Alpesh Patel's December & January Newsletter

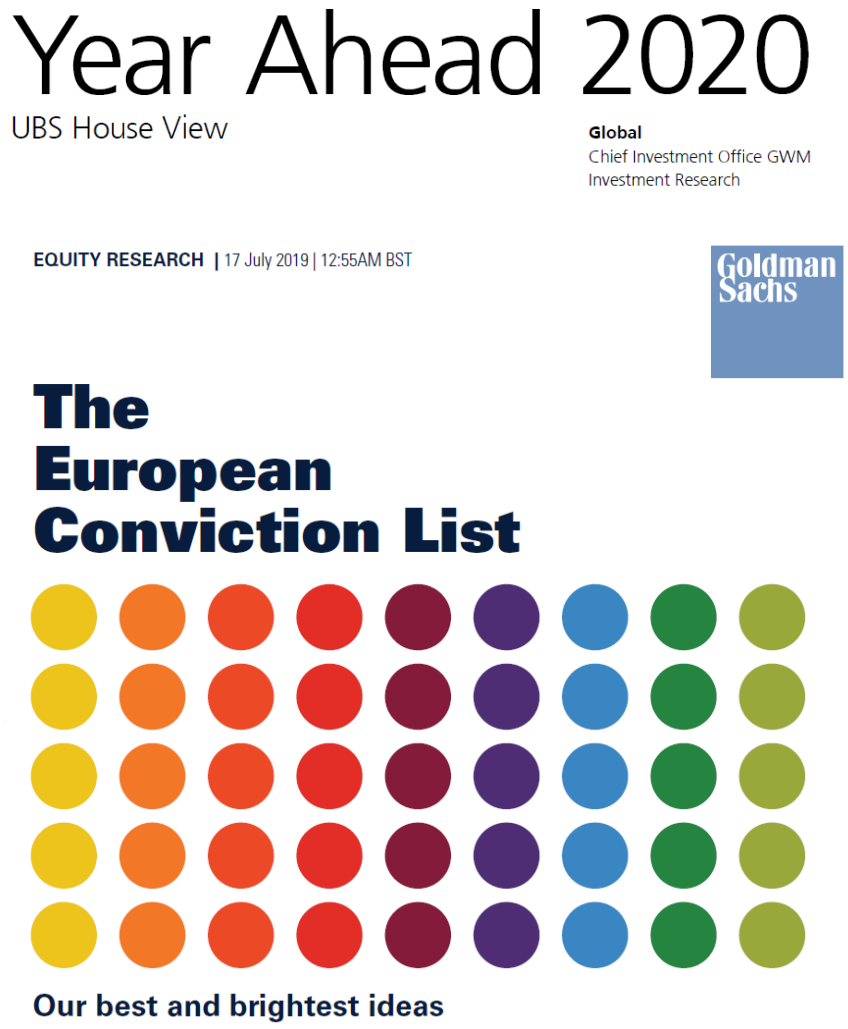
Exclusively for ShareScope Alpesh Patel Special Edition Subscribers

13 January 2020

Overview

This will be a bumper issue with my picks for the year and much, much more too.

First a reminder of the Goldman Sachs report:



So, you don't have to wait between newsletters, I am going to make available to Sharescope APSE users my private mobile app for communicating my market thoughts. It's free via this app on Telegram: https://t.me/pipspredator

From the two images below which I've been showing you, in my talks, tweets etc all year long, are the two which prove the case why we had a great year.

