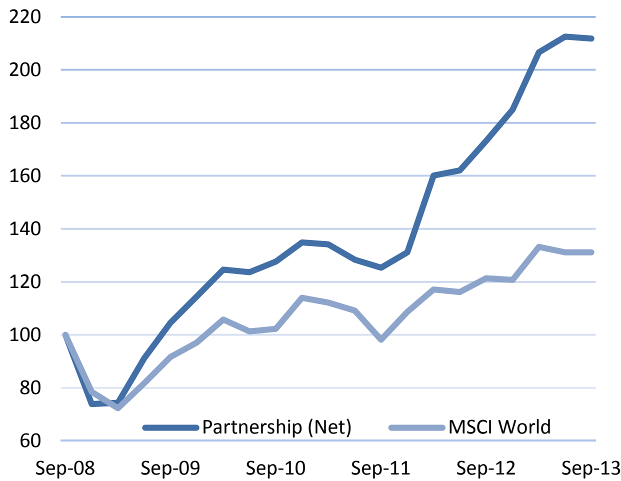
CORE PORTFOLIO Q3 2013

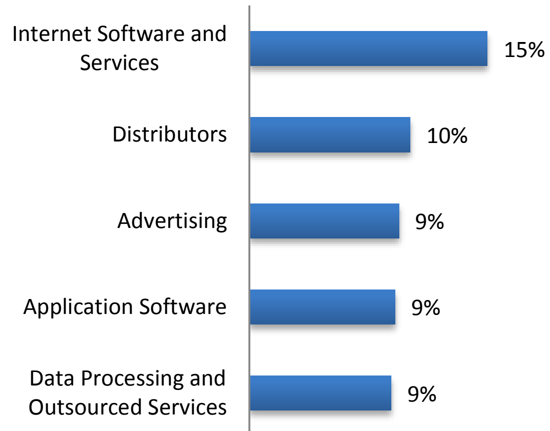
iolite

Performance			EUR[1]	Index
Inception Date:	01 October 2008	**Quarter**	-0.3%	3.1%
Portfolio Style:	Value / Total Return	**Since inception (annualized)**	16.2%	6.2%
Manager:	Robert Leitz	**Since inception (cumulative)**	111.8%	35.3%

Performance in EUR



Top 5 Positions



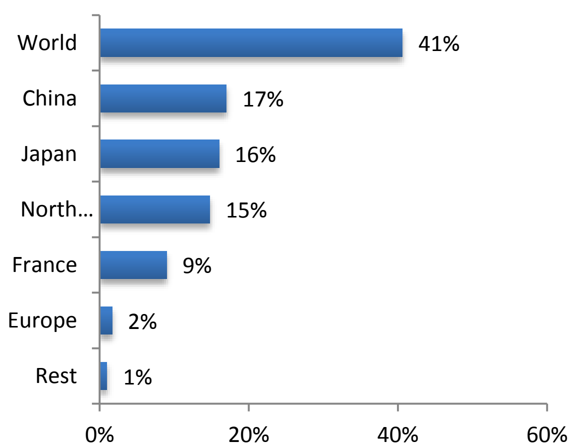
Market Review

Much of the third quarter was dominated by worries that the US Federal Reserve (Fed) might taper its quantitative easing program, but in September, the Fed's announcement to delay tapering triggered a rally and most equity markets globally ended the quarter with positive returns. Meanwhile, Europe saw renewed political uncertainty at the end of the quarter, particularly with regard to the Italian government, while the German elections left Angela Merkel needing to seek a grand coalition. Emerging equity markets underperformed developed markets, hurt by concerns about the impact of a possible reduction in global liquidity, especially on emerging market countries that had sizeable current account deficits.

