EPILOGUE

WHAT HAPPENED NEXT

2ND EDITION UPDATE

At least three years have elapsed since the original interviews for *Free Capital*, a long enough period to be worth reviewing for any new conclusions. All the investors were contacted in spring 2013 and invited to give an update on their results, as well as any changes in their investment activity or opinions expressed in the original text. This chapter summarises a mixture of email, telephone and in-person updates for the three years 2010, 2011 and 2012.

The most important take-away from the updates is that none of the investors has suffered a major reversal of fortune which would call into question his inclusion in the original text. Although the various indicative figures provided are not directly comparable, my sense is that the best results over the three years were probably from Eric, Owen and Vernon.

Markets have been broadly benign over the three-year period, although the middle year of 2011 was difficult for many investors. A phenomenon which hurt results for some was the large difference in returns from companies on the Full List and those on AIM. Over 2011 and 2012, the FT-Actuaries Smaller Companies Total Return Index (covering fully listed smaller companies) rose 12%, while the FT-Actuaries AIM Total Return Index fell 23%. This unusually large divergence reflects the heavier weighting in the AIM index of poorly performing oil and mining companies. Thus the investors with a particular focus on the oil sector (Luke) or mining sector (Nigel) produced lower results over this period.

In the following text, the 'three-year indicator' of A, B or C immediately after each investor's name represents my personal and subjective assessment of how well the new information about each investor's recent performance fulfils the impression given in the original text. An A grade means that recent results are probably above the original impression; a B grade means in-line (or

insufficient information); a C grade means that recent results are probably below the original impression.

Luke

Three-year indicator: grade B

Luke's results over the past three years reflect his oil-sector focus and extremely concentrated portfolio. A flying start to 2010 saw a gain of 50% at mid-year, but by year-end the gain had shrunk to 15% following disappointing drilling results at his largest holding, oil explorer and producer SOCO International. In 2011 he was down over 20%, reflecting the 25% fall in the FTSE Oil & Gas Index. 2012 produced a recovery of nearly 30%.

At the time of the original interview, Luke had recently taken up a non-executive directorship of a small oil exploration company. In spring 2013 he still held this role, but was certain he would not take another one. "Pay is low, restrictions on dealing are high, opportunity costs are high. There is no recognition for doing a good job. And investors' expectations often seem detached from reality – it is a constant challenge for companies to draft announcements which will not be over-interpreted or misunderstood."

Nigel

Three-year indicator: grade C

Nigel has continued with his approach of monitoring market cycles, looking for markets which are in a bull phase and seeking to "catch the swings". He has found it difficult to make money consistently in equities from 2010 onwards. He thinks this is because signals of market direction which worked reliably for him in the past have been over-ridden in recent years by central bank intervention. "For example, markets have risen on relatively light volume. Traditionally this would suggest that the rise was poorly supported and likely to soon reverse, but in recent years rises on low volume have persisted over long periods."

Despite often misjudging overall equity market sentiment, Nigel has managed to find two bull markets: gold and Hong Kong housing.

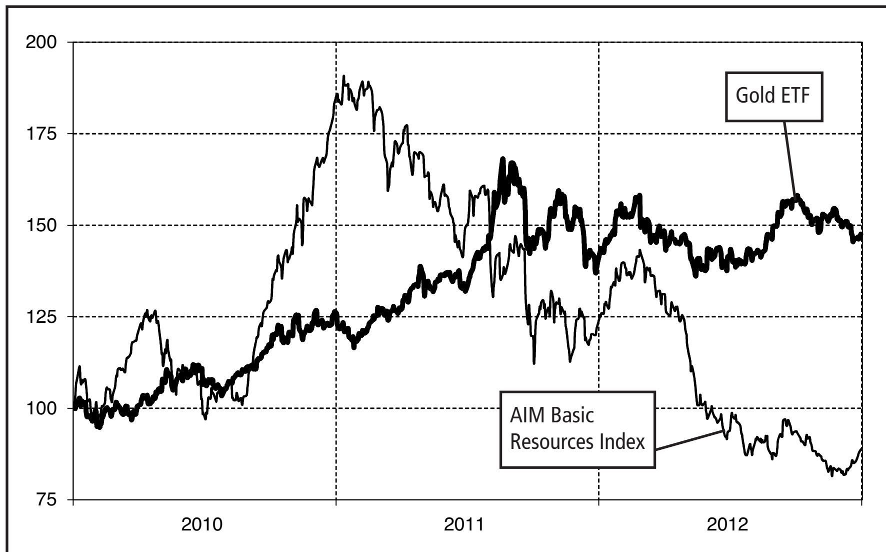
From the start of 2010 the price of gold rose 69% in 20 months, before falling back to end 2012 up 47% from three years earlier. Shares in small gold-mining companies did well in 2010 but poorly in both 2011 and 2012, and have

