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

Year (ending 31st 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%
2020 to 2021	83.7%	39.7%	56.4%
Compounded Annual Gain	**3.9%**	**10.1%**	**16.3%**
Overall Gain	14.9%	41.0%	72.0%

** 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 benchmark.

Year (ending 31st December)	Peter Partnership (after fees) (in USD)	Benchmark[1] (in USD)	Difference
From 31st March 2008	-21.1%	-32.4%	11.30%
2009	64.5%	49.9%	14.60%
2010	56.2%	36.0%	20.20%
2011	-0.9%	1.0%	-1.90%
2012	29.5%	17.4%	12.10%
2013	12.5%	5.9%	6.60%
2014	15.1%	13.5%	1.60%
2015	-18.6%	1.2%	-19.80%
2016	47.0%	12.0%	35.00%
2017	21.6%	21.1%	0.50%
2018	8.2%	-4.4%	12.60%
2019	34.5%	31.5%	3.00%
2020	-39.7%	18.4%	-58.10%
Until 31st March 2021	18.3%	6.2%	12.1%
Compounded Annual Gain	**13.3%**	**11.8%**	
Overall Gain	508.9%	426.2%	

[1] *KLCI + 3% a year from Inception until year 2013. S&P 500 Total Return Index thereafter.*

Peter Partnership Fund 2021 annual letter

To the investors of Peter Partnership Fund:

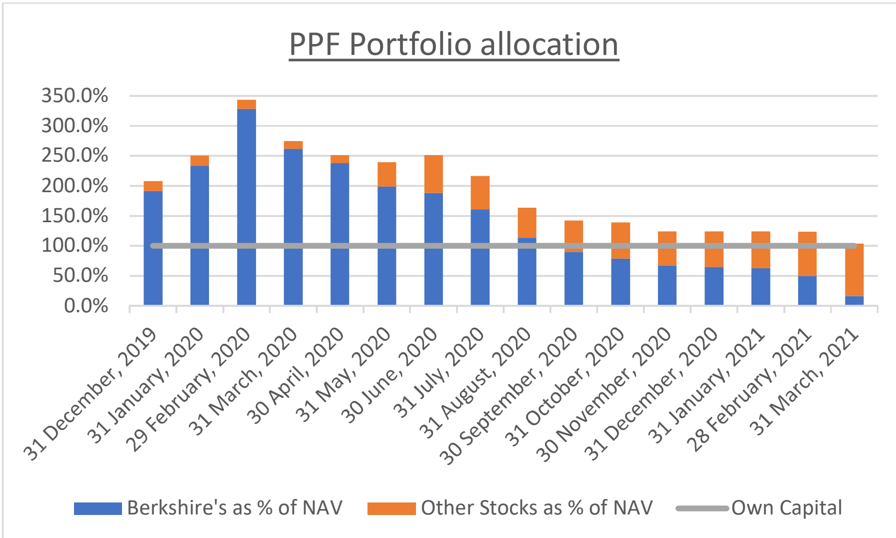
Our fund's change percentage wise last year (from 1st April 2020 to 31st March 2021) was 83.7%. During the same period, Berkshire Hathaway's Class B (BRK.B) stock gained 39.7% while the S&P 500 (with dividends included) gained 56.4%. Over the last 3.6 years, our fund's ordinary class NAV has increased from $ 10.00 to $ 11.4857, a rate of 3.9% compounded annually.

Usually, last year's return of such magnitude would have been an occasion for celebration. However, this is not (yet) the case as the fund have not reach back to its pre Covid-19 NAV at the end of December 2019, which was $16.111 per unit. There is another 40% to recover, plus another 11% (and increasing every month) before it reaches the fund's high-water mark plus hurdle rate.

The above shows how hard it is to recover from the huge loss sustained during February and March 2020. While both Berkshire and S&P 500 have recovered and surpassed its pre Covid-19 level, our fund is still recovering. This is due to a lack of holding power from our leveraged positions which forced me to make a tough decision during March 2020. That is not a situation I would want to repeat, and the best way to ensure that is to use little to no margin/CFD.

