The Next Level Portfolio
2Q 2021 Investor Letter

Dear Long Term Investors,

The earnings season for 2Q 2021 is just about over so it is timely for the The Next Level Portfolio Investors' Letter.

For those who are still not aware, you will be able to see your portfolio at https://wm.phillip.com.sg/.

2021 has been an interesting year. In the 1Q, we witnessed the massive run up in tech and growth companies. However, in the 2Q, the tech and growth companies saw a rapid turndown while the value stocks were in favour.

To start off, I want to take a leaf from Warren Buffett's annual letter where he always starts with the mistakes.

Therefore, I will start with the mistakes, mainly two.

1. Overestimating in growth business model - If you have a sharp eye, you would notice that we exited from Lemonade (LMND) and Unity (U) at a loss. Both businesses were identified as disruptors initially as they presented a new method to the business of insurance and virtual gaming respectively. However, as I analyse the business further, it was brought to my attention that both businesses have inherent challenges in the business model. I will take LMND as an example which I will detail below:

    a. LMND introduces a new model to how insurance is done. Their main model is to offload the risk to re-insurer while aligning themselves with the insured. However, after several discussions with personnel in the insurance industry, the model may not be as sustainable as I initially thought.

b. While they claim that they are aligned with the insured since the insurance payout is with the re-insurer, LMND is still responsible for part of the payout.
c. Therefore, as they scale bigger, concerns regarding that model starts to surface. As LMND onboard new policies quickly using AI, their payout ratio is likely to increase as more policy claims take place.
d. With that in mind, we can no longer value LMND not as a tech company but as a true blue insurance company as the true addressable market is still the number of people that will take on the insurance policy.
e. For example, AIG (Diversified insurance) is priced at 0.65 Price/Sales, Progressive (Property and casualty insurance) is priced at 3.24 P/S and Fidelity (Specialty insurance) is priced at 1.55 P/S. As of writing, LMND is priced at 4.44 P/S which is definitely on the high side. While LMND may still prove to be a good business later on, with the current valuation and uncertainty, we decided that the capital can be better deployed elsewhere.

2. <u>Not breaking down the investment into smaller tranches</u> - While we have bought into good companies, we noticed that due to the portfolio size minimum of $30,000, we do not have the liberty to break down investments into smaller tranches. This prevented the portfolio from investing at better prices after the market pullback. As a result, we have raised the minimum investment sum to $50,000 to avoid a repeat of such instances. Take note this will only apply to new investors.

With that, I would like to further elaborate the type of companies that we are looking for at Next Level Portfolio.

Software eats the world, Hardware keeps it.

As software continues to eat up the world, as quoted from Marc Andreessen, we are looking for the next bound of development and innovation. One such innovation edge will be companies that can combine both their software edge with hardware dominance.

A good example is Roku Inc, which we are invested in. (For newer investors, we are still patiently waiting for a better price)

To give a brief introduction, Roku is a Connected TV company that brings you all the streaming services such as Netflix and Disney+. However, if Roku only exists in the software realm, while it can grow quickly, it will have a very low moat. A determined competitor will be able to pivot into the space and steal your “lunch”.

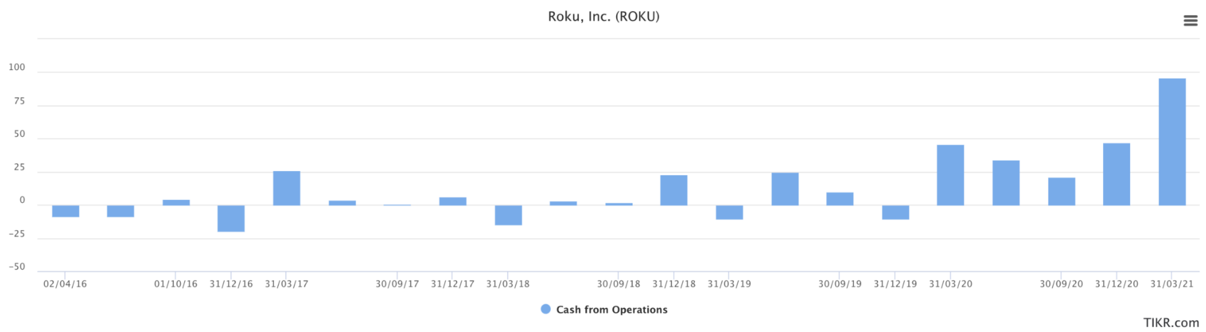
However, Roku has another competitive edge that is hard to replicate. Its hardware TV.