substantially underperformed the price of gold itself over the full three years. The chart illustrates this by comparing the price of a gold exchange-traded fund (a proxy for the metal) with the FTSE AIM Supersector Index for Basic Resources (this has a 98% weighting in mining companies).

Reflecting on this divergence, Nigel remarked: "The main problems are that these companies cannot guarantee exploration success, and they have trouble controlling their costs. You can make some money on the swings, but it is not a safe place to invest for the long term."

In Hong Kong housing, prices have more than doubled since the low of early 2009. At the time of the original interview, Nigel owned several apartments. He sold these as the market rose and is now down to his last apartment, the one in which he lives. He now wishes he had held onto more of the properties for longer. "With hindsight it was a mistake to sell Hong Kong properties and put the money into cash and gold shares."

Gold ETF price versus FTSE Supersector AIM Basic Resources Index, January 2010 to December 2012 (both rebased to 100)



Source: data from Yahoo

Bill

Three-year indicator: grade A

Bill made a portfolio gain of 86% in 2010, followed by a loss of 23% in 2011 and a gain of 10% in 2012. He withdrew part of his funds from the market to buy a house in 2012 after renting for three years.

His investment strategy continues to focus on "just the facts": simple metrics, tail-coating bulletin board sector specialists, and largely avoiding contact with company management. He bought bank preference shares and corporate bonds for the first time in 2009, and has traded these occasionally since then.

He continues short-selling, an activity where he has become better at risk management. He now takes only small short positions, sourced mainly by tail-coating specialist short-sellers such as Citron Research, Bronte Capital and Muddy Waters Research. Most of these positions have come good after six to 12 months. The strategy of small bets on several short ideas from others is less risky than his previous strategy of large bets on one or two short ideas of his own.

He feels he has become better at cutting losses, having trained himself not to check his original purchase price when considering what to do after bad news. He has also become more cynical about human nature. "I have sadly concluded that corruption in markets is the rule not the exception."

Bill has continually vowed to spend less time on investing, but admits progress on this front has been impeded by "fear of missing out, introversion and the sheer enjoyment of reading and learning".

John Lee

Three-year indicator: grade A

John made a gain of 29% in 2010, a loss of 2% in a "disappointing and difficult" 2011, and a gain of 25% in 2012 (all figures excluding dividends). In November 2012 he retired after more than 15 years of writing his 'My Portfolio' column in the *Financial Times*.

John's investment style remains broadly the same as for the past several decades: "defensive value and dividends". However, one tweak is that from late 2011 he has adopted a stop-loss policy: he will automatically seek to sell any share which falls more than 20% from his initial purchase price. This new

policy was inspired by the realisation that in the previous five years his portfolio had been dented by three large losses – Dawson Holdings, HMV and Cable & Wireless – and hence his increasing belief that "the key to successful investing is avoiding losses". The benign markets of 2012 and early 2013 mean that, so far, the stop-loss policy has not been put to the test.

In mid-2011 John invited *Financial Times* readers to write in with their own investment success stories. This led to a fascinating article 'I always wanted to own a railway' (easy to find on the internet). The title refers to an investor who bought a small holding in what was then the Antofagasta and Bolivia Railway Company (later Antofagasta plc) in 1978, and after many corporate events ended up with a holding which paid tens of thousands in dividends every year. Another reader – one I wish I had found for *Free Capital* – reported an ISA worth nearly £3m in mid-2011.