A few months ago, a professional investor named Bill Hwang, who managed Archegos Capital Management, lost virtually all his net worth of around USD 10-30 billion (and probably more since his brokers also suffered losses from extending credit to him) due to his highly leveraged positions. When I told my wife, she replied that she is thankful that we did not end up like him (which seemed possible March 2020 if Berkshire's stock price continued to drop and I did not reduce the leverage then). I assured her that PPF will never be in such situation again. The days where our fund focus on a strategy of low-cost leverage to increase returns are over. Going forward, PPF will no longer be subject to the possibility of forced selling or margin calls. Leverage will be kept a minimum.

The use of leverage



The chart above shows PPF's portfolio allocation in Berkshire and other stocks since December 2019 to March 2021. Notice that:

1) The investment in Berkshire reduced over time; and as of end of March 2021, it represents a mere 16.6% of the fund's holdings,
2) The fund used decreasing leverage; down to 3.7% as of 31st March 2021,
3) Non-Berkshire holdings increased and totalled 87.1% of the fund's NAV as of 31st March 2021.

Let me explain the rationale for these decisions:

In my view, Berkshire is probably the safest public listed company in the world. The company have an unmatched balance sheet with over USD 100 billion in cash, almost little to no debts (at the parent company level), continuous profits coming in from over 80+ subsidiaries, float (which is basically money that does not belong to the company but can be used by the company to invest) of over 30% of the company's net worth and managed by one the best capital allocator in the world.

However, Berkshire's current size is simply too big since the last 10 years or so, and it becomes harder to generate outsized returns by investing only in Berkshire. We could use low-cost leverage to increase returns as long as we are not using too much leverage until we face a possibility of margin call/ forced selling. But what is considered too much?

Before the current Covid-19 pandemic, I would never have thought that Berkshire would drop more than 30% below its buyback level (which is 1.2 times its book value). I was wrong in this regard, and no back testing would have prepared us for the things that have not happened in the past. And just because it did not happen in the past, it does not mean it will not happen in the future. I am sure Bill Hwang would have thought that his strategy is safe, until he was proven wrong.

To make it safer, the fund could reduce its leverage from borrowing a maximum of 2 dollars to borrowing only a dollar or even 50 cents for each dollar of the fund. But I find that such strategy may still put the fund in a difficult spot if another pandemic, war, or something of such magnitude is to occur in the future.

On the other hand, interest rates are at an extremely low level in developed countries to the extent that in Japan, Switzerland, Denmark and the EU, banks or brokerage firms charge us interest for keeping a cash balance there. But a bigger risk in the long run, is inflation risk. The more (and the longer) our assets are kept as cash, the more inflation will erode our purchasing power.

Keeping a portion of the fund's assets in cash is not something I prefer (due to erosion of our purchasing power), while using margin exposes the fund to the possibility of margin call/forced selling if used too much. Thus, the method that leaves me comfortable, is for the fund to be as close to 100% invested with little/no margin. Most of the time, the fund will be investing 90% to 120% of the fund's net worth, which gives me some flexibility in capital allocation without putting the fund at the risk of margin call.

I believe it is not a bad thing to have a portfolio that only has Berkshire stock and does not use any form of leverage. In fact, that is what I suggested to my wife (with some allocation in a S&P 500 ETF) should I pass away tomorrow. I estimate that Berkshire will probably earn around 8% to 12% annualised in the long run; and such returns should be sufficient for the majority.

However, I believe there are other stocks that may give higher return than Berkshire in the long run. I also believe that with disciplined and careful stock selection, I can identify several companies that have a high chance of outperforming not just Berkshire, but also the S&P 500 index.

Our portfolio

The table below indicates the fund's portfolio as of 31st March 2021. Most of these stocks have similar characteristics, namely:

1) The company has earned high profits in relation to the company's net worth in the past 5 to 10 years; and is expected to continue to do so.
2) High growth rates in earnings; and expected to be earning at least at reasonable growth rates in the future too.
3) The company's interest expense is low in relation to the company's operating profits.
4) Management who is good at capital allocation.
5) Selling at a reasonable price in relation to the company's intrinsic value.