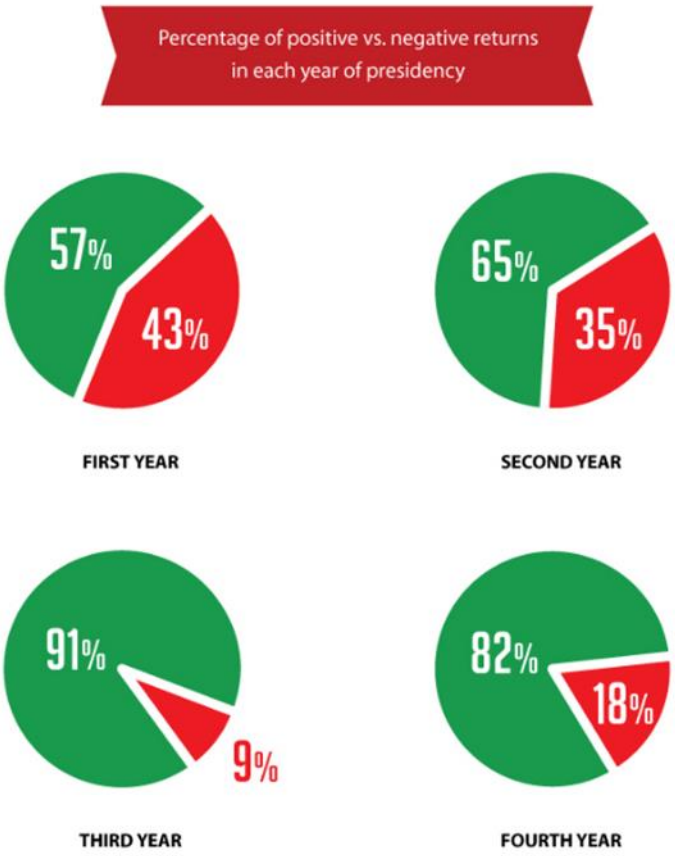
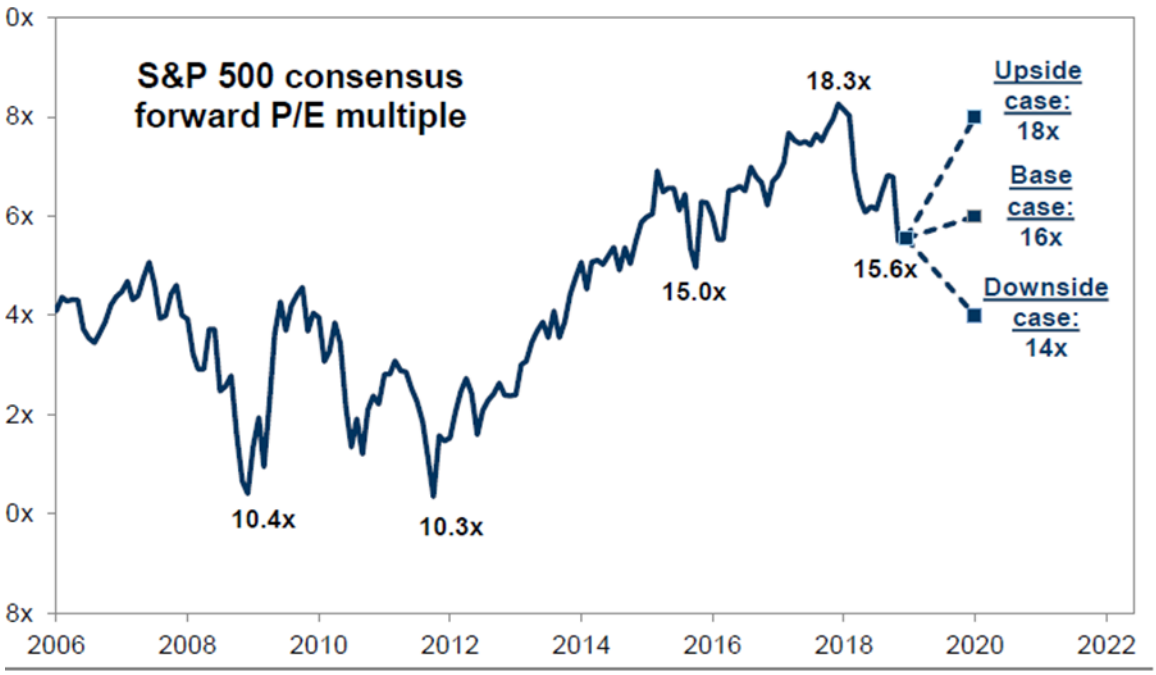


Exhibit 1: S&P 500 valuation under our 3 scenarios for 2019
s of December 13, 2018



ource: Compustat, Goldman Sachs Global Investment Research

The FTSE 100 P/E is around 18 – not expensive – still.