Sushil

Three-year indicator: grade C

Sushil modestly out-performed his preferred benchmark (the FT-Actuaries All-Small Total Return Index) in both 2010 and 2011. But he had a poor result in 2012, nearly 20% behind his benchmark and only slightly ahead of the AIM index. This large shortfall left him only slightly ahead of his benchmark over the full three years, albeit still 5% per annum ahead of the AIM Total Return Index (the poor relative performance of this index was discussed in the introduction to this chapter).

His poor result in 2012 was caused mainly by RSM Tenon, an accounting firm which has fallen more than 80% from his average purchase price. This followed the discovery during due diligence by a potential acquirer of the company of past mis-statements of RSM Tenon's own accounts. It is a situation which in Sushil's words "clearly exposes the company to ridicule – they are accountants themselves, for goodness' sake!" Even with the benefit of hindsight, he finds it hard to see how he could have anticipated this particular problem. "I can pick up unusual accounting policies, but if the figures are just false, I am probably going to be caught out."

Sushil feels that compared to the earlier part of his investing career, his rate of learning has slowed down. "I used to have a constant perception of rapid learning and retrospective naiveté – that I was always much smarter than two years earlier – but I don't feel that any more. I'm not sure if this is because I'm

finally getting the hang of things, or because the neurons in my brain are slowly dying."

Taylor

Three-year indicator: grade B

Taylor made a gain of around 25% in 2010, followed by a loss of 4% in 2011 and a gain of 10% in 2012. His loss in 2011 was mainly attributable to two oil companies, PetroNeft Resources and BP.

There have been two main developments in his investment methods. First, he now uses the ShareScope Pro software. Second, he has developed an interest in Japanese 'candlestick' charts and the 'Ichimoku Kinkō Hyō' method of technical analysis (*Ichimoku Kinkō Hyō* translates as 'one glance cloud chart').

His post-viral fatigue (ME) was particularly bad in summer 2012; for some months he felt too ill to be thinking hard and taking risks on shares, and so made new investments mainly in more secure corporate bonds. His health has improved following diet changes and a new allergy treatment, for which fees and travel expenses already run to £8,000 – money he feels fortunate to have.

Vernon

Three-year indicator: grade A

Vernon made a gain of 18% in 2010, followed by a loss of 5% in 2011 and a gain of 28% in 2012. A substantial part of his 2012 gain was attributable to Quindell, an insurance claims software and outsourcing firm which almost trebled over the year. This wasn't predicated on his usual "buy the glitch" thesis, but relied partly on his work experience in the sector. "One of my last contracts as a developer in the early 2000s involved insurance claims software."

For the original text Vernon provided detailed notes on his "buy the glitch" decision process for two shares in 2008. The notes outlined a core thesis, secondary factors and hygiene factors for decisions on car repair manual publisher Haynes Publishing and life insurer Hansard International. The original text noted that he had already sold all his Haynes and half his Hansard; the remainder of his Hansard was sold in mid-2011. Prompted for

a current opinion, he said that many factors had changed and he would not buy either of these stocks now.

Eric

Three-year indicator: grade A

Eric's results since publication are outstanding, almost certainly the best of this group of investors. Because his portfolio has a 'long tail' of over 80 shares, mainly very small holdings in a variety of personal and spread bet accounts, a lot of work is required to provide a full valuation. However, he provided lists of his top ten holdings at intervals over the two years ending 31 March 2013. The tables show his top ten holdings at 31 March 2011, and their performance over the next 12 months; and his top ten holdings at 31 March 2013, and their performance over the last 12 months.

