

# Comus Investment, LLC

Dear Partners,

January 1<sup>st</sup>, 2019

In the fourth quarter of 2018 our investments experienced a total return of -9.20% before fees and -9.83% after fees, versus -13.53% for the S&P 500 index. For the year of 2018, we generated a total return of -4.47% before fees and -6.99% after fees, versus -4.39% for the S&P 500 index. At this point you will have received reports with the details on your balance, fees, holdings, and performance from InteractiveBrokers for the past quarter and full year.

This year stocks in most countries did poorly, particularly in Asia. Including dividends, the Shanghai Stock Exchange index experienced a total return of around -25%, Hong Kong's Hang Seng Index around -15%, Japan's Nikkei 225 about -12%, and Japan's Topix (a broader Japanese index with 1000 smaller companies) about -16%. With the exception of India and New Zealand, all major Asian indices were down for the year. Worldwide most major indices experienced losses as well, with every European index that I can find down for the year. In the Americas, U.S. markets were down for the year along with Canadian and Mexican indices. Most in South America were also down. Global indices that weigh many countries were of course down as well for the year, in most cases well into double digits.

It was a very odd year for us. We had poor absolute returns in 2018, and when compared to the S&P 500 we did not do well, but we did well relative to nearly every foreign or global index, particularly compared to the markets in which we operate. With the markets we primarily invest in down well into the double digits we were only slightly bested by the S&P 500, which I believe puts us in a great position moving forward. There is increasing opportunity around us as prices continue to drop worldwide, and as a result we hold many more stocks now than we did a year ago- 22 now compared to about 15 then. Our markets have become even cheaper relative to the U.S., and it happened without our portfolio experiencing the same temporary losses that the local indices did.

I expected our type of company- small, obscure, and mediocre, to be the hardest hit during any crashes in demand for stocks and so far that hasn't been the case. I still think we may take larger temporary drops than the market averages when stocks experience larger losses than they have recently but it will be impossible to know until it happens. Berkshire Hathaway stock for example has experienced four temporary drops in price of 50%+ since 1973, which is about once every 12 years. I would expect our portfolio to temporarily have price drops at least as bad and at least as often.

This is the first year I have experienced as an investor in which the prices of most companies publicly traded worldwide dropped significantly and seemingly in unison. I can say with certainty that the value of companies worldwide has not dropped over the past year, but recent activity has felt like a wave of selling leading to broad declines for most stocks- again, particularly where we operate. It has been well reported that this December was the worst for U.S. stocks since the Great Depression and many other countries followed a similar path. I won't

speak to future stock price predictions, but regardless of whether recent losses are temporary or not, I believe we are well positioned and able to take advantage of whatever happens.

We had more than a few clients join us in mid-summer, and those clients have experienced deeper unrealized losses than those who have been invested for longer. As stated in previous quarterly letters this year, we were up over 10% in June and so if you invested around that time you will have experienced a total return since then approaching -15%. This is quite unfortunate timing, because if you were able to invest in January you would have experienced our early gains, and if you invested now you would have skipped our unrealized losses over the past two quarters and would be able to invest in our portfolio at lower prices. Investing being a service where most people would like confirmation of their choice, it is likely uncomfortable for this to be how you start off and I can empathize if there are concerns. Due to the nature of investing, generally in the short-run most investors cannot know for sure whether the active manager of their funds has done a poor job and has made bad investments if they experience losses or if it is just temporary fluctuation.

If I ever make a mistake that leads to real losses, I will immediately let you all know. I believe our fluctuations however, are both illogical and short-term in nature and I would like you all to continue to focus on the long-run. My focus is on compounding over decades and our total cumulative returns relative to every other option over quite long time periods is how our success will be measured. If done properly, I do not think that any amount of temporary unrealized losses will have a factor in our results and I believe they may actually be necessary for long-term outperformance.

Further, while I find the timing unfortunate in that you all could have invested at lower prices if the timing was changed by a few months, I do not find the price drops unfortunate whatsoever. Every company purchased at that time I found cheap and as prices drop they only become cheaper in my eyes. The price drops do not mitigate the potential profit I saw when you invested in each of them at the time you did, they only offer further opportunity.

To help explain my focus, mindset and how I would like everyone to view unrealized losses, I want to use a brief metaphor.

Imagine that we are a pottery trader. Like other pottery stores, we have a retail location at which the public can buy what we offer. We don't make the pottery, we just buy it from others who make it and we sell it to the public in our shop. Unlike most retailers which make a profit from charging a mark-up on their inventory, we can only sell at the current market price that pottery makers ask for. So if it costs us \$700 to buy a piece of pottery on some day, then on the same day we can only sell it to the public at \$700.

As pottery experts, we have a good idea of what the future price will eventually be, because we know what the price of each piece of pottery should be. By looking at each piece, we can estimate its worth and buy from the manufacturers when the price they ask for is less than what we estimate the value of each piece to be. The difference between our cost per piece and our estimated value per piece is our theoretical profit, and our real profit is the difference between the cost per piece and what we sell each piece at. If we are estimating well, then our theoretical

and real profit should be pretty close. The price that pottery makers ask from us is always changing and to a very high degree, while the value of pottery doesn't change much at all, which is how we make money. So if we have a high level of confidence that a certain piece of pottery is worth about \$700 and we can buy it from manufacturers at \$500, then we can make \$200 a piece from buying it up and hopefully selling some time in the future at \$700. We will have to wait for the market price to move towards \$700 because as of the time of our purchase we can only sell it at \$500.

