

Peter Partnership Fund's (PPF) return vs. benchmarks

Year (ending 31 st March)	Peter Partnership Fund *	in Per-Share Market Value of BRK Class B	in S&P 500 with Dividends Included
Fund inception to 2019	15.3%	10.9%	18.3%
2019 to 2020	-45.8%	-9.0%	-7.0%
Compounded Annual Gain	-16.6%	0.4%	3.8%
Overall Gain**	-37.5%	0.9%	10.0%

* All returns refer to the Ordinary Units of Peter Partnership Fund. Due to lower performance fees for the Elite Units, the returns from Elite Units would be equal or higher than the Ordinary units during the same period.

** From inception of our fund at end of August 2017, giving it 19 months instead of the usual 12 months.

Peter Partnership's composite results of all managed accounts during the period before the fund's inception (and PPF's results thereafter) vs. selected benchmarks

Year (ending 31 st December)	Peter Partnership (after Fees) (in USD)	Benchmark ¹ (in USD)
From March 31 st , 2008	-21.1%	-32.4%
2009	64.5%	49.9%
2010	56.2%	36.0%
2011	-0.9%	1.0%
2012	29.5%	17.4%
2013	12.5%	5.9%
2014	15.1%	13.5%
2015	-18.6%	1.2%
2016	47.0%	12.0%
2017	21.6%	21.1%
2018	8.2%	-4.4%
2019	34.5%	31.5%
Until 31 st March, 2020	-61.2%	-19.6%
Compounded Annual Gain	9.1%	8.8%
Overall Gain	183.9%	174.9%

¹ KLIC + 3% a year from Inception until year 2013. S&P 500 Total Return Index thereafter.

Peter Partnership Fund 2020 annual letter

To the investors of Peter Partnership Fund:

Our fund's change percentage wise since inception at end of August 2017 until 31st March 2020 is negative 37.5%. During the same period, Berkshire Hathaway's Class B (Brk.B) stock gained 0.9% while the S&P 500 (with dividends included) gained 10.0%. Over the last 2.6 years, our fund's ordinary class NAV has dropped from \$ 10.00 to \$ 6.7614, a rate of negative 16.6% compounded annually.

In the 9 months from April 2019 to December 2019, the fund recorded a gain of 39.7%. About $\frac{2}{3}$ of the gains comes from Berkshire's performance using a low-cost leverage strategy, while the remaining $\frac{1}{3}$ comes from our position in Dart Group, which we use less than 1/10 of the capital compared to Berkshire's strategy. Little was I prepared for what's coming for the next 3 months.

Covid-19 became a global pandemic, causing most of the businesses around the world to stop functioning. It's as if we were in World War 3, except that it's not a war between humans, but humans against an invisible threat, a virus.

In USA (since our biggest investments, Berkshire, have its biggest operations in USA), the number of Covid-19 cases were minimal in January and February 2020 (less than 2 new cases a day in most days). In fact, until 29th February 2020, the total number of cases in USA were merely 24. But in the month of March 2020 the total cases spiked up to 185,991 with 3,806 deaths due to Covid-19². The biggest jump happened in the middle of March, where the total case jumped from 936 cases in the 10th March to more than 17,436 cases 10 days later, or an average of 34% new cases compounded daily. Now, the number hovers around 2% new cases daily (though, when measured in absolute numbers, the new cases are in tens of thousands daily).

In the first quarter of 2020, Berkshire's stock price (as well as the S&P 500 Index and Dow Jones Index) reached its lowest price in 23rd March 2020. The lowest price traded on that day for Brk.B was at \$159.50 per share, which is a far cry from \$221 to \$231 per share just 1 to 2 months ago). Nobody knows if this is the lowest price of the year and only time will tell. From Brk.B's highest stock price this year of \$231.61 on January 17 to the current low slightly 2 months later at \$159.50 per share, it's a drop of 31%, and since our fund is leveraged, this drop is magnified in our fund.

