

KRAEMER, SCHWAB & CO. AG

Investment Management

## Investment Philosophy

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# Our Investment Approach

## Investment Objective

### Long Term Absolute Capital Appreciation (3-5 years)

through:

- Global equity investments within our circle of competence
- Debt investments, mostly government, high yield when attractive
- **Flexible allocation to cash when equity and debt do not meet our criteria**

# Our Investment Approach

## Investment Style

*“In the long run, the market is a weighing machine - in the short run, a voting machine”*

B. Graham

- At times Mr Market behaves like a maniac depressive or is excessively euphoric: we try to be contrarians
  - Sooner or later, fundamentals act like gravity on prices
  - We can achieve our investment objective only if:
    - **Performance is measured on a long term basis (3-5 years)**
    - **Investment guidelines are flexible**
- We need investors that are long term partners, aligned with our investment objective**

## Our Investment Approach

### Investment Style

- Value oriented: we require a margin of safety (avoid losses, invest defensively)
- Low portfolio turnover
- Bottom up
- We do **not** try to predict market movements over 6-12 months
- We are **not momentum** players
- Bonds provide steady income and liquidity reserves to use when corrections occur
- **We are not renters of stocks, but owners of businesses we understand and that we can value**

# Our Investment Approach

## Key Benefits

- Reduced risk of permanent losses (we typically buy good companies when out of favour, hence at reasonable prices)
- Decreased transaction costs as turnover is low
- Stable Long Term Performance

