

**John Huber, Managing Partner**

(919) 610-6809

[john@sabercapitalmgt.com](mailto:john@sabercapitalmgt.com)

[www.sabercapitalmgt.com](http://www.sabercapitalmgt.com)

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**Saber Investment Fund, LP: 2019 Mid-year Update**

Dear Investment Partner,

In the first half of the year through June 30<sup>th</sup>, Saber Investment Fund gained 26.09% before the General Partner's performance allocation, which resulted in a net gain of 24.37% for limited partners.

	<b>SIF Gross<sup>1</sup></b>	<b>SIF Net<sup>2</sup></b>	<b>S&amp;P 500</b>
<b>2014</b>	10.54%	9.39%	13.69%
<b>2015</b>	7.35%	7.08%	1.38%
<b>2016</b>	42.21%	32.41%	11.96%
<b>2017</b>	41.60%	31.72%	21.83%
<b>2018</b>	(8.09%)	(8.09%)	(4.38%)
<b>2019 (1/1 - 6/30)</b>	26.09%	24.37%	18.54%
<b>Compound Annual Gain</b>	<b>20.35%</b>	<b>16.67%</b>	<b>11.08%</b>

You should have received your 6/30/19 account statement from Liccar & Co., which has your capital account's value as well as your individual net return. Note that your individual return may vary depending on when you entered the fund and the timing of any new contributions.

Most investors who entered the fund last year had a loss at year end, and thus will have a net return so far in 2019 that is higher than partners who entered the fund this year. This is because you don't pay any fees until a) all your previous losses are recouped, and b) your capital grows above the 6% hurdle. As a reminder, the 6% hurdle is not just a fixed 6% hurdle rate: **it compounds annually**, meaning after a losing year, the 6% hurdle is now a 12.36% hurdle in year 2 (6% compounded).

**Bottom line:** If your money is not growing by more than 6% annually, then you're not paying a dime in fees.

<sup>1</sup> Gross return before performance allocation

<sup>2</sup> Net return assumes investment in the fund at inception with no additional contributions/withdrawals, and assumes 0% management fee and a 25% performance fee over a 6% compounding hurdle

## **Bargains in Plain Sight**

Our portfolio's first half result was mostly due to Apple and Facebook. From the time Santa was packing up his sleigh on December 24<sup>th</sup> just 7 months ago, Apple and Facebook have climbed 39% and 61%, respectively. This represents a total change in market value of a whopping \$480 billion between the two companies, which are obviously two of the most widely-followed companies in the world.

As I've mentioned before, there is no informational advantage; nothing the market doesn't know about these two companies. They are the same today as they were last winter. What changed was the sentiment of market participants, which is part of what makes up what I believe is the most sustainable edge in markets today. Saber's strategy rests on two types of investments: the long-term compounders and the less-exciting but durable businesses that occasionally trade at large discounts to fair value. I'm always hunting for smaller, faster growing companies, but given the nature of markets, we will likely continue to find more obvious opportunities simply by patiently waiting for the "bargains in plain sight".

## **Facebook and Antitrust**

We invested in Facebook last year ([I mentioned my thoughts on this investment in this letter](#)).

I recently talked about Facebook [as a guest on The Investor's Podcast](#). In the discussion, we talked about Facebook's business, as well as the antitrust issues facing big tech. There is a view that these firms are anti-competitive. I believe that thousands of small businesses exist solely because of the tools provided by Amazon, Facebook, and Google. Individual merchants can buy their inventory, locate buyers, and then ship the merchandise all by using Amazon's platform, often without ever interacting with the buyers or even touching the product. Small businesses with a shoestring budget can now compete against much larger brands by utilizing Instagram advertising. If not for the iPhone, there probably would be no Uber. If not for YouTube, no Dollar Shave Club. Many businesses have been created and have thrived, not despite these big tech firms, but in many cases, because of them.

On balance, I think the big tech firms have created an enormous amount of competition and helped spawn a significant amount of vibrant, competitive new businesses. Barriers to entry have never been lower. If you're an entrepreneur with a good idea, you will not be starved for either capital or access to markets, and you'll likely use at least one of these big platforms, not because you have to, but because it is to your benefit.