Since Buffett took over the management of Berkshire until the year 2019, Berkshire had 4 major dips in its stock price. Below are the details (only the price below refers to Berkshire's Class A stock. All other Berkshire price in this letter refers to its Class B stock, or Brk.B)³:

² Source: https://en.wikipedia.org/wiki/COVID-19_pandemic_in_the_United_States

³ Source: <https://berkshirehathaway.com/2017ar/2017ar.pdf>

Period	High	Low	Percentage Decrease
March 1973-January 1975	93	38	(59.1%)
10/2/87-10/27/87	4,250	2,675	(37.1%)
6/19/98-3/10/2000	80,900	41,300	(48.9%)
9/19/08-3/5/09	147,000	72,400	(50.7%)

I'm aware that all these drops historically happened when Berkshire's stock was selling at a high price in relation to its book value, usually at 2 times its book value, or higher. For instance, at the High price of \$147,000 on 19th September 2008, Berkshire was selling at nearly 2 times its book value. If you think Berkshire's trading at 2 times its book value was high, then consider the fact that on 19th June 1998, Berkshire was trading at nearly 3 times its book value (yes, it's not a typo). One word; madness!

In 1998, the dip was a few years into the dotcom mania, where all stocks were valued not by multiples of its earnings, but on multiples of its revenues (because many of these companies didn't have earnings to show). We would not have owned any Berkshire's stock at those high valuations. In fact, the strategy employed in Peter Partnership Fund would not have any Berkshire's stock (or own very little of it) when Berkshire is selling above 1.6 times its book value. But the recent drop in Berkshire's stock price in early 2020 was very different. Let me share what happened.

When Berkshire's annual report was released on 22nd February 2020, its book value was \$174.28 per Class B equivalent share. Also, the annual report stated that Berkshire repurchased more than \$430 Million of its stock at an average price of \$221.94⁴ between December 2nd to December 10th, 2019.⁵

Armed with the above knowledge, and with Berkshire trading at around 1.25 times of its book value on the following Monday after the release of Berkshire's annual report (which is unlike the 4 major dip periods above where Berkshire was selling 2 or even 3 times its book value), I increased the fund's position to around 2.7 dollars in Berkshire for every dollar of the fund's net worth. That time, Brk.B was selling at around \$220 per share (from about \$230 per share a few days ago).

In February 2020 Brk.B closed at \$ 206.34, 8.2% lower than a month earlier. Our fund recorded a much bigger drop, at negative 25.8% due to the fund's leverage as well as our minor position in Dart Group. Our position in Dart Group was around 12% of the fund's net worth. It would be considered a major position for most typical funds, but it was a minor position in relation to our fund's position in Berkshire. Dart Group, which earlier contributed half of the return in the calendar year of 2019, saw its stock price dropped by 28% in the month of February, which dragged down our fund's net worth. While February's performance was within expectation, little was I prepared for the next month, which was the toughest period I'd ever faced in my entire career.

Berkshire started off the month of March 2020 selling at less than 1.2 times of its book value. I was expecting Berkshire to repurchase its shares. After all, Berkshire was selling at a price roughly 10% cheaper than Berkshire's earlier stock repurchase on December 2019. But there was no news of it. Berkshire and in fact the share price of almost all listed stocks continued to drop. In some of those days, the stock price dropped in the range of 10% A DAY (yes, even for Berkshire, which is considered

⁴ Berkshire repurchase 674 of its Class A shares at an average price of \$333,298.06 and 953,070 of its Class B shares at an average price of \$221.67.

⁵ Source: <https://berkshirehathaway.com/2019ar/2019ar.pdf>

as a financial fortress), which was very rare before the Covid-19 pandemic. Towards the middle of March, Berkshire's price dropped to around \$170 per share. At that time, our fund's leverage increased to more than 5 times, even when the fund did not purchase any stocks earlier.

