Portfolio Update

First full year of the Jenga Global strategy

Dede Eyesan - 15 September 2021

For the first full year, the Jenga Global Fund returned (**+27.3%**) and outperformed the FTSE All-Share Index (**+22.5%**), MSCI World Index (**+23.0%**) and the S&P 500 Index (**+23.0%**) in British pound sterlings (£) and dividends included.

We launched the Jenga UK Fund (now the Jenga Global Fund) on the 15th of September 2020 with our partners and set a long-term goal of outperforming the FTSE All-Share Index, MSCI World Index, S&P 500 without using leverage or options.

While the fund has delivered value for money in year 1, we expect the following years to be even more challenging as our AUM increases, business models change, and as algorithms get smarter.

The top contributors to our total return of +27.3% were Evolution Gaming (+8%), Garmin (+4.5%) and Medifast (+4%). While the largest detractors were Teamviewer (-2.4%), Balco (-1.3%) and Stillfront (-1.4%).

In the final quarter, we sold our investments in Teamviewer, Stillfront and YouGov. We bought shares in InMode, AlphaFX Group and eXp World Holdings.

The current investments are classified into five key themes on the table below:

Health and wellness	Leisure and entertainment	Software and support services	Industrials, IT hardware and semiconductors	Consumer, luxury and brands
Garmin	Evolution Gaming	eXp World Holdings	KLA	Kering
Medifast	Playway	Alpha FX Group	Mo-Bruk	L’Oréal
InMode	Team17	Livechat	Mycronic	Leatt Corp
	Facebook			
		Sold positions		
	Stillfront	Teamviewer	Balco Group	
		YouGov		

Our stock selection, diversification and portfolio weighting are guided by three main insights into companies, consumer trends, human nature and economic data:

1. The increasing collaboration among the healthcare, technology and entrepreneurship fields
2. The leisure economy impact on both work and leisure remains undervalued
3. The enablement of old economy sectors by advancements in hardware, software, semiconductors and the web 3.0

For the first insight, Garmin provides a good example. A decade ago, the majority of its revenue came from automotive devices, but its co-founder and current chairman, Min Kao, saw the application of GPS in fitness, and Garmin launched its fitness wearables and outdoor devices to support athletes and consumers with various tracking and health monitoring features. More than half of its revenue currently comes from these fitness and outdoor wearables, while only 10% is generated from automotive GPS devices. Garmin watch users can track their stress levels, set up swimming training, and gauge menstrual cycles for women.

Insight 2 comes from the study of civilisation we shared here. For the past 120 years, working time has fallen from 65 hours per week in 1900 to 34 hours in 2021. Leisure time has benefitted from this, and in the roaring 1920s, we saw the first wave of leisure and entertainment companies like Walt Disney, NBC and CBS. Today, we believe gaming and the metaverse will continue driving the future of leisure and entertainment. The Facebook Oculus Virtual Reality headset is one of its industry leaders. Our gaming studios like Evolution Gaming and Playway are some of the most profitable and fastest-growing studios among listed companies.

For insight 3, we saw the first wave of 'technology enablement' in the financial and retail industry, and we believe for the next decades, healthcare, industrials and the automotive industry will drive the next waves of technology enablement. More entrepreneurs like Elon Musk will dedicate their purpose to bolstering the advancements and capabilities in the driving experience via autonomous driving and more electric vehicles. A net beneficiary is the role of microchips needed for digital transformation in cars, and KLA Corporation has almost a 60% market share of the global microchip measuring and inspection industry. Another example is Mo-Bruk, a niche player using its patents in technology to reduce, process and manage the industrial waste produced in Eastern European countries.

The market today

Today, equity investors are dealing with three big themes;

1. The recovery from the Covid-19 impacts
2. The crackdown on inequality and the technology sector in China
3. Rising inflation and a potential increase in interest rates

Understanding the operations and business drivers of investments have never been more critical. All 16 of our current holdings have so far outperformed market expectations in revenue and profits for this year and have reaped the benefits of various investments in their people, processes, culture and operations. We are very optimistic about the recovery, and we believe increased consumer activity will further boost our portfolio companies. While rising interest rates make all equity investments less attractive, our companies have minimal balance sheet interest-bearing debt and are less exposed to the real fundamental impacts of increasing interest rates.

China

The crackdown on the Chinese technology, education, gaming, VIE structures and more recently, the Macau casinos and medical aesthetics companies have been turbulent for markets. The shares of Tencent and Alibaba have declined more than 40% since their February 2021 peaks. Listed Education companies like New Oriental Education & Technology Group have fallen more than 80% YTD as they have been told to convert into non-profits.

This experience has been a reminder of the political and regulatory risks global investors face. We currently do not own shares in any Chinese listed companies.

Due to the global nature of our companies, 6/16 portfolio companies make some of their revenues and profits from Chinese consumers and businesses. We continue to monitor how the new policies will affect each. For example, we believe a potential increase in income taxes as a wealth redistribution tool will affect Kering, the parent company of global luxury brands like Gucci and Saint Laurent, as disposable income in China falls in the short and medium term. KLA could potentially be in the middle of renewed semiconductor trade wars between China and the USA. InMode may lose some clients if aesthetics minimal-invasive surgeons are banned from advertising or operating aesthetics surgeries. We recently reduced our positions in L'Oréal and Kering, but we view the current risk/reward attractive enough to remain on the portfolio.

Would we invest in China in the future?

Definitely.

