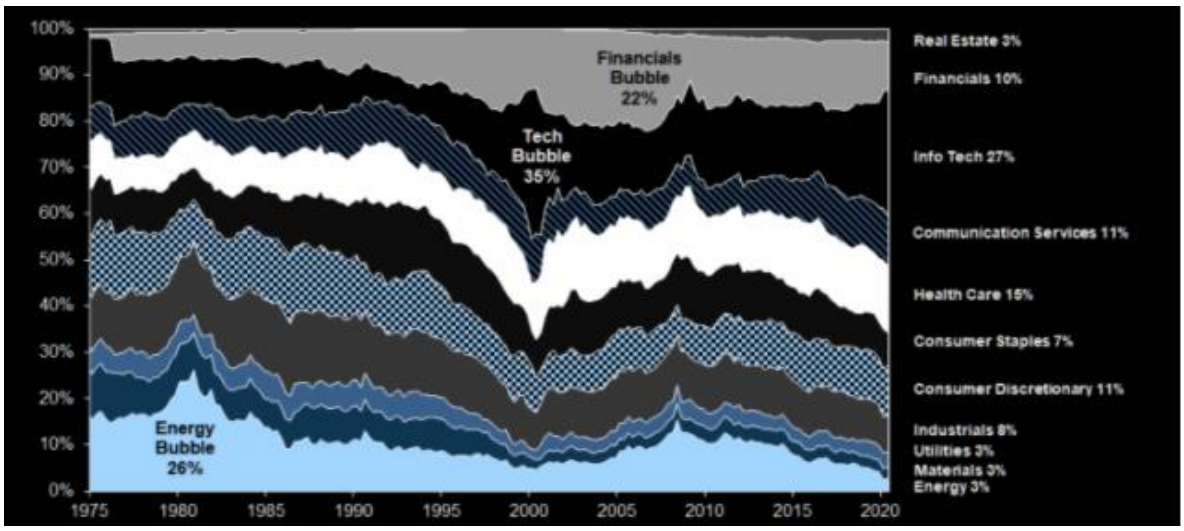
How to strategically hedge in today's market?

Are commodities an option?

- Certain financial assets (technology sector) are becoming increasingly expensive but are you game enough to switch up your Microsoft shares into Exxon?

- Have you noticed Apple is roughly three times the weight of the entire energy industry within the S&P 500 index?

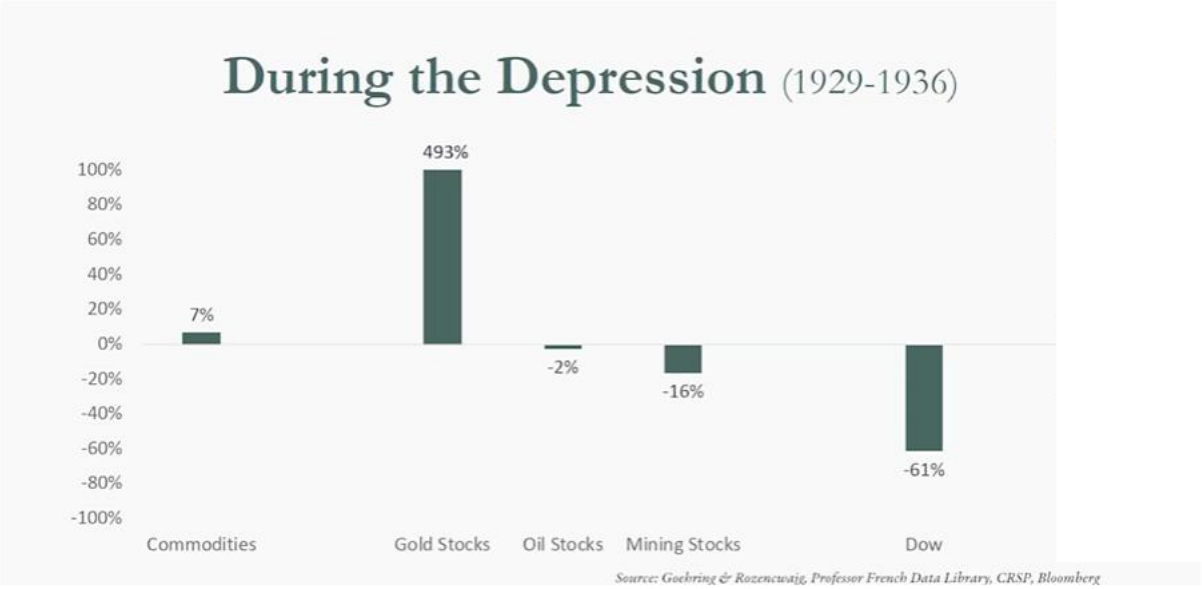
- The energy sectors weighting in major equity indices has been falling for years. As of July 31, 2020, the energy sector made up less than 3% of the S&P 500 index and roughly 2% of the Russell 2000 index. To put that into perspective, in 1980 the energy sector peaked at 30% of the S&P 500 index.



- Relative to the S&P 500, commodities overall are the cheapest they have been in 50 years and its apparent most investors are very underweight commodities and very overweight technology.

Source: The Marketeer

- Its unloved and interesting and commodities also provide a natural market and inflation hedge - a characteristic which we find interesting. **See commodities performance during the depression.**



- In addition, the energy sector overall appears the most discounted of the commodity segment.
- Below are some more charts that further explore this possibility.

Chart 14: Today 1 share of SPY ETF buys 8 barrels of oil, was 1 in 2008

Source: BofA Global Investment Strategy, Bloomberg

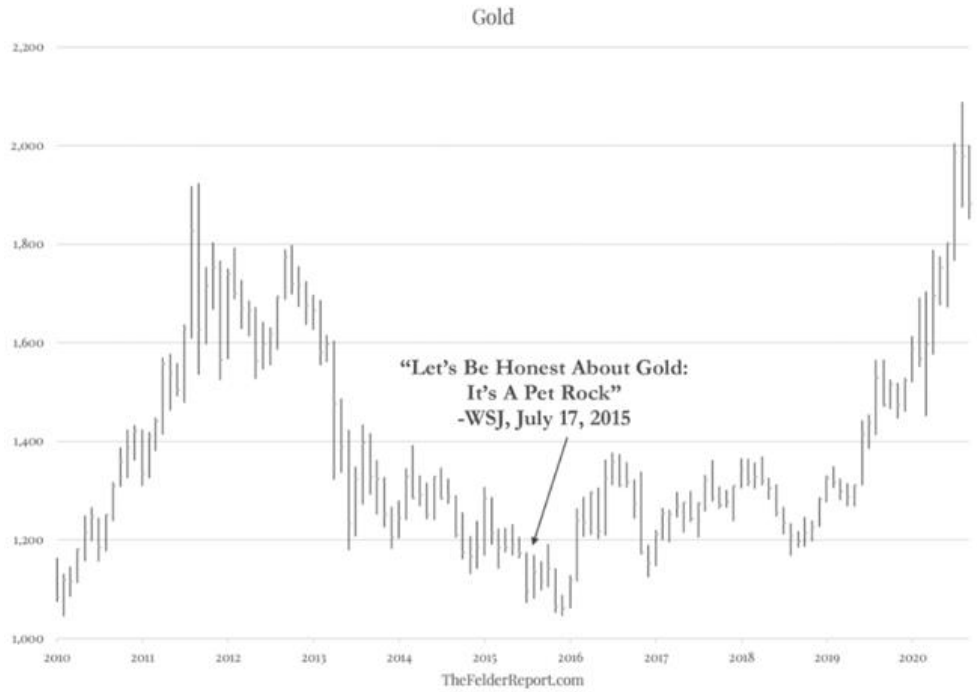
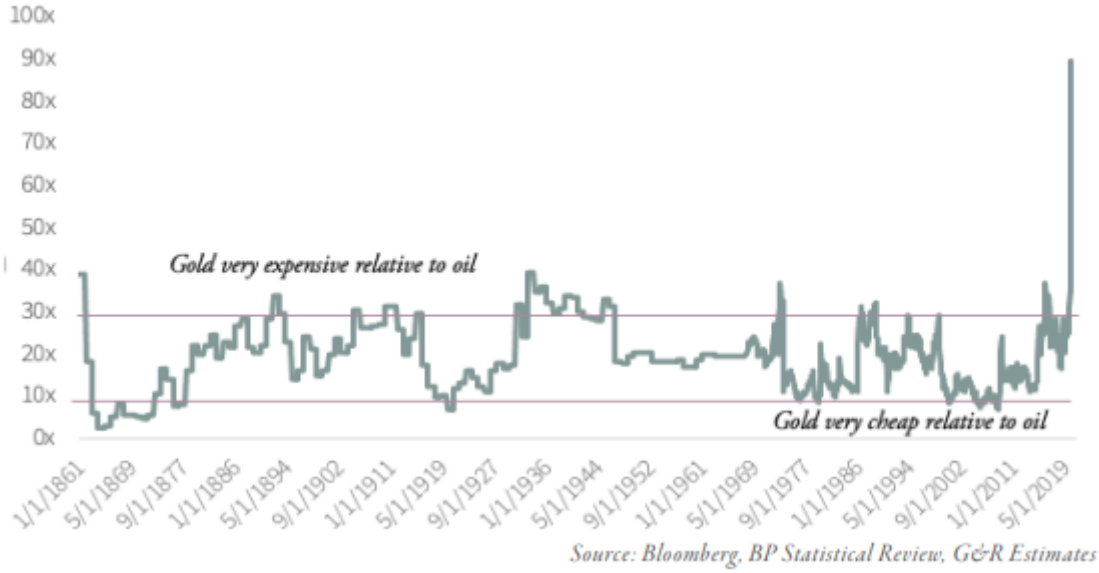


FIGURE 5 The Gold-Oil Ratio *1860-2020*



- Looking at oil versus gold is interesting as it provides a potential insight into potential returns as the last time oil prices traded at higher than 47:1 to gold – oil rallied 191% and oil stocks appreciated significantly.

So should commodities play a part in a balanced portfolio?

- In our opinion the answer is yes, and it depends.
- The two greatest endowment funds of our generation are Harvard and Yale (super endowments below) and they both maintain a commodities exposure. They are tactical around this exposure and increase it as equity valuations increase – as do we.
- Why do they? Because they provide a natural market hedge – i.e. commodities perform counter cyclically to the broader equities market.

