Skiff Asset Management



First Ever Quarterly Letter: Q3 2018

Dear investor,

First of all, thank you so much for entrusting me with your hard-earned money. It is something I do not take lightly.

Second, this is the first of many communications you will receive, granted you are satisfied with our performance over the years.

Third, since this is the first communication, expect the format and depth to become increasingly advanced. I have an idea for the blueprint of these communications, but I will improve as time marches along.

Fourth, each quarter, you will receive a letter such as this one, plus an individual account statement for your portion of the portfolio’s quarterly performance.

Fifth, I am still working on the legal documents for this fund, but you can see the progress on request. The main thing I am sure you care about is the fee structure.

Here it is:

* I get nothing until we return 8%.
* I get 30% of profits from 8% upwards.
* No asset under management fee.
* I will take fees after a year (this is subject to change, most managers take quarterly fees)

Hypothetical scenarios:

* After a year, we return 7%. I get nothing.
* After a year, we return 20%.
  + 30% \* (20% - 8%) = 3.6%
  + On a 1,000, I would take $36 after a year.

Sixth, the goal of this letter is to keep you informed on the state of the portfolio and decisions that impact your money. After all, it’s your money. My goal is to be as transparent as my bandwidth allows me. In other words, if I had all the time in the world, I’d let you know every decision I made. But that would be burdensome on me and you likely wouldn’t want that anyway.

Seventh and finally, let’s dive right in. I’m am excited and honored to start this journey alongside each of you.

All the best,

Ryan, CEO and CIO

Vision for Skiff Asset Management

Warren Buffett’s original investors have compounded their money at about 20% for the past 50 years. That means every $1,000 invested is now $9 million. I am not saying I will be Warren Buffett and I am not promising returns on par with the greatest investor of all time, but I bring that up to make a point. The point being that investing is a journey. It’s surely not a sprint.

My vision for Skiff is that we would be family, that we would share in each other’s successes and failures. I envision a life-long relationship with each of you rather than a way to fatten my own checkbook (\*do those exist anymore?). That’s why I don’t get paid unless I perform. The incentives are mutually beneficial and I wouldn’t want it any other way.

I promise to do everything in my power to continuing growing so I can adapt and provide you with the best returns possible. I’ll end with an incredible quote from Henry Ford,

“Even the man who most feels himself ‘settled’ is not settled — he is probably sagging back. Everything is in flux, and was meant to be. Life flows. We may live at the same number of the street, but it is never the same man who lives there. It could almost be written down as a formula that when a man begins to think that he at last has found his method, he had better begin a most searching examination of himself to see whether some part of his brain has not gone to sleep.”

Overview

2018 has been too kind. Our portfolio has grown and grown, then grown some more. While a lot of value investors have been reeling, growth is king right now.

A confluence of software-as-a-service, tax cuts, GDP growth, and IT spending has led to the run-up in stock prices of a lot of the stocks in our portfolio. A lot of people think that the “tech bubble” will burst but I am sincerely trying to see things from both sides.

Granted, I am nervous about Skiff’s overall performance because I have been conditioned to believe in gravity. In other words, what goes up must come down. Check the performance, to see why I am nervous. It is almost too good to be true. At least, in this short of a timeframe.

On the other hand, growth and earnings are stronger than I have ever seen them. Valuations are getting kind of absurd, but, in the short term, valuations are practically meaningless. Who is to say when the so-called “bubble” is to burst?

As legendary investor Peter Lynch once said, “More money has been lost preparing for bear markets than in actual bear markets.”

If you know when we are going to have a recession, let me know. I have no clue.

I believe one’s time is better spent focusing on what you can control.

As someone once said, “I cannot think of a more useful subject than microeconomics and one more useless than macroeconomics.”

Focusing on the big picture, the macroeconomics, is likely a fool’s errands. I do think there can be some value in knowing the general consensus just to be informed. However, there are simply too many factors that affect such things like the economy, global trade, IT spending, and consumer confidence to speculate on the future.

I would rather try to pick out the best company in a fast growing sector that looks like it is going to dominate its market. There are simply a lot fewer moving parts.

So why I am going into all of this?

Well, frankly I need to think through this as well and I don’t want to just fall into one camp or the other.

First camp: Value Investors

Second camp: Growth at all costs

The value investors stay far away from anything technology because they worship at the feet of Warren Buffett. I used to be one but I have realized the power of technology and I understand it a lot better now. Here’s a secret. Being a technology investor takes diligence and the ability to change one’s mind. Since technology changes rapidly and there is a decent amount of complexity, one needs to be able to take a holistic view of the situation.

