SHIPS ON THE WAVES

When people ask me why I invest in stocks, I tell them that it is because I'm trying to reduce certain risks in my life. Investing in stocks is often associated in the public mind with maximizing returns or with risky speculation. Experience tells me, however, that sophisticated investors think differently. In their eyes, investments serve a much more important function. They see investments as a tool for managing and reducing financial risks, and most especially risks associated with long-term currency depreciation and inflation. Many people tend to understand investing in stocks as something that brings risk rather than something that reduces risk. Yes, investing in stocks, like any other activity, carries with it certain risks. But taking reasonable risks can in return reduce other, much more substantial long-term risks that investors face.

Vltava Fund is a fund for qualified investors. The definition as to who is regarded as a qualified investor changes over time. One of the current conditions is that every such investor must have a certain relatively large amount of assets. Our investors meet this condition, and some of them have truly vast assets. This puts most of them in a somewhat different position compared to ordinary retail investors with regard to why they invest and what they want to achieve. In addition to their desire to realize an attractive return, most of them also strive to protect the value of the assets they already have – not only for themselves but often also for future generations.

If a person has greater wealth and holds it in cash or other low-yielding assets, this may seem safe at first glance, but the long-term, systematic, and essentially inevitable devaluation of the currency will exist as a constant threat. The real value of their savings is very likely to decline significantly over time. It can be said that a person who has greater assets automatically becomes an investor, because even the decision not to invest has a major impact on the real value of his or her assets.

The impact of currency devaluation is very much evident with the passage of time. Over the past 80 years (that is to say in one human lifetime), cumulative inflation in the US has exceeded 1,500% (Source: Federal Reserve Bank of Minneapolis). Simply put, what 80 years ago cost $10 would cost more than $150 today. The US currency has lost more than 90% of its value during that time. The dollar is the main global reserve currency, and yet its value is rapidly declining. A handful of countries (for example, Switzerland and Japan) are doing slightly better, but most developed countries are even worse off (the UK, Australia, France), and that's not even to mention the many countries such as Turkey, Russia, Argentina, Brazil, and Israel. The future does not look bright when one considers the rates at which most currencies are depreciating. Indeed, quite the opposite. Structural deficits, growing government debt, and long-term expansionary monetary policies suggest that currency devaluation will continue to be the main risk with which investors must contend. Investing in stocks can help them to do just that. Exactly 80 years ago, the S&P 500 stock index stood at 14.87. As I write these lines, its value is 6,092. That is more than 400 times higher. Taking into account and reinvesting all dividends (which is largely just a theoretical exercise), the total return would be even higher, exceeding 5,000 times. Using the US market in these comparisons amounts to a bit of "*data mining*" inasmuch as few other markets have similarly high 80-year real returns, but the argument about stock returns compared to the rate of currency depreciation is valid also more generally.

Vltava Fund is an equity fund. Therefore, we do not consider which asset classes to invest in as part of our investment considerations. We see our fund as a product intended for the equity portion of our individual investors' asset allocations. When selecting individual stocks for the Vltava Fund portfolio, however, we constantly remind ourselves of the long-term goals for most of our investors. We try to put aside what is happening today and instead visualize what may happen in a few years. Rather than to consider a speculative horizon of less than 90 days (3 months), we prefer to consider an investment horizon longer than 1,090 days (3 years). Market developments often tempt us to think in a manner that is too short-term in nature, and we believe that to be a mistake. The past few months have provided a case in point. The market has been hit by dramatic statements that would make it easy to succumb to emotion, to overreact, or to try and time the market.

You may have noticed that our letters to shareholders do not very often dive into politics. It is not our tendency to overestimate the extent to which politics influence the stock markets. Oftentimes, people misjudge in just such a manner. The main economic trends and, above all, significant developments in individual companies span several governments and often defy party labels. If I count correctly, in the 21 years of Vltava Fund's existence, we have already lived through seven US presidential terms. As for some of the other countries in which we have long-term investments, the UK has had 8 prime ministers in that time, Germany 4 chancellors, Japan 11 prime ministers, and the Czech Republic 9 prime ministers.

When I look back at our own investments, the most common denominator among those that have been most successful was that these were high-quality, well-managed companies whose value climbed markedly over time. The development of their share prices then favorably reflected both the growth in the company's value and its undervaluation at the time of purchase. In the case of investments that did not work out for us, the most common denominator was that our perception of the company's quality and value had been mistaken. I cannot recall a single case where we decided to buy or sell an investment based upon who was or was not the president or prime minister in a given country at the time. Politics influence global developments, but in long-term investing, as we understand and practice it at Vltava Fund, we consider it much more important to focus on analyzing individual companies and looking for those that have strong competitive advantages, capable management, strong free cash flow, potential for long-term growth, and effective asset allocation. These considerations, combined with an emphasis on attractive stock valuations, allow us to look beyond the daily news and price charts and to benefit from an advantage that cannot easily be quantified but is nevertheless very valuable — the advantage of patience and a long-term perspective.

The saying "what doesn't kill you makes you stronger" can be applied to high-quality companies. The world is constantly changing and evolving. The economic, political, regulatory, and competitive environments within which individual companies operate are in a state of continuous change. We look upon companies as living organisms in which people create value through their work and at the same time influence their capability to adapt to changing business conditions. Better companies tend to have greater adaptability and overall resilience, and very often they emerge stronger from the maelstrom of events. Lower quality companies many times face deterioration in their market positions, marginalization, and sometimes even existential challenges. We have seen examples of such development many times in the markets, which is why we at Vltava Fund strive to look beyond the horizon of current events when selecting investments. In valuing companies, we emphasize their

abilities to adapt to change, to innovate, and at the same time to remain true to their corporate cultures. We believe that the key to long-term success is not to try to predict every wave that will sweep across the market but to find ships that are built to sail even through storms. If you look at our portfolio, I believe you will agree that it is dominated by companies possessing just these qualities. Such companies allow us to take advantage of something that the market often disregards: time.