Let me share the mathematics of leverage with the following example. If we have \$100 and borrowed \$150 from the bank to buy \$250 worth of stocks, we basically have 2.5 dollars' worth of assets for every dollar we have, which we'll refer to as leverage ratio. The assets are divided by what we will have if we sell off everything, or equity starts off at 2.5. Now, if the stocks we own drops by 20%, the stock value is now only \$200, and because we owe the bank \$150, we are left with \$50 of our own money (equity). This means that the leverage ratio now stands at 4 (\$200 divide by our \$50). *Chart 1* below shows how the leverage ratio increases when stock price drops from a starting leverage of 2.5. Margin call is enforced when the leverage ratio reaches 10. Notice that the leverage ratio increases slowly at the beginning, and then increase exponentially later. The leverage ratio increases tremendously when the leverage ratio reaches around 5 or so, and that was what happened to our fund in the middle of March 2020. At that time, even a further small percentage drop in Berkshire's stock price becomes a large percentage increase in the leverage ratio.

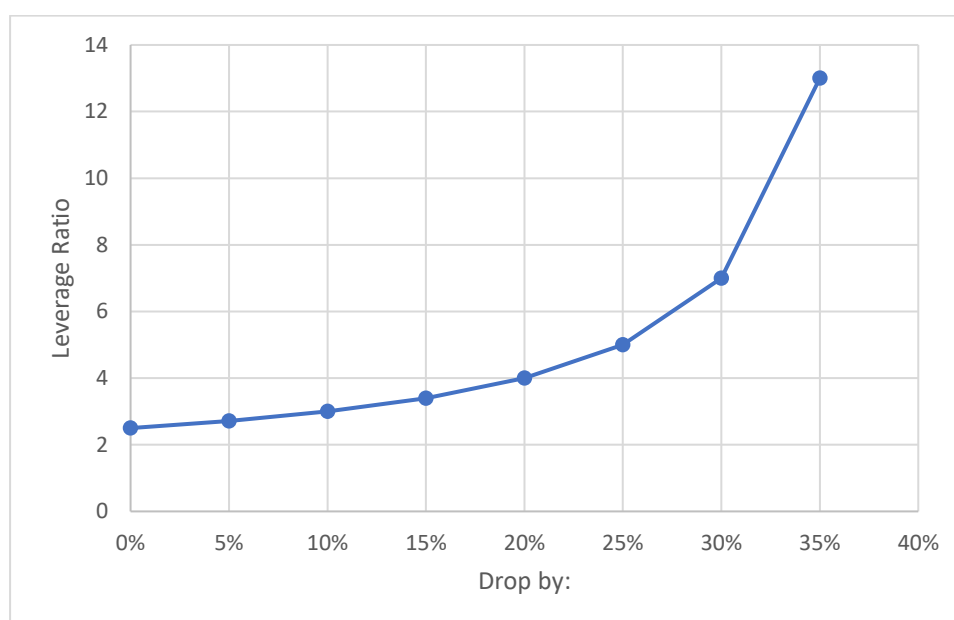


Chart 1: How leverage ratio increases when stock price drops (from initial 2.5x leverage ratio)

For housing loans, the banks do not revalue your house once the loan is approved. But it is different for margin loans and in CFDs (which is generally a leveraged product like margin loans) because the banks/brokerage company revalue the asset daily. Some brokers even evaluate this on a real time basis. This means that if at any day our portfolio (which comprises mainly of Berkshire's stock) drops to an abnormally low level (irrespective of the company's intrinsic value), the bank/brokerage company would ask the fund to top-up (a term called "margin call") or sell our stock (called "forced selling") in order to reduce leverage. Should that happen, our fund would almost be wiped off as the bank would sell our position at a loss of 90% or more. At a loss of 90%, the fund would need a whopping return of 900%, which is 10 times the percentage drop just to get back to its pre-drop level, which would be a massive uphill task and take possibly 20 years or longer.

The thought that the fund could be entirely wiped off if Berkshire's price continued to drop was very terrifying. It was not something that I previously thought was possible, yet that was the situation I was faced with at that time. I watched the stock price almost every hour (or even minutes). I couldn't sleep well at night, and so did my wife when she was aware of the situation the fund was in.