China's role in civilisation cannot be overestimated. By the end of the decade, we expect the Chinese economy to be larger than the USA. However, we must respect and follow the local rules, improve our knowledge of the region, and invest prudently. Investing with these risks is something we must accept and factor in when making investment decisions. At the moment, we believe the Chinese sports brands like Anta Sports and some Chinese industrial groups with global operations like Sany Heavy Industry have very attractive investment cases and are currently on our shortlist of global stocks.

Inflation

To deal with inflation, we currently place our investment focus on companies with pricing power, market leadership, high growth potential, top management teams and attractive valuations. These attributes are natural inflation hedges because they can raise prices, increase product quantities and improve goods and services over time. Kering, the parent company of Gucci, has raised prices by 7% since August 2019 in key markets. InMode has both increased prices and expanded product categories which significantly boosted profits in H1 2021.

Losses, mistakes and mistimed sells

If we aren't delivering 30% above the benchmark, then we can improve something in our investment approach and stock selection. Not many managers admit this, but we do make mistakes every year.

Our most obvious mistakes have come from the now sold positions - Stillfront, Teamviewer and Balco Group. Although all three currently trade at much higher share prices than when we sold, we made a loss on our investments. Despite being a quality company, in our opinion, we misjudged Teamviewer's potential growth as it already has the majority of Fortune 500 companies as clients in its remote desktop software operations. Balco Group has appreciated by +34% above our average purchase price, yet we lost 20% on our investment. This taught us why we should strongly avoid allowing near term difficulties to affect our long-term judgements of companies. Our worries about the short-term difficulties of the Nordic regions balcony installation market was simply overblown.

Mistakes extend beyond what we bought or sold to investments we analysed and passed on. In November 2020, we thoroughly assessed Fortinet, a leading company in various cybersecurity solutions and also discussed the prospects with current Fortinet employees. However, we passed on buying the cybersecurity company and purchased Teamviewer instead. Since then, its share price has returned +165% and would have been our best holding.

An even bigger mistake was being too slow with our healthcare investments and not fully understanding the potential of mRNA on genome sequencing and vaccines. Since our initial coverage of the healthcare industry, Moderna has delivered a total return of +336% (we now have our first healthcare investment in InMode).

The companies of some products and services we use every day were passed too and cost us some returns; MSCI and S&P, the parent companies of our fund benchmarks, have outperformed us! Alphabet, the parent company of the google search engine we use every day to read articles on various investments, also outperformed the fund! Your investment manager has worked from home in Crocs, analysed its turnaround, yet failed to snap up shares despite being significantly undervalued. Its share price has returned +260% in the past year. Almost 10x what we achieved!

All four companies are companies we assessed, found to be undervalued but failed to buy. If there's anything we can promise, it is there will be more mistakes, investment losses and missed out opportunities in the future. However, if we learn from these mistakes, minimise their impact and avoid repeating them, we believe we can achieve our long-term goal of delivering a net fund return in the top 3% of all global equity funds.

Current holdings

The table below compares the portfolio average versus the S&P 500 on key metrics we believe are vital when assessing potential investments (Management quality can't be measured).

	Jenga Global Fund Average	S&P 500 Average
Return on equity	25.8%	16.6%
Return on capital	16.5%	13.3%
Debt/Capital	10.7%	37.3%
EBIT margin	35.4%	14.4%
Net Income	30.1%	11.3%
3-year Revenue CAGR	18.2%	5.9%
3-year EBIT CAGR	19.2%	9.36%
TEV/EBIT	23.7x	24.3x
P/E ratio	29x	28.66x

Data from the S&P CapitalIQ

The first five are metrics that represent the financial quality of a company. Our portfolio companies are well above the average S&P 500 company. The next two reflect past growth, and our portfolio companies more than double the S&P 500 3-year revenue and operating earnings growth. The final two are relative valuation metrics, and we do better on an EV/EBIT basis but slightly more expensive on a P/E ratio view.

Some other facts on our current portfolio:

- 12/16 of portfolio companies are interest-bearing debt-free
- 13/16 are either founder-led or, in L'Oréal's case, founding-family led
- 15/16 are growing revenues and operating profits by at least 10% per year
- 15/16 have a net profit margin of at least 10%
- 16/16 met or surpassed H1 2021 revenue and EPS estimates

We remain confident about the founders, management teams, people and culture behind our portfolio companies and are excited about the long-term growth potential. Each showed top leadership qualities needed in dealing with the pandemic. KLA Corporation and Garmin increased their R&D budgets faster than in previous years and invested heavily in innovation and engineering capabilities. Medifast and L'Oréal coped very well with the global supply chain disruptions in the consumer staple industry. Medifast's turnaround was appreciated by Fortune and was ranked 2nd among the top 100 Fortune's fastest-growing companies in 2020. Playway and Team17 were exemplary in their gaming operations. Each delivered new game franchises during the pandemic and exceeded expectations. Evolution Gaming and Mycronic found high-quality acquisition targets, and we expect their profit margins and offerings for clients to be further boosted by the newly acquired companies.

Final thoughts

Our focus remains on learning more about the world, the current portfolio companies, expanding our circle of competence and finding the best investments possible to our knowledge. We think long-term in years and decades, and our partners do, which helps us make better investment decisions.

Our investment universe expanded from approximately 1,500 companies to 6,000 companies across the globe. We can say we have a bigger pond to fish in. However, we expect the journey over the next years to be very volatile, with more losses and drawdowns. We will go through many more uncomfortable periods, and our conviction on portfolio companies will be tested. If there's anything we've learnt from the past two years of compounding our clients capital, (1) is being curious, (2) seeking the truth, (3) being disciplined but not rigid, and (4) creativity are the recipes needed for fundamental investors to outperform over the long-term.

For now, it's back to research for the Jenga Global fund team. Again, thank you to all our partners.