

August 2018 Investment Letter

July 31, 2018 YTD



Sparrowhawk Fund (EUR)

13,07%



Royal Albatross Portfolio (USD)

1,84%



Kingfisher Portfolio (EUR)

-3,25 %

| | |
|---------------------|--------|
| DJ Industrial Index | 2,81% |
| S/P 500 Index | 5,33% |
| MSCI World Index | 2,36% |
| Berkshire Hathaway | 1,32% |
| Gold | -6,10% |
| EUR/USD | -2,51% |
| Oil WTI | 15,58% |

15.38%

In 1980, 37 years ago, the investment manager launched the FCM Opportunity Fund (Sparrowhawk Fund as of 2009).

The value of the Fund has grown from \$900.000 to \$321 million at a rate of 15,52% compounded annually.

Two rules
Rule no 1: Never lose money
Rule no 2: Never forget rule no 1.

China is taking the next step in the ever-escalating trade war with the US. The country announced it will put 25% tariffs on \$16 billion worth of US goods, including oil, steel products, autos and medical equipment. This



move was widely expected after the US announced back in August that it would add a 25% tariff to \$16 billion of Chinese goods.

Thus far, tariffs haven't slowed the flow of goods from China. Exports to the US rose 13,3% in July compared to a year ago. Eventually tariffs will hurt both countries. We expect a "mutual" agreement to be announced soon that will remove all tariffs, and free trade will win out.

The Fed discussed raising rates soon to counter excessive economic strength, but also examined how global trade disputes could batter businesses and households. Trump is not really thrilled with rate increases by the Fed.

The difference in yield between 2-year and 10-year notes narrowed, making it the flattest yield curve since 2007. NOT GOOD.

You may think it is hard for the stock market to ignore these kind of moves, but it does. The Sparrowhawk Fund has again benefitted from being patient. The Fund is up 13,07% as of end July 2018.

The Albatross Portfolio is up 1,84% end July 2018 with 40% still in cash. The commodity part is + 3,85% and the US equity part is +6,54%.

The Big Picture

Interest rates are the most important markets in the world to follow because they point the way for other markets. They determine which way the economy is headed. The numbers to watch is 3% for both the 10 and 30 year yields.

Interesting, last month Trump essentially called on the Fed to cool it with their interest rate hikes, noting that higher rates could undo the positive benefits the economy is now enjoying. Normally, this is unusual because the Fed has traditionally been independent. In fact, it's been over 25 years since a president publically put pressure on the Fed about rates.

Rising interest rates will slow the economy, but it could be even worse. The Fed Funds interest rate, has already been raised 7 times since 2015. Still it's only at 2%.

They are rapidly closing in on the 10-year yield and this is causing concerns. It could trigger a recession, along with a drop in the stock market. This has happened, every time short-term rates have risen above long-term rates. It's called an inverted yield curve and it's abnormal.

And since T-bills and the 10-year yield are getting closer to becoming inverted, markets are nervous and it have to be watched closely. We don't want this to happen, but it would if the Fed hikes rates two more times this year, like they're planning to do.



What are the Markets telling us?

The economy is sending mixed signals. Even though it grew 4,1% in the 2ndQ, several factors aren't in synch, like the slowing real estate market.

The Misery Index is rising (unemployment rate and the annual inflation rate) which is not good. But at the same time, consumer sentiment is rising and that is good news. So no wonder the markets are getting mixed messages and reacting accordingly. Again this makes things difficult to analyse.

But the Sparrowhawk Fund is not making market timing and is therefore fully invested at all times with a high conviction in a limited number of positions.

Stock Market

This is already a very long bull market. In fact it is the longest bull market in history.

Low interest rates have been a real plus for the stock market. Unlike the other markets, stocks are not at a crossroad. In fact, they just keep chugging higher, especially since April when tariff talk started. Currently, Nasdaq reached a new record high and the S/P follows and all systems will be go for an ongoing renewed stock market rise. This could end up being spectacular, and very profitable as the final phase of this bull market unfolds.

But you have to be selective because not all stocks are participating. The Sparrowhawk Fund selects a limited number of quality stocks which are held for the long term. This month, for example, we saw some differences. Facebook plunged in the biggest one day loss for any stock ever. Amazon surged on the best earnings on record. And then Apple hit the \$1 trillion value mark, which was yet another record for any stock in recorded history.

The bottom line is, regardless of these differences, we believe the companies we are holding have good upside potential.

Most important, earnings have been great and that is the primary driving force, pulling stocks out of their doldrums.

So far, the tech heavy Nasdaq has been the only index to hit new all time record high. But it'll probably be a matter of time until the other indexes follow.