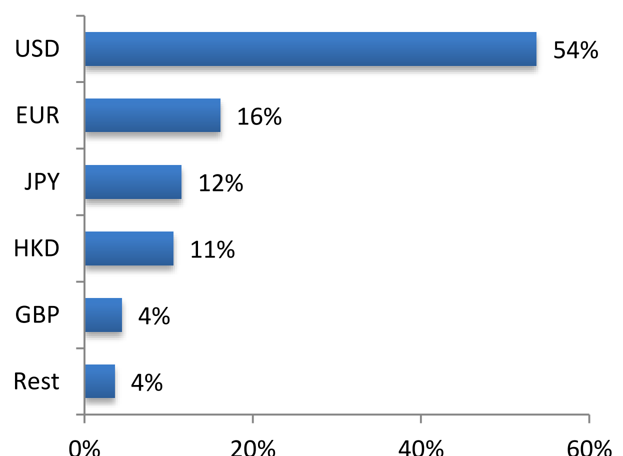
Portfolio Review

The strengthening of the euro vs. the dollar cost about two to three percentage points of performance as measured in euros, and the portfolio underperformed the MSCI World Index for the quarter. The portfolio remains fully invested, as I continue to find what I believe to be attractive opportunities. I significantly reshuffled the portfolio in the first half of 2013 after big bets had turned out well and none of the bigger bets I put on in the last three quarters have played out in a major way yet.

Geographic Breakdown by Revenue Market



Geographic Breakdown by Listing Currency



[1]Net returns: no leverage, after all costs (no management fee, 25% performance fee for returns greater than 4% p.a., high watermark)

QUARTERLY REVIEW

For the quarter ended September 30, 2013, the portfolio returned net -0.3% in EUR (+3.3% in USD). Since inception on October 1, 2008, the core portfolio has generated net cumulative returns of +111.8% in EUR (+108.0% in USD) and annualized net returns of +16.2% in EUR (+15.8% in USD). I consider unleveraged long-term absolute performance far more important than relative performance against a benchmark.

Macroeconomic Environment

"History doesn't repeat itself, but it does rhyme." (Mark Twain)

I wanted to stop writing about the macroeconomic environment, as it does not impact my investment strategy that much (I pick individual companies and don't bet on the market as a whole) and because the world doesn't need yet another pseudo expert on global affairs. Popular writer Michael Lewis once said economists are "the modern day fools of the financial circus". It's just too difficult to predict macroeconomic events – history has shown us time and again that most economists are wrong most of the time (and the few times when they were right were probably lucky draws).

However, ongoing excessive monetary policy in the United States, Europe, and Japan as well as recent interviews and letters of Paul Singer, a brilliant mind with a convincing long-term track record at hedge fund Elliott, have led me to revisit the topic of hyperinflation in the Weimar Republic. I believe it's fair to say that while it is impossible to predict what will happen, common sense and history tell us that an economic system out of balance and dependent on ever-increasing levels of debt is not sustainable.

Hyperinflation in the Weimar Republic

In order to pay the large costs of World War I (WWI), Germany suspended the convertibility of its currency into gold when that war broke out. Unlike France, which imposed its first income tax to pay for the war, the German Kaiser and Parliament decided to fund the war entirely by borrowing. As a result, the exchange rate of the Mark against the US dollar (due to the gold standard effectively a substitute for gold) fell steadily throughout the war.

Germany had come out of WWI with most of its industrial power intact, as the battlefields were mostly limited to France and Belgium. However, under the Treaty of Versailles following Germany's defeat in the war, Germany and its allies had to transfer substantial reparation payments, property and equipment for loss and damage mostly to France, Britain, Italy, Belgium and the US.

Because war reparations were required to be repaid in hard currency and not the rapidly depreciating paper Mark, one strategy Germany employed was the mass printing of bank notes to buy foreign currency which was in turn used to pay reparations. This greatly exacerbated the devaluation of the paper Mark, and, by consequence, worsened domestic inflation.

In January 1923, French and Belgian troops occupied the Ruhr valley, the industrial heart of Germany, to ensure that reparations were paid in goods such as coal. Because the Mark was practically worthless, it became impossible for Germany to buy foreign exchange or gold using paper Marks.

Inflation was exacerbated when workers in the Ruhr went on a general strike, and the German government printed more money in order to continue paying them for "passively resisting."

Effectively, the Weimar Republic was all but reduced to a barter economy. People watched helplessly as their life savings disappeared and their loved ones starved. Germany's finances descended into chaos, with severe social unrest in its wake.

