

Sleep, Zakaria and Company, Ltd.

1a, Burnsall Street
London
England
SW3 3SR
T: +44 (0) 20 7101 1960
F: +44 (0) 20 7101 1965

Nomad Investment Partnership

Interim Letter

For the period ended June 30th, 2011.

Cumulative results to June 30 th , 2011.	<u>Nomad Investment Partnership</u>	<u>MSCI World Index (net) US\$</u>
Trailing:		
One year	73.7%	30.5%
Two years	139.9	43.8
Three years	100.5	1.4
Four years	64.0	-9.4
Five years	112.5	12.4
Six years	134.0	30.9
Seven years	195.3	44.1
Eight years	316.6	78.7
Nine years	412.5	74.3
Since inception (Sept 10 th 2001)	487.5	64.7
Annualized since inception		
Before performance fees	20.9%	5.5%
After performance fees	17.7	
Value of a dollar invested at inception (pre fees)	\$5.87	\$1.65

The figures above are unaudited, presented on a cumulative, percentage gain basis and, as ever, are before fees. We present results in this way as Nomad's refundable performance fee and time dependent performance fee hurdle mean that the net-of-all- fees results will vary with subscription date, and from investor to investor. Partners will, therefore, each have their own, unique, net-of-all fees experience of investing in Nomad. As a guide, we have also detailed the net-of-all-fees results from one point in time, in this case since inception. An index is used in the table to place our results in context with a broad swathe of share prices from around the world. We do not feel strongly about the merits of the index we have chosen, and partners may wish to use another. Whatever the yardstick, we ask only that Nomad be compared over the very long-term. Below, the same pre-fee results are presented in discrete annual increments. In our opinion, it is probably the upper table that is most useful in assessing long-term investment performance.

Calendar Year Results:	<u>Nomad Investment Partnership</u>	<u>MSCI World Index (net) US\$</u>
2011 year to date	17.5%	6.3%
2010	43.9	11.8
2009	71.5	30.0
2008	-45.3	-40.7
2007	21.2	9.0
2006	13.6	20.1
2005	9.2	9.5
2004	22.1	14.7
2003	79.6	33.1
2002	1.3	-19.9
2001 (inception Sept 10 th 2001)	10.1	3.6

A US dollar invested in Nomad at inception has grown to be worth \$5.87 before fees, as of June 30th, whilst a dollar invested over the same period in the average share, as reflected in the index above, would be worth around \$1.65. Put a slightly different way, net asset value (i.e. after fees) has compounded at 17.7% per annum, whilst the index has managed 5.5%.

Some observations on mental shortcuts

At Professor Richard Zeckhauser's Behavioural Finance course at the JFK School of Government at Harvard University, the following note was scribbled by Professor Zeckhauser and passed to a fellow panelist, whilst both men hosted a discussion group with an audience of investment professionals.

Zeckhauser: One of our participants is buying Zimbabwean securities, which are priced at a small percentage of Net Asset Value. Would you try to invest with him?

Other panelist: *No!* (the exclamation mark is original)

Oh dear! We suspect that the other panelist made up his mind the moment he saw the word Zimbabwe and that blocked his thinking of the gain that could be made from such low prices. We all do this to some extent. It is so easy to screen out a good idea because of a bad association. As Charlie Munger quipped at a speech given at the same course a few years earlier "*the human mind is a lot like the human egg*": once one sperm has entered then all the other sperm are locked out. A market research company we visited recently told us that most car advertising is read after the purchase decision for the car has already been made! And it was read only then to gather information to convince other people the purchase decision was rational ("*no, no it wasn't the car's sexy shape – this car has twelve airbags and emits 170g of carbon per mile!*") We have all done it. The human mind has these learnt biases, short cuts, fears, habits, and associations and, in the case of the panelist above, they can stop us from making rational decisions.