For the first time in my investment career, instead of feeling excited, I was fearful of drops in the stock price of the fund's holdings. It all boiled down to holding power, which the fund was lacking at that time. Other than having virtually all my family's net worth in the fund, we have many close friends and family members who invested a huge percentage of their net worth in the fund as well.

Thus, there was a decision to be made. Either I hold on to all our positions and hope that Berkshire's price does not drop a further 15% or so from that level, or I trim down our leverage so that we have higher holding power. Doing nothing, which was basically holding on all our positions would mean faster recovery when Berkshire's price goes up but would also mean the possibility of our fund being wiped out entirely (or close to it). On the other hand, trimming down the funds leverage at that price would mean that we would be realising a permanent loss of capital for the position I sold off, since I wouldn't be increasing the fund's leverage after I trimmed it down.

Each day of not making this decision would mean that the fund faced a possibility of being wiped off completely, and when Berkshire's stock price could drop by 10% in a single a day, a 15% margin of safety didn't look like much.

Finally, I decided to trim our leverage by around half. It was a very painful decision to execute, but as long as the fund was not wiped off (or somewhere close to that), we can recover back to pre-Covid-19 level and eventually higher. The downside is that it will take a longer time to recovery, which in my view, was a better choice than the alternative.

What went wrong?

In my view, it was due to my belief that Berkshire will repurchase its stock when the stock was selling at a price below 1.2 times its book value. After all, Berkshire had ample liquidity with over \$120 Billion in cash, \$20 Billion in bonds, and over \$180 Billion in marketable securities (which can be converted to cash easily). On top of that, there was over \$2 Billion coming to Berkshire headquarters every month. I relied heavily on Buffett to repurchase Berkshire's shares at a low valuation, but it turned out that Berkshire did not do so. (perhaps it was because Buffett and Munger were unsure of the economic damage caused by the pandemic to their subsidiaries), As a result, the impact of our leverage coupled with Berkshire's stock price dropping below its book value reduced our holding power significantly. Though there was a buffer for Berkshire's price to drop by about 30%, but that buffer had proven to be insufficient in this case. All prior back tests did not prepare me for this pandemic.

Some investors commented that our fund should employ "stop loss"⁶ strategy. In Berkshire Hathaway's 1994 Annual Meeting, Buffett says, "It has always struck me as like having a house that you like, and you're living in, and, you know, it's worth \$100,000 and you tell your broker, 'You know, if anybody ever comes along and offers \$90 [thousand], you want to sell it,'" Buffett joked to the audience at the 1994 meeting. "It doesn't make any sense to me."

Do note that when I trimmed down the fund's leverage in middle of March, I was not employing "stop loss" strategy. Had the fund used little or no leverage, I would have held all our

⁶ A stop-loss is designed to limit an investor's loss on a security position. Setting a stop-loss order for 10% below the price at which you bought the stock will limit your loss to 10%. For example, let's say you just purchased Microsoft (Nasdaq: MSFT) at \$20 per share. Right after buying the stock you enter a stop-loss order for \$18. If the stock falls below \$18, your shares will then be sold at the prevailing market price. Source: Investopedia

positions, and possibly even have bought more if the fund had excess capital. I did the trimming to increase the fund's holding power just in case Berkshire's price drops further.

What's the plan moving ahead?

The interest rate for banks in most developed countries are at a very low level. For instance, USA and UK's interest rates are currently around 0.1% a year. In fact, Switzerland, Denmark and Japan have negative interest rates. While it is understandable to have capital to take advantage of good opportunities, I would rather have our capital owning businesses rather than to leave a certain portion of the fund's capital in cash earning such low rates of return, which will definitely be less than the inflation rate. To take advantage of good opportunities and low interest rates, the fund will continue to use low cost borrowings, though at a much lesser leverage. While it is bad to be savers/depositors at such low interest rates, it is good to be borrowers, as long as the borrowing is done prudently.