Time and a longer perspective also provide for another opportunity that markets offer to long-term investors. The vast majority of both amateur and professional investors and speculators operating in the stock markets have time horizons that are too short. They try to find stocks where they feel there is a chance for quick profits. At the same time, they tend to ignore stocks where the hope of getting rich quickly is small but the probability of attractive long-term returns is high. This activity creates great competition at the short end of the market; but, as the market lengthens, competition diminishes. Taking advantage of this phenomenon is sometimes referred to as time arbitrage. If you look at the individual stocks in the Vltava Fund portfolio, almost all of them offer little hope of getting rich quick but a high probability of attractive long-term returns. It seems to me that, as the years go by, the conditions for taking advantage of time arbitrage are improving more and more, and we are striving to take maximum advantage of this. It makes a lot of sense to us. Such investments do not require taking on a lot of risk.

Changes in the portfolio

We added no new companies to our portfolio this past quarter, nor did we get rid of any. Nevertheless, we were rather active and focused on buying additional shares, especially during April, when the prices of some stocks were so low that we couldn't even believe our eyes. Usually, that is a good sign. We strengthened our positions in 10 different companies, which represent half of our portfolio. In percentage terms, we increased our holdings most in Applied Materials, Lam Research, United Rentals, and Arrow Electronics. We also added to our position in the Nikkei 225 index.

We welcome the volatility that this year's events have brought to the markets. The more stock prices fluctuate, the more they deviate from their fundamental values (in both directions) and the more often they give us opportunity to take advantage of this. As a result of our long-term analytical work, we have a list of companies that we like and whose fundamental values we understand. We are continuously expanding and updating this list, inclusive of our assessments of fundamental values. This, then, is a kind of shopping list of stocks, and currently it comprises about 100 companies. Most of these stocks are trading most of the time at prices that are too high for us to buy. We are accustomed to waiting patiently for some of their prices to fall convincingly below the companies' intrinsic values. Greater market volatility means that this favorable situation arises more frequently. Even during relatively calm times, it is normal for the price of a typical stock to fluctuate within a range of 40% of its initial price during the year. This does not require any dramatic developments within any given company. In contrast, the fundamental value of a company usually changes much more slowly. The volatility of share prices is several times greater than is that in the development of fundamental share values. Our approach to the markets is based on this fact, which has been proven many times over. It is founded on an activity known as "pricing" (meaning to take advantage of a favorable ratio between the share price and a stock's value) and avoids an activity termed "timing" (meaning to attempt at predicting market movements and trying to profit from them in the short term). Pricing is a much easier and more logical way to invest money in stocks than is timing.

While trying to predict short-term market developments, it is not enough in and of itself for one correctly to estimate what the immediate political, economic, and other developments will look like. It is necessary also to know what other investors are expecting and to what extent this is already reflected in prices. Imagine that you have been invited to a Ball of Illusions. In a luxurious hall full of mirrors and soft whispers, a hundred guests gather to take part in a beauty contest organized by a prominent patron. Six ladies in silk dresses, each beautiful in her own way, stand on the stage. But the winner will not be chosen based upon who the individual spectators like the most. No. The task of each spectator is to choose the lady they think the others will choose as the most beautiful. Sounds strange? That's the magic of it. This is a Keynesian beauty contest. Economist John Maynard Keynes used it as a metaphor for investor behavior in the markets. When investors buy stocks, often they do not choose the one that might be seen as having the greatest real value but rather the one they think others will think has value. And that's a game of illusions — just like at the ball.

We avoid short-term timing and playing with illusions. Pricing is at the heart of our considerations. We are aware that estimates of a company's intrinsic value necessarily embody certain elements of subjectivity, but, by taking a conservative approach to valuation and ensuring that there is a margin of safety between the price and the value of the share, it is possible to invest money in shares calmly and methodically without having to take great risks. In this way, the speculative element in investing is kept to a minimum. We hope that the markets will remain volatile in the future and that we will be able to take advantage of this. This year has brought a few opportunities. For example, when Williams-Sonoma's share price was above $200 at the beginning of the year, it was significantly higher than our estimate of its intrinsic value. We sold the shares. Conversely, when United Rentals' share price was below $600 in March and April, it was significantly lower than our estimate of its intrinsic value. We have now added it to our portfolio. These are just two examples from this year, but they illustrate how we make decisions about individual transactions. For shares that we hold or are potentially interested in owning, we monitor the ratio between their prices and values on a daily basis.

Our approach to markets and investments may sometimes seem unusual. We find joy in periods when the market is highly uncertain. This is because stock prices are usually more attractive during such periods. Times of maximum uncertainty usually bring the best prices. History provides us with countless examples. Conversely, when investors believe that the markets are heading for smooth sailing, prices tend to be high and opportunities few and far between. Low stock prices not only benefit us in our investments, but also provide better opportunities for intelligent and effective investments to be made by the companies in our portfolio. In such an environment, it is easier to create value for companies and value in the portfolio. Higher volatility, higher uncertainty, and lower prices – that is the ideal combination I would like to see. Our shopping list is ready, and so are we.

Daniel Gladiš, July 2025

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