GRC
Global Rational Capital

Global Rational Capital
68 Fort Street, George Town
Grand Cayman, Cayman Islands
www.globalrationalcapital.com
+1 345 929 9943

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Global Rational Capital Management Ltd. is the Investment Manager of Global Rational Capital Fund and is registered with the Cayman Islands Monetary Authority under the Securities Investment Business Law.

In this letter, I shall explain the most important things to know about Global Rational Capital which can be summarised in five words: Focus, Alignment, Incentives, Rational and Trust.

FOCUS

We manage one Fund and our sole objective is to ensure it outperforms the global equity market. We are focused on long-term investment outperformance and our objective gives us a sense of purpose and justifies our existence.

When Warren Buffett and Bill Gates met for the first time, Gates' father asked both to write down, on separate blank pieces of paper, one word that describes the reason for their success. Incidentally, they both wrote the same word… Focus.

A professional sportsman cannot expect to be the best if he divides his time between different sports. Likewise, we cannot expect to be the best if we divide our time between different funds.

Focus is vital for success and this is why we will never manage more than one fund or any segregated client accounts because this would distract us from our sole objective.

If you consider the number of products we offer relative to our competitors, you will see that while we offer one fund that we are singularly focused on and fully invested in; most of our competitors offer many products and are constantly launching new ones, chasing after hot money while diluting their time across competing priorities at the expense of their clients' investment performance.

We also believe that a lot of choice doesn't necessarily help you make better investment decisions.

ALIGNMENT

All of our investable net worth is in the Fund alongside the interests of all shareholders. So, if we underperform, it hurts us just as much as it hurts you.

The first question you should ask any investment manager is: "Are you going to be invested in the funds that I'm going to be invested in?".

Many managers don't invest in the funds they manage, or they only invest a small portion of their net worth.

"THERE'S SOME GOOD NEWS. WHILE OUR FUND LOST MILLIONS, NONE OF IT WAS OUR OWN MONEY."

When we look at listed businesses to invest in, we always consider how much management are invested in their company and whether they are buying more shares because that means they are committed to their company and believe in its future success.

At Global Rational Capital, we don't simply try to avoid conflicts of interest, we eliminate them, and we start by being fully and solely invested in the Fund so that it is impossible to put our interests against yours. We are all in this together.

INCENTIVES

Our fees are more sensitive to investment outperformance than to assets under management. Which means that you only pay over-and-above a minimal fee of 0.5% per annum when we outperform the benchmark over all periods to date. And the outperformance fees we earn must be reinvested back into the Fund.

I was fortunate enough to learn about the power of incentives early on. You see, I wanted to play rugby at school but needed to get stronger, so I bargained with my mom to pay for a gym contract on condition that I improve my grades. And so, she agreed, and per the agreement I started working harder at school. My grades improved and eventually I was the top of my class. It then dawned on me that if the incentives are designed carefully, good outcomes are more likely.

Most investment managers are rewarded almost exclusively by fixed fees based on assets under management. And so most cannot overcome their personal equation, namely, the higher their assets under management, the higher their fee income. Because of this conflict of interest, they spend the bulk of their time marketing and trying to gather assets under management. They are paid unjustifiable amounts even when they underperform relative to passive benchmarks. The problem is pervasive and has caused many to lose faith in the active investment management industry.

Our fee structure forces us to prioritise long-term investment outperformance over short-term profitability and it provides a powerful incentive against gathering assets at the expense of investment performance. It's very different from the traditional "heads manager wins, tails clients lose" fee structure.

If we can't beat the benchmark, there is no reason for our existence. The fee structure is designed so that if we don't outperform, we will not profit. Our efforts are focused entirely on the Fund's performance because the long-term success of Global Rational Capital is dependent on our ability to outperform. We have the courage to design the compensation structure in this unconventional manner because we believe we have the ability to outperform and will continue to prove it.

RATIONAL

We look for good businesses we can understand and buy at a price below intrinsic value. The approach is simple, but it requires a lot of time, effort and emotional intellect.

Intrinsic value is an estimate of the discounted value of the cash that can be taken out of a business during its remaining life. It is what a prudent businessman would be prepared to pay for an entire business with consideration for the company's long-term prospects.

The lower the price of a share as compared to its assessed intrinsic value, the higher the margin of safety, and the more attractive we consider the share. The margin of safety is by definition, a favourable difference between price on the one hand and intrinsic value on the other. The higher the margin of safety, the higher the potential profit.

We view each stock investment as if we are the owners of the entire underlying business. This enables us to invest intelligently in a business-like manner and helps us avoid contagious irrational market emotions.

We know that in the short-term, share prices are affected by market psychology; but over the long-term, share prices are determined by the economic progress of the underlying business and that is precisely what we pay attention to.

Our investment research is focused on understanding businesses, estimating intrinsic value, and seeking undervalued companies with excellent potential. Research includes but is not limited to: reviewing company and competitor financial statements and historical records; meeting company management; testing company products and services; questioning industry contacts; reading industry news; and screening various databases for undervalued businesses.

A key component of our research process is direct contact with company management through calls and face-to-face meetings. This is because we believe that company management should be industry experts best positioned to explain drivers of the industry's supply-demand dynamic and profitability. During these meetings, management may elaborate on the weakest, strongest and upcoming competitors and the manager's passion for his businesses can be evaluated.

We believe that successful investing is 90% hard work and our annual goal is to have over 100 company meetings and to read over 400 financial statements.

LONG-TERM

We view all shareholders as owner-partners who have entrusted their capital to us for the long-term. Having shareholders with a long-term orientation is the most important factor in enabling us to take a long-term time frame while the world puts disproportionate pressure on short-term results.

When I was working for Deloitte in Port Elizabeth South Africa as an auditor in charge of the General Motors audit, the managing partner, Stuart Wedderburn, said to me: "when dealing with clients, always under-promise and over-deliver." I think this is very good advice, particularly when you are working with other people's money.

We put our clients' interests first and treat them as we would want to be treated if our roles were reversed and we believe our promises to manage the investments of only one fund and to be fully invested in the Fund are important commitments that will benefit you and us over the long-term.

The Fund is suitable for those investors who:

- Seek exposure to listed equities globally to provide long-term capital growth
- Are comfortable with stock market fluctuations, i.e. short- to medium-term volatility
- Are prepared to accept the risk of capital loss
- Have a long-term orientation and an investment horizon of at least five years
- Understand that we generally assess investments using a five-year time horizon

The Fund is available to long-term investors globally and while we may not be the best fit for everyone, we can help you decide if we are the right partner for you.

Louise Tate *Robert Tate*
Co-Founder *Founder & Investment Coordinator*