The following lessons learned are taken from a review of the book "When Money Dies: The Nightmare of Deficit Spending, Devaluation, and Hyperinflation in Weimar Germany":

- Most Germans had not grasped the draconian terms of the Treaty of Versailles at the time it was agreed upon.
- Logically, the enormous government debt could only be paid back through inflation. Nevertheless, people were not prepared for hyperinflation.
- Government and banks continually reassured the population the worst was over, and people usually were encouraged as a result.
- Food and fuel prices went up faster than those of clothing and other goods.
- The middle class in particular was wiped out.
- To service debt, government enacted many new taxes.
- For the sake of survival, everybody broke laws concerning hoarding, black markets and taxation.
- Foreigners were buying businesses, land and anything that could be sold. Because foreigners got everything at fire sale prices, resentment built against them.
- Extremist factions arose. Riots and unruly mobs became common.

Adam Fergusson, author of the book, concluded in a 2011 interview with James Turk I highly recommend to my readers (http://www.youtube.com/watch?v=sqffE6pDXuA):

AF: If you debauch your currency, you are asking for trouble … History has taught us not to go there in the first place. What really broke Germany was the constant taking of soft political options in respect of money. That is what's going on now … Hyperinflation is caused by the loss of trust by people in their money, the cowardice of governments who don't say, 'This is stopping now,' and then if people lose trust in their currency, then they start to get rid of it … What is not clear is at what point does people's confidence in their currency disappear? … [In Germany] there came a stage when it became politically impossible to halt inflation.

JT: Have we seen this now in the west?

AF: Not quite, but we are getting near that situation. If inflation is the only way out of government debt, as it is in the western nations, then it's going to happen, and the question is: how much? And once you don't even know how much, how are you going to stop it? I don't want to predict hyperinflation; I do predict high inflation, and I hope it can be stopped. And it may need the kind of courage that politicians cannot have. Monsieur Juncker, who is the Luxembourg prime minister, he said something so wise, he said: we all know what has to be done; what we don't know is how to get re-elected once we've done it.

Asset classes that have historically performed poorly in times of high inflation are cash, bank deposits and bonds, as fixed interest rates don't offset the loss of purchasing power from higher price levels. Asset classes that have performed better are real estate, foreign exchange, stocks and commodities. This is because owners of businesses, commodities and real estate see income from operating cash

flows rise with higher overall nominal price levels. Still, even if invested in these asset classes, investors have to prepare for all kinds of possible setbacks (some only temporary in nature): e.g. significant market volatility, government intervention or the time lag of a company's earnings catching up on cost inflation.

Inflation favors people and corporations in debt, as they see the real value of their debt decline over time. Still, rising interest rates or liquidity and refinancing risks might break the back of anyone that is heavily levered. Worst hit are traditional savers with most of their wealth locked into fixed income deposits, such as savings accounts, treasuries, pension funds or life insurance.

Portfolio Positioning

The portfolio remains fully invested, as I continue to find what I believe are attractive investment opportunities, despite the market rally of the last two years. Over the past six months, I continued to reshuffle the portfolio after some bigger bets played out successfully and I sold out of winners such as Sohu.com, GVC, and the Daily Journal. In the case of Sohu.com, the bet played out rather quickly: the 78% total return was realized in less than six months, resulting in an annualized return (IRR) of almost 400%. In the case of Daily Journal, the portfolio gained on average 28% per annum for almost 4 years, resulting in a total return of 139%. I am happy with the performance of both positions.

None of the new bets I have put on in the last three quarters have played out in a major way yet. However, I see no cause for concern. I consider these stocks undervalued because the market unjustifiably dislikes them for one reason or another. And while my investment theses haven't changed, Mr. Market hasn't changed his views either. In the meantime, I hope these businesses continue to perform well operationally, and I hope to increase my stakes in these positions with new funds coming in.

I am happy to answer your questions and see assets grow.
Please spread the word!

Robert Leitz

Closed Positions (Q2 and Q3 2013)

<table>
<tr><th>Position</th><th>Sector/Industry</th><th>Listing Currency</th><th>Absolute Return</th><th>IRR</th></tr>
<tr><td>Daily Journal</td><td>Publishing</td><td>USD</td><td>139%</td><td>28%</td></tr>
<tr><td colspan="5">
Daily Journal Corporation publishes news to lawyers on litigation, transactions, regulations, law firms, and settlements, in California and Arizona. More importantly, the company owns a significant investment portfolio managed by Warren Buffett’s right-hand man, Charlie Munger.