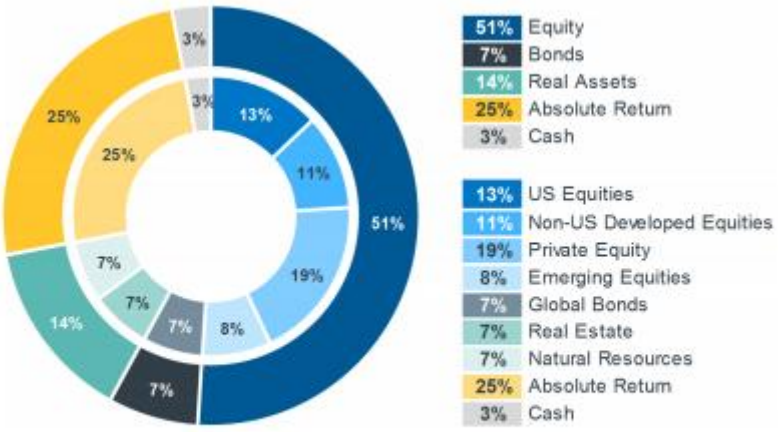


Chart 1: Asset Allocation of the top US Endowment Funds > $ 1billion 2016[6]

What about bond allocations?

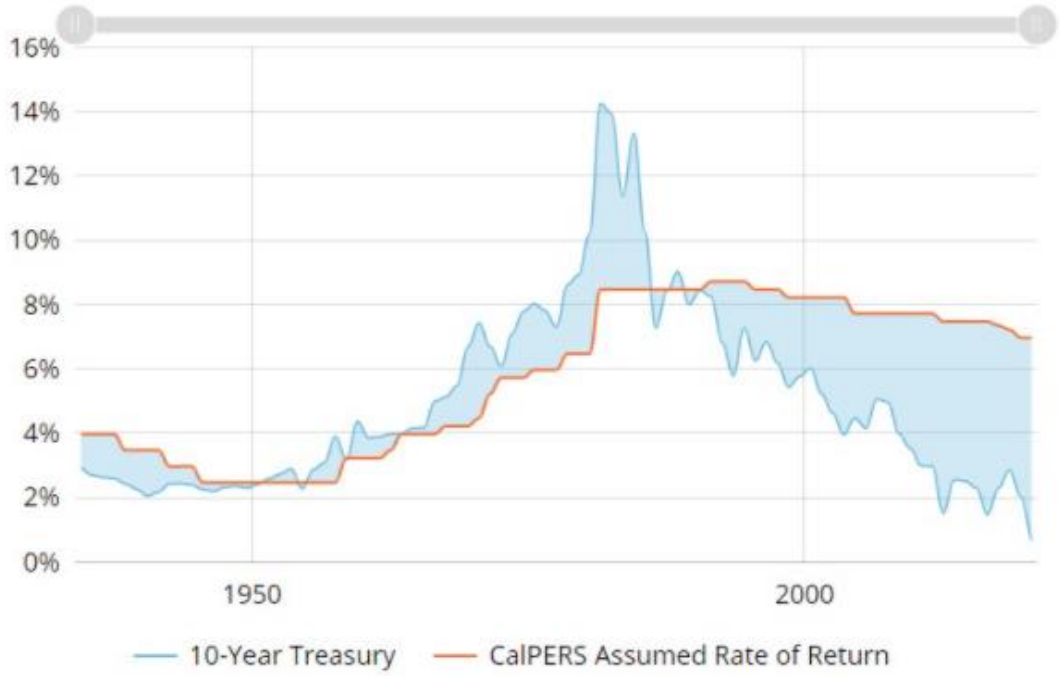
- What to do as a bond investor in today's market?
- Only last month CNBC produced a story of a $330 billion dollar pension plan reviewing its bond allocation on the basis of a non-existent return profile.
- The real question here is how could they not? It has to be addressed when the average return required in this environment is 6% and sovereign bonds are largely negative yielding instruments and investment grade corporates offer circa 2%.

What does this mean?

- The below shift in large institution asset allocations paints a pretty clear picture – an increase in allocation to alternative assets such as private equity whilst maintaining large public equity weights.

CalPERS is the Californian pension fund (largest on earth)

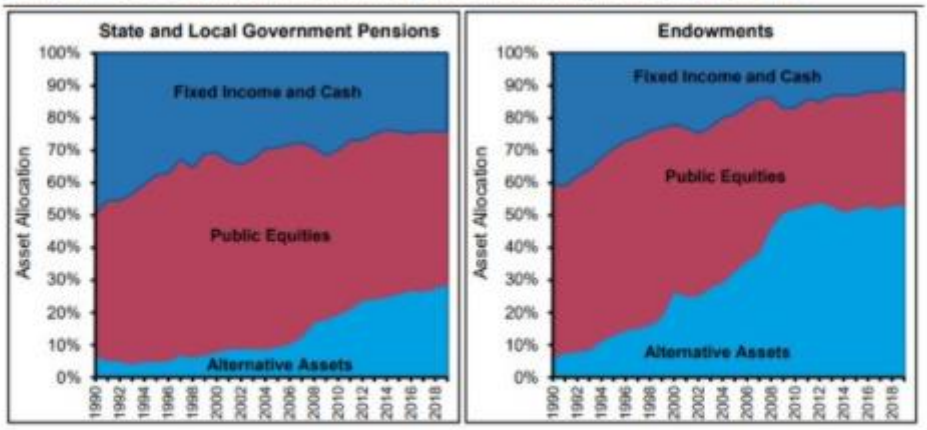
- Maintains a circa 7-8% return expectation despite 10-year treasuries offering next to nil return…?



What are their options? Same as any family household

- Take more risks
- Change your asset allocation/investment strategy
- Lower your expectations
- Spend less (or fundraise more)

Exhibit 11: U.S. Pensions and Endowments Move to Alternative Assets, 1990-2019

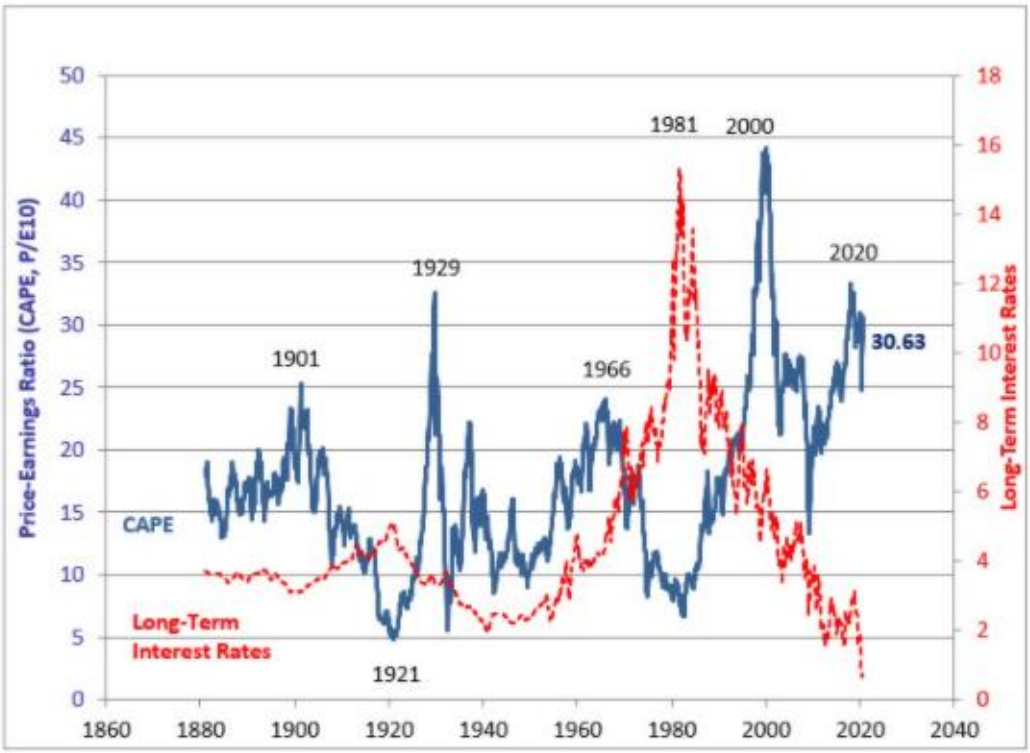


Source: Public Plans Database; Ronald J. Ryan and Frank J. Fabozzi, "The Pension Crisis Revealed," Journal of Investing, Fall 2003, 43-48; National Association of College and University Business Officers (NACUBO); and "Stephen G. Dimmock, Neng Wang, and Jinqiang, Yang, "The Endowment Model and Modern Portfolio Theory," Working Paper, April 23, 2018.

Note: Asset-weighted.

What potential risks emerge from this?

- Higher market valuations (see the direct correlation between lower interest rates and higher market valuation).



Higher prices paid for private equity

- The new average EBITDA multiple is 11x when it was 7x a decade ago.

Buyer beware in private markets

- We like to focus on jumping small hurdles as it just makes it so much easier. Our latest private investment was priced at 3x (a lot can go wrong at 3x and we are still ok)
- With more and more interest in the private space (based on historical premium returns to public market) and a touch of perceived sexiness, in the same vein as public markets **just don't overpay.**

The risk in overpaying is severe

- When/if multiples do retreat – it means more growth is required.

Hypothetical example – *if purchasing a $100m revenue business with EBITDA margins of 20% at 11x. On exit if it can only be sold for 8.5x (still higher than the long term average), the investment must grow sales at 18% year on year for 7 years to generate a 15% return (expected for risk in private markets). Just so you are aware, 18% year on year growth is no easy feat.*

In summary:

Giving up liquidity and diversification is not something that should be contemplated lightly, especially considering the opportunity costs of not having access to capital in turbulent times.

Beware the IRR can be easily distorted

- Large investment firm Apollo said it had generated an IRR (internal rate of return) of 39% over the past 30 years.

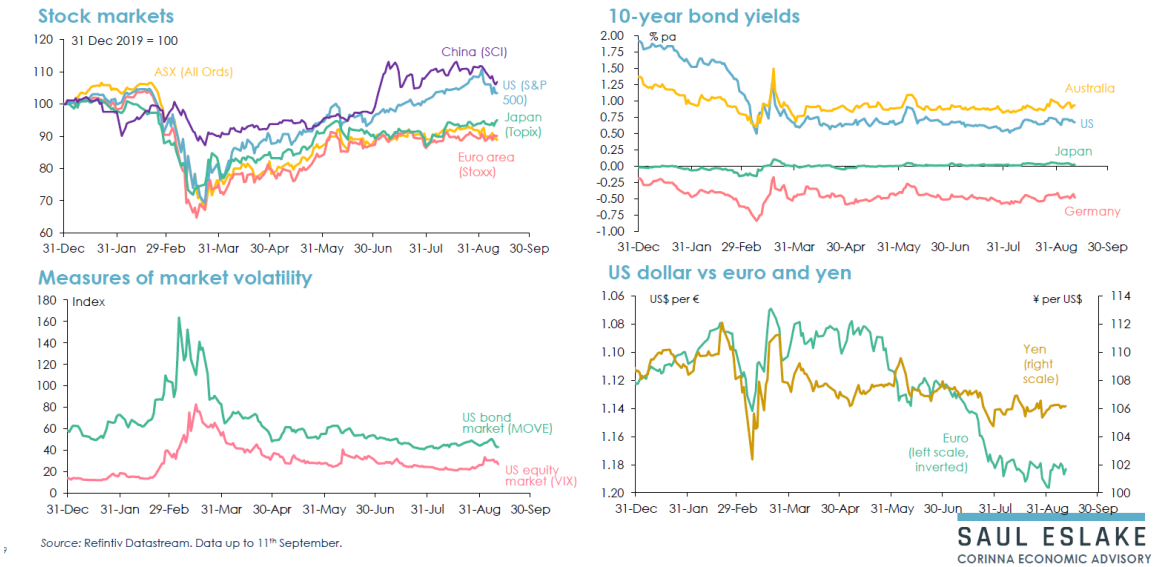
Risk management

JP Morgan had a famous quote about finding an equity asset allocation that allows you to sleep at night. But does it make sense?

