

**We invest in winners.** That means we invest in strong companies that create value for their shareholders with sustainable business models, solid balance sheets and high margins. We keep the risks low and invest when our position is fuelled by a positive event. We refer to that as the combination of value and event.

### The value of liquidity

Stock markets are occasionally very volatile. In such phases they offer attractive, sometimes absurdly favourable, buying opportunities. The only problem is that we have to be prepared for such times without knowing what is going to happen.

*„No one can tell you when these will happen. The light can at any time go from green to red without pausing at yellow. When major declines occur, however, they offer extraordinary opportunities to those who are not handicapped.” (Warren Buffett, 2018)*

If a crash occurs, someone who is always fully invested not only has to take a larger hit on his portfolio, he is also deprived of the opportunity to take advantage of low prices. In order to achieve our fund objective, i.e. equity-like returns with reduced volatility, we are only fully invested if we find many irresistible opportunities. Otherwise, we hold liquidity and wait patiently until our ambitious rate-of-return requirements for equities and bonds are met. Admittedly, when interest rates are low, liquid funds are less attractive. However, the opportunity costs of insufficient liquidity can sometimes be very high, even with a negative interest rate. The mathematical disadvantage becomes clear if we consider the example of investor A who is 100% invested in the market and loses exactly 25% in a medium-size crash. He must then

achieve a return of 33% in order to reach his initial level of 100%. Investor B, on the other hand, is only 70% invested in the market and also loses 25%, assuming an identical and market-neutral stock selection. The remaining 30% is held as interest-free liquidity, which we assume he reinvests at the bottom of the market. If the stock market actually rises by 33%, investor B has a pecuniary advantage of 10% over investor A. This means that investor A would have to start out with 1.1 times the capital of investor B in order to end up with the same assets. To obtain this 1.1-fold advantage with a 100% investment ratio compared to a 70% investment ratio during the recovery phase, stock market prices need to have risen by 44% in the period before the decline. Even if Investor B pays a penalty interest rate of 0.5% on his liquidity, the increase must still be 43% ( $x = 1.43$ ).

$$100\% \cdot x = 1.1 \cdot [70\% \cdot x + 30\% \cdot 0.995]$$

This example is naturally based on model assumptions. We have neither a market-neutral portfolio nor the visionary ability to deploy liquidity at precisely the lowest point. However, the more powerful the crash and the more frequently such events occur, the greater the probability that investor B will achieve a pecuniary advantage over investor A. For this reason, our investors should not be surprised if our liquidity ratio fluctuates counter-cyclically and sometimes significantly.

Sincerely yours



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