We are here

30Jun13

To my Partners:

There is a lot of "stuff" going on. The US is lurching forward while China, Europe, Japan and the Middle East are question marks. I am not in the prediction business so I cannot lay out a roadmap for you. As Howard Marks says, there are two types of investors: those who don't know and those who don't know they don't know! Price or more specifically discount to intrinsic value (NAV) is the hook on which we hang our hat and over the last 6 months discounts to NAV have narrowed. For us, this means we sold shares as they reached our target prices. While we have found the odd thing to do, it has been less than the proceeds of our sales and as a result our cash holdings have increased.

Our performance so far this year has been primarily driven by five stocks: Monex Group, Howard Hughes Corp, H&R Block, VOYA Financial and Dole Foods. To date in 2013, we have lightened up on both Howard Hughes Corp and Monex Group. In both cases, they continue to trade somewhat below our estimate of intrinsic value however the discount has significantly narrowed. Dole Foods received a takeover bid in early June. We had purchased shares in Dole in late January 2013; we sold our holding into the takeover bid news at a modest gain of a couple of dollars a share. We continue to hold VOYA Financial and I will discuss the investment below. Finally, we exited our H&R Block position in early May for a little over $27. We had purchased H&R Block in Sept 2011 for approximately $13 a share; our estimate of intrinsic value was in the mid to high $20s. In other words, we got a double over a year and a half as well collected $1.20 or so in dividends from our investment in H&R Block.

In our Canadian portfolio, our gainers roughly offset the losers leaving the market value pretty much unchanged on the year. The share price of our sole remaining European holding, RHJ International, is more or less flat in 2013 although I think the next couple of months will be very interesting. RHJ expects to hear by late summer whether they have received approval to purchase BHF, a large private bank, from Deutsche Bank. If RHJ does not receive the regulator's blessing, RHJ has indicated it will pay a large special dividend. By the fall either we will have a holding in an expanded European private bank with a good balance sheet or we will get a slug of cash back and hold shares in small private bank which will likely be listed for sale by the Board.

Our cash and net working capital has increased over the last 6 months to about 34% of net assets at June 30th. Our cash fell slightly in early July as we acquired shares in a recent spinoff. By spinoff, I mean a special situation where a larger company distributes or spins off a portion of its operations in a new listed company. Spinoffs have been somewhat of a picked over area the last couple of years although from time to time interesting things show up. As we are buying as I write this, I will fill you in on the details at a later date. The last spinoff we purchased was Howard Hughes Corp and so far so good on that one.

In a somewhat similar "special situation" vein, in early May we acquired shares in VOYA Financial (formerly ING US). ING Group, the Dutch banking and insurance company, was required as part of its 2009 regulatory restructuring plan to dispose of a portion of its US subsidiary (VOYA) by the end of 2013. This led to an interesting situation where ING Group was

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more focused on getting the transaction completed rather than securing the best possible price. I don't want to bore you with the details but the bottom line is VOYA trades at a large discount to book value and at a modest prospective price to earnings ratio. It is one of the top companies in several of its business lines. Management is both experienced and well incentivized to increase earnings (and the share price). This will be accomplished primarily by improving VOYA's return on assets. Several years ago, in early 2004, we purchased shares in a similar situation; it was an Australian spinoff called HHG plc. It worked out well in the end for us so I have fond memories of this type of situation.

As we enter the summer, our cash position will give us both some downside protection as well as lots of flexibility should ideas present themselves. I realize the "return on cash" is low however I have found the "opportunity cost" of not having cash when investment opportunities suddenly appear is very high. In the current market environment where I find things somewhat overdone, I am happy to have amble firepower for a rainy day.

Performance:

The McElvaine Investment Trust's 30Jun2013 net asset value for the Series B units was $18.6880. This represents a gain for the first six months of 2013, net of all fees and expenses, of 10.5%. During this period, the S&P/TSX Composite Total Return Index fell by 0.9%.

Conclusion:

As always, many thanks for all your support and confidence. I appreciate your trust.

All the best,

Tim McElvaine
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