VLTAVA FUND

8-1-1

Dear shareholders,

The Fund's NAV grew by 10.05% in the fourth quarter of 2013. Thus, the returns to Vltava Fund SICAV reached 21.26% for the year 2013 as a whole.

A look back

Inasmuch as we have our first 10 calendar years behind us, now is a good time for a brief retrospective. Our score from the first decade is 8-1-1. Eight times a positive result (including the unique year 2009), once a negative year within normal bounds (2011) and once an abysmal year (2008). We refer to 2008 and 2009 as the "Halley's Comet Years", because we believe that we will not live to see such bad or such good years again.

Our investment strategy is not the same today as it was 10 years ago. It is developing – and we believe improving – step by step, and we ourselves are eager to see how it will evolve going forward. Our greatest mistake in the Fund's earliest years – and which backfired on us in 2008 – was that we were trying too hard to be too clever. In short, we overcomplicated things. We attempted to make too much money too fast using too large a combination of short and long positions. We gradually came to realise that this is unnecessary.

We started out like the Earl of Sandwich, inventing the sandwich in the short story by Woody Allen. His first completed work – a slice of bread, a slice of bread on top of that, and a slice of turkey on top of both – failed miserably. His second attempt (two slices of turkey with a slice of bread on top of them) was not successful either. Not even the two following experiments (three slices of turkey and three slices of bread) caught on. Crushed by his failures, the Earl of Sandwich noted in his diary: "Simplify, simplify!"

We wrote the same into our diary. **Since the start of 2009, our investment strategy has been much simpler. Perhaps paradoxically, this has not been to the detriment of returns. The Fund's NAV increased almost four times over between 2009 and 2013.** This puts our standing quite high in an imaginary worldwide ranking – possibly even at the very top, as we have yet to find a fund that would have higher returns for the given period. In any case, it appears that our portfolio can do just fine without the dose of steroids with which we formerly were doping it.

The facts that not only can things be done in a simpler way but also that we will be better off for so doing might be termed our 'great stroke of enlightenment'. Had we known 10 years ago what we know now, we could have avoided the great plunge of 2008. Unfortunately, that is not the way things work. Everything follows its own course, even knowledge. We might think today that we are much better investors than we were 10 years ago, but it is quite possible that after 10 more years we will critically evaluate the ideas we adhere to today and reproach ourselves for today's mistakes.

This is the most intriguing thing about investing – that one can continuously develop and improve. Each error can be become a source of knowledge and further advance our understanding. I even think that if our experience from 2008 had not been so bad and intensive, we might have atrophied and be worse off for it today. Who knows how it all works?

Now, enough of ruminations upon the past and let us look into the future…

A look forward

As always, the only thing we can say with reasonable certainty about the future is that it will bring a lot of things that nobody expects. We have not the slightest idea as to the direction in which the world economy and financial markets will develop. We are in no way disadvantaged by that, however. Inasmuch as we have not heard of anyone who would be able to predict future development with sufficient probability, our own inability in this regard does not worry us in the least. **On the contrary, the fact that we recognise our own inability (and the impossibility generally) of reliably predicting the macro development, market movements or even investor confidence is a fundamental source of our investment strategy.**

We endeavour to focus on specific, individual companies, upon evaluating their competitive advantages and especially their sustainability, their financial strength and the activities of their managements with a view to creating value for shareholders. The macroeconomic circumstances usually play no role in these considerations. And instead of prognosticating upon the movements in share prices we emphasise the importance of low investment price. This is the best protection from permanent loss of capital.

The future was, is and always will be uncertain. This is nothing new. Indeed, one of my earlier letters to shareholders was called "On the Beauty of Uncertainty". Uncertainty is a good thing for the investor. The greater is the uncertainty, the better are the investment opportunities. Investors may be more aware of uncertainty today, but uncertainty in and of itself does not change much.

We can imagine our future returns as the product of future development and our portfolio. While we can say but little about future development (let alone think about having any control over it), we fully control what will be the composition of our portfolio. And that is where we direct all of our efforts. We try to invest so that our results will be good under almost any future development scenario.

Long-term threat

As we have written in the past, inflation is the investor's greatest enemy (and at the same time his or her motivation). If inflation were zero, or even negative, it would not be necessary to invest. Money would not lose its value. Unfortunately, inflation is almost invariable positive and this fact compels anyone who has money to invest. We have been living recently in an environment of very low inflation (if we believe the official numbers), and no indications of rising inflationary pressure are on the horizon.