When I bought into this position in late 2009, the company was trading at just 2 times cash flow net of its investment portfolio at book value. I liked the company’s niche publishing business and the absence of debt. In my mind, the nature of the business (highly specialized information-provider to the legal profession) protected the company from the intensity of the digital interruption seen in other publishing areas such as newspapers, consumer magazines and books. In addition, from reading the annual reports it was obvious that Charlie Munger had used lower stock prices during the financial crisis to deploy the company’s significant cash holdings (after almost a decade of sitting on cash) to buy a concentrated portfolio of stocks (rumored to include a large position in Wells Fargo). Given the investment expertise and the rise of the stock market in 2009-2010, it was likely that reported book value understated the market value of the company’s stock portfolio.

Over the time of the holding period, Daily Journal’s stock price rose thanks to steady operating cash flows, gains in the company’s stock portfolio as well as higher market awareness. I sold out of the position in Q3 2013 after a few newspaper articles helped push the stock price to levels I believed to be at or higher than the company’s fair value. I would argue the market, after its recent enthusiastic run, is now understating risks around the company’s operating cash flow and the fair value of the investment portfolio’s underlying securities as well as the age of Charlie Munger (89 years).

There are other lessons to be learned here as well:
1. Thousands of people travel to the mecca of value investors every year, Omaha, to learn from the combined wisdom of Warren Buffett and Charlie Munger. Thousands of people say they watch their every move. Yet, most of them missed this great opportunity.
2. From 2000 to 2008, Daily Journal was effectively accumulating and holding cash from operating cash flow. Then, after February 2009, the company invested over USD 30 million into common stocks. Whereas Daily Journal’s stock price increased by only 27% from January 2000 to January 2008, it increased by over 250% from January 2008 to November 2013, driven by the highly successful capital deployment in 2009. On a long-term basis, these returns handily beat 90% of all other businesses and asset managers in the period – and arguably with taking on very little risk. In the case of Daily Journal, Charlie Munger was living up to his principles: “Be patient, bet selectively, put all your eggs into one basket, and watch that basket carefully.”
</td></tr>
<tr><td>Sohu.com</td><td>Internet Software and Services</td><td>USD</td><td>78%</td><td>388%</td></tr>
<tr><td colspan="5">
Sohu.com provides online media, search, gaming, community, and mobile services in the People’s Republic of China. At the time of purchase in February 2013, Sohu.com was trading at a low EV/EBITDA multiple with lots of cash. I believed the shares had traded down due to overall negative market sentiment regarding China (slower growth, regional real estate and debt bubbles, weak corporate governance, and common corporate fraud) and the company’s complex corporate structure.

The trade worked out well as the share price rose significantly shortly after I bought into the stock. I realized profits once the share price hit my conservative valuation levels (I put a discount on the company’s cash position, as most of it is held in associates – potentially with up-streaming and control issues).
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GVC Holdings	Casinos and Gaming	GBP	175%	65%

GVC Holdings is an operator of online betting services and provider of technology services to online betting companies. The company has historically exploited legal gray areas in European gaming jurisdictions to run niche online gaming sites (mostly in Germany) and has recently de-risked the businesses through higher, acquisition-driven diversification and changes in its operational setup. GVC is run by true masters of capital allocation and "deal savviness". Over the last few years, the company has paid out significant cash dividends – often equal to 20% of market capitalization - despite frequent (and profitable) acquisitions funded through a healthy mix of share issuance, operating cash flows and leverage.

I realized profits after recent acquisitions led to a more prominent public profile and a parallel run-up in the company's share price. While I do believe recent acquisitions provide great businesses opportunities and management appears to be very capable, I also see the need for GVC to digest recent acquisitions to justify current valuation levels.

