

14 November 2013

Investors' Letter for October 2013

We have a little explaining to do.

We told you last month that we had moved somewhat closer to beta-neutral. Then the market ripped up for a month and we more than kept up despite our biggest long (Herbalife) having a very poor month. Our performance (+3.6%) was much better than our ex-ante guidance. We shall not complain – but we should explain.

Firstly there were a few things in the long book that went right:

- One large position (which we would rather not name) became the subject of takeover rumours.
- Google, also a large position, produced great results and appreciated almost 20 percent. In January 2012, we described having a bad month in part because of an oversized Google position and we explained why we thought the market was wrong discounting Google at the time. The stock has doubled since then. Equities are a fickle business.
- Verizon – which is also a large position – produced good results. Revenue in the wireless business was up over 8 percent and free cash flow is growing at about 20 percent – an astonishing rate for a big market company with a starting yield of almost 5 percent. We think the grandmothers (who are far more likely to own Verizon) are going to beat the financial professionals here.

Secondly, our shorts did not hurt us much, if at all. Some shorts did surprisingly well. The US shorts that hurt many hedge funds all year came back, led by Green Mountain Coffee Roasters. Our position in these stocks remains small – but every little bit helps. Less crowded shorts (which we will refrain from naming) also produced some returns.

Herbalife - the big portfolio change

The biggest change in our portfolio this month was a sharp reduction in the size (and the removal of all our call options) on Herbalife. This stock has more than doubled since we initiated our position in December. It owes us nothing.

The position got large the right way. It kept going up.

We kept the position oversized for two reasons. Firstly (and unfashionably), we believe in Herbalife's business. Secondly, we thought that a large hedge fund (Pershing Square/Bill Ackman) had a grossly oversized short position and would be forced to capitulate. Actually, capitulation is understating what we thought would happen – John thought that Pershing Square would end up as a mangy maggot-infested carcass swinging in the breeze waiting for their prime brokers to cut them apart. Our maths indicated that Pershing Square was going to have massive problems when Herbalife went to \$110 per share (and we think it does go to \$110 a share) so we thought that the “mother of all short squeezes” was inevitable.

We were wrong. Bill Ackman radically cut his position (we estimate from 24 million shares short to 10 million shares short) and bought some put options. The Armageddon point moved from \$110 a share to something like \$170 a share. Even though we believe in Herbalife stock on its own merits, we do not think that \$170 a share is likely in the next couple of years. [We don't think it is impossible though...]

The day Bill Ackman announced a reduced short position we reduced our long position. Herbalife, however, remains one of our largest positions. There is no change to our view of the long-term prospects of the company – indeed they have somewhat improved because the share price is weaker and Herbalife regularly buys back its own shares. The shrinking of our position just reflects the removal of the chance of – for once – being on the long side of a major short squeeze.

Towards the end of the month CNBC reported that Mr Ackman was going to present on Herbalife at the Robin Hood Foundation Investment dinner in late November. The stock was weak on this news and we repurchased some of our long position. We don't think Bill will come up with anything substantial. He has been wrong on almost every substantive point so far – and we don't see that changing.

Thanks again,

John and Simon

Performance

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin Year to Date Return	Average Monthly Return
FY13											5.4%	1.3%		2.4%
FY14	6.0%	-2.5%	0.4%	3.6%									7.5%	

