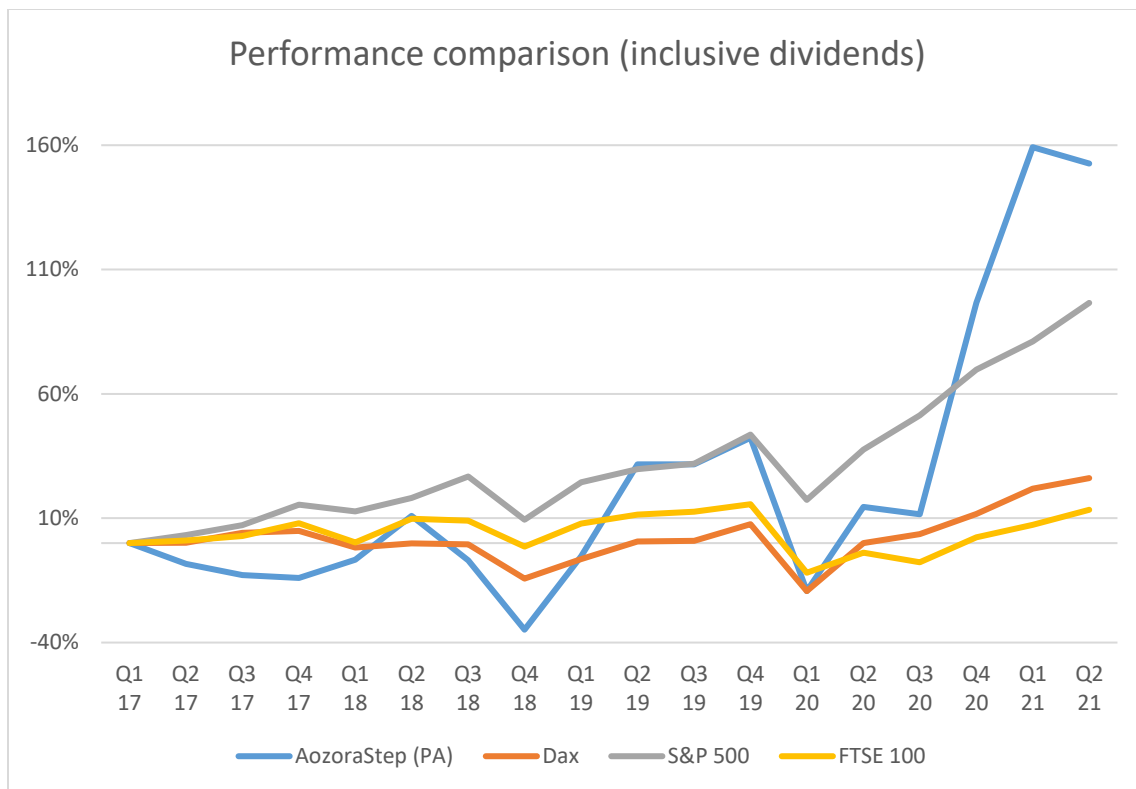


## Quarterly Performance vs. S&P 500, FTSE 100 & DAX

Quarterly Performance	Our Performance	S&P 500	FTSE 100	Dax
Q1 17	0%	0%	0%	0%
Q2 17	-8%	3%	1%	0%
Q3 17	-5%	4%	2%	4%
Q4 17	-1%	8%	5%	1%
Q1 18	9%	-2%	-7%	-6%
Q2 18	19%	5%	10%	2%
Q3 18	-16%	7%	-1%	0%
Q4 18	-30%	-14%	-10%	-14%
Q1 19	45%	14%	9%	9%
Q2 19	39%	4%	3%	8%
Q3 19	0%	2%	1%	0%
Q4 19	8%	9%	3%	7%
Q1 20	-43%	-18%	-24%	-25%
Q2 20	42%	17%	9%	24%
Q3 20	-3%	10%	-4%	4%
Q4 20	76%	12%	11%	8%
Q1 21	32%	7%	5%	9%
Q2 21	-3%	9%	6%	3%

Annual Performance	Our Performance	S&P 500	FTSE 100	Dax
2017	-9%	15%	8%	5%
2018	-31%	-5%	-9%	-18%
2019	113%	31%	17%	25%
2020	52%	18%	-12%	4%
H1 21	28%	16%	11%	13%