In the podcast, we go into more depth on Facebook's business, the antitrust topic and the comparison to one of history's most famous monopolies, which I'd recommend if you're either interested in my views on Facebook, or in dire need of a power nap. My parents and in-laws, all of whom are loyal Saber investors, claimed it worked wonders for the latter.

## **Our First New Investment in 2019**

We were very active in December and early January, but then things quieted down and outside of the minor downturn in May when we added to a few positions, we didn't make a single new investment until late in the 2<sup>nd</sup> quarter, when we began buying shares of Wells Fargo. [I wrote more details on the investment here](#).

Incentives drive behavior, good or bad. And without question, Wells Fargo’s behavior was bad prior to 2016. But two CEO’s have left the firm, and just as its safest to fly right after a crash, I think Wells has corrected the incentive issue, and is laser focused on ensuring that their customers are taken care of. I’ve noticed this as I do much of my business and my personal banking there. This case is also a testament to how sticky the big banks are.

Despite glaring headlines, lots of political rancor, and high-profile hearings, customers seem to have mostly yawned. Deposits stood at \$1.3 trillion during the climax of the scandal, a level where they remain today. Deposits are the raw material that a bank uses to make its finished goods (interest income), and Wells Fargo has had no trouble maintaining its supply. The company remains among the best banks in terms of funding costs and profitability. Returns on assets have remained strong, matching or even exceeding the ROA of its competitors.

What makes Wells Fargo attractive right now? In late June, the Federal Reserve published the results of their annual Comprehensive Capital Analysis and Review (CCAR). The [CCAR](#) and its cousin, the Dodd-Frank Act [stress tests](#), are a big portion of the regulatory framework that the Fed uses to supervise the big banks in the United States. Part of this regulation gives the Federal Reserve the authority to approve the capital allocation program of the banks.

Basically, each bank submits the dollar amount of capital that they’d like to return to shareholders over the coming 4 quarters, and the Fed, based on their review of how the bank performed during the stress tests, either approves or rejects the bank’s proposal. In recent years, most of the big banks have built up sizable capital positions, and they’ve had no real trouble getting Fed-approval for their buyback and dividend.

This table summarizes the buyback approval (in billions) and dividend yield for the big four banks for the upcoming year. The buyback “yield” is the percentage of the shares outstanding that each bank could acquire at the current share price:

Total Yield for Banks (Buybacks and Dividends)						
	Buyback Approval	Market Cap	Buyback Yield	Dividend Yield	Total Yield	ROA
WFC	\$23.1	\$201	11.5%	4.5%	16.0%	1.31%
JPM	\$29.4	\$365	8.1%	3.2%	11.2%	1.41%
BAC	\$30.9	\$278	11.1%	2.5%	13.6%	1.23%
C	\$17.1	\$163	10.5%	2.9%	13.4%	0.94%

The table shows that at the current price, Wells Fargo can buy back 11.5% of its shares in the coming year (this is on top of the 9% they bought back last year). Thanks to its extensive amount of excess capital and strong earning power, Wells has turned into what Charlie Munger calls a cannibal: a firm that eats up its own shares.

After this year’s buyback, Wells will be left with around 4 billion shares outstanding. With no growth in overall earnings, this will equate to nearly \$5.75 per share in earning power a year from now. At \$46 per share, the stock trades at just 8 times that earning power. Another way to look at it: Wells Fargo is likely going to buy back around \$40 billion worth of stock in the next couple years. Again, assuming the current level of overall earnings (no growth), we’ll have a business with over

\$6 of earning power and at 11 or 12 times earnings, a stock worth somewhere between \$65 and \$75. Including the hefty 4%+ annual dividend, that is 50-75% upside for a boring, staid bank.

Of course, this is the *value* per share. The stock price of course might not reflect this value in the time frames I'm outlining above. Economic headwinds and a market downturn would certainly cause the stock price to fall and potentially impact near term earnings, but Wells Fargo has a great balance sheet, a sticky customer base, and a predictable business that is very well prepared to ride out future storms.