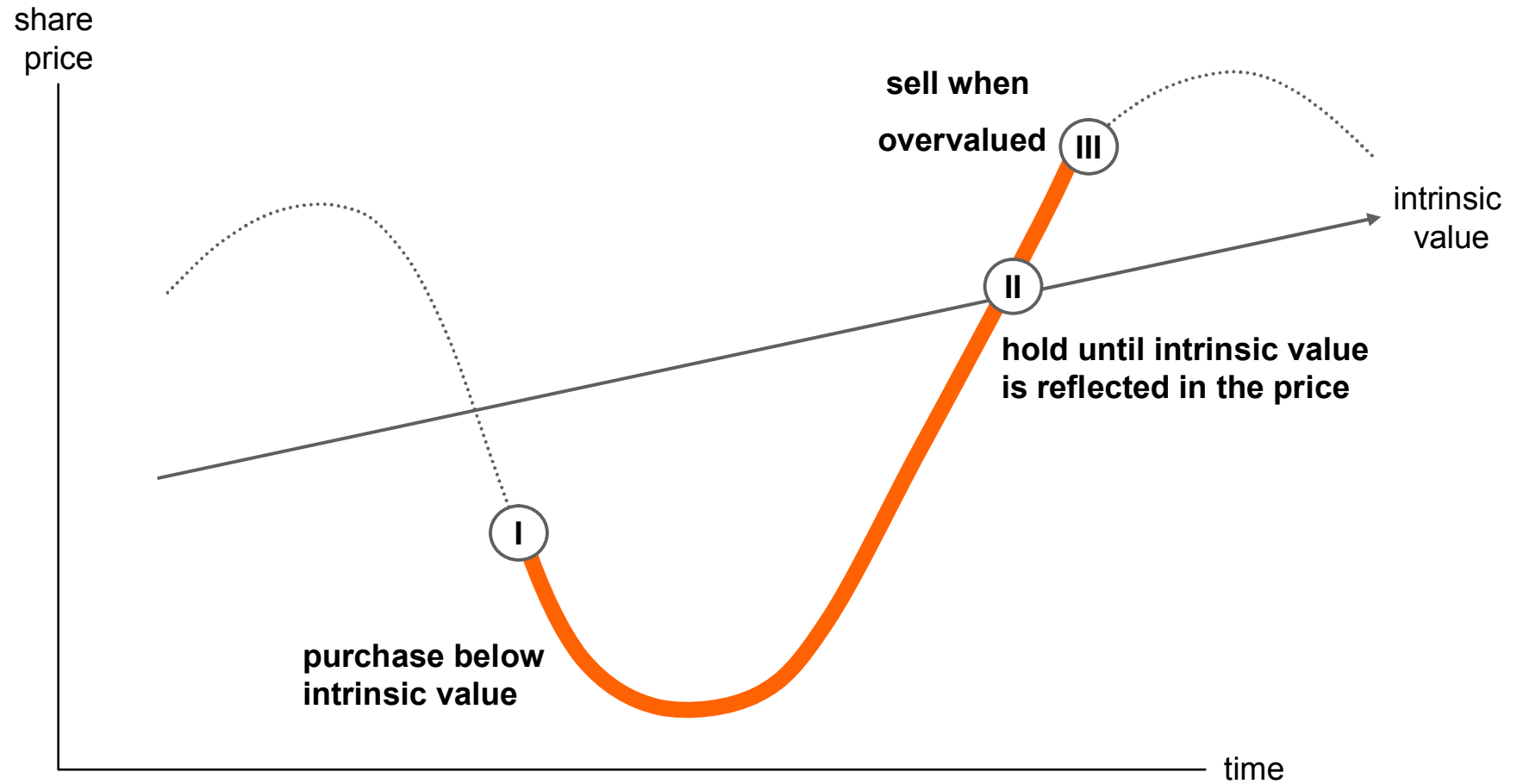
# Our Investment Approach

## What Is Risk For A Long Term Investor?

- **Risk:** Possibility to have a permanent loss of principal
  - We try to avoid investing in poor businesses or in quality businesses at excessive prices
  - **Short term volatility** is:
    - An **opportunity** to invest in quality businesses below their value
- **Our Priority is not to loose money and to earn a decent return over time**

# Our Investment Approach

## Volatility Provides Buying Opportunities



# Investment Environment

## Shortcomings Of Limited Investment Flexibility

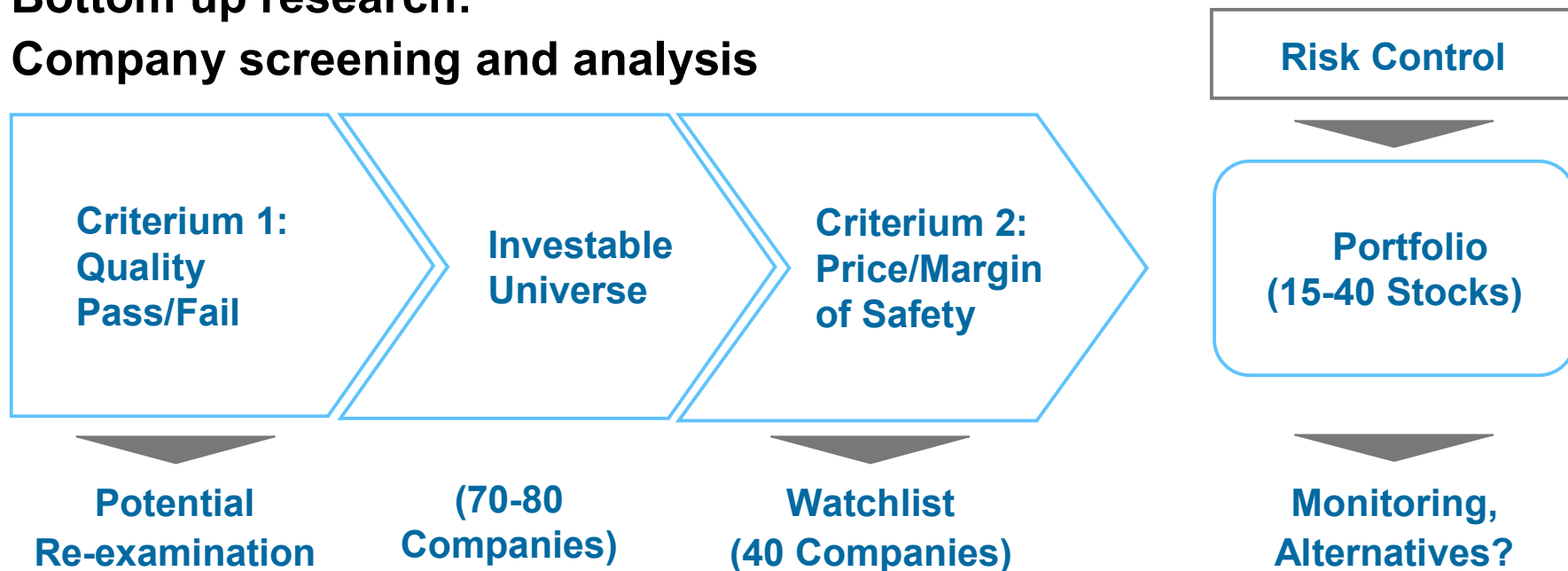
Key Features	Undesired Effects
<b>Rigid Asset Allocation</b>	<ul style="list-style-type: none"><li>• Money not always employed in the best reward-risk propositions</li></ul>
<b>Low tolerance for deviation from benchmark</b>	<ul style="list-style-type: none"><li>• How to outperform a benchmark with a portfolio virtually identical?</li><li>• Massive diversification may replace investment analysis</li></ul>
<b>Short term measurement of performance</b>	<ul style="list-style-type: none"><li>• Group behavior is encouraged: <b>Failing with the herd is the safest route!</b></li><li>• Active management is penalized: Reputation issues, client defection and frictions within the organisation</li></ul>