Many say the stock market is overvalued and by several measures it is. But based on the earnings estimates 12 months going forward, the PE ratio is only 16,9. And over the past 28 years the average has been 17. So the stock market is not cheap, but it's not expensive either.

Meanwhile, the global stock markets have generally been weaker than the US market. That is because the trade tariffs are not hurting the US as much as some of the other countries, at least for now. And if the US market heads higher as we suspect, the global markets will probably join and follow...like they usually do.



| Index | 2018 Peak | YTD |
|------------|-----------|---------|
| BSE SENSEX | 13.21% | 13.21% |
| S&P 500 | 7.45% | 6.86% |
| CAC 40 | 6.17% | 1.26% |
| FTSE 100 | 2.47% | -1.26% |
| Nikkei 225 | 5.97% | -2.49% |
| DAXK | 4.96% | -7.22% |
| Hang Seng | 10.81% | -7.76% |
| Shanghai | 7.63% | -18.41% |

As of Aug 20 2018

The Sparrowhawk Fund has as a long term strategy to be fully invested at all times, convinced that spending time in the market is much more important than trying to time the market. The Fund has a CAGR of +15% and is up 13% so far this year.

US Dollar

Despite all the reasons why the dollar “should” be declining, like escalating trade tensions, the fact that Trump wants a weak dollar, lower interest rates and more, it is not happening.

Instead safe haven demand pushed the dollar to a 14 month high, fueled by the financial crisis in Turkey due to concerns over its leader, trade tensions with the US, new tariffs and sanctions. This sent the Turkish lira and its stock market plunging. It increased worries about Turkish contagion affecting the EU and its banks. So the euro declined.

You will remember that a contagion can affect all of the markets. The Asian contagion in 1990 was one example, even though it was triggered by Thailand, many markets were affected. The same was true of Greece several years ago. Its financial crisis spilled over to most of the global markets because of contagion fears that Greece’s problems could affect the rest of the world.

For now, we still do not know if Turkey will have longer repercussions. But since the dollar is on the upslope, it suggests the delicate tariff war could continue to affect the emerging countries. It could spread, and if it is sustained, the dollar will head higher, at least until things settle down.

The Chinese yuan, keeps on dropping. It is pretty clear the Chinese are weakening their currency to offset the new US tariffs on Chinese goods. This policy will probably continue as long as the trade war remains in force.

This will increase pressure for the US to weaken the dollar too. We have seen this happen before as countries play one against the other to gain the currency advantage, which a weak currency will provide. It’s called competitive devaluations.

Gold and Natural Resources

Safe haven demand hasn’t moved to gold, and the summer months are seasonally bad too. But if the trade war escalates, it will eventually hurt the strong US economy. And this in turn would be good for gold.



Western investors have a very low percentage in gold. They are not interested in gold and in fact the amount of speculative short positions is at a high last seen in December 2015. The gloom today is as deep as it was when gold reached a major low.

Sentiment for precious metals today is among the worst since 1990. Gold is held down by the paper trades, and not by any lack of demand, which continues to grow in the East. China is the biggest producer in the world and they are keeping their gold. It's also reported that they are accumulating as much as 30 tonnes of gold daily.

Russia is similar. They have been dumping their Treasuries and raising their gold buying. And then there are many other central banks of Eastern countries following.

The Royal Albatross Portfolio is still 20% long in commodities, 20% long in US equities and 20% long in real estate and 40 in cash.

Summary

The Sparrowhawk Fund strategy is to always be fully invested for the long-term in order to catch the force of the long-term compounded returns. (CAGR +15% since 1980).

US and global growth remain, healthy. Interest rates may rise but are still low. Central banks are unlikely to be overly aggressive in raising interest rates.

The Sparrowhawk Fund has a significant allocation to quality US focused companies priced at attractive levels in industries like media, payment industry, pharma, infrastructure and consumption.

The Sparrowhawk Fund, a Long Global Conviction Equity Fund that is actively managed based on views with a time horizon measured in years, emphasizing fundamental, economical and geopolitical analysis and select those sectors that should benefit from these movements. The Fund has a selection of a limited number of leading stocks in each chosen sector.

