Dear fellow shareholder,

**The Return of Opportunity**

Persistent readers among you will recall that two and a half years ago, in the eye of the Covid storm, we ran through a list of stocks we were buying at what seemed very unusual prices (see our first quarter letter 2020, “How to Panic Well”). Here is an update on what happened next:

| Company | Cost price | Sold price | Current price |
|---|---|---|---|
| *Section I, Crisis Neutral* | | | |
| Record plc | 30 | 47 | 74 |
| Curtis Banks | 190 | 248 | 273 |
| *Section II, Manifestly Cheap* | | | |
| Premier Miton | 71 | Held | 87 |
| GAM | 136 | 98 | 75 |
| CIR | 41 | 50 | 43 |
| *Section III, Probably Cheap, High Upside* | | | |
| British Land | 458 | 498 | 365 |
| On the Beach | 267 | Held | 102 |
| *Section IV* | | | |
| Burford bonds 2024 | 67 | 93 | 96 |
| Burford bonds 2026 | 68 | 87 | 87 |

Overall, this was a rather profitable exercise (our gains in the twelve months following were over 50%) but the most intriguing data are for British Land. In the following quarter we made three other investments in property companies, Land Securities, Capital & Counties and Harworth. British Land and Land Securities we conceptually bracketed together. These are long-established, rather institutional property companies which, although they do possess some developmental swagger, have not performed that impressively over the long term. Both were badly diluted during the Lehman crisis fifteen years ago. We were nevertheless prepared to buy them in the Covid crisis because their debt levels were markedly safer than they had historically been and there was little risk of default – or further emergency dilution. And of course, the prices looked silly. As the table shows, we paid £4.56 for British Land compared to its then net asset value of £8.56 and paid £5.32 for Land Securities, whose then NAV was £11.92. Because we were not especially impressed with either their histories or how they coped with Covid, we were happy to exit with a 9% profit on the former and a 32% profit on the latter (in one year). The other two investments have more impressive histories and a more welcoming future, so we hold.

What has attracted our attention right now is that all four companies' share prices are just above or way below where they were in that Covid slump. I am sure you won't need reminding but around Easter 2020 there was a sense of existential doom in the economy (and in our lives) and most especially in the property sector. Public transport was empty, offices and shops were closed by law and rent was not being collected. A slump in investor demand was almost mandatory.

But today? It is true that there is a terrible war in Europe and energy prices have sparked a generational peak in inflation, and so we are on the brink of a likely recession. But surely things are not as bad as they seemed in that first lockdown. The missing piece of the puzzle is interest rates. We have become used to low rates and every crisis in the past forty years has been met with ever lower money prices. This time is different. Because of the inflation we have seen a prolonged spike in interest rates and this has a rather mechanical effect on property valuation. Property companies are required to value their assets periodically and this is carried out by surveyors. The process is quite simple, being a combination of projected rents and interest rates; as interest rates go up, the valuations come down. The current low level of share prices is likely because investors are anticipating material down valuations the next time surveyors take out their pocket calculators. The investor reaction is itself somewhat mechanical as it ignores the likely uplift in rents because of that same inflation; real assets that can replace income at higher nominal levels perform well in inflations. And the remaining debts of these property companies, which tend to be fixed rate, are also prone to be inflated away.

Other sectors also seem unduly depressed. As the On the Beach data above shows, travel companies have not yet found their zing although many of their struggles stem from coping with too *much* demand (On the Beach is an intermediary and does not itself have to worry about fuel prices). Small companies, technology companies, asset managers – many very promising sectors have had their share prices taken back to the levels of lockdown. There are also again a few interesting bond opportunities.

Which is all to say that winter is approaching but at Derby Street it is still the season for sowing. Our funds have plenty of cash and there are as many interesting situations as there were two years ago, at what are starting to feel like fire sale prices.

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

Richard Simmons
Portfolio Manager
Derby Street Investments

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