Overall Performance	Our Performance	S&P 500	FTSE 100	Dax
CAGR	22.9%	16.2%	2.8%	5.3%
2017-21 Return	153%	97%	13%	26%



4<sup>th</sup> July, 2021

Dear Investor,

While this is my first quarterly report without being regulated by compliance of my previous employer (minimum holding periods, limited number of trades per month), it has really only been two, three weeks since I stopped working for Bluecrest Capital. In the previous quarterly report I was uncomfortable with the slightly larger level of diversification than usual. At the end of Q1 2021, I invested in around seven different and fairly large, and hence complex, businesses. Despite seeing all these opportunities, I realized that it varies quite a bit from the strategy that enabled me market beating returns, namely by investing only in a handful of businesses where my calculated fair value has the largest upside vs. the current market valuation. A few of the companies that I invested in, however, had estimated returns of around 25%, while I had others with estimated returns of over 40%. For that reason, I filtered out those firms where I see the largest upside and shifted the portfolio accordingly. Still being subject to Bluecrest compliance rules, this caused a bit of suboptimal allocations during the month of May, which will be explained under the Performance part.

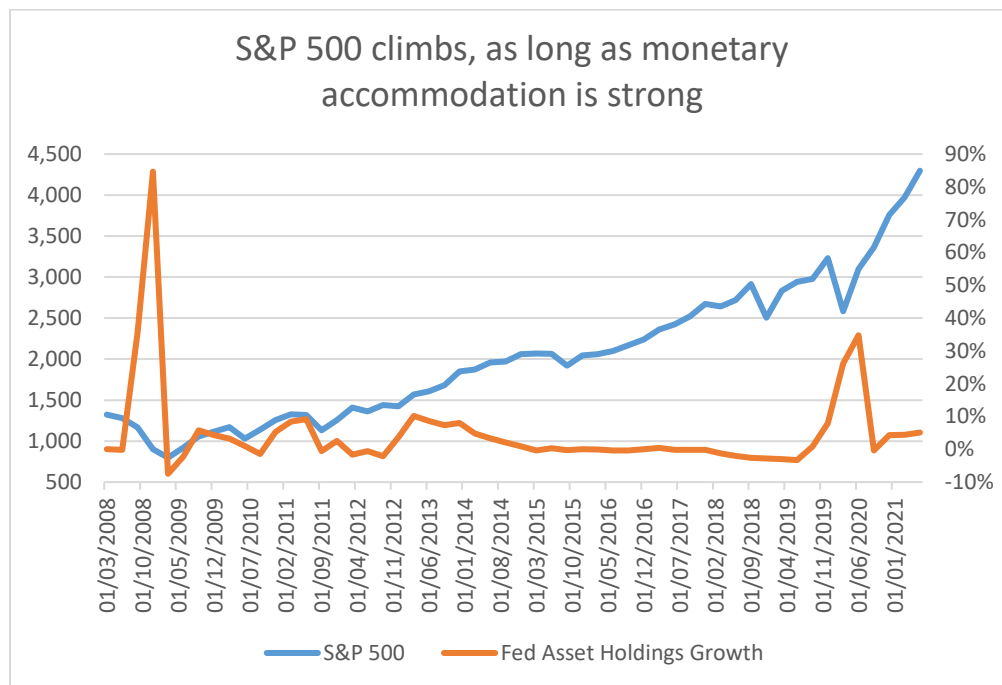
Before moving on to the performance, however, I will provide a brief market overview and where we are in terms of the economic environment in general. In [Q1 2021](#), I compared the current economic environment with the Dot-com crash as well as the 1920s forgotten depression and then flagged the risk of leverage in the system with the Archegos Capital blowup. What all market crashes have in common? Monetary (& fiscal) tightening. In 1919, 2000, 2007, monetary policy tightened faster than the market was prepared for. The Federal Reserve is well aware of the impact of monetary tightening and since 2008 been