Eric: Prospective performance of top ten holdings by value at 31 March 2011

Rank in portfolio at 31 March 2011		Gain over next 12 months (ignoring dividends)
1	Lo-Q	113%
2	Nautical Petroleum	-22%
3	Judges Scientific	42%
4	Robinson Packaging	45%
5	FW Thorpe	21%
6	Tandem	34%
7	The Real Good Food Company	23%
8	Ensor	100%
9	Inland Homes	-7%
10	Public Service Properties	-16%
Average gain of top ten holdings over next 12 months:		23%
Change in FTSE AIM All-Share Index over same period:		-11.8%

Eric: Retrospective performance of top ten holdings by value at 31 March 2013

Rank in portfolio at 31 March 2013		Gain over past 12 months (ignoring dividends)
1	Lo-Q	95%
2	Ensor	24%
3	Judges Scientific	104%
4	FW Thorpe	14%
5	Idox Group	68%
6	Inland	38%
7	Robinson Packaging	39%
8	Universe Group	125%
9	Quintain Estates & Development	74%
10	Smiths News	108%
Average gain of top ten holdings over past 12 months:		69%
Change in FTSE AIM All-Share Index over same period:		-7.3%

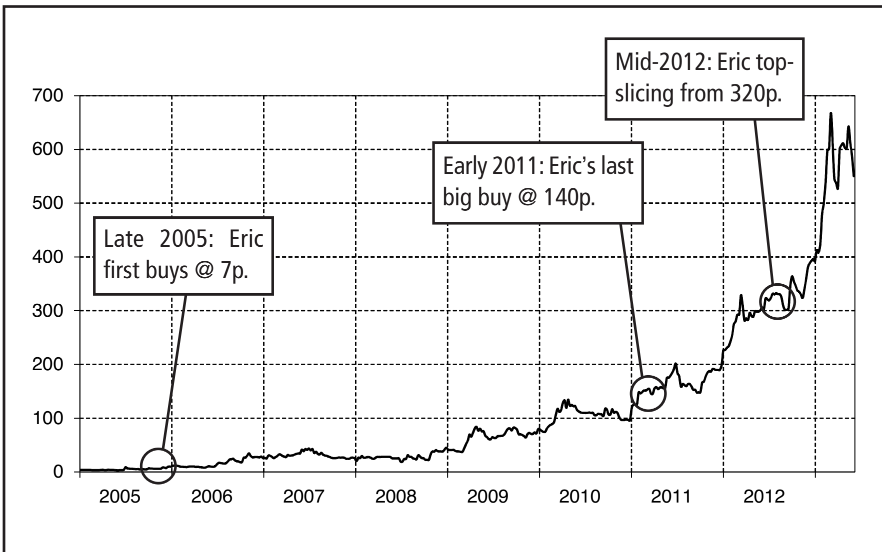
Some observations on the tables are as follows:

- Looking prospectively at the initial top ten holdings at 31 March 2011, the average gain after 12 months was 23%.
- Only three of the initial top ten at 31 March 2011 showed a loss after 12 months.
- Looking retrospectively at the top ten holdings on 1 April 2013, the average gain over the previous 12 months was 69%.
- Most of the companies were listed on AIM, with just two (Quintain Estates and Smiths News) fully-listed. They were all small companies: market capitalisations at 31 March 2013 ranged from £8m to £349m, with a mean average of £126m.
- The composition of the portfolio changed only slowly over time. Of the top ten holdings at 31 March 2011, six remained in the top ten after 24 months; one (Nautical Petroleum) was lost to takeover, two (The Real

Good Food Company and Tandem) remained as portfolio holdings outside the top ten, and only one (Public Service Properties) had been sold completely.

- Lo-Q, a supplier of patented queuing systems for crowds in amusement parks, was the top holding at both dates. Lo-Q was mentioned in the original text as one of Eric's successes. The following chart shows the full extent of this success.

Lo-Q price chart from January 2005 to March 2013



Source: data from ADVFN

Talking through the details of his current largest holdings with Eric reminded me that these outstanding results are earned by hard work. He had attended not one but several annual general meetings or private meetings with the directors of every one of the top ten companies. Asked if he preferred AGMs or private meetings, he said the most useful meetings were those with a small group of investors present: "perhaps four investors, few enough that the directors are answering questions rather than making speeches, and many enough to generate questions from several different angles". He also noted that AGMs rather than private meetings with executives "have the advantage that you can meet the non-executive directors, who are very important in some companies".