Since Berkshire might not repurchase its stock below its intrinsic value (which is estimated to be more than 1.2 times its book value), we can't rely on Berkshire's repurchase to centre our strategy on. Also, there might be the possibility of another pandemic or similar events in the next 50 years. This means that, going forward, the fund will use less leverage than it has for Berkshire. Instead of using 3x leverage when Berkshire's stock price reaches 1.2 times its book value, it will be reduced to only 2x leverage. While this reduction in leverage means that the future returns would be lesser, but this change provides more holding power, and it also means more "sleep well at night" factor. Let's call this as "Berkshire's Basket".

The main reason I find Berkshire's strategy appealing (before this pandemic) was because of its low-cost financing rate, and the ability to use 2x to 3x leverage. While reducing leverage to 1x-2x means more safety, the expected returns will not be as high anymore. Thus, I will look for other stocks to gradually replace the above "Berkshire's Basket". Lesser leverage will be used for these stocks as they're usually less diversified than Berkshire, and these companies' market value will most probably be lesser than Berkshire (since there are less than 10 public listed companies that are larger than Berkshire). As I have no idea how long this pandemic will last, I will only consider investing in industries that are little or not affected by this pandemic. Let's call this the "Value Basket". Below are my criteria for this "Value Basket":

- 1) Be in industry with predictable income. This excludes many industries as of now due to the Covid-19 pandemic.
- 2) Companies earning good return on the company's capital. My benchmark is 15% or higher.
- 3) High conversion of the company's profits to cash. I don't want the company's profits is in the company's properties, machineries, plants, inventories and receivables.
- 4) Good track record of revenue and well as earnings growth.
- 5) Uses little or no debts.
- 6) Sensible capital allocation of the company's profits is very important. Also, I prefer one where the management owns a substantial stake in the company.
- 7) Selling at an attractive price. Most often companies meeting all these 6 criteria's above are selling at a high multiple in relation to its normalized profit, and probably deservingly so. However, I'm not willing to pay over 30 times in all cases, and rarely pays anything above 20 times too. A good price in my view, is less than 12 times its normalized profit.

Newly acquired stake of the fund: Ameriprise Financial Group and Ninety One PLC

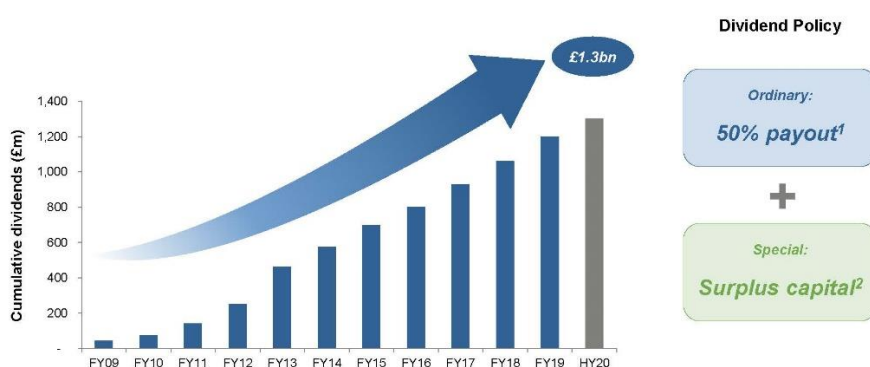
I started my career in the financial industry as a unit trust consultant. At that time, I already fell in love with financial companies, especially asset management companies. The business uses little capital, has a high conversion of profits to cash, and is very profitable. While some funds might be good for investors, it's always good for the owners (when measured in profits). Investors in mutual funds might gain in some years, but could lose in some years. However, almost all mutual fund companies charge fees regardless of their fund's performance⁷. To quote Buffett, "Performance comes, performance goes. Fees never falter."

Besides the continuous fees to the owners of the asset management company, there is also economies of scale that comes into the picture. For every percent growth in revenue, the asset management company does not need to increase its expenses by the same rate. This is unlike most manufacturing and retail businesses that need to increase inventories, retail outlets, staff cost, machineries, etc. every time their revenue increases. This means that most asset management company's profits would generally rise at a rate higher than the company's revenue growth, if the expenses are kept in check.