- **Sleeping at night is not always the right goal for your portfolio.**
- **It makes sense in theory to select an asset allocation with a risk first mindset but figuring it out based on a what allows you to sleep is not sound advice.**
- **Many would have slept better knowing they were in cash in March but this would have been terrible for their portfolio.**
- The problem is your preference for risk often changes more than your tolerance for risk based on what's happening in the markets.
- **Most good investing should be at least a little uncomfortable at times.**

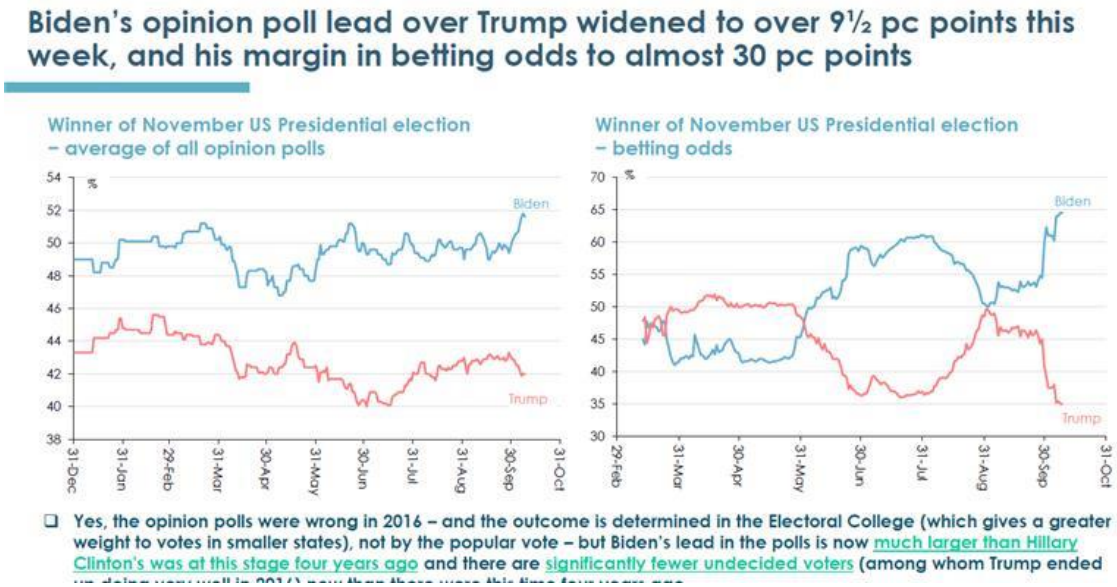
Markets and bond yields

- Best Covid performers were the two in dispute (China and the US) for two very different reasons.
- Aussie 10-year bond yields holding a 1% earn which is actually relatively generous in a world where Greek bonds offer sub 1%.



Source: Saul Eslake

Biden is leading the polls if you believe them – consensus fear is it's bad for asset prices however it might not be (a Biden stimulus package is likely to be larger than Trump's)



Source: Saul Eslake

Overall there is much to decipher regarding the election but it's important to note that irrespective of the outcome that the stimulus will be significant

- The below summary from Wellington Management breaks it down succinctly

FIGURE 1

Scenario	Economic implications	Risk-asset effect	Comment
Trump status quo	Continued low-tax/ low-regulatory regime; increased spending; continued geopolitical uncertainty	Moderately positive	Markets like lower taxes and lower regulation, but don't like trade tensions.
Biden + split Congress	Somewhat higher taxes/more regulation; increased spending; more predictable trade/tariff outlook	Unchanged to moderately negative	Fiscal support will continue, but Congress may keep spending, taxes, and regulation in check. Trade policy should stabilize.
Blue wave	Highest taxes/most regulation; increased spending; more predictable trade/ tariff outlook	Moderately negative to negative	Higher spending and taxes, but trade policy should be more stable.

Source: Wellington Management. | For illustrative purposes only. | Views expressed are current only as of the date of this publication and may be subject to change.

FIGURE 2

Scenario	Priorities	Potential winners	Potential losers
Trump status quo	Infrastructure	Value, retail, travel, materials, defense	Stocks reliant on global trade, renewables
Biden + split Congress	Infrastructure, climate	Renewables, transport, materials, munis	Telecom, technology, pharma
Blue wave	Infrastructure, climate, health care	Renewables, transport, insurance, munis, small caps	Banks, pharma, energy, technology, telecom, defense

Source: Wellington Management. | For illustrative purposes only. | Views expressed are current only as of the date of this publication and may be subject to change.

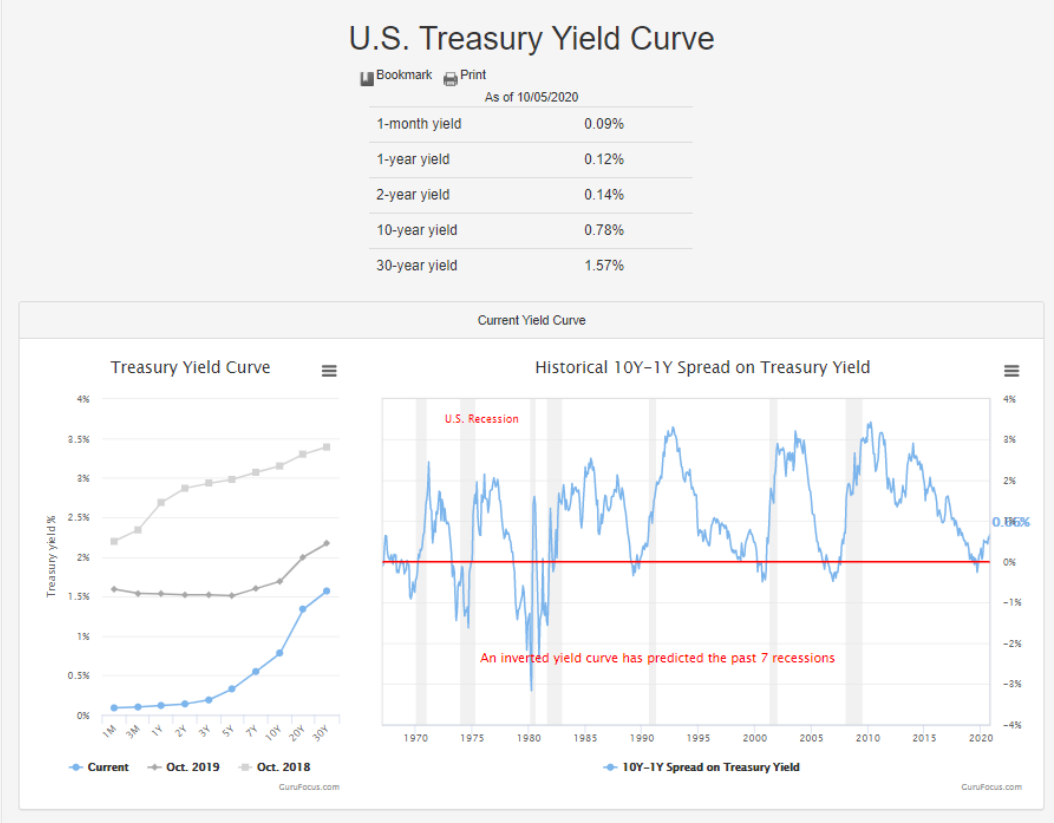
Stimulus is short/medium term good but long-term nasty

- Expansionary policy is a sugar hit but can have longer term health impacts
- It drags forward consumption – i.e. home buyer borrows earlier and larger than anticipated.
- Lower IRR projects see the light of day that might not under different conditions.
- Labour hiring activity is pulled forward around project pull forward.

Problem with all the above is:

- Expectation for ever stronger doses builds to offset the potential contraction in the future and resilience for the contraction suffers.
- The law of diminishing returns kicks in and ever larger responses are required to induce acceptable responses.
- Zombie entities prosper without being tested by business cycles.
- Easy money brings rogues and frauds to the dance.
- Genuine prosperity isn't created as insiders prosper and outsiders miss out.

10-year Treasury watch, gold and the S&P (what a journey)



Source: Gurufocus

Current 10-year yield – why is it important?

- Because almost all assets worldwide use it as a base rate, and it provides a sense of expectation.
- It's actually been very volatile this year.
- On February 26th the yield was 1.27%
- On May 27th the yield was 0.68%
- On October 1st it was 0.68%
- **Current 0.78%**

S&P 500 vs. gold

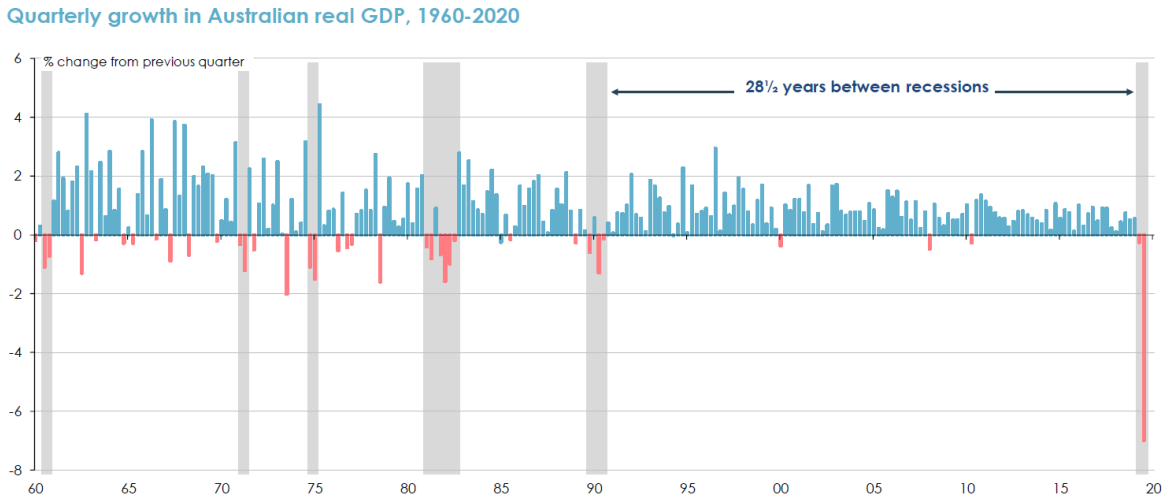
- 3,116 February 26
- 2,237 March 23 (trough)
- 3,381 October 1

