

Dear fellow shareholder,

A note on performance. This was one of our best ever quarters in both funds. We are also more fully invested than we have been a long time. Pleasingly, returns were fairly evenly spread over virtually every security, although there was a good contribution from two of the securities outlined in our last letter, Record and Premier Miton. Both companies announced cautious but positive updates, and readers will recall that our cost prices reflected extremely pessimistic downturns, which at this stage have not materialised.

Cash as a percentage of assets between the end of the March and June quarters fell from 37.6% to 17.3% in the European fund and 31.7% to 7.3% in the UK fund, as we continued to unearth bargains in these volatile markets. We found rather inexpensive employment agencies in France (Synergie) and the UK (Robert Walters) and invested further in a number of property companies.

The latter, four apparently cheap and lowly geared UK landlords, we have limited to 15% of the fund, at cost. This is because they have some debt, so we wish to keep our own downside protected, and because their long-term returns may be good but not great. In most cases share prices will not appreciate faster, over extended holding periods, than the long-term rate of growth of the underlying businesses. In the case of the property companies we hope to capture that growth, which may be modest, plus a narrowing of the discount to fair value for the properties. That discount is currently large. So we hope to make reasonable returns as the ideas play out, but, other things being equal, we prefer to invest in companies with better growth rates and hold for longer periods.

The Cicada and the Apple

I am sitting in the garden of my wife's parents in Italy. She asks if I can hear anything? I am washed out by the heat and the excellent lunch, oblivious. But as soon she asks, I hear it, the insistent chirping of the cicadas¹. And once I am aware, I can hear nothing else: they are loud! "Has this been going on for long?" I ask. "All the time," my wife replies.

There's no mystery in this, I suppose. Our brains evolved to notice change, like the sudden appearance of the lion breaking cover to rush us on the savannah. Because cicadas are not dangerous to us, it is not useful to notice their repetitive chirping and we edit it out of our consciousness.

The crisis we are living through (and one of its many frustrations is that we cannot say whether we are nearer its beginning or its end) has redirected our attention to the cicadas we had stopped noticing in our economy. The pandemic has demonstrated the importance of essential workers, such as farmers and hospital staff.

But if we always knew the importance of the lowest level of the Maslowian pyramid, the lockdown has revealed how resilient are the upper levels. The working life of my profession and of many people in my social circle has changed little. We are privileged to be knowledge workers and many people around the world, especially in the retail and leisure sectors, have been badly affected, but my experience is common in large parts of the UK and in many other big cities in the world.

¹ A posh grasshopper

To take a huge step back, one way to examine progress in human history is as a series of solutions to the coordination problem. If you live in a small pack of humans on the aforementioned savannah you would do well to post a lookout for the onrushing lions. Perhaps you would take turns. But as humans banded together in larger settlements, villages and ultimately towns and cities, it was more difficult to coordinate groups counted in the hundreds and thousands. Larger groups allowed specialisation – one person to guard the settlement, ten to hunt, two to cook – and this was another important leap forward. Some have speculated that the development of music (which regulates behaviour at a distance) and even language enabled the existence of large and stable groups. The emergence of law and religion also reinforced norms.

Just as astonishing was the ability of groups to coordinate between themselves and the epitome of this is trade. Obsidian, lava used to make tools, was traded up to 500 miles away in the Stone Age. And thousands of years ago merchants in the Middle East moved spices, raw materials and jewellery across thousands of miles, through chains of traders, the last never meeting the first. Europeans were able to use nutmeg and black pepper in their cooking two thousand years before they were physically able to visit Indonesia.

The Middle Ages brought (or compounded) trade finance, shipping fleets, the printing press and empire. But the acceleration of communication since then, especially in the past one hundred and fifty years, has been astonishing. Newspapers, railways, the telegraph, the telephone, flying, container shipping, satellites, and now the Internet and the mobile phone, have made coordination fast, cheap and universal. Like ET, we can phone home.

My cicada moment during lockdown was the realisation that, even as we shelter at home, almost all of the coordination aspects of our lives have been uninterrupted. An enormous change in our economics (and social arrangements) that has crept up on us over decades, and we should take a moment to be astonished. Only fifty years ago, in the age of telex and expensive telephone calls, when a lot of commerce was still arranged by post, it would have been impossible to sustain our economy at such a high level in comparable circumstances.^{2 3}

While he was discussing his large investment in Apple, Warren Buffett said that at \$1,000 an iPhone was dramatically undervalued since most customers get far more value than that from it. A brilliantly simple insight: the company adds value (to its shareholders) by producing something massively more valuable than its cost (to its customers). So smartphones (and Google and Facebook and Zoom and ...) have enriched their shareholders and also enriched society.

Economists have been complaining about a productivity drought for the past decade but the lockdown has revealed that we are in a golden age of productivity improvement. With one portable device we can speak to anybody instantly, order food or a cab, buy airplane tickets – or place an

² It is a commonplace among screenwriters that few traditional plots would survive the introduction of a mobile phone. “Hi, Juliet, just txtng to say I made it fine. LOL, Romeo”

³ On the other hand, something that disabled electronic devices, such as an electromagnetic pulse, would bring the world to its knees

order in a factory on the other side of the planet. This is a step change in our productivity that doesn't appear in the official statistics.⁴

Many of our most successful investments (Ryanair, Paddy Power, Domino's, Impax) were not technology companies, but businesses that used technology to improve their costs and the quality of their products, while maintaining competitive advantage, and we shall continue diligently to seek their future equivalents. After a while one ceases to hear the cicada and we shall try to remember to listen.

Thank you for supporting Derby Street. We look forward to speaking to you all soon,

Richard Simmons
Derby Street Managers Limited
Investment Adviser to the Fund

Important Information Note

The content of this promotion has been approved by Eschler Asset Management LLP which is authorised and regulated by the Financial Conduct Authority in the United Kingdom. Investors are warned that past performance is not necessarily a guide to future performance, income is not guaranteed, share prices may go up or down and you may not get back the original capital invested. The value of your investment may rise or fall due to changes in tax and rates of exchange if different to the currency in which you measure your wealth.

It is only suitable for professional, high net worth and sophisticated clients as set out in COBS 4.12 of the FCA handbook. If you do not meet these criteria you must not place reliance on this document and will not be eligible to invest in the fund. This document has been created for information purposes only and has been compiled from sources believed to be reliable. None of Eschler, Derby Street or their directors, officers or employees accepts liability or for any loss arising from the use here of or reliance hereon or for any act or omission by such person or makes any representations as to its accuracy and completeness. No part of this report may be reproduced or distributed in any manner without the written permission of Eschler.

No investment in the Fund should be considered without reading the prospectus in relation thereto and in particular the risk warnings contained therein.

⁴ It is of no especial relevance to how we might value specific companies, but I wonder if there is any general inflation in the economy. Technology is making almost every industry more productive (in its operations and to its customers) at a lower cost each year