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Sparrowhawk Fund
Monthly Performance Figures

| Year | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD (USD) | YTD (EUR) | S/P 500 |
|------|-------|--------|-------|-------|--------|-------|-------|--------|--------|--------|--------|-------|-----------|-----------|---------|
| 1980 | | | | | | | 7,04 | 3,45 | 3,77 | 5,46 | 16,3 | 0,54 | 41,70% | 57,35% | 18,83% |
| 1981 | -3,78 | -2,08 | 1,23 | -5,70 | 0,53 | -2,60 | -4,00 | -5,64 | -3,98 | 3,55 | -2,1 | 0,15 | -22,23% | -6,54% | -9,73% |
| 1982 | 2,70 | -5,83 | -0,88 | 3,63 | -0,42 | 3,93 | 2,92 | 9,78 | 8,83 | 12,96 | 9,02 | 9,05 | 69,77% | 92,22% | 14,76% |
| 1983 | 3,26 | 4,96 | 5,07 | 9,53 | 5,68 | 7,51 | 0,05 | -1,77 | -0,45 | -2,86 | 0,18 | -1,28 | 33,20% | 57,97% | 17,26% |
| 1984 | -2,67 | -2,98 | -0,35 | -1,91 | -3,04 | 0,82 | 0,33 | 10,61 | -3,33 | 4,6 | -0,12 | 7,42 | 8,63% | 25,61% | 1,38% |
| 1985 | 6,11 | 0,16 | -1,19 | -0,4 | 7,38 | 2,93 | 1,15 | 1,31 | -1,95 | 4,42 | 5,04 | 3,57 | 31,95% | 5,45% | 26,36% |
| 1986 | 1,71 | 4,30 | 1,59 | -0,54 | 4,23 | 1,47 | -2,39 | 1,65 | -4,40 | 2,42 | 0,41 | -1,53 | 8,89% | -9,69% | 14,62% |
| 1987 | 6,80 | 2,35 | 1,09 | -3,85 | -0,23 | -2,31 | 7,59 | -1,12 | -2,11 | -20,52 | -4,48 | 5,03 | -14,00% | -29,60% | 2,03% |
| 1988 | 4,17 | 2,54 | 1,08 | 2,65 | -3,62 | 3,53 | 0,10 | 0,18 | 1,82 | 0,76 | 0,82 | 1,75 | 16,71% | 30,43% | 12,39% |
| 1989 | 1,99 | 1,44 | -0,09 | 1,46 | 2,05 | 0,99 | 3,99 | 0,67 | -0,52 | -0,71 | 1,69 | -2,08 | 11,29% | 9,62% | 27,25% |
| 1990 | -2,2 | 1,23 | 3,18 | 0,09 | 6,79 | 3,21 | 2,10 | -5,39 | -6,21 | 0,58 | 3,24 | 2,44 | 8,64% | -5,29% | -6,56% |
| 1991 | 5,73 | 6,16 | 3,8 | 0,45 | -1,06 | 4,12 | 3,45 | 0,62 | -0,32 | 0,67 | -2,53 | 8,10 | 32,69% | 35,65% | 26,30% |
| 1992 | 2,88 | 4,53 | -3,22 | -1,73 | -0,33 | -2,42 | 0,52 | -0,33 | 2,50 | 3,85 | 8,52 | -2,77 | 11,93% | 24,27% | 4,47% |
| 1993 | 1,31 | 3,11 | 3,08 | 2,39 | 8,59 | 0,57 | 1,89 | 1,91 | 0,33 | 3,48 | 1,61 | 3,52 | 36,93% | 48,19% | 7,06% |
| 1994 | 5,00 | 1,94 | -0,14 | 2,36 | 2,4 | 0,07 | 5,65 | 5,25 | 1,25 | -1,21 | -6,24 | -0,86 | 15,91% | 5,15% | -1,55% |
| 1995 | 3,43 | 3,26 | 5,03 | -0,22 | 1,55 | 2,76 | 11,64 | 1,77 | 0,80 | -0,73 | 7,45 | -1,47 | 40,58% | 35,01% | 34,12% |
| 1996 | 5,67 | 6,01 | -5,00 | 5,88 | -0,38 | -3,34 | -6,79 | 5,56 | 5,67 | -0,34 | 8,17 | -1,27 | 20,07% | 22,34% | 20,26% |
| 1997 | 7,63 | -0,27 | -2,94 | 4,23 | 9,81 | 1,87 | 11,37 | 1,75 | 0,95 | -2,25 | 3,28 | 1,17 | 41,93% | 61,92% | 31,01% |
| 1998 | -2,25 | 16,05 | 5,26 | 0,82 | -4,70 | 6,31 | -1,19 | -12,08 | 0,00 | 11,64 | 10,66 | 14,16 | 49,43% | 43,31% | 26,67% |
| 1999 | 6,37 | -5,14 | 8,10 | 1,87 | 0,24 | 7,37 | -3,04 | 2,64 | -2,51 | 7,09 | 3,53 | 10,54 | 42,20% | 61,76% | 19,53% |