PERFORMANCE & BENCHMARKING

%	in EUR				in USD			
	Portfolio Net[2]		MSCI World DM		Portfolio Net		MSCI World DM	
	quarter	cum	quarter	cum	quarter	cum	quarter	cum
Q4 08	-26.2	-26.2	-21.6	-21.6	-26.3	-26.3	-22.2	-22.2
Q1 09	0.7	-25.5	-7.8	-27.7	-4.6	-29.7	-12.5	-31.9
Q2 09	22.6	-8.9	13.0	-18.3	29.9	-8.7	19.7	-18.5
Q3 09	14.7	4.5	12.2	-8.4	18.4	8.1	16.9	-4.7
Q4 09	9.5	14.5	5.9	-2.9	7.8	16.5	3.7	-1.2
Q1 10	8.8	24.5	8.9	5.7	4.1	21.2	2.7	1.5
Q2 10	-0.7	23.6	-4.2	1.3	-10.1	8.9	-13.3	-11.9
Q3 10	3.2	27.6	1.0	2.3	15.5	26.1	13.7	0.1
Q4 10	5.7	34.8	11.4	13.9	3.3	30.3	8.1	8.3
Q1 11	-0.5	34.1	-1.5	12.2	4.3	35.8	4.3	12.9
Q2 11	-4.3	28.3	-2.8	9.1	-1.9	33.3	-0.3	12.6
Q3 11	-2.3	25.4	-10.0	-1.9	-9.9	20.0	-17.1	-6.6
Q4 11	4.6	31.1	10.7	8.6	1.2	21.5	7.1	0.0
Q1 12	22.1	60.1	7.8	17.1	27.5	54.9	10.9	11.0
Q2 12	1.2	62.1	-0.8	16.2	-3.8	49.0	-5.8	4.5
Q3 12	6.8	73.1	4.5	21.4	9.1	62.6	6.1	10.9
Q4 12	6.9	85.0	-0.6	20.7	9.0	77.3	2.1	13.2
Q1 13	11.7	106.6	10.3	33.2	9.2	93.6	7.2	21.3
Q2 13	2.8	112.5	-1.5	31.1	4.0	101.3	-0.1	21.2
Q3 13	-0.3	111.8	3.1	35.3	3.3	108.0	7.7	30.5

	EUR Portfolio Net	EUR MSCI World DM	USD Portfolio Net	USD MSCI World DM
1-Year	22.4	11.4	27.9	17.7
Annualized	16.2	6.2	15.8	5.5
Total	111.8	35.3	108.0	30.5

[2] Net returns: no leverage, after all costs (no management fee, 25% performance fee for returns greater than 4% p.a., high watermark)

INVESTMENT APPROACH

"Price is what you pay, value is what you get." [Charlie Munger]

"You will not be right simply because a large number of people momentarily agree with you. You will not be right simply because important people agree with you. You will be right, over the course of many transactions, if your hypotheses are correct, your facts are correct, and your reasoning is correct." [Warren Buffett]

A share represents a fractional ownership of an underlying business and a bond is a loan to a business. Therefore, in the medium to long term, the performance of shares and bonds correlate with those of the underlying businesses.

I see myself as a value investor. That is, I invest in what I consider undervalued securities instead of betting on the development of the market as a whole. I buy securities if the market price is below my fair value estimate. I do not believe in timing the market as this would be speculation. Neither do I believe in overweighting certain countries or industries simply to beat a certain index. I avoid leverage and try to minimize complexity (such as derivatives or complex capital structures) in order to provide better protection from permanent capital loss.

My goal is to generate sustainable market-beating absolute returns with a few select value investments. It will always be difficult or near impossible to exactly predict when these undervalued securities will reach fair value - in some cases the progression could be very fast, but in many cases it could take years. Therefore, investors need to be patient and should have a long-term horizon. In my mind, a track record of at least three years is required to draw conclusions about the qualities of a portfolio manager. Financial markets are very volatile and what may appear to be a trend, even over a couple of years, can sometimes be misleading.

KEY BENEFITS TO CLIENTS

1. **Low/no management fees.**
   It is not unheard of in the fund management industry for investors to be charged 3-5% of assets annually. At iolite, the maximum fixed fee that you would pay is 1%.
2. **No performance fees without sustainable capital gains.**
   We only charge a performance fee for annual returns greater 4% (including a high watermark).
3. **Client portfolios are modeled after the portfolio manager's personal account.**
   At iolite, we eat our own cooking.
4. **No leverage, no margin loans, no complexity.**
   At iolite, we try to keep things simple and stick to time-tested value investing strategies.