

# Q3 2013 Letter



<http://shihinvestments.com>

kai@shihinvestments.com

## **[For: Joe Public]**

### **Q3 2013 Summary**

- **Your quarter-end balance of \$XXX,XXX is an all-time high and has increased by \$XX,XXX (X%) this year.**
- **We started new, long-term positions in General Motors and ViaSat.**
- **We successfully completed several short-term trades aimed at profits without undue market risk.**



## Account Statement 9/30/2013

YOUR ACCOUNT BALANCE: **\$XXX,XXX**

### PORTFOLIO SUMMARY

Since: 1/1/2013

Beginning Balance	\$XXX,XXX
+ Deposits	\$XX,XXX
- Fees	
+/- Market Value	\$XX,XXX
<b>End Balance</b>	<b>\$XXX,XXX</b>

### RETURN SUMMARY

	Since:	<u>1/1/2011</u>	<u>1/1/2012</u>	<u>1/1/2013</u>	<u>6/30/2013</u>
Returns (before fees)		XX%	XX%	XX%	XX%
<b>Returns (after fees)</b>		XX%	XX%	XX%	XX%
S&P 500 Index		33.7%	33.7%	17.9%	XX%
<b>Delta returns vs. index</b>		XX%	XX%	XX%	XX%

### FEE SUMMARY

(No quarterly fees - fees charged annually based on performance)

Fellow Investors,

Our account balances hit new highs this quarter, and I'm pleased with our returns for the year. I continue to think the market is fairly valued or even a bit expensive as I discussed in [my previous quarterly letter](#). Despite my conservative outlook, we've enjoyed reasonable profits.

This quarter, I invested around 20% of our portfolio in short-term opportunities. These trades generally last a few hours to a few months, and are designed to be somewhat uncorrelated with the wider stock market. So far, all of these short-term trades have been profitable, and I'll probably continue these short-term trades if I can garner reasonable profits from them.

One interesting short-term trade has been Linn Energy, which pays a hefty 1% distribution each month. The market is pricing Linn as if that distribution will be cut substantially. I think the market is vastly overestimating the likelihood and/or severity of such a cut. For more details, I wrote and received compensation for two articles:

- [Linn Energy: 30% Upside, Even Agreeing With The Critics](#)
- [Linn S-4 Indicates Sustainable Dividends And 33% Returns](#)

Most of our holdings, around 60%, are long-term in nature and were acquired a few years ago. The most prominent holdings here are the large banks acquired in 2011.

We added two additional long-term holdings to round out the final 20%, General Motors (GM) and ViaSat. I found General Motors by studying Berkshire Hathaway's (Buffett's company) filings. Berkshire bought 15 million shares recently, which brings their total to 40 million shares. When I started studying GM, I almost immediately understood Berkshire's attraction to the stock, and the more I looked, the more I liked the company. I'll discuss General Motors in more detail on the following page.

Our portfolio went through a number of changes this quarter, and, while I am not enthusiastic about the market overall, I am excited about the prospects for our holdings going forward.

Sincerely,



## General Motors (GM)

I found GM by looking through recent buys at Berkshire Hathaway – one of my favorite ways of finding stock ideas. As I investigated the company further, I found many things to like, among them:

### GM is a “stinky” stock

I mean stinky in a good sense: as a value investor, I like to buy companies that other investors instinctively avoid. I buy stinky stocks, hold my nose, and wait for the smell to dissipate. GM is associated with two events that many investors find distasteful: the government bailout, and GM’s bankruptcy.

The government was given about a third of GM (aka “Government Motors”) shares in return for a hefty cash infusion. Even today, that bailout remains part of our political discourse, and there are even people that refuse to buy a “Government Motors” car. Some investors, who do not like the idea of co-owning a company with the government, have stayed away.

However, government ownership of GM should [end in a few months](#), when the government completes its sale of its remaining shares. And as their ownership ends the “Government Motors” nickname should slowly fade away too, and both car buyers and investors should return.

The government’s sale of several billion dollars of stock each month is pushing the stock price downward. The end of those sales is in sight, and I believe the stock will move up when the downward selling pressure ends.

GM also went through bankruptcy a few years ago. This is a type of “stink” that I have come to enjoy and pursue. The taint of bankruptcy stays with many investors. For example, investors that lost all their money on GM stock during bankruptcy probably will not return to the stock for some time.