Look at *Chart 2* below, which is extracted from Ninety One's prospectus⁸. Considering the company has a net worth of only GBP 151 Million as at 31st March 2020, it has paid over GBP 1.3 Billion (or more than 8 times the company's net worth) in dividends to its owners in the last 12 years. I'm yet to find a fund that report this kind of consistent and high returns to its investors. In short, just like in casinos, banks or in mutual funds, it's more financially rewarding to be the owners (or part of it through stocks) rather than their customers (if the price paid for owning part of the company is not too high).

Dividend policy

Since FY09, IAM has paid out £1.3bn in dividends



43 Notes: Cumulative dividends excludes total dividend payments paid for annual bonus of 20% equity stakes between 2015 and 2018.
¹ Expected to be an ordinary dividend representing at least 50% of operating earnings adjusted for tax.
² Expected to be a special dividend representing at least 50% of operating earnings adjusted for tax. Subject to the approval of the Ninety One Board, it is expected that the remaining balance of after-tax earnings, after taking into account any specific events, would be returned to Ninety One Shareholders through the payment of a special dividend.

Chart 2: Ninety One's cumulative dividends paid to its shareholders since 2009

Ninety One (formerly known as Investec Asset Management), is a spin-off from its parent company, Investec. Though I normally don't invest in newly listed companies, but this company is different because the parent company is a listed company since the year 2002. When listing this Ninety One stock, the management and employees did not sell any of their shares, and only 10% of the company's shares outstanding was sold to the public, which is another thing I like about this company.

⁷ Unlike most funds, Peter Partnership Fund does not charge any management fee. I estimate 98% of mutual funds in the market charge management fees.

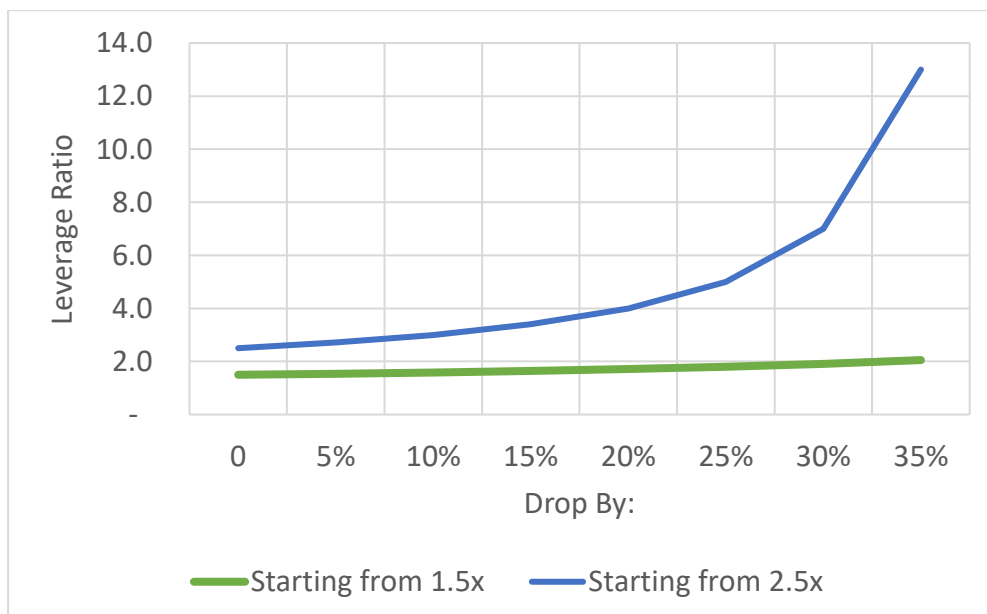
⁸ Source: <https://www.investec.com/content/dam/investor-relations/capital-markets-day/CMD-Presentation-3-dec-2019-final.pdf>

The management and employees of Ninety One owned 20% of the company when it was listed and has since increased their ownership to 21% recently. I believe the ability for the management and employees of Ninety One to increase their ownership in this company was one of the reasons for the spin-off.