# Investment Process

## Investment Criteria

- The quality of the business is the first condition to be met
- Assessment of the price vs value ratio is key to proceed to an investment
- Discipline and patience are essential: The market will present opportunities

### Bottom up research: Company screening and analysis



# Investment Process

## Company Selection Criteria

### Competitive Advantage

- Customers switching costs (banks)
- Cost leadership/scale economies (retailers)
- Intangibles (brands, patents: consumer goods, healthcare)
- Network externalities (trading platforms, Microsoft)
- Consequence: ability to weather storms, more predictable returns

### Balance Sheet & Cash Flow

- Strong cash flow generation
- Above average return on capital
- Track record of profitability

### Management

- Transparency
- Commitment to shareholders (e.g. buy backs at low prices)
- Focus
- Avoid unprofitable growth at any cost

**+ Margin of safety in price versus value**

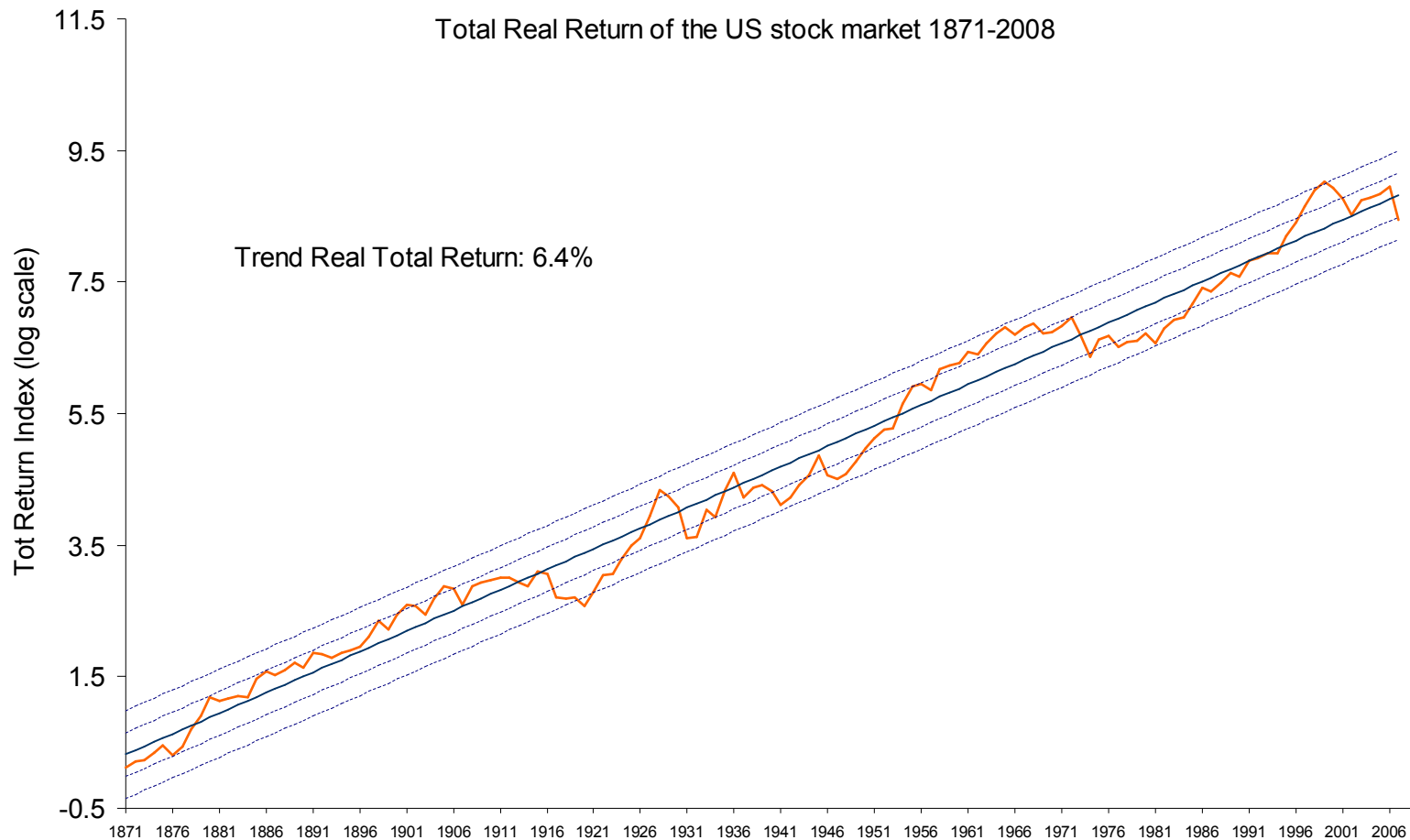


**Equity investments for the long term**

# Rationale Of The Investment Opportunity

## History of the US Stock Market

The most efficient stock market in the world has a successful history of long term returns