Gold

- US$1,642 February 26 US
- $1,561 March 23
- $1,911 October

Australian macro

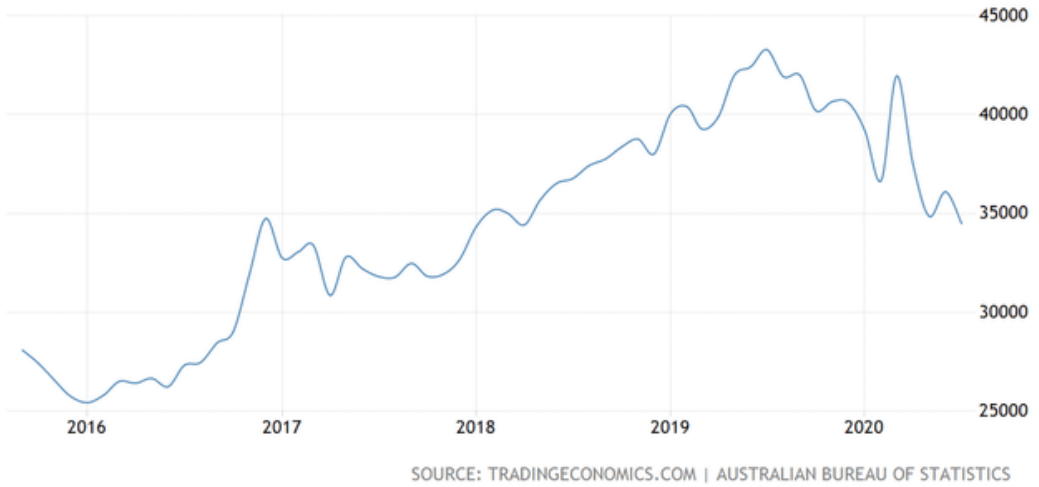
At least we can stop talking about the pending recession…



- Iron ore prices have saved our bacon again
- We continue to export significant volumes to China and have eaten into Brazilian exports despite Australian and Chinese relations deteriorating.
- It would be naïve to believe that this continues and that China is not seeking to develop alternative sources (i.e. Africa) to reduce their reliance on Australian iron ore and commodities in general.
- Trade tensions between Australia and China are reflective of Chinese inbound investment, with the Australian National University reporting that Chinese investment into Australia is down by 47% percent, from $4.8 billion in 2018 to $2.5 billion in 2019

- Export volumes also reflect a relationship softening (below).

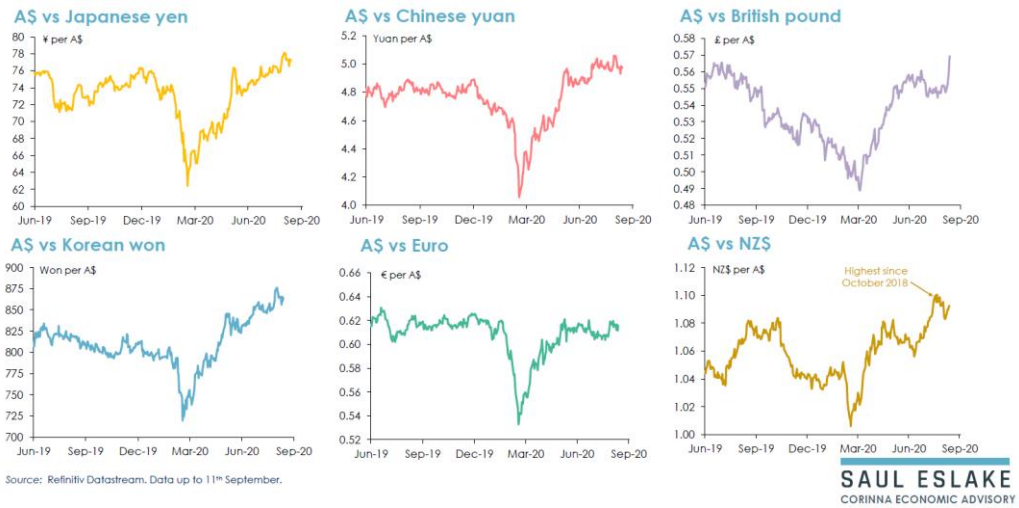
Chinese Exports



Source: ABS

- It's obvious that as an economy our balance sheet has deteriorated significantly with net debt set to blow out to in excess of $1 trillion or 44% of GDP (at least relative to others we look less levered).

- The AUD has been incredibly strong against most counterparts (commodity strength). See below.



Source; Saul Eslake

Today's largest risk for many is expectation unmet

- It's fair to say that many of today's listed entities with a good story and not much else face an age-old risk factor and that's unmet expectation.

- It's hard to find a better example than alternate meat company Beyond Meat.

Example: Beyond Meat (BYND)

It's fair to say that the market has some pretty high expectations, willing to paying a multiple of 1476 times questionable EBITDA...

Therefore, it needs to produce the goods, or they may have some problems. As investors that pride ourselves on a margin of safety, we highlight a few roadblocks in their way to meeting lofty expectations:

- *Slowing revenue growth*
- *Lots of competition*
- *Lack of competitive advantage*
- ***Most importantly, a stock price that discounts the above and implies huge growth.***

I am backing the below new competitors with deeper pockets and better fundamentals

Company Name	Ticker	IC Turns	NOPAT Margin	ROIC
Hormel Foods Corp	HRL	1.3	10%	13%
SYSCO Corporation	SYY	4.0	3%	12%
Nestle ADR	NSRGY	0.8	14%	11%
Kellogg Company	K	0.9	10%	9%
Tyson Foods, Inc.	TSN	1.3	5%	7%
The Kroger Company	KR	2.8	2%	6%
ConAgra Foods Inc	CAG	0.5	13%	6%
The Kraft Heinz Co	KHC	0.2	14%	3%
Beyond Meat Inc.	BYND	1.6	2%	3%
Peer Group Market Cap Weighted Average		0.8	12%	9%

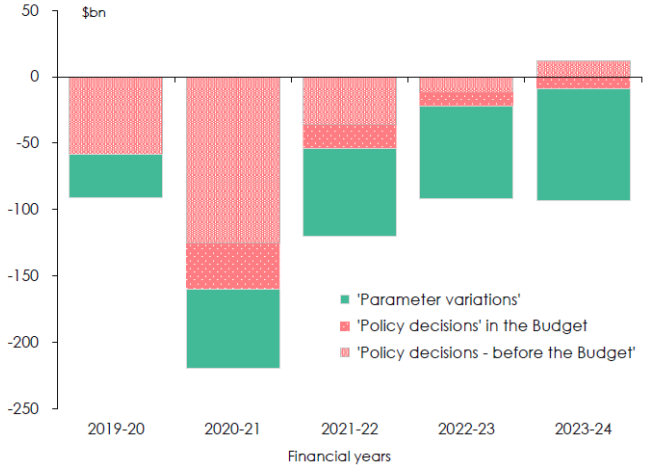
Source: New Constructs

Covid update – lets try and be optimistic

We figure enough has been said for a lifetime on Covid so we will keep it short and upbeat

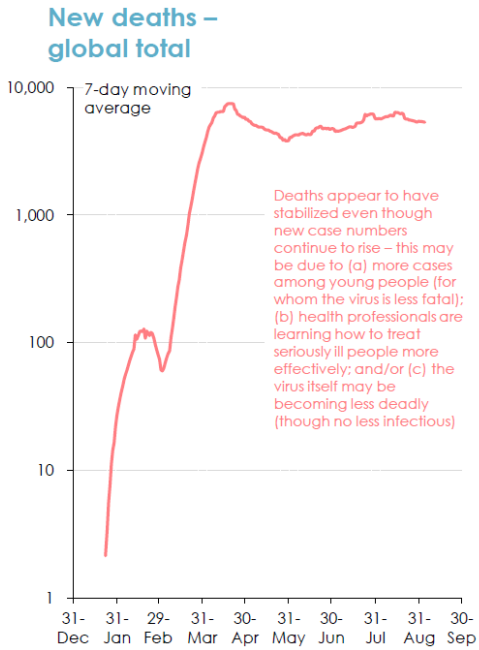
- Health outcome has been excellent relative to the Spanish Flu pandemic of 1918 that killed as many as 50 million people worldwide, yet people barely talked or wrote about it after the fact.
- In summary we are safe but with safety comes a big financial burden for future generations.

Budget – hey big spender



Source: Australian Government, 2020-21 Budget Paper No. 1, Statement No. 3 and Budget Paper No. 2, Budget Measures; Corinna.