Now my annual picks which I give each January for 2020 based on APSE and my algorithms which have beaten every UK fund manager since 2004. To see historic performance have a look at www.sharescope.co.uk/alpesh

VGI Annual Picks – How Did We Do?

1. You exit at the failsafe 25% drop – eg in 2008 we had a few of those!
2. You never ever expect everything to always rise all the time under all market conditions. If you are looking for a crystal ball, it's the circus you need.
3. 12 month hold based on our algorithm which examines company valuations, growth and dividend yields.

This is how we've done so far…

	Alpesh Patel Special Edition	FTSE All-Share
2004 performance	+ 34.9%	+ 9.2%
2005 performance	+ 44.2 %	+ 18.1%
2006 performance	+ 40.6%	+ 10.8%
2007 performance	- 2.3%	+ 2.3%
2008 performance	- 18.4%	- 32.4%
2009 performance	+ 17.4%	+ 28.0%
2010 performance	+ 16.1%	+ 9.1%
2011 performance	- 4.4%	- 6.5%
2012 performance	+ 18.9%	+ 7.4%
2013 performance	+ 33.5%	+ 12.9%
2014 performance	- 4.3%	- 2.4%
2015 performance	+ 23.3%	- 6.6%
2016 performance	+ 19.4%	+ 20.0%
2017 performance	+ 32.8%	+ 8.7%
2018 performance	- 14.2%	- 13.2%
2019 performance	+ 18.9%	+ 10.3%
Average	+ 17.1%	+ 5.1%
Average (last 5 years)	+ 16.0%	+ 3.8%

Last year results

Picks from 10 Jan 2019 (date of newsletter) to 31st Jan 2019:

Gordon Dadds (now Ince Group) -25%

Polymetal +39.1%

Britvic +6.9%

Cineworld -23.1%

Dunelm +69.5%

El Group +43.6%

Marshalls +74.6%

Telecom plus -0.3%

Cosan (US) +130%

Pointer Telocation (US) + 17.9%*

Walgreens Boots (US) -18.7%

D4t4 Solutions +7.4%

James Halstead +23.4%

* take over at $8.50 per share cash + 1.27 Powerfleet shares

Picks for 2020

Avation

Alumasc

Belvoir

Brooks Macdonald

Cairn Homes

Care Tech Holdings

International Consolidated Airlines

Liontrust

Menzies

DS Smith

Plus500

Smiths Group

Polymetal

Ten Entertainment

British American Tobacco

Vp

A reminder from Goldman Sachs.

A selection of our Best and Brightest UK Ideas
GS 12m PT

Company Name (*denotes on CL)	Sector	Sub-sector	Upside to PT
Melrose*	Industrials	Machinery	35.2%
Rolls-Royce*	Industrials	Aerospace & Defence	87.3%
Equiniti*	Business Services, Transport & Travel	Business Services	46.2%
Ascential Plc*	TMT	Media	37.1%
Anglo American Plc*	Basic Resources & Energy	Mining	36.7%
BP Plc*	Basic Resources & Energy	Oil	60.2%
Fresnillo Plc*	Basic Resources & Energy	Mining	51.3%
Tullow Oil Plc*	Basic Resources & Energy	Oil E and P	92.3%
Aviva Plc*	Financials	Insurance	37.4%
Standard Chartered*	Financials	Banks	58.3%
Bunzl	Business Services, Transport & Travel	Business Services	30.2%
Ferguson Plc	Business Services, Transport & Travel	Business Services	28.5%
BT Group	TMT	Telecoms	43.7%
WPP Plc	TMT	Media	25.7%
Next	Consumer	General Retail	20.8%
Tesco	Consumer	Food Retail	27.3%
HSBC	Financials	Banks	46.6%
Royal Bank of Scotland	Financials	Banks	76.1%
Persimmon Plc	Financials	Home Builders	31.5%
Taylor Wimpey Plc	Financials	Home Builders	20.3%
Standard Life Aberdeen Plc	Financials	Insurance	20.9%

All pricing in this note as of last close Aug 7, 2019, except WPP as of last close Aug 8, 2019.