Source: Standard and Poor's, R. Shiller, January 2009 (Latest S&P level 870)

# Rationale Of The Investment Opportunity

## The Importance of Dividends

The bull market of the last 20 years was driven by P/E expansion and dividends, not by earnings growth

Period	Total Real Return	Dividends	Earnings Growth	P/E Change
<b>1871-2003</b>	6.9%	4.8%	1.6%	0.5%
<b>1982-2003</b>	10.1%	3.1%	2.2%*	4.8%!

\* Part of this growth is, in fact, dividend yield in the form of share buy back  
Source: Standard and Poor's, R. Shiller, Bernstein, J. Siegel

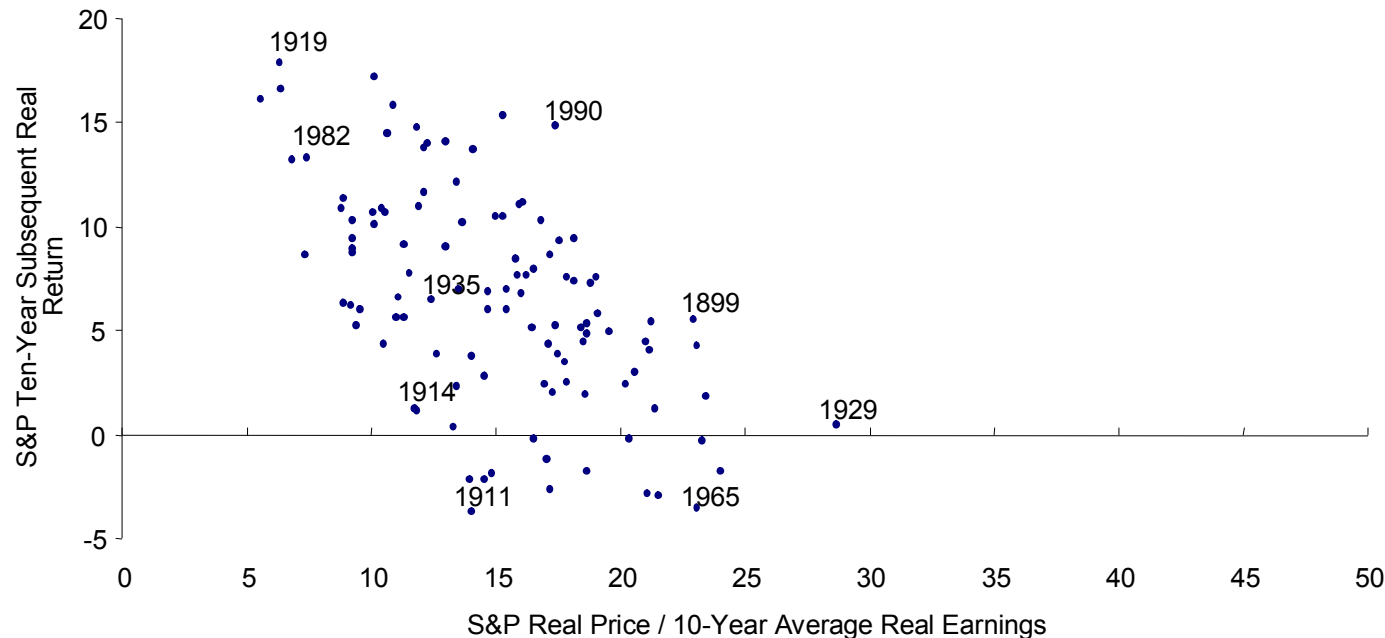
# Rationale Of The Investment Opportunity

## Buy And Hold Indexes Not Always A Win

...attention to valuation level when investing has a significant impact on subsequent returns for many years

### Price Earnings Ratio Predicting Subsequent Ten-Year Real Returns

Annual January Data, 1881-1990 (1891-2000 returns)



Source: Standard and Poor's, R. Shiller, September 2004

## Conclusion



**Long term performance measurement and flexible equity exposure**

We can deploy capital where and when we see value



**High quality businesses and margin of safety**

Reduced risk of loss of principal and of no returns over the long term



**Low portfolio turnover**

Decreased transaction costs and increased returns