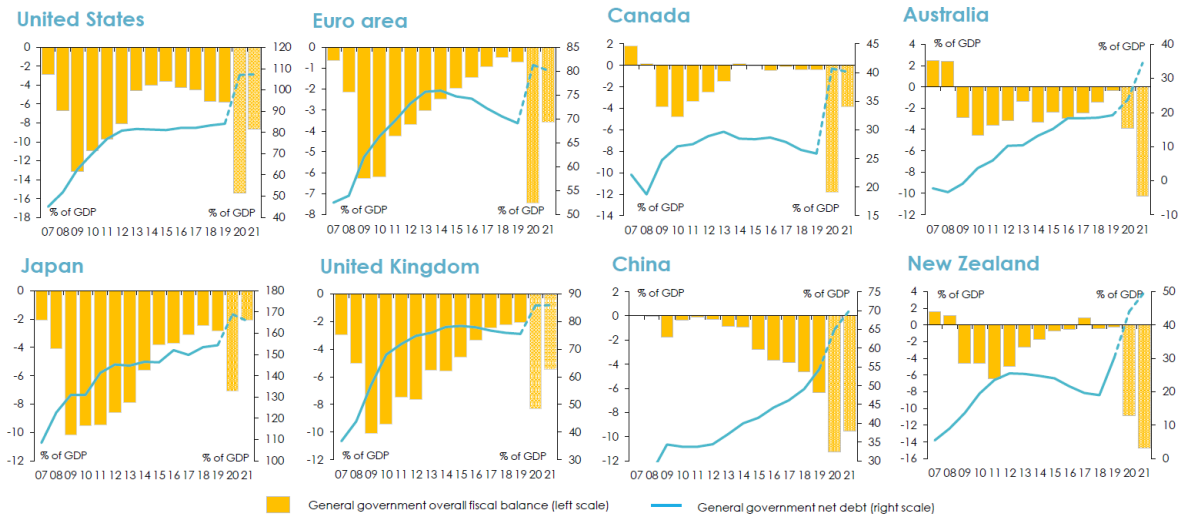
11



Source: Saul Eslake

Fiscal and monetary stimulus combined

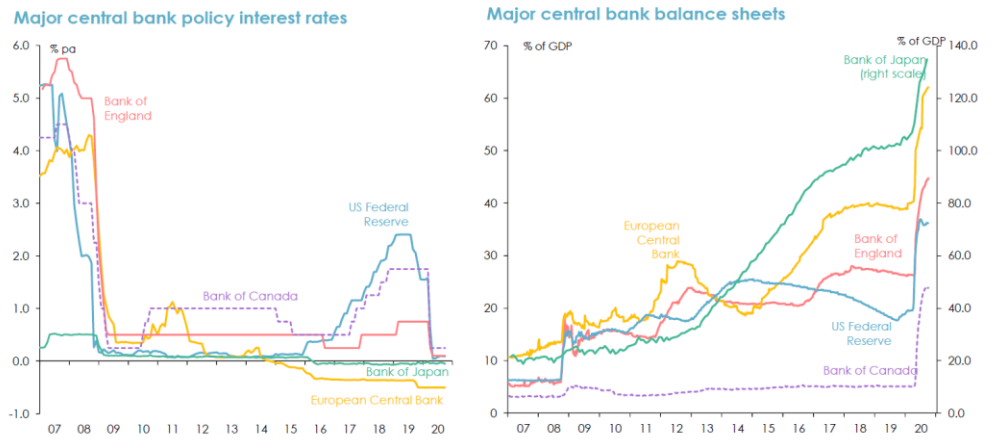
Governments around the world are doing more by way of fiscal stimulus than they did during the global financial crisis



Note: UK data does not include the measures announced by the Chancellor on 8th July; China debt is gross debt, not net; Australian data are for the federal government only and are for fiscal years ended 30th June; NZ data are for fiscal years ended 31st March. *Sources:* International Monetary Fund, *Fiscal Monitor*, April 2020, and *World Economic Outlook*, June 2020; Australian Government, *Economic and Fiscal Update*, July 2020; New Zealand Treasury, *Budget Economic and Fiscal Update*, May 2020.

SAUL ESLAKE
CORINNA ECONOMIC ADVISORY

Major central banks have cut interest rates to record lows, and done more 'quantitative easing' than during the global financial crisis



Note: estimates of European Central Bank assets as a pc of GDP for weeks since the beginning of April have been revised upwards by around 5 pc points of GDP following the publication by Eurostat this week of estimates of Q2 nominal GDP (as happened with estimates of Bank of England assets as a pc of GDP three weeks ago. Estimates of US Fed, and BoJ assets as a pc of GDP were also revised up with the use of Q2 nominal GDP as the denominator, but less sharply.
Sources: US Federal Reserve; European Central Bank; Bank of Japan; Bank of England; Bank of Canada; national statistical agencies; Corinna.

SAUL ESLAKE
CORINNA ECONOMIC ADVISORY

Expectations for 2021 are driven by unheralded stimulus producing a bounce

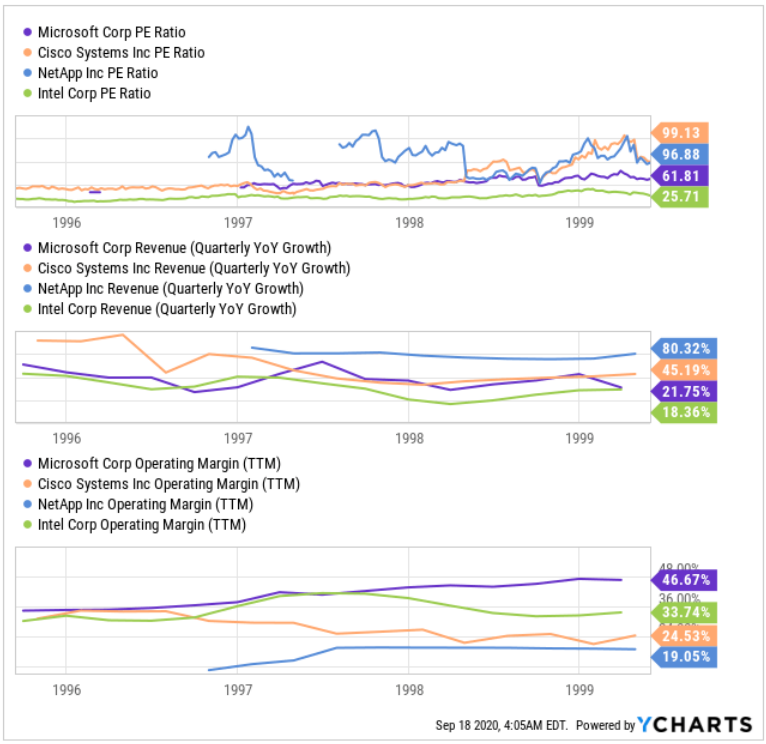
Major global institutions' growth forecasts for 2020 and 2021 compared

	Actual	IMF		World Bank		OECD*		Australian Treasury	
	2019	2020	2021	2020	2021	2020	2021	2020	2021
US	2.3	-6.1	4.5	-6.1	4.0	-7.3	4.1	-8.0	4.8
China	6.1	1.2	9.2	1.0	6.9	-2.6	6.8	1.8	8.3
Euro area	1.2	-7.5	4.7	-9.1	4.5	-9.1	6.5	-8.8	5.0
India	4.2	1.9	7.4	-3.2	3.1	-3.7	7.9	-4.0	4.3
Japan	0.7	-5.2	3.0	-6.1	2.5	-6.0	2.1	-6.3	2.8
UK	1.4	-6.5	4.0	na	na	-11.5	9.0	na	na
Australia	1.8	-6.7	7.1	na	na	-5.0	4.1	-3.8	2.5
New Zealand	2.2	-7.2†	5.9†	na	na	-8.9	6.6	na	na
World	2.9	-3.0	5.8	-5.2	4.2	-6.0	5.2	-4.8	5.0
World trade	0.9	-11.0	8.4	-13.4	5.3	-9.5	6.0	na	na

With this significant expectation we have seen the **quality at any price army continues to grow its ranks...**

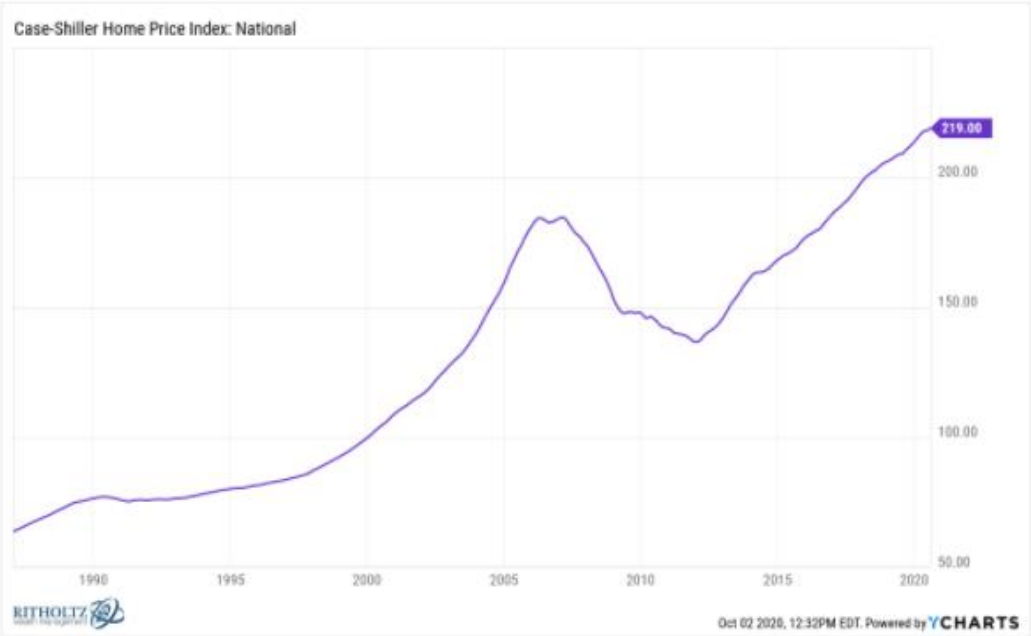
Price does matter no matter what anyone says – it always has.

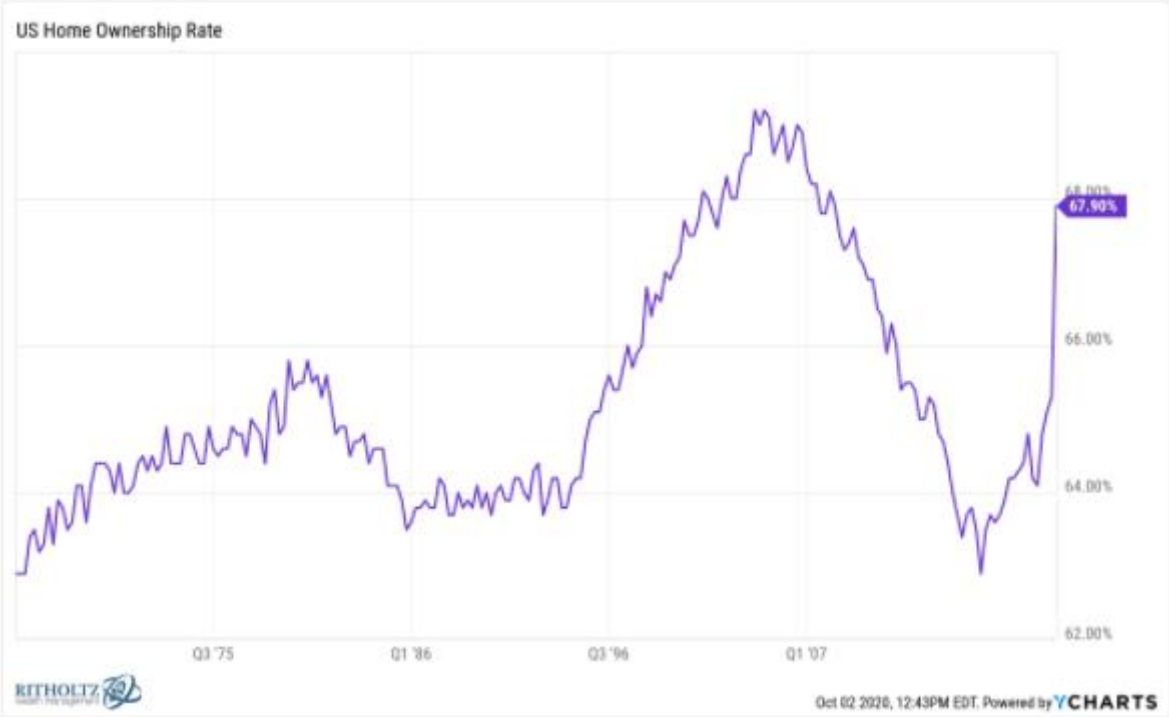
- The facts are capitalism is brutal and margin of safety remains a relevant component of good valuation discipline – price paid therefore matters.
- So let's take a simple trip down memory lane – using four well known examples.
- Microsoft (MSFT), Cisco (CSCO), Netapp (NTAP) and Intel (INTC) were hot among investors pre-2000 as they looked unstoppable with annual revenue growth of 20%-100% and operating margins of 20%-50%.
- Simply if you buy at stock without addressing the valuation, that company at best will deliver as well as it maintains the attention of the herds (they tend to get distracted easily) or you leave yourself open to mean reversion.
- When buying a stock, you purchase a part of all future cash flows discounted to today. If you purchase a stock at extreme valuations, you will be very vulnerable to any negative news.
- Of these four companies, only one has surpassed its 2000 price level (20 years on) and interestingly they have all held their margins very well (measure of quality).
- So what happened? **– their growth rate didn't hold and market sentiment shifted (it's very fickle) ...**
- **If there is such a thing as a value trap there must also be such a thing as a growth trap!**