Source: Goldman Sachs Global Investment Research

Exhibit 2: ...while UK equities are trading at a significant discount to global equities
UK vs World 12-m forward P/E Premium/Discount

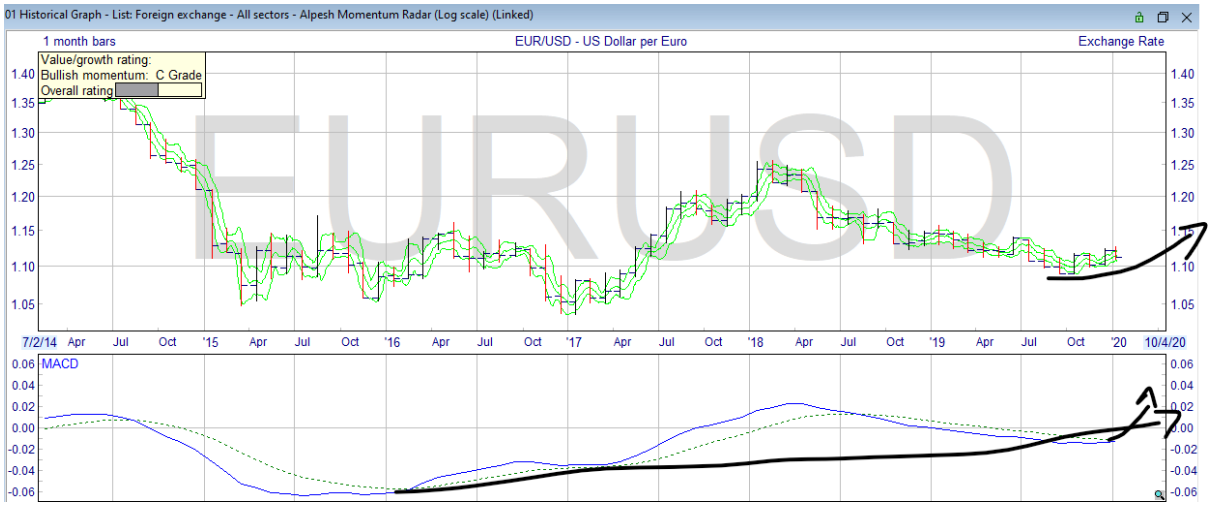
Source: Datastream, Goldman Sachs Global Investment Research

It should be a good year for UK

Forex

Longer term GBPUSD - for those who like charts - should be on the upside.

Similarly, a EURUSD move up over the year? As things stand I would say yes.



EURUSD also looks more likely to rise than fall.

ETFs

This image shows why you should for 12 month or longer holdings look at ETFs. It shows in red in the case of these tech companies how many failed to meet their benchmark over 12 months. You could argue 50/50 – and shows you why tracker ETFs are liked so much.

Technology Majors Review

Benchmark: Technology Select Sector SPDR® ETF	Week % 2.18%	YTD % 2.92%	1Y % 50.17%	
Ticker Company Name	Week %	YTD %	1Y%	Vol. Trend Market Cap
GOOG Alphabet Inc	3.84%	6.19%	32.12%	3.56% ▲ 979.24B
AAPL Apple Inc	3.09%	5.44%	105.0%	6.85% ▲ 1.357T
CSCO Cisco Systems Inc	-2.27%	-0.62%	12.24%	0.09% ▲ 200.74B
FB Facebook Inc	4.06%	6.36%	51.36%	0.06% ▲ 622.54B
IBM International Business Machines Corp	0.97%	2.01%	18.73%	0.48% ▼ 121.10B
MSFT Microsoft Corp	0.92%	2.78%	57.76%	0.87% ▲ 1.237T
ORCL Oracle Corp	1.24%	3.10%	16.26%	5.15% ▲ 174.43B
QCOM Qualcomm Inc	1.38%	1.90%	64.60%	-5.87% ▼ 102.66B