Owen

Three-year indicator: grade A

Owen made a gain of 37% in 2010, followed by a loss of 6% in 2011 and a gain of 29% in 2012. This result was probably the second best after Eric's, and less dependent on favourable market conditions. His strategy remains as described in the original text: activist investing in closed-end funds at large discounts – in this particular three-year period, mainly hedge funds-of-funds and listed private equity. For the present update, Owen provided names and details of the most significant events (both good and bad) in his portfolio over the past three years.

In 2010 several closed-end funds (e.g. Acencia Debt Strategies, Private Equity Holdings) made partial returns of capital to shareholders through share buybacks or tender offers – largely in response to pressure from activist shareholders such as Owen himself.

In 2011 several closed-end funds went into solvent liquidations (e.g. Tapestry Investment Company, Gottex Market Neutral, FRM Diversified Alpha). Unlike ordinary companies, liquidation of a closed-end fund is usually good news; it means that the underlying investments are being sold and their full value returned to shareholders. At mid-2011 Owen was more than 10% ahead, but in the second half the euro crisis led to a widening of the discounts on European closed-end funds, so that he lost all the mid-year gain and more. One big loser was Marfin Investment Group, a Greek fund listed on the Athens Stock Exchange; this fell steeply due to a combination of "mismanagement, leverage and the euro crisis" and Owen sold at a large loss. Another big loser was Vision Opportunity China, an AIM-listed fund invested in NASDAQ-quoted Chinese companies, which fell when fraud was uncovered at several of its investee companies.

In 2012 a lessening of worries about euro break-up led to a narrowing of discounts; continued buybacks or tender offers by funds such as Shape Private Equity and Apollo Alternative Assets also helped, and hence Owen's 29% return for the year. A big winner was AIM-listed Loudwater Trust, a private equity fund which sold one of its underlying investments for several times its carrying value in the accounts.

The original text suggested that Owen's specialist sector focus probably meant that he spent less time on investing than some of the other investors. Whilst I still think there is some truth in this, it is notable that names above include

funds listed on stock exchanges in Greece (Marfin Investment Group), the Netherlands (Apollo Alternative Assets) and Switzerland (Shape Private Equity). So whilst Owen's sector focus is narrow, it is applied across many national markets.

It is also notable that Owen's ten recent large holdings named in the last four paragraphs are all obscure companies. I suspect that most private investors – even the others in this book – would not have heard of any of them.

Peter Gyllenhammar

Three-year indicator: grade B

Peter's results reflect mainly the timing of financial engineering at specific companies rather than general market movements. In late 2010 a bid for Hartest Holdings realised a gain of more than 50% on the cost of his 29% stake. In 2011 MDY Healthcare, an AIM-listed investor in healthcare companies, sold its principal investment for more than five times MDY's total market capitalisation and distributed the proceeds to shareholders, returning more than twice his cost. In 2012 21st Century, a supplier of CCTV systems for buses, sold its freehold head office and distributed the proceeds to shareholders, returning over half Peter's cost. He retains holdings of 29% and 24% respectively in the continuing business of MDY Healthcare and 21st Century. At all three companies events followed a common pattern: a change of chairman supported by Peter, followed by an increased focus on returning cash to shareholders. This benefited small shareholders as well as large (I was myself happily invested in all three companies).

Other companies where Peter currently has stakes of more than 25% include display screen manufacturer Densitron Technologies, consulting engineer Waterman and antiques dealer Mallett. A common feature Peter perceives at all three companies is hidden value in property assets. He recently attempted to install himself as a director at Mallett, so far without success. Another 29% investment is Swallowfield, which has been a long-running saga where the board has resisted attempts by Peter and another larger shareholder to influence the choice of new directors.

Discussing these experiences, Peter highlighted the inhibiting influence of the 'acting in concert' provisions of the City Code on Takeovers and Mergers policed by the Takeover Panel. Where several activist shareholders hold similar views – say that a company's management should be replaced – the

management may complain to the Takeover Panel that the activist shareholders are 'acting in concert', that is colluding to gain control of the company. Because this can have severe regulatory and financial consequences for the shareholders if the Panel judges it to be true, any allegation of acting in concert – even where the shareholders are in fact acting independently – is enough to scare off many would-be activists. In Peter's experience, "once the allegation of a concert party has been made, fund managers will sometime hang up the phone on me on the orders of their compliance departments".