I think Wells Fargo is actually facing a similar type of negative sentiment that Facebook was (and is still) facing. The sentiment winds can shift at unpredictable moments, and I think eventually the market will value Wells Fargo's cash flow more appropriately. In the meantime, the bank gets to use a bunch of that cash to buy back shares on the cheap, and we are getting a 16% "yield" (partially in cash and partially as a greater piece of the business), which isn't a bad result on its own.

## Portfolio Summary

Our top four holdings are Apple, Facebook, Tencent, and Wells Fargo, and these represent nearly 4/5ths of our capital. The rest of the portfolio contains eight smaller positions that may have a chance to become larger depending on prices. We have not sold a single share of any stock in 2019.

Earlier this month, we used funds from incoming investors to buy more Wells Fargo. Our portfolio will never have a lot of turnover, but I will always try to maintain the optimal weighting in order to maximize returns, which means selling certain stocks to reinvest in more attractive stocks at times. So far, inflows have allowed us to capitalize without selling anything. But you should anticipate some modest turnover as opportunities arise. The vast majority of our gains will remain long-term, which should help minimize any tax drag that we experience.

## A Word on Buybacks

Many of our investments are in companies that throw off lots of excess cash that they use to buy back their own stock. Buybacks are not evil, contrary to the dramatic political rhetoric you might have heard. The people espousing this view forget that a dollar spent on buybacks is an actual cash exchange between two parties, similar to any other transaction in the economy. The money doesn't disappear. Actual dollars go to the person selling shares to the company, who then can spend the money elsewhere in the economy, such as purchasing an iPhone, attending a concert, buying groceries, shopping on Amazon, or taking a vacation.

Maybe those dollars go toward paying someone else's wages, or to expand a small business. Perhaps the money goes into a bank, which can lend it out to finance someone else's mortgage. And of course, the seller of stock might reinvest those dollars into another stock, which in turn means the person selling *that* stock then gets that original dollar to reallocate, and so on.

The point is that buybacks allow dollars to flow from where they are relatively unproductive to a location where they can be reallocated to a higher and better use. Legislation that would force companies to use it internally would invariably lead to lower returns on capital in many businesses. Higher returns on capital are better for a society than lower returns. Yes, rich people might benefit, but on balance, so do lower wage and middle class workers through lower prices, better services, and a greater selection of products. Our overall standard of living is aided by productive allocation of resources, and buybacks help grease the wheels.

It should also be noted that buybacks are not a magic elixir for stock prices. They are simply one of four main ways to allocate excess cash. And like any other capital allocation decision, they can be good or bad for shareholders depending on how much value is acquired for the price paid. In the case of our holdings, I believe lower stock prices would benefit us, as each dollar spent would acquire more value.

This is one reason why shareholders should often hope for lower stock prices in the near term. Even a fully invested portfolio benefits by falling stock prices if the companies in the portfolio are net buyers (as opposed to net issuers) of their shares. It's much safer to be able to take advantage of capital markets than to be at their mercy, which is what so many cash-consuming companies are today. I rest easy at night knowing that we have shares in well-capitalized, durable businesses that produce lots of cash, and should be able to take advantage of any potential downturn.

### **Summary**

As a reminder, our fund can accept new contributions once a month. If at any point you would like to add to your investment, please contact me or Maureen Murphy at [mmurphy@liccar.com](mailto:mmurphy@liccar.com) (the fund's administrator). Maureen and the rest of the team at Liccar & Company have done a great job handling numerous back office tasks for us, and they are always available should you have questions regarding your account statements, or anything related.

As always, I want to thank you for your partnership. Your trust and confidence in Saber Capital as your investment manager is what makes it possible for me to do what I love for a living, and I'm very grateful for that. It's a privilege to be your partner.

**Best Wishes,**



**John Huber**  
Managing Partner  
Saber Capital Management, LLC  
[john@sabercapitalmgt.com](mailto:john@sabercapitalmgt.com)