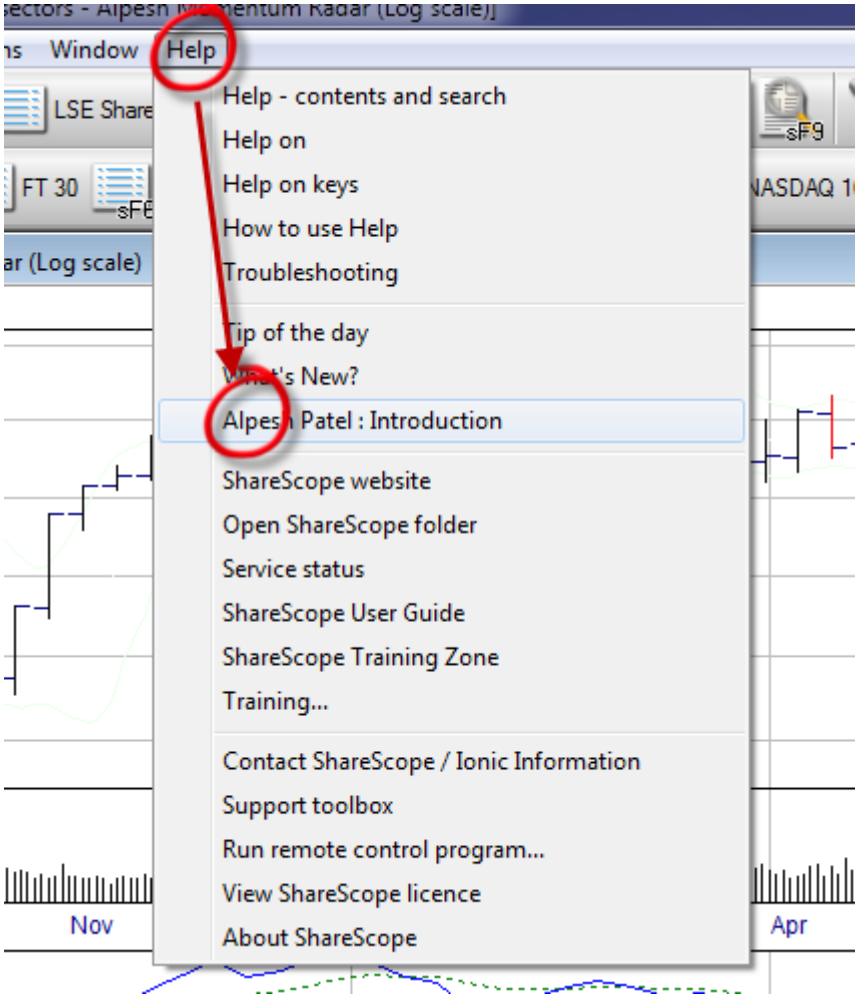
But look at the same for Consumer Cyclicals and you're more likely with the household names to beat the index. Why? I think it is because in consumer companies the money goes to the big guys and squashes the minnows, but in tech, it's the smaller tech companies, not on the list above but in the index, which get the big returns and so the tracker is better for you.

Consumer Cyclical Majors Review

Benchmark: Consumer Discret Sel Sect SPDR® ETF	Week % 0.41%	YTD % 0.73%	1Y % 22.56%	
Ticker Company Name	Week %	YTD %	1Y%	Vol. Trend Market Cap
BABA Alibaba Group Holding Ltd	0.91%	4.56%	45.98%	-3.11% ▼ 594.97B
AMZN Amazon.com Inc	0.16%	2.88%	14.56%	5.02% ▲ 942.54B
MCD McDonald's Corp	3.77%	5.43%	18.35%	7.15% ▲ 156.91B
NKE Nike Inc	-0.70%	0.17%	33.91%	-0.74% ▼ 158.04B
SBUX Starbucks Corp	1.32%	2.97%	44.36%	0.39% ▲ 106.92B
HD The Home Depot Inc	2.52%	3.12%	28.69%	-12.76% ▼ 245.64B
DIS The Walt Disney Co	-2.27%	0.14%	30.12%	-4.58% ▼ 261.04B
TJX TJX Companies Inc	1.52%	2.59%	34.74%	-10.23% ▼ 75.37B