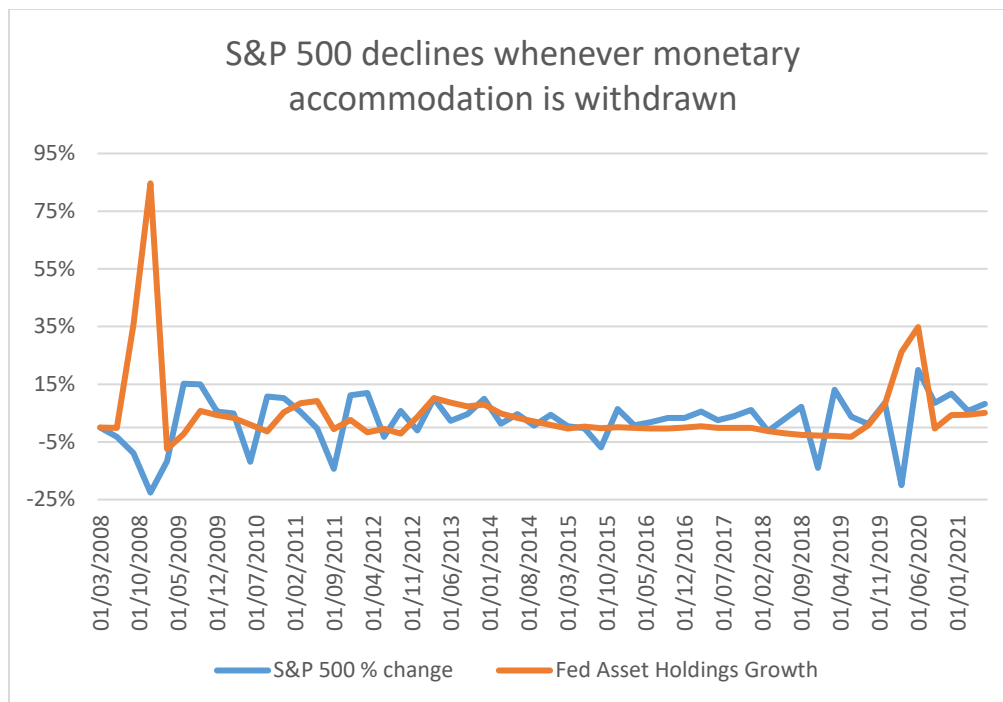
extremely accommodative. In the [Sunday Research paper](#) from two weeks ago, I matched the current environment with the one in 2013, as the FOMC changed their guidance in the same manner as today.

What do we have in common with 2013?

1. Fed asset purchases grew at a similar pace as today
2. The Dot Plot increased by 40bps two-year forward
3. The FOMC began talking about tapering asset purchases
4. The usage of the Overnight Reverse Repo Facility increased from zero to nearly 10% of all Federal Reserve Assets, indicating excess liquidity in the system
5. The prior six months were a period of fast UST yield curve steepening.

The importance of accommodative monetary policy can be seen in the below two graphs, which show that equity valuations dropped whenever the Fed began tapering bond purchases, except during 2013-14 (although the market sold off in 2015). The success of monetary tightening during 2013-2014 makes it the perfect playbook for the Fed today to remove the excessive monetary accommodation of today in a similar manner.





Source: Bloomberg

Back in 2013, it took the Fed seven months to start tapering after first announcing it in May 2013 (December 2013 FOMC meeting tapering began). In today's world, we will likely have the Fed talking about tapering in July, which according to the 2013 playbook would then mean they begin tapering in February 2014.