Company	**Listed In**	**Industry**	**% of NAV**
O'Reilly Automotive Inc.	US	Specialty Retail	16.59
Berkshire Hathaway Inc. -Class B1	US	Conglomerate	16.58
AutoZone Inc.	US	Specialty Retail	15.21
Open House Co Ltd.	Japan	Real Estate - Diversified	11.80
Ninety One PLC	London	Asset Management	10.21
LGI Homes Inc.	US	Residential Construction	8.67
Pax Global Technology Ltd.	Hong Kong	Business Equipment & Supplies	5.74
D R Horton Inc.	US	Residential Construction	5.15
Alimentation Couche-Tard – Class B	Canada	Grocery Stores	4.83
Facebook Inc.	US	Internet Content & Information	3.11
Sprouts Farmers Markets Inc.	US	Grocery Stores	2.81
Azimut Holding SpA	Europe	Asset Management	1.73
Senvest Capital Inc.	Canada	Asset Management	1.11
Dream International Ltd.	Hong Kong	Leisure	0.08
Total			**103.64**

The fund's biggest and third biggest position is in O'Reilly Automotive and AutoZone. They are among the largest American auto parts retailers that provide automotive aftermarket parts, tools, supplies, equipment, and accessories in the United States serving both the professional service providers and do-it-yourself customers. The other two largest auto parts retailers in America are Advance Auto Parts and Genuine Parts, which are not owned by the fund mainly because these 2 large competitors have a much lower return on invested capital than O'Reilly Automotive and AutoZone.

O'Reilly Automotive and AutoZone are not considered cheap when measured against historical earnings. At the time of purchase, they were trading at 20 and 15 times their past year's earnings, respectively. However, these companies would have been a good investment had a person bought them at these valuations 5, 10 or even 15 years ago. This is because these two companies have consistently increased its earnings at a high rate on a per share basis. Two good articles written about O'Reilly Automotive are here and here.

Though I always known that the value of a good company comes from its ability to continually grow its earnings at a high rate, I always wanted to buy these companies at a low multiple in relation to its historical earnings. Sadly, such companies rarely sell at a low valuation, which made it almost impossible for me to buy them.

But last year, while reading a book called "100 Baggers" by Christopher Mayer, it dawned on me that the purchase of a company that earns high return on shareholder's capital that can retain a huge portion of its earnings to continue to grow at a high rate deserves a higher (perhaps much higher) valuation than other companies. While it may seem obvious now, it took me more than 15 years to finally discover this simple truth. With this enlightenment, a whole new world of stocks suddenly opened to me. That is also one reason why you see Facebook as one of the fund's holdings.

However, our fund will never invest into any company that does not produce anything from its assets. For instance, our fund will never buy any cryptocurrencies as these assets do not produce anything. Assets that do not produce anything does not have any intrinsic value.

Our fund will also not buy into companies that have not produce any profits (but with lots of promises of future profits). One example is Grab. The company have yet to report any profits, and yet they are valued at USD 40 billion in the market. I simply have no idea how to value such companies, nor am I interested in attempting to do so. Similar to space exploration, we applaud the endeavour, but prefer to skip the ride.

If my friends or neighbours profit from such assets, good for them. I do not feel envious, just like how I do not envy someone who becomes rich from winning the lottery or from gambling in casinos. Personally, I prefer to own these lottery companies or casinos instead.

A banker friend once asked me, *"Do you know what kind of customers banks like to lend money to?"*. He shared, *"It's the customers that don't need the bank's money (basically the rich customers)"*. Likewise, as an investor, I am interested in investing in companies that do not need my money.

Though I like companies that have high growth rates, the price paid must be reasonable. For instance, Tesla which is priced at about 600 times of its last year's earnings, is simply way too expensive for me to even consider looking at the company. At such an exorbitant price, the company is priced for perfection, perhaps for the next 15 years or longer. There is simply no margin of safety at such prices. In reality, many things can happen over the next 10 to 20 years.