For Your Personal Perusal

Some interesting things you might like:



Personal Thoughts

Unrecognised Simplicities: The Secret to High Performance Teams & Why Asset Management is Broken

(With thanks to Dominic Cummings, Senior Special Advisor to the Prime Minister)

Asks Dominic, "The investor Peter Thiel (founder of PayPal and Palantir, early investor in Facebook) asks people in job interviews: *what billion (109) dollar business is nobody building?* Warren Buffett, illustrated what a quadrillion dollar business might look like in his 50th anniversary letter to Berkshire Hathaway investors."

'There is, however, one clear, present and enduring danger to Berkshire against which Charlie and I are powerless. That threat to Berkshire is also the major threat our citizenry faces: a "successful" … cyber, biological, nuclear or chemical attack on the United States… The probability of such mass destruction in any given year is likely very small… Nevertheless, what's a small probability in a short period approaches certainty in the longer run. (If there is only one chance in thirty of an event occurring in a given year, the likelihood of it occurring at least once in a century is 96.6%.) The added bad news is that there will forever be people and organizations and perhaps even nations that would like to inflict maximum damage on our country. Their means of doing so have increased exponentially during my lifetime. "Innovation" has its dark side.'

Charlie Munger, half of the most successful investment team in world history emphasised the importance of simplicity:

'There isn't one novel thought in all of how Berkshire [Hathaway] is run. It's all about … exploiting **unrecognized simplicities**… It's a community of like-minded people, and that makes most decisions into no-brainers. Warren [Buffett] and I aren't prodigies. We can't play chess blindfolded or be concert pianists. But the results are prodigious, because we have a temperamental advantage that more than compensates for a lack of IQ points.'

Dominic Cummings: Perhaps the most profound aspect of broken systems is they cannot reflect on the reasons why they're broken — never mind take effective action.

Fields dominated by real expertise and those dominated by confident 'experts' who make bad predictions

'To know whether you can trust a particular intuitive judgment, there are two questions you should ask: *Is the environment in which the judgment is made sufficiently regular to enable predictions from the available evidence?* The answer is yes for diagnosticians, no for stock pickers. *Do the professionals have an adequate opportunity to learn the cues and the regularities?* The answer here depends on the professionals' experience and on *the quality and speed with which they discover their mistakes*. Anesthesiologists have a better chance to develop intuitions than radiologists do. Many of the professionals we encounter easily pass both tests, and their off-the-cuff judgments deserve to be taken seriously. In general, however, you should not take assertive and confident people at their own evaluation unless you have independent reason to believe that they know what they are talking about.' Daniel Kahneman - Nobel Laureate.

Even though experts usually possess deep knowledge, they often do not make good predictions…

In fields ranging from medicine to finance, scores of studies have shown that replacing experts with models of experts produces superior judgments.

Human experts typically provide signal, noise, and bias in unknown proportions.

Kahneman also recently published new work relevant to this.

'Research has confirmed that in many tasks, experts' decisions are highly variable: valuing stocks, appraising real estate, sentencing criminals, evaluating job performance, auditing financial statements, and more. The unavoidable conclusion is that professionals often make decisions that deviate significantly from those of their peers, from their own prior decisions, and from rules that they themselves claim to follow.'

Experienced professionals tend to have high confidence in the accuracy of their own judgments, and they also have high regard for their colleagues' intelligence.

Kahneman summarises the evidence:

'People have competed against algorithms in several hundred contests of accuracy over the past 60 years, in tasks ranging from predicting the life expectancy of cancer patients to predicting the success of graduate students. Algorithms were more accurate than human professionals in about half the studies, and approximately tied with the humans in the others. The ties should also count as victories for the algorithms, which are more cost-effective…

'The common assumption is that algorithms require statistical analysis of large amounts of data. For example, most people we talk to believe that data on thousands of loan applications and their outcomes is needed to develop an equation that predicts commercial loan defaults. Very few know that adequate algorithms can be developed without any outcome data at all — and with input information on only a small number of cases. We call predictive formulas that are built without outcome data "reasoned rules," because they draw on common sense reasoning.