If inflation remains low over the long term (which is a variant that can occur), then our portfolio will fare well and provide respectably positive real returns. However, a diametrically opposing variant is also possible. There is a chance for long-term higher inflation that is accompanied by much higher interest rates. We cannot say which of these two scenarios is the more probable, but it is clear that the scenario of higher inflation and higher interest rates is the more dangerous. There are two reasons why that is true.

First, higher inflation erodes the value of money much more quickly. And second, higher interest rates weigh upon the gains accruing to all asset classes. This would affect bonds, equities, real estate and gold. The interest rate is perhaps the most important quantity in investing. It is used as a gauge for valuing individual investments. Currently, interest rates are being deformed by central banks and skewed downward from their equilibrium values. Their more pronounced rise would affect literally all markets. Bonds would be impacted more notably than equities, and not all equities would be hit to the same extent, but nothing would be spared.

We endeavour to choose our investments so that they provide the best possible compensation in the event of long-term higher inflation. For example, we own companies that will directly profit from higher interest rates, companies with low capital expenditures, and companies which are positioned to be able to shift rising costs to their customers. Such companies should be able to fare relatively well in a higher inflation environment, both in absolute terms and relative to others. We are working to build into the portfolio protection against high inflation, so long as such equity titles are low--priced. Perhaps we are starting too early, and maybe things will turn out such that this will not have been necessary. We are aware of such possibilities, but we nevertheless believe that this is the right way to go. It is better to be insured more than necessary than not at all.

Changes in the portfolio

We did not sell any positions in the past quarter and opened two new ones. In both cases, these titles are among the most valuable of global brands, and the description from the previous paragraph fits them precisely. We intend to gradually build our exposures to both companies, and we expect that they will bring us attractive returns with very low risks for many years to come.

Through the whole of 2013, we opened 5 new positions and sold out 4 older ones. In total, we have 24 various titles in our portfolio. Approximately 80% of the portfolio's composition did not change over the year. Only the sizes of individual positions changed. We view ourselves as long-term investors, and our investment considerations look to horizons of several years. The stability of the portfolio's composition corresponds to this view and these considerations.

Up or down?

The question we get asked most frequently is whether the markets will go up or down. When we sincerely answer that we do not have the faintest idea, some people look at us with puzzlement. What sort of amateur ignoramuses are these people, after all? Others, meanwhile, wink at us as if to acknowledge that we naturally would not wish to reveal to others where lies the Holy Grail.

But we truly do not know – and do not even seek – the answer to that question. Instead, we search out low-priced titles and good investments. Some markets are today more expensive while others are less so. But even on the more pricey markets there are good investment opportunities. A person must respect the overall valuations of entire markets and cannot ignore these realities. If a market seems expensive, there are still several possibilities for how to deal with it.

In some cases, one can take a long-term view. While this is often used as an alibi for instances of not very successful investments, sometimes it can be a very rational approach. One can then focus on individual special cases, whether the particular situation concerns the company itself or an exceptional personality who is leading it. Alternatively, one can hold cash.

This combination also describes our approach. We have certain companies in our portfolio whose extraordinary quality, strength, stability and predictable development practically assure us that in future the prices of their equity will stand much higher than today and with minimal risk to boot. We also have companies in our portfolio which are led by people with exceptional abilities to create value for shareholders. Then, too, we own shares in companies which, because they are presently overlooked and underappreciated by the market, have very low share prices even though they are faring very well. Moreover, we also have a lot of cash.

When markets move up, we will be better off on paper, but later returns will be lower for it. If the market turns down now, we will be worse off for a while, but we will make that much more money later. In either case, it is probable that over time our equities will be much more valuable than today. **How much more they will be worth will not be decided by whether the market will now move up or down but by how well we are able to select the individual investments.**

We thank you for the support you have given us in the past year, and, for many of you, through the entire 10 years, and we wish you all the best in 2014.

Daniel Gladiš, January 2014

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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").

The shares in the fund shall not be offered to investors in the Czech Republic on the basis of a public offer (veřejná nabídka) as defined in Section 34 (1) of Act No. 256/2004 Coll., on Capital Market Undertakings.

Historical performance over any particular period will not necessarily be indicative of the results that may be expected in future periods.