Another company bought by the fund is Ameriprise Financial. It was formerly a spin-off from American Express in the year 2005. The company manages close to \$1 Trillion dollars of assets (i.e. asset under management). The company is ranked 249th on the Fortune 500. It is also the 9th largest independent broker-dealer based on assets under management. It is one of the largest financial planning companies in the United States and is among the 25 largest asset managers in the world. It is ranked 8th in long-term mutual fund assets in the U.S., fourth in retail funds in the U.K., and 27th in global assets under management.⁹ The company uses more than ⅓ of the company's profits for share repurchases almost every year, which led to the shares outstanding shrinking by roughly half in the past 15 years. For the past 15 years, the company's revenue and net profit margin have been on an increasing trend. Since the company's share repurchases reduce the number of shares outstanding, shareholders are also getting a larger share of the growing earnings (i.e. increasing earnings per share).

These 2 companies meet all the criteria I mentioned above, and these are the kind of companies that I would be excited about if the stock price drops, as it gives us the opportunity to increase our stake in the company at a lower price. I believe "getting excited if the stock price drops" is a good test to see if a person is a long term investor or a short term speculator, and one which I will ask myself every time before I invest in any investments.

I aim to find similar quality companies as above to replace our Berkshire's stake. If I manage to replace all, the fund would own between 6 to 10 companies of such good quality companies above, employing between 1x to 1.5x leverage. Since 1x is our own money, it means the fund would borrow maximum of 0.5x of the fund's capital for investments. *Chart 3* below shows the impact of leverage ratio given various percentage drops of the entire portfolio. With a maximum of 1.5x leverage, the fund can sustain a drop of 63% of stock price of the entire portfolio before a margin call, which is roughly double the drop compared to 2.5x leverage.



⁹ Source: Ameriprise Financial, Wikipedia (https://en.wikipedia.org/wiki/Ameriprise_Financial)

Chart 3: Comparison between 1.5x vs. 2.5x leverage ratio when stock price drops

Other developments

The fund started to own Dart Group PLC's stocks in August 2018. They're in Leisure Travel business. At that time, the stock was selling at a price around GBP 9.50 per share. The company meets all the criteria of a good company, run by good management, and was selling at an attractive price. We own it throughout the year of 2019, and we rode with more than 100% gains in the 3 months after one of its biggest competitors, Thomas Cook, filed for bankruptcy at end of Sept 2019. Its stock price rose until GBP 19.50 per share in 19th February 2020, and saw the price drops more than 90% to GBP 1.825 exactly 1 month later, on 19th March 2020. We sold off Dart Group PLC in mid of May 2020 at around GBP 4.70 per share, because it's too hard to evaluate the company's intrinsic value due to current pandemic. It was replaced with an asset management firm, Ameriprise Financial Group, which in my view, is a much easier company to evaluate.

The fund currently uses 3 brokerage firms; Interactive Brokers, Maybank Kim-Eng, and CGS-CIMB. The latter two are brokerage firms based in Singapore. One good thing that happened after opening the CGS-CIMB account is that Maybank Kim-Eng offered to reduce their financing rates to match CGS-CIMB. Thus, the fund enjoys a further savings on the financing rate. Also, since this pandemic, the US government has reduced the effective federal funds interest rates to around 0.1% from about 2.5% a year ago. All in all, the fund is currently borrowing at an interest rate of less than 1.2% a year, or savings of more than half the financing rate compared to a year ago.

Final words

It was my mistake to have focussed too much of the investment strategy on Berkshire's previous practice of stock repurchase resulting in our fund being over leveraged. This mistake caused the fund to lose a tremendous amount of money. I understand the pain caused by these losses and for that I am truly sorry. My wife and I have virtually all our net worth in the fund, and we will continue to do so. On top of that, my immediate family members (my parents, parents-in-law, sister, brother-in-law and sister-in-law) have more than 90% of their net worth in the fund alongside all investors in the fund. We are all in this boat together. Though it has been a painful experience this year, we hope all investors can stay alongside us until you reach your financial destination.

22nd June 2020

Peter Lim
Fund Manager
Peter Partnership Fund