| 2000 | -1,56 | 5,36 | 9,32 | -8,22 | -5,69 | 5,95 | -1,98 | 17,36 | -8,48 | -9,31 | -12,12 | 1,49 | -11,46% | -5,37% | -10,14% |
| 2001 | 3,32 | -14,68 | -2,93 | 12,31 | -11,19 | -3,55 | 1,56 | -1,09 | -4,28 | 2,4 | 3,72 | -1,88 | -17,52% | -12,72% | -13,04% |
| 2002 | -0,64 | -5,42 | 2,56 | 1,33 | 1,15 | 2,13 | 6,73 | -0,78 | 2,8 | 0,33 | -6,24 | 2,93 | 6,34% | -9,79% | -23,37% |
| 2003 | -0,18 | -2,24 | 2,61 | 0,00 | 2,40 | -4,62 | 0,88 | 4,33 | -4,38 | 5,5 | 3,16 | 4,44 | 11,85% | -6,72% | 26,38% |
| 2004 | 2,01 | 3,32 | 1,12 | -4,67 | 2,07 | 2,02 | -1,67 | -1,75 | 0,95 | 2,53 | 4,35 | 1,2 | 11,71% | 3,70% | 8,99% |
| 2005 | 4,71 | 10,78 | -2,84 | -4,9 | 3,00 | 2,41 | 6,54 | 3,85 | 3,78 | -4,17 | 6,2 | 3,87 | 37,24% | 57,15% | 3,00% |
| 2006 | 21,12 | -4,49 | 9,06 | 8,97 | -5,29 | -5,14 | -4,86 | 2,62 | -4,86 | -0,47 | 5,10 | -1,61 | 18,09% | 5,95% | 13,62% |
| 2007 | 5,72 | -3,93 | 3,2 | 7,28 | 6,50 | 2,25 | -1,57 | -2,05 | 15,1 | 9,58 | -2,69 | 3,46 | 49,90% | 35,58% | 3,53% |
| 2008 | 3,31 | 9,14 | -6,09 | 8,25 | 0,62 | 6,98 | -8,8 | -8,56 | -11,02 | -4,71 | 0,81 | 4,39 | -8,92% | -4,93% | -38,48% |
| 2009 | -0,08 | 2,82 | 1,29 | 7,80 | 7,74 | 9,18 | -9,41 | 9,63 | 3,71 | 3,34 | -0,08 | 2,98 | 48,08% | 44,51% | 23,45% |
| 2010 | -9,79 | 3,43 | 7,78 | -5,85 | -6,39 | -4,61 | 9,02 | 3,11 | 8,70 | 3,77 | 1,11 | 9,89 | 7,71% | 15,27% | 12,78% |
| 2011 | 3,02 | 0,40 | -7,01 | 0,94 | -2,98 | -2,73 | 5,63 | -8,41 | 4,32 | -7,97 | 2,70 | -3,27 | -17,60% | -15,46% | 0,00% |
| 2012 | 4,49 | 0,03 | -1,33 | -1,03 | -2,91 | -1,10 | 3,18 | 0,53 | 0,73 | -0,96 | -2,14 | -1,86 | -0,73% | -2,60% | 13,41% |
| 2013 | 2,81 | 2,24 | 0,99 | -3,69 | -0,88 | -5,21 | -2,3 | 0,25 | -1,70 | 1,55 | 1,45 | -0,25 | -1,36% | -5,31% | 29,60% |
| 2014 | -0,02 | 2,94 | 2,75 | -0,86 | 1,22 | -0,49 | -0,53 | 3,01 | -0,51 | -0,32 | -0,01 | -0,02 | -5,71% | 7,16% | 11,39% |
| 2015 | 1,59 | 3,94 | 1,79 | -2,84 | 1,21 | -1,90 | 0,55 | -5,42 | -2,47 | 6,06 | 2,15 | -3,39 | -9,62% | 0,64% | -0,73% |
| 2016 | -2,71 | 1,16 | -0,99 | -0,04 | 1,17 | -0,10 | 2,72 | -1,08 | 0,37 | 1,84 | 1,78 | 2,48 | 3,28% | 6,69% | 9,54% |
| 2017 | 2,17 | 4,16 | 0,39 | 0,47 | -1,09 | -1,46 | 0,49 | -2,76 | 0,25 | 4,39 | 0,53 | 0,64 | 23,52% | 8,33% | 19,42% |
| 2018 | 5,79 | -1,20 | -4,80 | 2,80 | 5,69 | 2,22 | 2,05 | | | | | | 10,25% | 13,07% | 5,33% |

Performance prior to January 2009 is based on the FCM Opportunity Fund (USD) which has been managed by the Investment Manager since 1980 using the same investment strategy and approach as the Sparrowhawk Fund. Past performance is not an indicator of future results.

Audited YTD performance.
1980-2008 in USD
2009-today in EUR

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