As much as I do not like companies that lose money or companies that are priced exorbitantly against its earnings, I will not engage the fund in "naked" short selling, which basically means borrowing a stock (which you do not own, hence the term "naked") from a brokerage firm to sell and hope to buy the stock back later at a lower price. Borrowing a quote from John Maynard Keynes regarding short selling (which also applies to the use of margin/CFD), he said, *"the stock market can remain irrational longer than you can remain solvent."* A famous example is GameStop, which saw its stock price rise from around $5.00 per share a year ago to a whopping $483.00 sometime in January 2021. Many fund managers that shorted GameStop found themselves unable to maintain such a position, which caused their fund to lose billions. We will not get into such situations for our fund, rest assured.

However, our fund did participate indirectly from the above GameStop's madness through Senvest Capital Inc. (Senvest). Senvest is an investment holding company as well as a fund management company. Thus, besides owning stocks of other companies, Senvest also receive fees from managing other people's fund. I have known about Senvest for quite some time and did owned it before for a brief period. What caught my attention was an article at Seeking Alpha (here) that said that Senvest owned more than 5% of Gamestop's stock.

After estimating Senvest's intrinsic value, I found that Senvest was an extremely undervalued investment. I aimed to allocate at least 5% of the fund's NAV at the prevailing price at that time, which was around CAD $270 to $280 per share. At that price, I was paying for around half of the company's stock investments. Furthermore, Senvest has income earned from the fund management business. But it was hard to buy as the stock's trading volume was extremely low. I could have kept buying at higher and higher prices, but that action simply meant we would be paying higher and higher prices for the stock, which is not a good thing. In the end, I only managed to buy slightly more than 1% of the fund's NAV in Senvest before the price climbed higher and higher.

There are a few things we can learn from the above.

First, the less people that know about any stock idea, the better it is for the buyer. This is the reason I do not want to share any stocks the fund owns (other than during the annual report to investors) when investors ask. It is not fair to other investors that some investors have these "inside information", which they can use to act for their self-interest at the expense of others.

Second, I could buy any stock for myself (or my family members or proxy) to enrich myself before I buy for the fund. Frankly, I find such practise unethical, and I do not, and will not practise this. Thus, years ago, I decided to close my wife, my company and my personal brokerage accounts, and invest as if PPF is entirely my family's fund. The only brokerage accounts that my wife and I currently have are legacy accounts with odd lots in Malaysia, totalling less than 0.01% of our wealth, and that we have not touched for at least the past decade. About 97% of my family assets are in the fund alongside with my investors, with the remaining 3% in short term assets like bank accounts and bond funds for our family's daily expenses, emergencies, holidays, etc. Even our performance fees, if any, are re-invested into the fund. Not only do we eat our own cooking, but we also only eat our own cooking, and our cooking is in PPF.

Third, I wish the stocks that I own drop in price so that I can buy more of it cheaper. This is true for all stocks in our portfolio since we are long term investors, and we are not at risk of any margin call even if all our stocks dropped by 80% in price. Also, several of our stocks like O'Reilly Automotive, AutoZone, Berkshire and Senvest repurchase their shares from the open market from time to time, and when the price is lower, the more shares they get to repurchase given the same amount. Like what Warren Buffett said in Berkshire Hathaway's 1998 annual report, "*So smile when you read a headline that says, "Investors lose as market falls." Edit it in your mind to "Dis-investors lose as market falls -- but investors gain." Though writers often forget this truism, there is a buyer for every seller and what hurts one necessarily helps the other.*"

Fourth, if the fund experience too much of above problem (i.e., unable to allocate funds to a given opportunity), then I will consider closing the fund to future subscriptions or top-ups (while redemptions are always open). Luckily, such problems are rare and still small in size, while the benefits from economy of scale far outweighs the problem above.

Reduction in performance fees

Our fund size has reached USD 33 million as of 31st March 2021, and I think it is only fair for me to share the benefits from the economy of scale with my investors. Starting from April 2021 onwards, the Ordinary units' performance fees will be reduced from 20% of the excess return to 18%; while for Elite, it will be reduced from 16% to 14% of the excess returns. This translates to a reduction of 10% on the performance fees for Ordinary units, and a 12.5% reduction for Elite units. This is the first fee reduction, and it will not be the last. You can expect more reductions to come when the fund size increases.