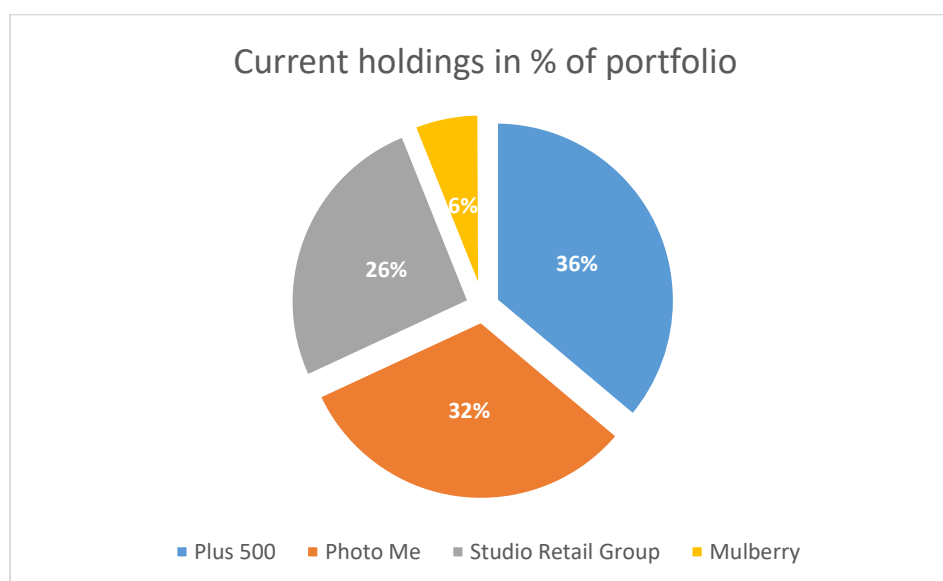
What is very different today from 2013, however, is the rapid economic expansion with booming manufacturing and supply bottlenecks, which lead to increasingly uncomfortable inflation (see UK Daily International Updates [1](#) & [2](#)). The Federal Reserve might therefore be pressured to tighten monetary accommodation earlier than in 2013. For that reason, I continue to be cautious and began position the portfolio in sectors I believe should outperform over the coming 3-6 months (consumer credit, machinery/automation used in retail and retail stock trading), even if the Fed and other central banks tighten early.

### Performance

After a 32% return in Q1 21 mostly amid the energy related rally, we declined by 3% in Q2 21. Overall it was a fairly disappointing performance, as the FTSE 100 gained 6% meanwhile. The biggest obstacle I faced when repositioning to companies that generate revenue from retail clients was that I was still subject to Bluecrest compliance rules. I added to my position in Centrica before the trading update, which turned out to be really poor, and then couldn't sell the position for nearly a month. I then sold the Gem Diamonds position to buy Mulberry shares. As Mulberry shares are quite illiquid due to the small free float, it was difficult to get liquidity and after day two (having only bought ¼ of my target amount) the management came out with a trading update which made the shares soar by over 70% (which I then couldn't sell due to

the compliance related 1-month minimum holding period). While I sold positions in Hunting, Just Group, BP and Aviva at decent prices, I sold BT shares after the conference call with management, as they hiked capital expenditures and indicated profits to recover only in five years' time. This reminded me of Covestro hiking capital expenditures while facing pressures on margins. However, Polymer Materials is a different industry from Telecommunications, and I could have gained another 30% before BT reached my fair valuation. Last, but not least, again due to the Bluecrest compliance rules having reached the maximum number of trades in a month, I could not buy into Enquest and then decided not to chase it (shares soared 30% in the first two weeks of June). Nonetheless, I am now very content with having reduced the number of holdings to Plus 500, Photo Me, Studio Retail Group and Mulberry, with the former two providing a trading update next week and the latter on July 22<sup>nd</sup>. As this quarter was more active than others, I have split the Performance explanation into 1. Exits & 2. Entrants.

Company	Average Purchase Price	Current Market Price	Currency	% change
Plus 500	14.67	13.35	GBP	-9%
Photo Me	0.72	0.71	GBP	-1%
Studio Retail Group	2.88	2.88	GBP	0%
Mulberry	2.45	3.35	GBP	37%



## Performance explanation: Exits

### 1. Energy

#### Hunting

There were no signs of a recovery in oil drilling and the valuation of the company looked vulnerable to any disappointing trading update. While I continue to believe in Hunting and its management, it is a company to own later on in the year when there is more visibility in terms of capital expenditures of oil firms. I sold the firm at a price of £2.51 per share – a 33% gain.

#### BP

Despite the increase in oil prices, BP's valuation just did not move. After WTI climbed above \$70 a barrel multiple times, Russia continued to immediately communicate to boost output – a strategy that could have been used in order to deter US shale production. The market seems to view the oil majors in a similar distrust as the large tobacco companies and for that reason I felt it is much better to buy the smaller player whenever valuations look attractive. I sold the shares at a price of £3.13 per share and exited flattish after receiving a dividend.