The reality is GM has emerged a far stronger company than before, after shedding debt, pension liabilities and health care liabilities. There is lingering negative sentiment, but I think the leaner, more focused GM is a much better company than GM has been in several decades.

## GM has good financial metrics

GM's financial metrics look good right now. Based on 2014 estimates, it looks like their P/E is around 8 (cheap, and well below market averages); EV/EBITDA around 3 (very cheap), and half their market cap is in cash (quite high) – the company is in good financial shape.

I have seen analyst reports that try to say that GM is trading within a “historical” P/E range. I think this is a mistake. Old GM was terminally losing market share, heavily in debt, and had some of the lowest profit margins in the industry. All these factors merited a low P/E. But new GM is growing market share, has more cash than debt, and is growing its profit margins – and thus deserves a higher P/E.

One of the biggest negatives with GM is they have underfunded pension and health care costs. This is a complicated topic, full of accounting rules and guesses about future interest rates. The bottom line, however, is that I think GM's pension problems will shrink as interest rates rise – making it one of the few companies to benefit from higher interest rates.

The “stinky” and financial aspects of GM convinced me the company was a buy; but what made it a long-term buy for me were the final two points:

## GM is dominant in the BRIC countries

It turns out that GM has a well-established presence in the fastest growing auto markets in the world - the BRIC (Brazil, Russia, India and China) countries. [This analysis](#) shows that GM is selling about as many cars in those countries as Toyota, Honda, Nissan, Chrysler and Ford *combined*. General Motors might as well be called China Motors because it sells more cars in China than it does here.

Normally a stock with a strong foothold in growth markets would be rewarded with a high stock price and enthusiastic investors. In GM's case, this enviable position seems to be overshadowed by the “stink” I mentioned above. But eventually the profits from those countries should shine through.

## They're *Finally* Building Good Cars!

Up until now, I've considered GM a very large builder of crappy cars, and for a few decades, GM continually reinforced that notion. I've never even test-driven a GM car.

I was really surprised when I started reading GM's new reviews. Dan Neil, the Wall Street Journal's excellent automotive reviewer, summarized the Chevy Stingray this way:

"I think it is a great car, and I'm proud it is an American product. So there!"

Almost all of Dan's reviews are of expensive, foreign sports cars, and this is the first time I remember him being downright enthusiastic about an American sports car.

I've read many reviews for various GM cars, and here's the impression I have. Reviewers are a little surprised, and a little proud, that GM's cars are actually good now. In many cases, GM is going head to head with foreign cars on their own turf. They're competing on quality with the Japanese cars; and on handling, speed and sportiness with German cars. And so far, they're holding their own.

I've compiled some reviews below:

- [JD Power initial quality](#): GM wins (by far) the most awards

Eight of GM's cars won their category rankings; no other company won more than two. According to the survey, the number of initial complaints for GM's cars and trucks is similar to premium brands like Acura and Lexus; and slightly better than long-time quality leaders like Toyota and Honda.

- Chevy Impala: [third highest Consumer Reports rating, ever](#).

The Impala is consumer report's highest rated sedan, the first time an American car has won the title. With a score of 95, the only cars with higher ratings cost tens of thousands of dollars more.

- Chevy Silverado: Consumer Report's top truck

Consumer reports also rated the Silverado their [best truck](#). This year, Chevy has sold more Silverados than Toyota has sold Camry's. Who knew?

- Cadillac ATS: competitive with BMW and Mercedes

Car and Driver recently did a [comparison test](#) between the new Cadillac, the ever-popular BMW 3-series, and the Mercedes C350. They summarized it as "beating the Germans at their own game" by building the best \$50,000 sports sedan.

- Chevy Stingray: the first GM car I've wanted.



In this [MotorTrend video](#), they pit a \$70,000 Stingray against a \$430,000 Ferrari and a \$151,000 Porsche. That it's even competitive with cars 2 to 6 times more expensive is the real news. They prefer the Stingray to the Ferrari.

I'll let Dan Neil close the article with [these thoughts](#):

**To cut to the chase:** The newly redesigned, seventh-generation Chevrolet Corvette (C7), aka Stingray, heir to Corvette's 60-year heritage and the bannered spear of a resurgent General Motors is an excellent car. Fast, authentic, tough as a rodeo steak. If you were planning to boycott GM for life, your road just got a little narrower.