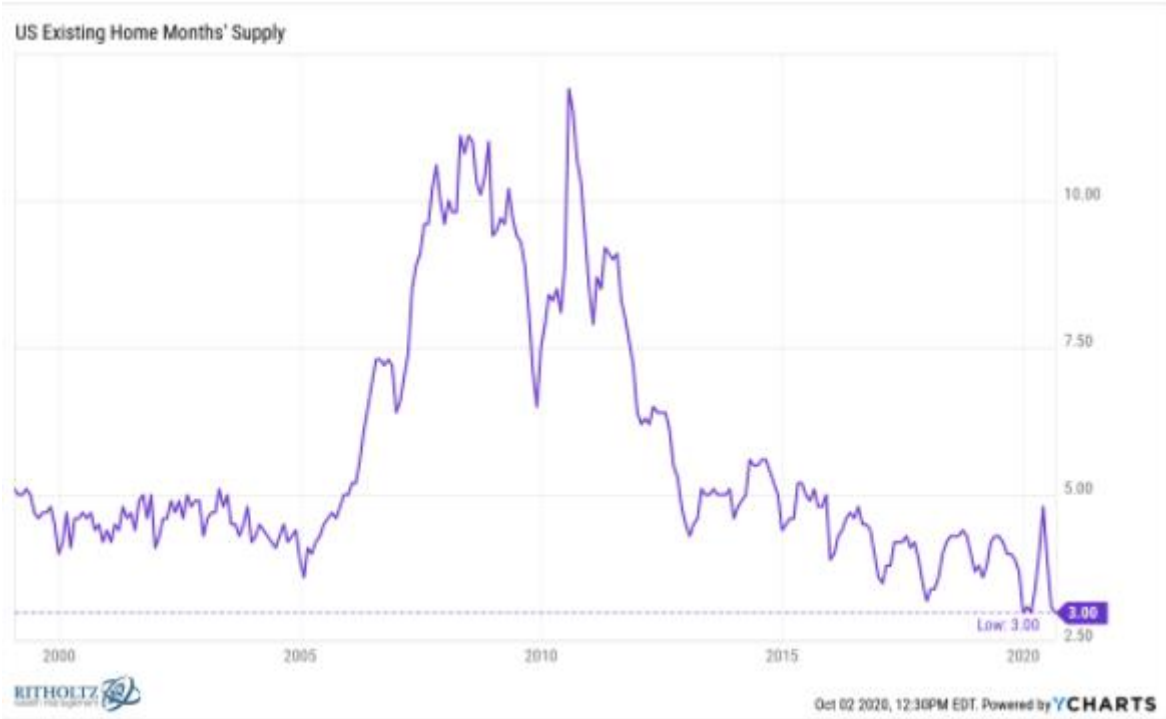


How has Covid impacted US housing? Different this time?

- Surpassed GFC Shiller home price levels (below)
- Home ownership is nearing 68%, which is close to GFC levels (see below)
- The only difference this time is that supply is much tighter (see below)




US Home Ownership Rate
67.90%
66.00%
64.00%
62.00%
Q3 '75
Q1 '86
Q3 '96
Q1 '07
RITHOLTZ
Oct 02 2020, 12:43PM EDT. Powered by YCHARTS


US Existing Home Months' Supply
10.00
7.50
5.00
3.00
Low: 3.00
2.50
2000
2005
2010
2015
2020
RITHOLTZ
Oct 02 2020, 12:38PM EDT. Powered by YCHARTS

Behavioural test of the quarter

Framing matters

Scenario 1

- This company will be profitable for each of the next 15 years. Both sales and net income will grow at close to a 40 percent compound annual rate.
- The company will also initiate a dividend in the third year, which will grow at nearly a 50 percent compound annual rate through the end of the period.

Scenario 2

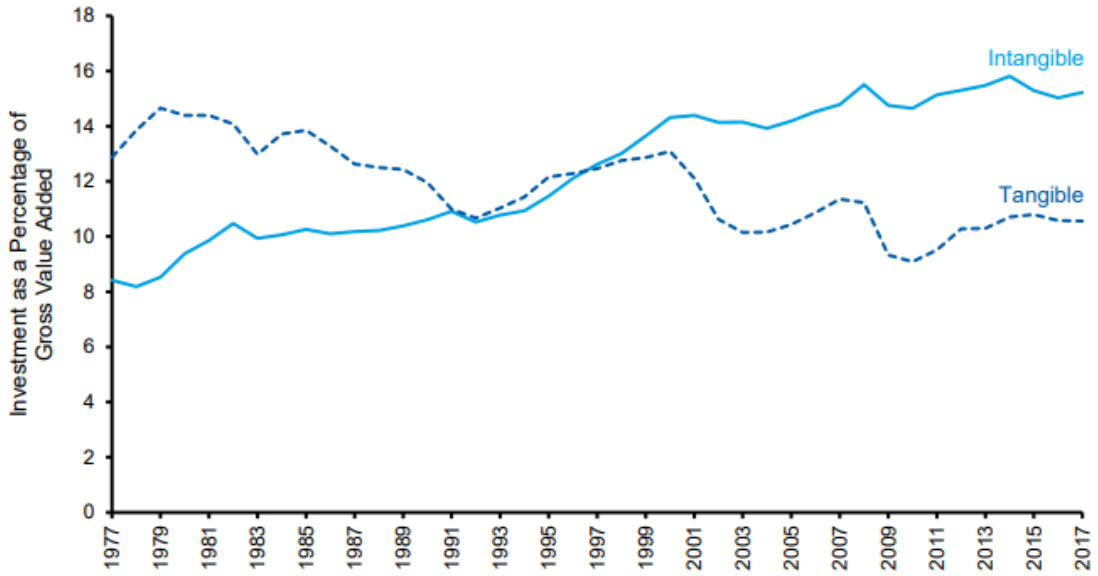
- This company will have negative free cash flow for each of the next 15 years.
- The level of debt will grow at a 34 percent compound annual rate over this time.
- Its cash balance will start at 2.5 percent of sales and will dwindle to 2.0 percent by the end of the period.

As you may have guessed, this is the same company, Wal-Mart Stores, Inc., from 1972 to 1986. The annual total shareholder return of Walmart's stock during this period was 29 percent versus the S&P 500's 11 percent.

Accounting has changed? Yes and no

- Intangibles are real assets but be careful (brand has real value but is not reflected on a balance, however, goodwill does and is close to useless).
- Some intangibles are very valuable but are also very difficult to value (see below)
- The new rhetoric of 'investing' through the income statement (P&L) is a dangerous phenomenon.

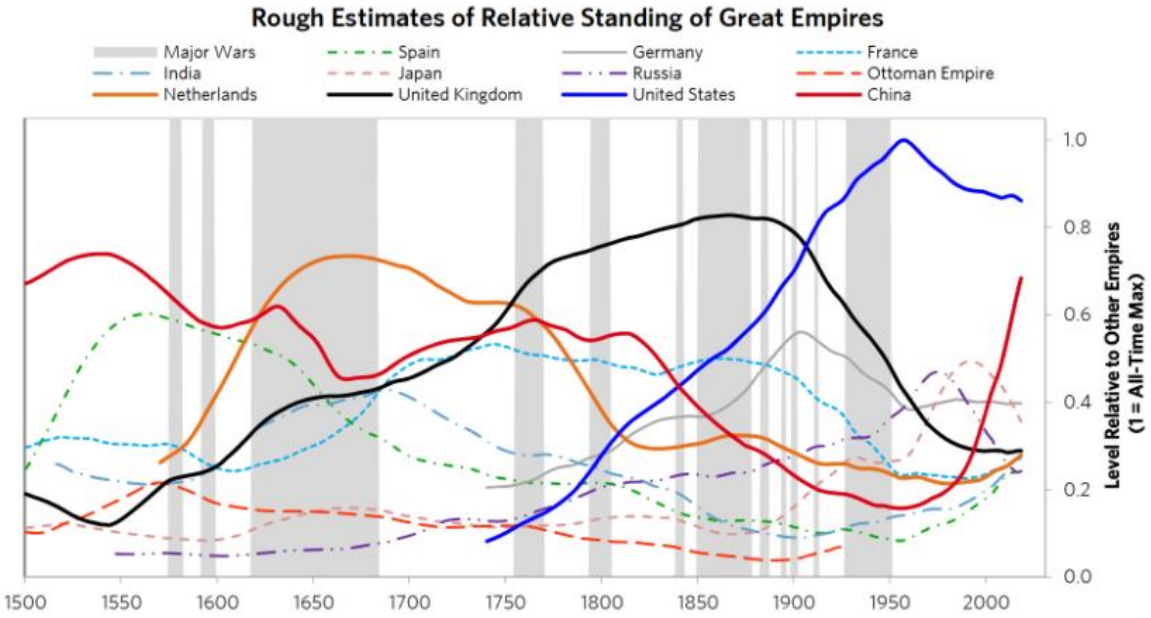
Exhibit 2: The Rise of Intangible Investments in the U.S., 1977-2017



Source: Unpublished update to Corrado and Hulten (2010) using methods and sources developed in Corrado and Hao (2013) and in Corrado et al. (2016) and Corrado et al. (2017) for INTAN-Invest© and the SPINTAN project, respectively. The SPINTAN project was funded by the European Commission FP-7 grant agreement 612774.
Note: Investment as a percentage of gross value added for the business sector.