#### Centrica

While I expected an upbeat trading update from Centrica in May, the update was short of details and very disappointing. Management has told investors to focus on free cash flow, which was very strong throughout 2020. However, in Q1 2021, Centrica generated negative free cash flow of £350mio. A discussion with their IR team did not make this number any clearer. Although the firm spent £100mio in pension deficit payments, £100mio in bonuses, £100mio of discretionary opex and working capital is highest at the end of winter, a cash outflow of this size was not what I expected. I sold all shares at a price of 54 pence a share (17% gain), but I continue the dialogue with their IR team, as in autumn working capital is expected to decline and with the high natural gas price currently, I expect the firm to increase their profits (all also depends on the pension tri-annual valuation outcome).

### 2. Insurance

#### Just Group

Just Group has had a phenomenal 2020/21 FY, as life insurance sales surged amid the lockdowns. For the first time in 5 years, however, the company has not provided a market update in June, and their IR team did not specify why. This comes at a time when Aviva saw a 50% decline in their Annuities & Equity Release sales in Q1 21 – a section Just Group is strong in. The 2020 results were also heavily influenced by one large contract win on defined benefit de-risking solutions, a section I haven't really heard of any large deals being announced recently. With the missing trading update and a profit of 23%, it felt prudent to lock it in and pursue other opportunities that show larger upside potential. I sold the shares at an average of 105 pence per share (23% gain).

### Aviva

Aviva remains one of the top insurance picks in the UK, as they are expected to pay out most of the money generated from selling their non-UK, Ireland, Canada businesses. The solvency II ratio is expected to reach 253% in June after divestment proceeds are completed. As our position was quite small, I sold it down to buy more Centrica ahead of the trading update, which as mentioned above turned out to be the wrong decision. I sold the shares at after receiving the dividend at an average of 396 pence (2% gain).

### 3. Telecommunications

#### BT

As mentioned earlier, I sold BT due to the increase in capital expenditures, which reminded me of the time when Covestro began hiking capital expenditures. Despite a 13% gain (sold at 155 pence), the shares actually ended up reaching my target price shortly afterwards at 200 pence. The phone conference with management sounded extremely negative, by providing a guidance of profit recovery in five-year time into the future. While I focus on numbers, I do pay attention to management, and in this case I wonder whether management is on purpose misleading investors to see a drop in share price to then buy them up at a lower price? A day after the phone conference, CEO Philip Jansen bought a significant stake in the company.

### 4. Mining

#### Gem Diamonds

Also mentioned earlier, despite continuing to think Gem Diamonds is an attractive business with further upside in terms of valuation, I sold the shares at 67 pence (37% gain) to buy Mulberry shares, as I saw more potential upside in Mulberry. Unfortunately, I could not buy as much Mulberry as I'd have liked. Gem Diamonds remains the most attractive diamond miner in my eyes and with 3ct+ prices up 23% this year in China, the current market valuation remains undervalued – maybe something to look at again in the future.

Most gains of the positions that were sold have been generated in Q1 already, and hence had no big impact on the Q2 performance.

## Performance explanation: Entrants

### 1. Financials

#### Plus 500

Plus 500 is one of the leading contract for difference (CFD) brokers and is attractively valued with a market cap of £1.4bn and a net cash position of £490mio, i.e. an enterprise value of ~£900mio, while reporting net income of \$500mio (£360mio). Why is the company so cheap? Multiple reasons:

1. The firm was under scrutiny by investors in 2019 amid confusion of statements from management saying that client trading activity can lead to profit or losses. Losses were previously ruled out, but around 5% of the company's revenue is due to taking the opposite side of the trade of clients. This 5% can impact earnings a lot though, as it did during Q4 21 when the market rallied, it cost Plus 500 \$100mio in losses from client activity.

2. Regulation to clamp down on excessive leverage for retail clients. Despite the continued regulation, Plus 500 was able to generate strong profits. In the UK the firm needs to state the percentage of clients who lose money from trading via Plus 500 (currently 72%). In the EU and now also in Australia, the firm needs to limit leverage to clients depending on what they trade to a factor of 1-5x. The less leverage clients take, the less profit Plus 500 can make.

3. Competition is heating up with eToro gaining market share amidst their tireless online marketing spending.

Both two points are valid and understandable. Nonetheless, an environment like Q4 21 was exceptional, and clients will unlikely be able to make that much money in such a short period of time causing losses for Plus 500. The firm states to expect this to come down close to zero amid better hedging algorithms.

