VLTAVA FUND

ON the BEAUTY OF UNCERTAINTY

Dear shareholders,

In the first quarter of 2012, the fund's NAV grew by 6.8%.

Please permit me to begin this letter with a slight digression…

In 1980, John Lennon put out an album entitled Double Fantasy. It was the last record released during his lifetime. The album includes the delightful composition "Beautiful Boy", a lullaby for his son who was six years old at the time. The lyrics contain an inconspicuous but aptly philosophical line: "Life is what happens to you while you're busy making other plans". The sad irony is that just a few weeks later Lennon was dead, and, judging from the extensive interview he gave on the day of his death, Lennon really was full of plans for the future.

Investing is similar in the sense that its results depend upon future developments. Stated more precisely, those results depend upon future developments in combination with the composition of the portfolio. While we have no control over the future, we have 100% influence over the composition of our portfolio. In a perfect world, we would have the ability to predict how the future will develop – and especially in matters affecting investment outcomes – and then we would compose the portfolio accordingly.

We openly admit that we do not possess such ability, nor do we know of anyone who does possess it. So, we have to create our portfolio such that it fares well in the majority of possible future scenarios.
As of the end of 2011, most investors thought that January would bring a considerable market slump and that the events in the euro zone, and especially concerning Greece, would continue sharply to escalate. For this reason, many investors held much more cash than usual, and short positions in the euro were reaching historic records.

The start of the year surprised most everybody

The situation in the euro zone has now calmed to a certain degree (although only time will tell for how long). The equity markets have risen significantly, and so has the euro. Our portfolio fared relatively well. For reasons that can be neither proven nor disproven and about which we can only speculate, history chose this course. We need to remember, however, that it could have gone down a very different path – indeed, any one of many other paths.

This gives rise to the following questions:
Would we have composed our portfolio differently had we known developments would take the course they did? Or, if we had known, on the other hand, that developments would have been significantly worse than they in fact turned out to be?

Probably not.

If we exclude extreme situations, which do occur sometimes but are hard to predict (in fact, difficult even to imagine), our portfolio would be the same, regardless of what development we anticipate. **Because we recognise that our ability to predict the future is marginal at best, it would be a grave mistake to make investments the success of which depends on one specific development scenario.**
It is better to try and make investments the success of which will not be significantly affected by most possible and reasonably probable scenarios of development.

When we speak of success, we refer here to what happens to the value of the companies in our portfolio, rather than to short-term movements in their share prices. Sometimes, we retrospectively test the correctness of our approach by considering possible alternative courses of historical development and endeavour to estimate what their impacts on our portfolio's value would have been. For example, how would our portfolio's value have been affected if Greece had declared bankruptcy last year and left the euro zone, if one or more large banks had collapsed, if the price of oil had plummeted or skyrocketed? If we conclude that the influence of these and other, similar alternative development scenarios and shocks would have had but little influence on the value of our companies, then this suggests that we are picking our investments properly.

Changes in the portfolio

We sold three positions in the quarter: Heineken, PepsiCo and Cielo.

Heineken we had purchased in early 2009 at prices around EUR 21. This year, it climbed to EUR 40 and we considered it more than fully valued. There was no margin of safety between the price and the value of the share any more. Indeed, the price had even exceeded the value. It was time to realise a profit and to sell Heineken.

Our position in PepsiCo had been a little disappointing to us. We had been expecting a better outcome. Finally, we sold the shares after holding them for nearly two years for the same price at which we had bought them. PepsiCo has been treading water for some time, growing only slowly, and there are better investment opportunities on the market.

The Brazilian Cielo was our first and to date only investment in Latin America. Cielo is one of two dominant companies in Brazil in the business of settling payment card transactions. This is a very profitable duopoly. We had expected to hold it for a long time, but the price of the shares started substantially to rise immediately after we bought them. After holding them for 9 months, we sold the shares with a 50% gain because, as true of Heineken, they were no longer sufficiently undervalued for us.

We have one new position. Here's a clue: It is an American company, well-known and very large. We have been monitoring it for 15 years, and I always wanted to have it in the portfolio. Nevertheless, its price was too high through that entire time despite its high quality. This has recently changed. Once again, high quality is available in the market for an unreasonably low price. There was no reason to hesitate. Moreover, the purchase of this share has another bonus for us. The legendary and genial businessman who manages it is now working for us. Have you already guessed which company this is? We will reward correct guesses at the shareholders' meeting with a bottle of wine!

In addition, we were continuously taking advantage of the market volatility and we added to our positions in five other companies.

World full of uncertainty – a normal state

Many people think today's world is full of uncertainty. That, however, is the way it has to be by definition, and the world cannot be any different. It is hard to say whether there are more uncertainties today than usual. People usually tend to overrate the importance and scale of recent events in comparison to those occurring earlier. If we look back into history, however, we can find any number of periods that were much more turbulent, both politically as well as economically. The current period appears scarcely dramatic at all alongside the likes of such years as 2008, 2000, 1997, 1991, 1987, 1980, 1978, 1968, 1962, 1939, 1929…

In looking at these years, we may not even realise what was going on at the time, even though it always was a serious crisis with global impacts. In any case, the one certainty in this world is that it will continue to be full of uncertainty. That may be a banality, but it has crucial consequences for investing. It leads us to the following conclusions:

1. **The greatest mistake would be not to invest at all.**
If the future is uncertain, that only heightens the need for people to prepare for it financially.

2. T**he best long-term investment is in stocks.**
Given the valuations today of stocks and other investment asset classes, and given the world's probable development, this scarcely can be doubted.

3. **Over the long term, stocks carry lower risk than do bonds and cash.** Inflation is the investor's greatest enemy (and one of the greatest uncertainties). In the long term, stocks are best able to cope with that uncertainty.

4. **Among stocks, we tend to focus on quality.** Considering the many and varied future development scenarios, they fare the best.

Our portfolio is today composed mostly of shares in high-quality companies that are financially strong, with solid positions in their markets, and with safe and growing dividends. This was not always the case, but the progressive acquiring of experience, advancing age, learning from our own errors and, ultimately, the valuations of the individual shares themselves all lead us down this path.

Daniel Gladiš, April 2012

P.S.: A hockey fan's postscript
If we were always certain at the start of the season that Kometa Brno would reach the championship finals, then hockey would hold no interest for us. The uncertainty is truly the most attractive part of it. Uncertainty is beautiful.

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Before subscribing, prospective investors are urged to seek independent professional advice as regards both Maltese and any foreign legislation applicable to the acquisition, holding and repurchase of shares in the fund as well as payments to the shareholders.

The shares of the fund have not been and will not be registered under the United States Securities Act of 1933, as amended (the "1933 Act") or under any state securities law. The fund is not a registered investment company under the United States Investment Company Act of 1940 (the "1940 Act").

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