Roku partnered with TV manufacturers to create Roku ready TV. It has been so successful that Roku TVs occupied 3 out of the 5 top selling smart TV on Amazon. This means that when there are other Connected TV competitors such as Google Chromecast and Amazon Fire TV, consumers prefer TV that comes ready with the Roku system installed.

These TVs are great distribution channels for Roku. While people have different subscriptions such as Netflix, Disney and Amazon Prime, they are able to consume all the streaming services on the Roku platform. In fact, the distribution channel is so strong that new streaming services fight to be onboard the Roku platform during their launch to ensure higher viewership.

This is a good example of how a successful software company protects its business with a hardware moat. It will be easy for another company to create a software platform but it will be tough for them to re-create the hardware distribution channel.

This strategy has been so successful that their earnings have been improving and resulting in 5 consecutive quarters of positive operating cashflow.



What to expect from the market going forward?

As we see the rapid changes in market sentiment, the stock market prices continue to be volatile. Instead of fearing the volatility, we welcome the volatility. It provides us with good opportunities to buy into great businesses at fantastic prices.

While stock market prices may move up or down, the business quality would not have changed much in the short period of time. I would urge you to view volatility as market noises when it moves against you. A good mindset to have is to think of stocks as real estate.

For example, you bought a house for US$1m and you know that it is worth around the same price. However, if someone come to you the next day and offer to buy it at $800,000, how would you feel?

You would probably view the offer as ridicule as you know that it is worth around US$1m.

The same mindset could be helpful in the stock market. When we have bought into good companies and we know their value, we should view market price volatility as a "ridiculous offer" when it is too low or too high. When it is too low, you buy more. When it is too high, you sell more.

Finally, another question that was asked frequently is "**Should we sell when the market is high and re-enter when the market is down?**"

While that sounds ideal, in reality it is hard to execute. The reason being that good companies tend to have higher prices over a long duration. This means while the prices might look high now, it could be the low of a new price range.

My personal experience is with Amazon which I bought back in 2015. It went to an all time high of $400. However, if you believe that it is at a high price and decided to sell, you would have missed the subsequent run up to more than $600. In fact, it never retraces back to $400 since then.

So what should we do when the market is high?

If I spot a good company, I will still invest but in smaller tranches, perhaps 1-2% first. If the market gives a better price subsequently, I will invest more. This will ensure that even if I got it at a higher price, I would have “bullets” to enter at better prices. However, should the prices run up from the all time high, I will still have a stake in the investment already!

Heads I win, Tails I win.

Finally some admin.

I am heartened that some of you have told me that you have forgotten your login details, because you are investing for the long term and not concerned about the short term fluctuations.

Jokes aside, please make sure you have your login details reset if you have forgotten it. Do call +65 6531-1555 and the good people at Phillipcapital will be able to assist you.

Also, I am looking to hire an analyst so if you know of anyone who is good at business analysis and a hardworking individual, please send the CV over. I want to spread my net wider to find the best companies for you in the Next Level Portfolio.

New Funds.

Firstly, a big thank you to those who referred their family and friends to join the Next Level Portfolio in 2021. Thank you for the stamp of approval and trust.

In order to focus on the portfolio, we are currently closed for new outside funds. We will share with you again when the portfolio is opened for new funds.

However, for existing investors, if you would like to add more funds, we are happy to assist. Please email me at petetanpy@phillip.com.sg.

With that, I will see you next quarter!

Regards,
Pete