Despite the tightened regulation, 2020 was a record year for Plus 500 and with the Reddit crowd remaining in the field, profits for Plus 500 should stay here as well. The first quarter saw EBITDA at \$122mio and while the 2<sup>nd</sup> quarter will likely see lower revenue, the firm is strongly positioned for the 2<sup>nd</sup> half of the year, in particular when the football season restarts, as Plus 500 stroke remarkable sponsorship deals with the #1 or #2 team in Switzerland, Poland, Italy and Spain (extended). My target price is £21 per share, giving the firm a valuation of £3bn and an upside of over 50% at current valuations. We bought at an average price of £14.67.

### 2. Consumer Machinery

#### Photo-me

Photo-me is mostly known for its photo booth - an industry that is in decline, as countries like the UK allow consumers to take their passport & driving license photos with their mobile phone. Although photo booths still make up over 50% of the firm's revenue, Photo-me invests into their laundry business (20% of revenue) and self-serviced juice machines to shift revenue towards these new business lines. In a trading update in April, Photo-me updated its profit guidance to between £15mio-19mio for the current (Covid) period. At the same time, the company maintains a net cash position of £22mio and with a market cap of £275mio



looks attractively valued for growth amid the reopening of economies (60% of their revenue is from Continental Europe, most from France). The net cash position is expected to turn into a net debt position of around £20mio due to higher capex in the laundry business in 2021.

One of the biggest concerns that's spooking markets right now is spiking input prices (inflation) as a direct result of rising raw material prices and a shortage of labour. While Photo-me is not immune against these factors, it is not as badly affected as other businesses. The capital expenditure figure is a fixed number, i.e. if the machines get more expensive to produce, they would produce less. The company has a network of a few hundred engineers (amongst others, 650 engineers in the UK for photo booths, 60 for the juice business). Although they could face labour constraint in that area (see Centrica, BT), it would be very small as their total labour costs in 2020 amounted to merely £1mio. Rather as labour costs are rising, machines should be the answer to these higher labour costs.

Last but not least, the owner has recently upped his stake by buying an additional 3mio shares at 75 pence each under his company Tibergest PTE LTD, which values the company slightly above the current market cap, after Japan sales soared from a higher usage in the personal identification "my number card". We bought at an average price of 71 pence.

### 3. Retail

#### Studio Retail Group

Studio Retail Group is in simple terms, the UK Amazon for cheap products and people who want to buy goods on credit. The company has recently sold off its education business and reduced its core net debt to zero. Since Covid struck, the resulting lockdowns have led more customers to shop online, which benefitted Studio Retail Group: Revenues were boosted by 33% to £578mio and adj. profit before tax climbed by 79% £48.8mio. Although the firm continues to borrow around £290mio from banks at an average rate of 3.5%, this debt is just offsetting the £315mio they provide in credit to customers at rates of 39.9% to 49.9% pa. As Studio Retail Group has credit risks, they need to account for bad debt charge/expected loss, which was 7.9% in FY 21. If those losses don't materialize, this would boost pre-tax profits to nearly £100mio (although this would surely not happen). The firm has a market cap of only £250mio.

Why is Studio Retail Group so cheap? First of all, the company has had a bit of a rocky history, emerging from Findel group and multiple equity raises. The business as it stands is also competing against Amazon, Argos, Primark and Next, which are tough competitors. Generally, most of their revenue (& profits) are generated over the Christmas period, as people run out of cash to buy presents and use the discounter, Studio Retail Group, to buy gifts for their loved ones on credit to repay it back in the following month. Nonetheless, with an increase in customers by 35% to 2.5mio in FY 21, some of those newly won customers are here to stay.

The group has an ambitious target to reach £1bn in revenues (nearly 100% increase) over the next five years. Although I'm not too sure whether they can reach this target, the company is very attractively valued at just around 5-6x pre-tax earnings. Frasers Group owned over 30% of outstanding shares, but recently sold around 5% of their holdings at a valuation of £260mio. This sale brought some shockwaves and made shares drop by nearly 20%. The headline "Frasers Group ends partnership with Studio Retail Group" was slightly misleading, as Frasers Group merely reduced their holdings to below 30%, which triggers a

regulatory notice. Studio Retail Group and Frasers Group flagged that there was never a working partnership between the two groups. I have bought some additional shares when the price dropped, which lowered our average price to 288 pence.