Last year, there were a few investors who suggested that the performance fees were unfair for top-ups. Previously, all subscriptions and top-ups were treated separately when calculating performance fees. Thus, it was possible for the investors to pay performance fees even when the overall investment was in the red.

For instance, suppose someone invested $100,000 at $10 per unit at month 1. The following month, the unit price dropped to $5 per unit, and the investor made a top-up of $50,000. If the unit price increased to $7 per unit in month 3, the investor would have to pay for performance fees on the top-up made in the month 2 under the existing calculation even though the investor's overall investment still shows a negative return.

This was not intention, and I do not think it is fair to charge performance fees when investors are having a return less than the hurdle rate (which is 6% annualised). Thus, I informed the fund administrator to treat all subscriptions, top-ups, and redemptions as a whole and that performance fees (or equalisation in this case) will only be charged when the client's aggregate return exceeds the hurdle rate. I believe this should have be the way, thus I have asked my assistant to recalculate the equalisation for all investors since the fund launched until today. This change would either mean the investors would be the same, or better off but will never be worse off than the earlier calculation. The refund will not affect the fund size nor the total units of the fund. Rather, it is just a movement between the units my in account to your account.

To apply the above calculation retrospectively, a good friend of mine, Leong Hoong Hann has helped me very much with the Excel file. Not only did he understand the calculation well, but he can also put those thoughts into Excel formulae for the convenience of all investors. The Excel file will be used as the template to check if the fund administrator has made any mistakes in the performance fees (equalisation) calculation, and more importantly, to provide you with detailed calculations on the equalisation fees. The Excel file also updates the monthly NAV automatically online, and you can use it to calculate the proportionate ownership among sub-investors in your account, if any. If your company needs a programmer or someone who is good with Excel, he is one I highly recommend for the job.

The Excel file above is so good that it even detected mistakes by the fund administrator in the early years of the fund (especially those who invested in 2018 or earlier). The mistakes were small, and it was towards the benefit of investors, so I did not mind earlier. But it is frustrating when the units shown in Excel did not tally with the numbers shown in the Apex statement.

I plan to ask the fund administrator to make a one-time adjustment to effect the changes above so that the investor's units tally with the Excel file. This would mean about 36 investors will receive more units (totalling slightly more than USD 1600 in value), while 19 investors will have lesser units (totalling less than USD 50 in value). One of the early lords of the Three Kingdoms, Liu Bei, said, *"I'll let the world betray me, but I won't betray the world."* Likewise, I do not mind reducing my units so that my investors have more units (especially when it is fair), but I feel bad to take more units from my investors (even when it is fair). Thus, for these 19 investors whom I had to take units from, I will ask my assistant to reimburse these investors in equivalent value back to their bank account. Moving forward, there should not be any discrepancies between the Excel file and the statement by the fund administrator (maybe except for 1 cent rounding error).

I am also considering uploading the Excel file to Google Sheets so that my assistant can update the spreadsheet whenever investors perform any top-up or redemption. Each investor will only access their own spreadsheet. One risk of this is privacy security. Let me know your thoughts, and whether you prefer the file in Google Sheets, or the current offline Excel file, which my assistant will send to you once a year at the least or whenever there a redemption or top-up is made.

Final words

Since the Covid-19 pandemic, many governments have been handing out financial aid to citizens and companies. This basically meant increased government spending, while at the same time, their income from taxes is reduced, which will eventually lead to higher inflation rates. While I do not know where the stock prices will go in the short term, I do know that:

1) cash and cash equivalents investments (FDs, bonds, and bond funds) will virtually lose its purchasing power in the long run even when you add in the returns earned from these investments, and

2) over the long run, ownership of productive assets (whether it is businesses, farms, or real estate) will prove to be much better investments among all asset classes.

Our fund's top asset class will always be in fractional ownership of productive assets (commonly known as stocks), now and forever.

18th June 2021

Peter Lim
Fund Manager
Peter Partnership Fund