If manufacturers then start asking for only \$400 for that same piece, then we can make \$300 per piece that we buy if we can sell it at \$700 in the future. If we have the cash to keep buying, this is great news because our profit margins have just increased by 50% and we can buy each batch of the same pottery for less than before. We will have to deal with increased inventory, because on our shelves we now have a lot of pottery that we are waiting to sell, and as long as it costs us \$400 a piece and we have cash for it, our inventory will keep growing. This means we will have to be comfortable buying and holding a lot of pottery and refusing to sell to the public for a while as our shelves fill up. We would only open our doors again to sell to the public when we can sell for the profit we expect.

If we bought 10 pieces for \$500 in year one and another 10 for \$400 in year two, you could say that year two was a better year for us although we still haven't realized a profit yet. Year two is a better year for us because our ability to make a profit has increased. If you were using market prices to do the profit and loss accounting, we would have a \$1,000 loss at the end of year one, since each piece that we bought would have to be sold for \$100 less at that point. That would be a -20% return because we spent \$5,000 in year one on 10 pieces and according to market prices they can be sold for only \$4,000 in year two. The thing is, we would never sell our inventory in year two- we're buying and happy about it.

Despite the fact that using market prices it looks like we have made a loss, if we think we can sell each piece at \$700 in the future, we don't care about our year one "losses", as they have actually increased our profits. If in year three, it cost us only \$200 to buy each piece, and if we had the cash, we would make \$500 per piece and would buy as much as we could. The accounting using market prices would make it look as though in year two we experienced even greater losses than in year one, but we would be able to buy at a much higher profit per piece.

The confidence in our pottery trading operation would depend on the accuracy of our \$700 estimate. If we either didn't know what pottery was really worth, or if we weren't very confident in our \$700 estimate per piece, or if we were ignorantly confident but wrong, we could be buying at a loss and not know it. If however, we did a good job estimating with a high degree of confidence, then in nearly all cases we would want to pay less for each piece we buy, as our margins would skyrocket. A very patient and logical pottery retailer in this scenario would want prices to shrink as much as possible and stay there for as long as possible to keep buying. If an outsider who wasn't a pottery expert looked at the financials of this pottery retailer, they would see large losses using market price accounting and likely think the pottery trader is losing money. The pottery retailer however, would see larger and larger potential profits each year as prices dropped as long as they were willing to disregard the current price.

As long as the pottery retailer had the willingness and ability to keep buying in the future, or if they expected to increase their inventory in the long-run (which we always do), they would like prices to stay low indefinitely. This is where this becomes an imperfect metaphor when thinking about businesses, as the pottery retailer may at some point need prices to rise to generate a profit and cash. Companies, unlike pottery, have the ability to pay dividends and so as investors we never necessarily need or want stock prices to rise. We would optimally desire prices to drop to near 0 and remain there indefinitely, while we receive high dividend payments relative to what we paid for. Therefore, we could keep buying for increasing returns as prices kept dropping without needing the price of our inventory to rise to generate cash or a profit.

Using another metaphor, if Michael Kors had a 50% off sale on all watches, would you suddenly question the quality of the watches, or think of it as a good opportunity to buy one? A smart consumer would remain critical of any purchase they make while also seeing it as a great time to get a watch. I want you all to know that this isn't just a theoretical exercise, I think this logic applies in practice and is necessary to understand. As the one who looks at each piece of pottery, I would personally like to pay as little as possible for each piece. There is no instance in which I would be happier paying more for any company I look at, and you should feel the same way. I expect our inventory of stocks to increase significantly in the long-run, and I would like to pay as low a price as possible to own each of them. This means that if we experienced a 60% drop in prices tomorrow and all else remained equal regarding the companies we owned, I would view it as a significantly positive event for our future.

Regarding the near-term, if stock prices continue to drop, it benefits us as long as most of us have the ability and willingness to invest more. If stock prices increase, our profit-making ability is decreased but we would likely realize significant gains. I'd prefer the former rather than the latter, although the latter would look better on paper in the short-run. Regardless of what happens over the next 3 years or less, I view current prices available to us as very attractive and they continue to become as attractive as I have ever seen them. I personally make deposits on a regular basis to take advantage of fluctuations and/or mitigate any unrealized losses by investing more at lower prices but that is something everyone should determine for themselves.

I was asked recently by a client/partner so I thought I should let everyone else know. I have only ever owned one other marketable security-type investment which was a few shares of Dodge & Cox that I sold in 2013 while in college- that's it. I think we own some of the cheapest companies in the world and see no reason to invest in anything else, so nearly all of my funds are plowed back into stock of the same companies we all own.

As always, feel free to contact me at any time with questions, comments or concerns.

Best,

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