The ‘growth at all costs’ camp focuses solely on growth. As long as revenue growth is high, it’s a good company. This is just not true though. Markets run in cyclical patterns and once investors fall out of love with growth, those companies can fall out of fashion. What keeps those companies’ stock prices inflated are the hopes and dreams of trades to sell them higher to the next sucker. As Warren Buffett says, “If you are playing poker and you don’t know who the patsy is, it’s you.”

What won’t fall out of fashion is buying great companies at prices that make sense within the context of your timeframe.

What I mean by this is that you can afford to overpay if your time horizon is years and years. Take Amazon as an example. If you had bought in 1999 and sold in 2009, you would essentially have had zero profit. Think about the opportunity cost of that. But if you had held it until today, your gains would be over 20x. Companies that are “overpriced” are subject to wilder swings in prices because there is more uncertainty over the value. This means more volatility but not necessarily more risk, unless you are the patsy and sell at inopportune times.

If you are 80 years old and don’t have a pension, buying aggressive tech stocks is likely not a good idea because you might need the cash at a bad time to sell.

But if you have decades in front of you, why not optimize your portfolio to capture the upside of innovation and technology?

All this is to say, I have no idea where the market is going to go from here. All I know is that the portfolio has performed very well and I don’t want it to go to my head. At some point, there is such thing as a bubble. Surprisingly, in some cases, there is something as too high a price to pay. If decades of a company’s growth is priced into a stock, it’s probably not going to offer great returns from here on out.

So I’m trying not to fall in Camp 1 or Camp 2. Join me over in Camp 3, the “I don’t know what’s going to happen, so I’m just going to keep learning and keeping an open mind” Camp.

Now, to the fun stuff, talking stocks and performance.

Portfolio Performer

Two of the top contributors to this quarter’s strong performance were Alteryx and Twilio. This was because both companies were already sizable positions in the portfolio and after strong earnings, the respective stock prices rocketed upwards. I will go into the investment rationale for Alteryx to give you an idea of how I think about a stock in the portfolio.

Alteryx

I first bought into the company in December of 2017, at $29 a share. Now it is above $60. Alteryx remains the largest position in the portfolio. Here’s why.

The company offers software subscriptions to enterprises looking to get more out of their data. Alteryx’s software allows “data citizens” or people who don’t have data science experience, make comprehensive models to make better business decisions. Think of it as Excel on steroids.

What really caught my eye other than the great consumer reviews, was the financials of the company. Sometimes the financials really tell the whole story and this was the case here.

Revenue growth has consistently been above 50%, reaching 54% in its latest earnings. Gross margins spiked up 90% which is essentially unheard of. It means the company is run really well on the production of its software.

I also like that the CEO owns a lot of stock in the company, meaning his future wealth is tied to ours as investors.

Furthermore, there is a strong community surrounding the company. Alteryx has community forums where people can post the process of achieving great outcomes through the software. After reading through these, the main value proposition seemed to be that the product was a huge timesaver. Over and over, customers raved about how a model that used to take days in Excel could be completed in five minutes with Alteryx.

Plus, I liked that the product suite was fuller than competitors’. For a while, the stock was stagnated because there were fears about Tableau, another company, releasing a competing product on the data visualization side. However, those fears have blown over because investors realize the product strength of Alteryx and the numbers reveal the same narrative.

Compared to other stocks in the portfolio, Alteryx had better gross margins, higher growth and smaller operating losses. Plus, the glowing customer reviews and insider ownership made me confident that this company had the potential to be a winner.

So far, I’ve been very happy with the stock’s performance. We’ll keep monitoring it closely but I hope this one stays in the portfolio for a while.

Performance

YTD = Year-to-date (1/2/2018 – 9/28/2018)

Q3 = Quarter 3 (7/2/2018 – 9/28/2018)

**Skiff Asset Management YTD: 59%**

NASDAQ (tech): 12%

Russell 2000 YTD (small caps): 9%

S&P 500 YTD: 8%

**Skiff Asset Management Q3 Performance: 23%**

S&P 500 Q3: 7%

Russell 2000 Q3: 2%

NASDAQ Q3: -6%

Hypothetical Fee for Investors from 1/2/2018:

$1,000 invested

59% return

Fee taken: 30% \* (59 – 8)% \* 1000 = **$153**

Investor Total Post-Fees: (1000 \* 1.59) – 153 = **$1,437**