An odd question popped into our heads the other day: why are internet retailers growing so slowly? Unlike traditional retailing, where growth is bounded by the physical constraints of a

building's size, location, and opening hours, internet retailing has no such constraints. We could all, for the sake of argument, decide to do all our shopping online next week, and Amazon et al would take the orders. Odd, then, that the growth rate in revenues at the main internet-based retailers is, very broadly, comparable to that enjoyed by a physically constrained retailer, say, Wal-Mart, at a similar stage in its development. So, what is going on?

If Frank Capra is right that “*a hunch is creativity trying to tell you something*” then our hunch is that the growth rate in online retailing is held back by consumers' psychological biases. We are all creatures of habit, and most of us give up comfort blankets quite reluctantly. It therefore takes time for a new regime to be adopted and, for instance, to buy books online instead of buying them at the local store. Perhaps then, after we have become comfortable with buying books online, we may experiment with something else, trainers say, or magazine subscriptions, or plant pots, or bike saddles or grocery. The process requires a good retail experience (price, convenience, selection etc.), the building of trust, and is often fanned with personal recommendations (social proof) and even bragging rights for the early adopters. The process is more of a drift than epiphany. Our hunch is that the growth rate in online retailing is regulated, not by physical capacity, although that can be a limiting factor, but more by the rate at which our own incumbent habits and associations are replaced with more rational behaviour.

The models we use may not be the right ones

In high street retailing we can estimate, broadly, what revenue growth for each firm will be next year: it is a product of same store sales growth plus any new stores. We might not be precisely correct about either number, but the range is bounded and so we can make a reasonable, “*generally-right*” (as opposed to “*precisely wrong*”) estimate. When investors think about the future of a business, they often have in mind the assumption that growth rates slow with time, as competition ekes away advantages and market places become saturated. Predicted revenue growth rates (used in valuation models) therefore start high and end low. This is especially true for firms that are quite large already.

However, if the rate of growth in internet retailing is a product of attitude, rather than assets, then, the fact that a firm is quite large already does not necessarily tell you that its growth rate is set to slow. The widely held presumption that regression to the mean begins the moment the analyst picks up their pen, risks being wrong footed as a result. Two years of forty percent revenue growth, for example, will result in revenues doubling in twenty-four months and regression to the mean based estimates would be out by almost a factor of two! That did not take long. In other words, although some online retailing firms may be quite large, they may also be quite young. In our opinion, it is this realisation that has partially driven the revaluation of internet retailers these last few years.

More on the principal agent conflict, and the lack of trust...

Whilst Zak and I do enjoy solving the investment problem, as it were, we are less enraptured with the tone of the investment industry, especially the state of industry governance. The rules embedded in regulation, accounting and “due diligence” may be well meaning and appear justified by past fund managers' rogue behaviour (and our industry has some choice rogues!), but their enforcement and adherence drains the life out of the innocent and would challenge the patience of Job. Just as sapping is that it is impossible for practitioners to earn their way

out of over-bearing governance through good behaviour. Trust, once the cornerstone of the industry and derivation of words such as unit trust, investment trust, trustee and so on, has been all but lost. It is a great shame.

The cynicism may be endemic, but it is no substitute for wisdom. We enjoyed the following paraphrased exchange related to us by one of the fund management industry's stars of a conversation he had had with an analyst:

Analyst: your performance is without peer in recent times, but if you did not own company x and company y over the last few years your performance would have been only average.

Star fund manager: but that's the point, I did!

The spirit in which the industry conducts its affairs is not always mankind at its best, and sometimes it does not bring out the best in people. What is required, in our opinion, is the rebuilding of a web of deserved trust between participants. We hope that the Nomad model, with its patience, reciprocated trust, and calm, is a small step in the right direction. It is rather wonderful that it is also a financially profitable way to behave.

There is a lot to celebrate.

There is a lot to celebrate at Galactic HQ. It might be that the weather has turned, it might be the bumper honey harvest from the bees on HQ roof (I kid you not, ask Zak), it might be Nomad's performance (but I don't think so). In the next few months we have lots to be grateful for: we celebrate five years of Sleep, Zakaria and Company, ten years since Nomad's formation and twenty years for each of us in the industry. We are grateful to be here, and we recognise that our genesis was pretty unique (thank you, Jeremy). We also have a pretty special group of investors: thank you for the trusting and wise role you play in the Nomad ecosystem. We shall raise a glass (of honey tea!) to you all when the crop is in.