'The construction of a reasoned rule starts with the selection of a few (perhaps six to eight) variables that are incontrovertibly related to the outcome being predicted. If the outcome is loan default, for example, assets and liabilities will surely be included in the list. The next step is to assign these variables equal weight in the prediction formula, setting their sign in the obvious direction (positive for assets, negative for liabilities). The rule can then be constructed by a few simple calculations.

'The surprising result of much research is that in many contexts reasoned rules are about as accurate as statistical models built with outcome data. Standard statistical models combine a set of predictive variables, which are assigned weights based on their relationship to the predicted outcomes and to one another. In many situations, however, these weights are both statistically unstable and practically unimportant. A simple rule that assigns equal weights to the selected variables is likely to be just as valid. Algorithms that weight variables

equally and don't rely on outcome data have proved successful in personnel selection, election forecasting, predictions about football games, and other applications.

'The bottom line here is that if you plan to use an algorithm to reduce noise, you need not wait for outcome data. You can reap most of the benefits by using common sense to select variables and the simplest possible rule to combine them…

'Uncomfortable as people may be with the idea, studies have shown that while humans can provide useful input to formulas, algorithms do better in the role of final decision maker. If the avoidance of errors is the only criterion, managers should be strongly advised to overrule the algorithm only in exceptional circumstances.'

'It may turn out that [the space program's] most valuable spin-off of all will be human rather than technological: better knowledge of how to plan, coordinate, and monitor the multitudinous and varied activities of the organizations required to accomplish great social undertakings.' Editorial in Science, November 1968.

For me this failure of 'experts' to see unrecognised simplicity is what allowed me beat all UK fund managers time and again - both in a Financial Times competition which launched my hedge fund career - as you'd expect(!) - to investing as results from this Financial Times awardee company who have tracked my algorithmic performance since 1994 reveals.

These institutions have a bias to self-preservation - so active management lives on. Neil Woodford was beaten by me in the above table, and so were others. And since 2004 even Buffet by my cheap, simple algo. The point is that institutions do not self-correct. Expert over-confidence in their own abilities plus status quo bias resists the nimble change that a Jim Simons brings. We misfits are more appreciated for hard-hitting comments:

As the Prime Minister's Special Advisor put it:

"We can see some reasonably clear conclusions from decades of study on expertise and prediction in many fields.

- Some fields are like extreme sport or physics: genuine expertise emerges because of fast effective feedback on errors.
- Abstracting human wisdom into models often works better than relying on human experts as models are often more consistent and less noisy.
- Models are also often cheaper and simpler to use.
- Models do not have to be complex to be highly effective — quite the opposite, often simpler models outperform more sophisticated and expensive ones.
- In many fields (which I've explored before but won't go into again here) low tech very simple checklists have been extremely effective: e.g flying aircraft or surgery.

- Successful individuals like Warren Buffett and Ray Dalio also create cognitive checklists to trap and correct normal cognitive biases that degrade individual and team performance.
- Fields make progress towards genuine expertise when they make a transition from *stories* (e.g Icarus) and *authority* (e.g 'witch doctor') to *quantitative models* (e.g modern aircraft) and *evidence/experiment* (e.g some parts of modern medicine/surgery).
- In the intellectual realm, maths and physics are fields dominated by genuine expertise and provide a useful benchmark to compare others against. They are also *hierarchical*. Social sciences have little in common with this.
- Even when we have great examples of learning and progress, and we can see the principles behind them are relatively simple and do not require high intelligence to understand, *they are so psychologically hard and run so counter to the dynamics of normal big organisations*, that almost nobody learns from them. Extreme success is 'easy to learn from' in one sense and 'the hardest thing in the world to learn from' in another sense."

I find that uneducated people on 20k living hundreds of miles from SW1 generally have a more accurate picture of daily No10 work than extremely well-connected billionaires. Dominic Cummings

Alpesh Patel