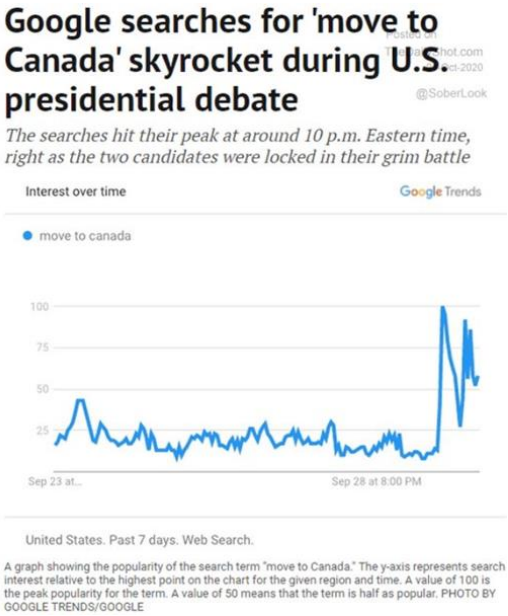
US and China – why all the bicker?

- We believe the below chart by Ray Dalio sums it up perfectly
- The US is the great empire being challenged by the refreshed challenger China.
- China is inherently long term focused with an accepted 100-year vision while the US is very tactical with a vision that aligns with its political 4-year window.
- China is governed from the top down and the US from the bottom up, optimising for the individual and herein lies the basis for almost all the points of tension.



Source: Ray Dalio

In a similar vein to Victorians fleeing for sunny Queensland it appears Americans are looking at a move to Canada

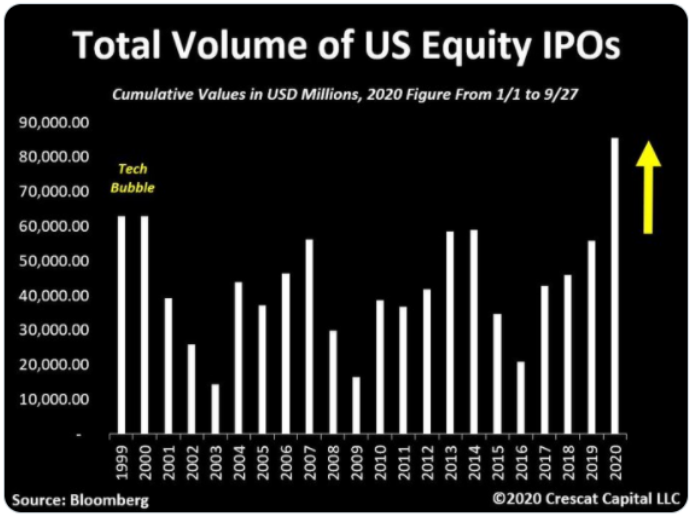


Source: Google Trends

Worry of the Quarter – sellers' market

- In summary, it's the easiness of money and the lack of appreciation for capital
- See below only 9% of all IPOs in 2020 actually generated a profit.
- Asana will list at 34x revenue (with no profit) which will be a new record for exuberance.

Only 9% of all 2020's IPOs were actually profitable.



Alvia qualitative check – the best businesses are aware of all stakeholders

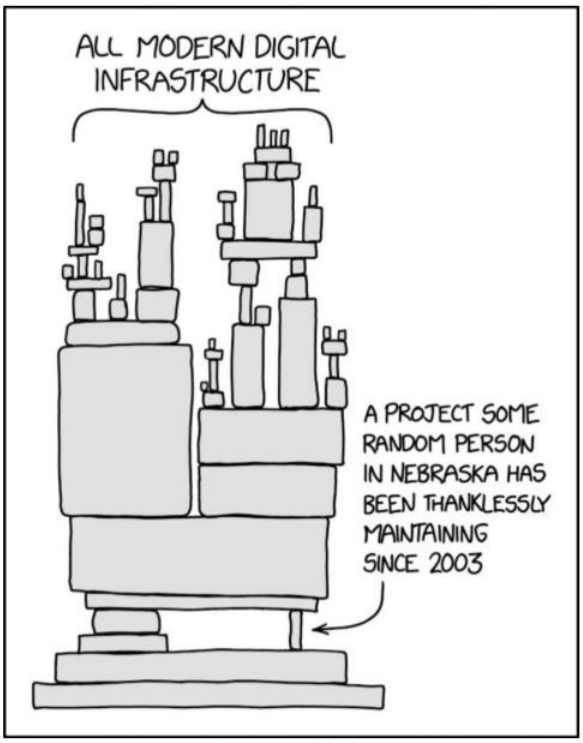
- A lot can be learnt about a business by asking them to prioritise their stakeholders in order – you can very quickly learn who is prioritised and who is ignored.

- In our experience it tends to be an important supplier whom (as below) is a critical cog in the operation but hasn't received a Christmas card since 1987.

- The best businesses map out all of their stakeholders and make everyone accountable to all stakeholders' happiness – i.e. this doesn't mean just looking out for customers or shareholders.

- In our experience 'critical cogs' also tend to make great investments if you can find them. A great example being one of our long term holdings, Gentex which makes high end mirrors for the auto industry – it has been working collaboratively with all the major brands for decades and is treated respectfully by them and retained due to their unique knowhow and maintaining a 90% market share.

- The critical cog tends to reflect in the margins and returns on capital.

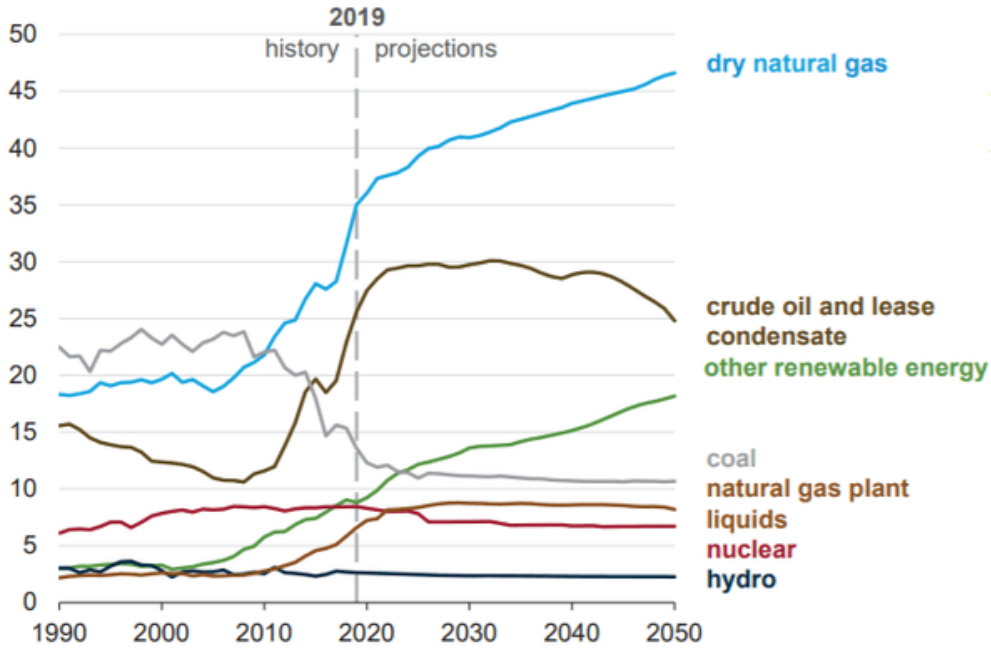


(Source: XKCD)

Source: XKCD

Going 100% Renewable?

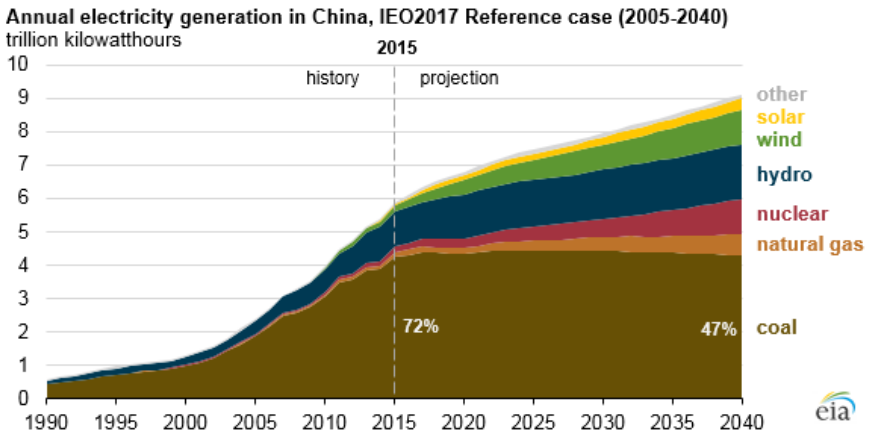
- Yes, an increase in renewables is required and a good thing but it is completely unrealistic to assume a 100% renewable scenario.



Source: U.S. Energy Information Administration's (EIA) Annual Energy Outlook 2020

Looking at China's projection is what really matters

- What does it mean investment wise?
- Unfortunately, renewables will not be able to carry the entire baseload and to physically keep the lights on will require diversity including gas, coal and nuclear.
- We will need to continue to focus on offsetting carbon intensive sources such as coal as globally they will be around for a long while yet.



Source: eia.gov

Berkshire watch

Turning Japanese

- Buying equity stakes in 5 Japanese trading companies – feels very much like a Buffett manoeuvre.
- They are cheap on all metrics and whilst indebted with interest negligible in Japan it shouldn't be a problem.
- They are almost bond proxies with good yields and some upside potential.
- What it does highlight is Buffett's willingness to migrate outside of an inflated tech heavy US market.

Snowflake IPO

- Purchase of $500m at IPO is very unlike WB given it's a tech start-up and an IPO (which he tends to steer clear of).
- Feels like a Todd investment and highlights where BRK might go in the future.
- Add this to an investment in Brazilian payments (StoneCo) and Indian payments via PayTm and it's certainly interesting to see this new side of BRK.
- Only time will judge this evolution – these are small investments in terms of portfolio size and equate to only 10% of the Japanese position which highlights that Warren is still very much in charge.
- In summary, one large conservative bond like bet and some smaller high-risk bets by the younger team members.