### Mulberry

When LVMH reported Q1 21 results, they showed rapid growth and high consumer demand in China, it became clear to me that luxury goods are in high demand and that pent-up savings are being put to work. Mulberry appeared cheap compared to the rest in the field with a market cap of only £145mio and no debt apart from leases. My wife also told me that some of her Asian friends look to buy a Mulberry bag. So I started a little field study by visiting some of the Mulberry shops in London...

Despite their Creative Director returning back to LVMH last year, his collection is still extremely popular, in particular in Asia. At the Mulberry flagship store I met a very friendly sales lady who then advised me that sales are stronger than 2019 – this was in April 1-2 weeks after reopening. Without putting too much trust into her words, especially as any change after lockdown appears like booming at first, the sheer amount of pent-up savings made her comments sensible. At the same time, like all businesses, Mulberry shed costs by laying off 25% of their shop staff and renegotiating their leases.

So why is Mulberry so cheap then? It wasn't always the case. In fact, 5 years ago the market cap was 3.6x higher than it is today and their revenues and profit were not much different from today – a lot more UK focused though. In 2018, when the House of Fraser collapsed, there was a bit of a retail slowdown in the UK. The House of Fraser collapse has cost Mulberry £2.1mio + the brand's launch in South Korea put another £2.5mio dent in their earnings. This has led to a selloff in Mulberry shares and until today, the market capitalization has not recovered. In 2020, ironically, it was the Fraser's Group that bought nearly 37% of Mulberry shares and are now the 2<sup>nd</sup> largest holder after owner Ong Beng Seng (56%). This puts the free-float at only around 6%, extremely illiquid. I realized that when I was trying to build a stake, as I couldn't get enough liquidity at a decent price. This led me to try and buy a little bit every day (and cost me a lot of compliance requests in May, as I was still working at Bluecrest – hitting my limit). And I remember Warren Buffett complaining about companies giving trading updates too often, which I never understood... until now. As I tried buying into Mulberry, the firm gave a trading update stating that they will edge out a small profit during the pandemic. This was unexpected and the shares soared over 70% to more than 400 pence a share. Sadly, as I was still under Bluecrest compliance regulation, I could not sell at that point. I also could not buy at that point, at least I didn't want to at those prices and ended up owning a very small piece of the cake. The average purchase price came in at 245 pence and I'm waiting for their interim report on 22<sup>nd</sup> July.

### Review

This quarter was a tough quarter, as I was very limited to act on opportunities due to Bluecrest compliance rules. It affected my positions in Mulberry, Enquest and Centrica, as I wasn't able to sell/buy when I wanted to. I made a mistake by selling BT too early, despite the higher capital expenditures being visible prior to the earnings call. As I'm looking ahead for the current quarter, I have lost nearly 10% in our Plus 500 position, which is also our largest share in any business. While I don't see having bought Plus 500 as a mistake, it

seems to pay off when the management decides not to release a trading update at a time they usually did so in the past (like Just Group). This is likely the driver of the mark-to-market loss in Plus 500. By next week, I do expect a trading update, which should shed some light on Q2 operations. Twice this quarter, BT and Centrica, I was surprised by the way management present their company's result in a slightly negative way, and then seeing them buying the dip in the subsequent sell-off. I do think listening to management is important, but they might have some incentives to mislead you on occasion in order to benefit from the market reaction. I will try and work on this a little harder.

### Outlook

With the Covid variant running rampant and differences across different regions in the world in tackling the virus, I expect the rest of the year to be very volatile. I have made multiple historic comparisons such as the Forgotten Depression in 1919/20, the DotCom crash and the 2013/14 US Fed tapering episode in order to understand the potential outcomes of the current environment better. For this reason, I shifted away from commodities, as they fared pretty badly in all of these periods (although 2013/14 it was only end of 2014 that oil sold off), towards consumer goods related businesses. With multiple trading updates coming up over the next two weeks, our current positions might change quickly again. I am currently looking at automotive retailers in the UK, as the shift towards electric cars can offer massive opportunities for car dealerships. The chip shortage is the biggest risk and likely the reason why those companies are so cheap despite record sales. There is also a cosmetics company, Brands Architekts, which I'm taking a closer look at.

Sincerely,

David Herrmann