Yours sincerely

Nicholas Sleep

Our Footnotes

There is, we are told, a ticket kiosk at a railway station somewhere in India with a sign above the window that reads, "*No Bamboozlement Here*". It is in the same spirit that we attempt these cautionary words. Disclaimers boil down to the following statement – if you choose to believe any of this, then you are on your own. Yikes! It will be hard for us to escape this conclusion too, and it makes little sense for us to do anything but disclaim liability for errors, omissions and offer no warranties – please, check everything we say, let us know when we are wrong and forgive our errors. We do promise you this: we are human, we make mistakes, but our mistakes are honest ones. Although we do not intend to mislead, we also cannot guarantee the information in these letters, or that some of our ideas may be interpreted in ways we do not intend. As investors we are trying to do as good a job as we can and we write these letters in good faith to inform and educate partners on our actions and thinking in the context of the Partnership. We hope that they will be read in the same spirit in which they are written.

Common sense tells you that the price and value of shares can vary greatly, and whilst we do not aim for this, we also recognize that permanent impairment of capital is possible. Our Partnership is concentrated in relatively few investments, perhaps more concentrated than many others, and as such our results will be more volatile than many of our peers. Nomad is also a very long-term Partnership. We do not think it is suitable for investors with time frames less than five years. We also do not think Nomad is suitable for investors overly conflicted with principal-agent issues. If you are at all uncomfortable then, we suspect, Nomad is not for you.

The Nomad Investment Partnership has had two General Partners, Marathon Asset Management for the period from inception in 2001 to September 2006, and Sleep, Zakaria and Company from September 2006 until the present day. Zak and I have been responsible for the investment decisions of the Partnership since inception, formerly as employees of Marathon and then at our own firm, which was set up for the purpose of managing Nomad. The adventure continues...

Some Notes on Housekeeping (stay awake at the back!)

This is the interim letter and, combined with the annual letter sent to investors in January, is the main format we use to communicate to our partners. In these letters we have tried to honestly and thoroughly provide all the information we would seek if the tables were turned and we were investors in someone else's fund. We own shares for very long periods and we are conscious that more frequent or detailed reporting may be unnecessary and even counterproductive. A copy of our magnum opus, the full Collection of Letters, is available upon request from Amanda at Galactic HQ (amanda@sleepzakaria.co.uk). Lots of coffee required. Partners in Nomad will also receive a full copy of our Schedule of Investments by separate post, every six months, which lists all of our investments in detail. In addition, in the Spring you will receive Nomad's annual accounts, audited by Ernst and Young. Each month statements of account are sent to you by Nomad's administrator (not us!), Phoenix Financial Services in Dublin, Ireland. Please call Gavin Gray and his team (+353 18 450 8161) with your statement queries. As should taxable US investors as Gavin and his team prepare their tax certificates (1099s) as well.

Partners should always consider Zak and me to be available at the end of the phone and our (somewhat shabby) front door open to visitors. And whilst we welcome your company, please don't be too disappointed if we don't have much that is new to say: we hope it is in the letters already.

Legal Footnotes

Performance numbers are produced by Phoenix Fund Services, Nomad's administrator, and are audited by Ernst and Young in their annual audit, which follows publication of our letters.

In our letters we refer to both limited partners in the Partnership, and common shareholders in the Nomad Investment Company (feeder fund) as "Partners". We do this to convey a relationship we seek in which our investors are partners in a shared experience and destiny, in which they too have something to contribute. We do not mean to suggest that there is a partnership, in the strict, legal, sense of the word, between the shareholders in the feeder fund and Nomad, or Sleep, Zakaria and Company, Ltd.

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The Nomad Investment Partnership is not a recognized scheme under the Financial Services and Markets Act 2000 ("FSMA"). Given the nature of Nomad's investor base, recourse to the FSA and the Financial Services Compensation Scheme may be limited.