Peter now feels that bidding for 100% of a company and taking it into private ownership is often more rewarding than owning a large minority stake in a listed company, both financially and intellectually. "When you own 100% of a business, you can do whatever needs to be done to create value. There is none of the obstruction from directors or advisers or Takeover Panel inquisitions which you sometimes get when you hold a large minority stake. And although I am a poor administrator, I think I am a good owner: I actually enjoy visiting factories, understanding business operations and making suggestions."

Khalid

Three-year indicator: grade C

Khalid had a satisfactory result in 2010 and the first half of 2011 was his best ever first half of the year. In the original interview he mused: "*I could afford to retire – just buy a few investment properties and live off the income …* " Acting on this thought, in mid-2011 he withdrew £1m to invest in office property in Newcastle, and continued short-term CFD trading with a smaller pool of free capital.

Taking some money off the table proved to be fortuitous, because in early August 2011 he made a disastrous trade on the Italian food company Parmalat. On 29 July 2011 the company issued second quarter results which were below forecast. As would be expected, the share price fell on the day, and continued to drift down for several further days. One of Khalid's technical indicators, the Relative Strength Index, indicated an extreme oversold position, leading him to go long the stock in early August. The drift downwards then continued for most of the month, giving Khalid the "drip, drip drip of an increasing loss". He eventually closed his long position in late August for a loss of £290,000 – his largest ever loss on a single trade.

In his post-mortem on the trade, Khalid discovered an important fact which he had overlooked in his initial analysis. Parmalat has only a small 'free float': more than 80% of the shares are held by the Besnier family of France, with less than 20% freely traded. Technical indicators such as the Relative Strength Index are not reliable for illiquid shares. It is easy to envisage that free float data might not come to the notice of a trader who has a relatively superficial understanding of companies and relies mainly on charts, technical indicators and short-term broker upgrades and downgrades. But in Khalid's own words: "I have no excuses, I should have done more homework on this".

Shortly after this mishap, he was more successful in dodging a second bullet: the October 2011 insolvency of his CFD broker MF Global. He was aware of press reports about MF Global's difficulties, and successfully withdrew all his cash from them the week before the insolvency. He now trades with ADM Investor Services International, a subsidiary of the American giant Archer Daniels Miller – "the biggest and safest firm I could find."

He has traded satisfactorily since late 2011, and continues to be quoted in market reports by Bloomberg and Reuters from time to time. But as of spring 2013 he had yet to fully recoup his 2011 loss. His overall results are therefore behind UK market indices for the past three years.

Vince

Three-year indicator: grade B

Vince remains in tax exile in Zug in Switzerland, which he characterises as a town of "non-practising millionaires": great wealth but no conspicuous consumption. He has spent much less time following the stock market in the past three years. He thinks residential property in Germany remains cheap compared with other developed countries, and has bought some more blocks of apartments. He has also passed on some investments and ownership of his publishing company to his children and grandchildren. At the age of 66, his aim is "to have an interesting life, rather than to make more money".

One feature of an interesting life is his non-executive directorship at a small AIM-listed company – formerly a property developer of GP surgeries, now refocused on developing cancer treatment centres. He first became interested in the company as an investor in 2010, and subsequently joined the board in 2011. His experience of the role of non-executive director is more positive than that of Luke above. However, he noted that non-executives "sometimes

need to be assertive, almost acting as forensic accountants, to get the information they need from the company" and that "relations between non-executives and executives can have a 'them and us' flavour".

Apart from the desire to broaden his interests, Vince's retreat from daily involvement in the stock market reflects his view that unconventional official policies such as quantitative easing by central banks have distorted markets, making traditional equity investment metrics and criteria less reliable. But this is not necessarily a permanent decision: "If conditions changed, I would become more interested again."