Berkshire Hathaway sum of the parts valuation (back of the envelope)

- Burlington Northern Santa FE - $200 billion at least
- Berkshire Hathaway Energy – $70 billion at least
- Manufacturing, service and retailing businesses – $180 billion
- Listed equities portfolio - $227 billion
- Insurance - $25 billion
- Cash - $143.5 billion

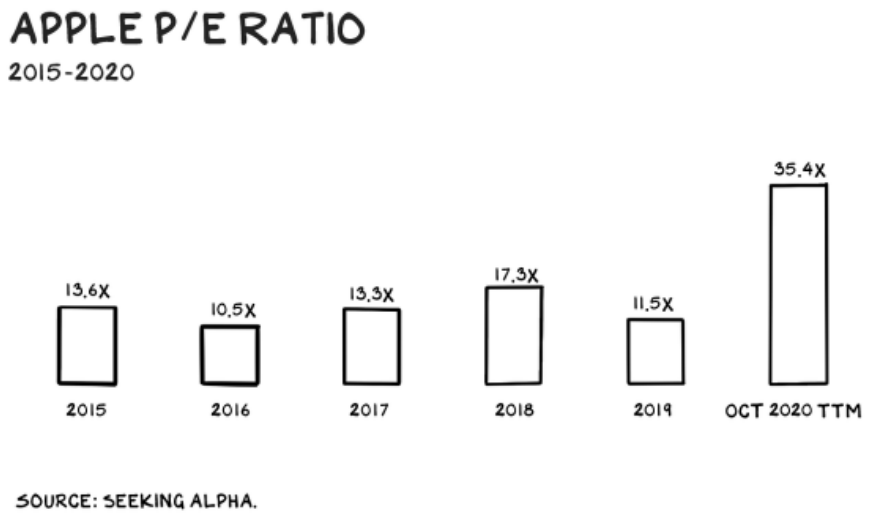
Total **$845 billion**

Current price **$510 billion**

Potential asset valuation upside **$335 billion**

Alvia spruik of the quarter

- We first purchased Apple in 2016 at 10.5x (see graphic below).



- In our opinion, for a business of the quality of Apple it just didn't make sense. Mr Market appeared to be grossly mispricing Apple.

- So what has changed? Well in fairness whilst the business has evolved incrementally, it's been marginal, although the investment community (Mr Market) has completely changed its opinion of the business.

- The investment community communicates in fables and herd views can take hold and when they do it can be powerful.

- The market re-rating of Apple (10.5x to 35x) has been extreme to say the least.

- In 2016, Apple was a tired commoditised hardware manufacturer and now quite simply the conversation has migrated to its recurring services revenue and TV/Pay/services income.

- **It took 42 years for Apple to get to $1 trillion in value and then only 5 months to get to $2 trillion – the difference is the market's perception.**

- Alvia's recent investment in Intel feels eerily similar – we hope for a similar outcome.

Alvia pick of the quarter: Intel (INTC) by the numbers

Intel Corporation (INTC)

By the numbers:

- Operating margin: 33%
- ROE: 30%
- ROIC: 20.5%
- 3-year average EBITDA growth rate: 21.6%
- Debt to EBITDA: 0.97x
- Price to free cash flow: 10.5x
- EV/EBITDA: 5.9x

Expected return – 20% pa

Are we missing something?

Did you know?

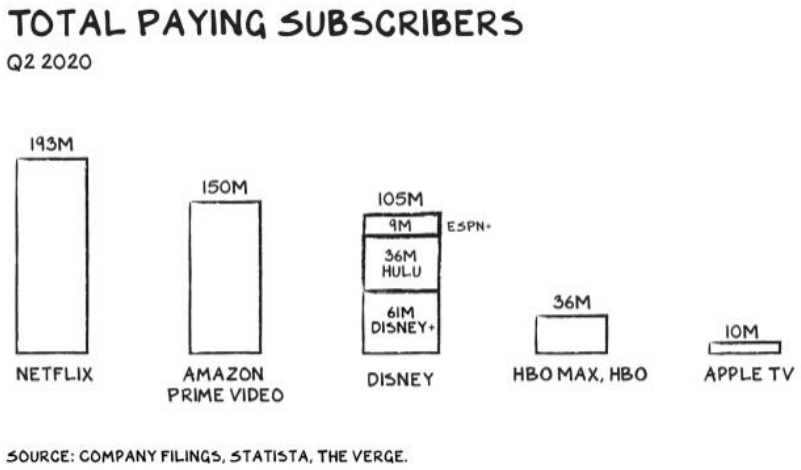
- *Brin and Page tried to sell the Google Algorithm to Excite for $1 million in 1999.*
- *Goes to show just how hard investing is when founders can't even value their own business.*

Fact check

A $1bn investment earning 39% annually over 30 years would be worth $20Tn today (equal to the GDP of the USA)....

Disney catching Netflix

- Yet trade at same price point?
- Doesn't Disney have some other valuable segments/brands?



Buyer beware the theme ETF

- The ETF revolution is largely a good thing but it's worth checking what you actually own.
- The new flavour of the month is the 'thematic' ETF, typically covering a good investment story.
- These are generally a well-publicised and first level thematic such as AI or robotics.

Exercise caution and check:

1. How sure can you actually be in your knowledge re whether the trend will actually play out at all or in the timeframe you believe?
2. How sure are you that the companies within the portfolio will actually benefit as you believe, or at all?
3. Do the price points of the underlying holdings actually create an opportunity to participate as an investor?
4. Is the ETF issuer just selling a product due to demand and do they actually care about performance?

Our favourite that we reviewed was a blockchain ETF:

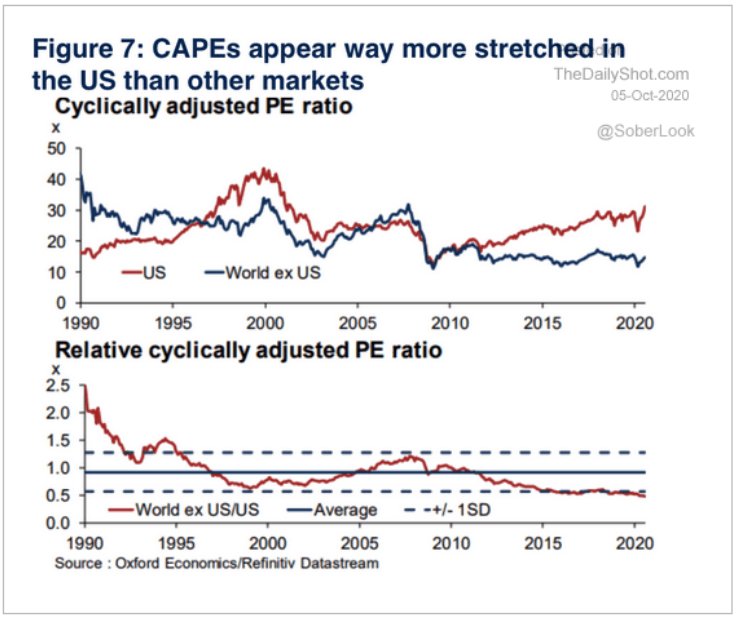
- **Its largest holdings are AT&T, Microsoft and Amazon.**

Yes, these companies might benefit from blockchain, but their price movements will certainly be driven by almost everything other than blockchain adoption.

Valuation check

- The US equities market continues to look strained however hugely dispersed and condensed to the technology sector

Equities: Based on CAPEs, US shares are extremely overvalued vs. the rest of the world..



Source: Oxford Economics

Sector	Number of Stocks	Shiller P/E	Regular P/E
Energy	26	10.40	-6.00
Financial Services	69	17.40	17.70
Industrials	73	25.00	35.80
Consumer Defensive	35	26.00	28.10
Utilities	28	29.00	21.30
Basic Materials	21	31.20	59.40
Healthcare	64	31.80	25.80
Technology	68	39.40	32.50
Communication Services	26	41.00	30.00
Consumer Cyclical	63	44.60	58.30
Real Estate	31	46.20	37.40
S&P 500	**500**	**31.3**	**35.3**

The death of the US dollar?

- Recent weakness in the USD has the death of the USD reserve status being called (see below).
- Our gut suggests this is unlikely, considering the USD accounts for over 60% of world currency reserves.
- The Renminbi (RMB) might get there one day but it will take a very, very long time.

Forex | Market Outlook

The U.S. Dollar May Be Due For A Collapse

Aug. 4, 2020 3:32 PM ET | About: Invesco DB USD Bullish ETF (UUP), Includes: GLD

What a U.S. Dollar Crash Might Mean for Canadian Investors

Victoria Hetherington | June 19, 2020

Markets

How the Coming Crash in the Dollar Will Unfold

The argument that there is no alternative to the U.S. currency makes little sense.

By Stephen Roach
June 14, 2020, 7:00 PM ADT

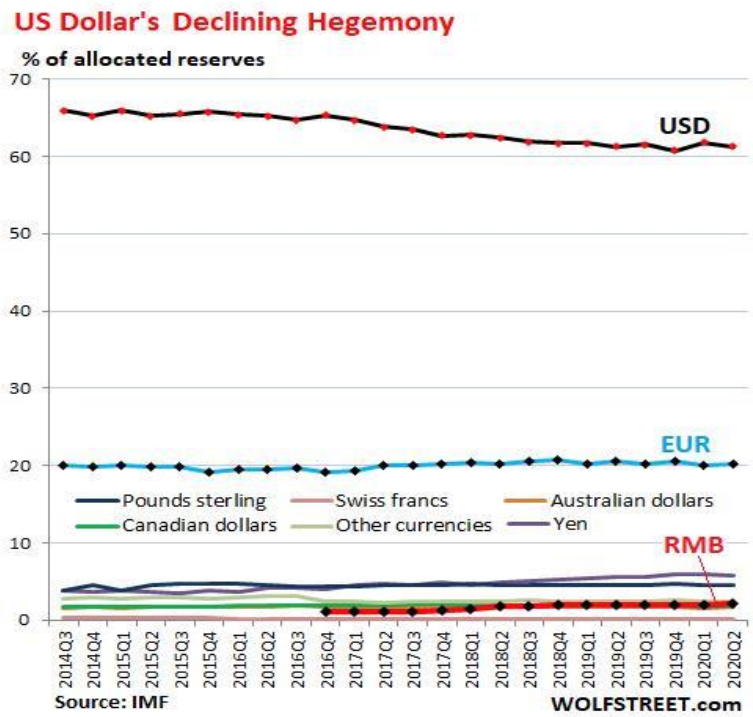
Economy / China Economy

US dollar at risk of sudden collapse? Ex-IMF official warns 'blow-up event' could sink currency as debt mounts

Currencies

Dollar could be a 'crash risk' if U.S. loses 'credibility,' analyst warns

Last Updated: Aug. 3, 2020 at 5:53 p.m. ET
First Published: Aug. 3, 2020 at 5:33 p.m. ET
—
By William Watts



What we are frequently asked: is venture capital a risky asset class and how should families participate?

- The answer according to Institutional Investor research is yes and no but the key is getting to a position of diversity.

- Classic portfolio theory suggests that between 20 and 40 stocks are required to garner appropriate levels of diversity in a listed public equities portfolio.

- **However, for VC the appropriate number is.... 500 positions to effectively diversify away the venture failure risk.**

- That's a lot of positions – making it almost impossible to do it directly from one's family office.

- Outsource to only the best with the scale to do it properly.

Source: Institutional Investor

Level 3

283 Elizabeth St

Brisbane QLD 4000

T: 07 3153 4879

W: alviapartners.com.au

E: info@alviapartners.com.au