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Nomad Investment Partnership

Interim Letter

For the period ended June 30th, 2013.

Cumulative results to June 30th, 2013.	Nomad Investment Partnership	MSCI World Index (net) US$
Trailing:	%	%
One year	36.9	18.6
Two years	29.4	12.7
Three years	124.8	47.0
Four years	210.5	62.1
Five years	159.4	14.3
Six years	112.3	2.1
Seven years	174.8	26.1
Eight years	202.7	47.5
Nine years	282.2	62.3
Ten years	439.1	101.3
Eleven years	563.0	96.5
Since inception (Sept 10th 2001)	660.2	85.6
Annualized since inception:		
Before performance fees	18.7	5.4
After performance fees	16.3	
Value of a dollar invested at inception (pre-fees)	$7.60	$1.86

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 crudely place our results in context with a broad swathe of share prices from around the world. One of the reasons that Nomad is Nomad is that Zak and I spend almost no time thinking about stock market indices. We do not feel strongly about the merits, or otherwise, of this particular index, indeed its continued inclusion here may have more to do with continuity than relevance, and we would encourage partners to employ another benchmark if they feel it is more helpful to them. 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:	Nomad Investment Partnership	MSCI World Index (net) US$
	%	%
2013 (year to date)	20.8	8.4
2012	39.8	15.8
2011	-9.9	-5.5
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 10th 2001)	10.1	3.6

The annualised return (i.e. before fees) of an investment made in Nomad on September 10th 2001, when Zak and I began managing the Partnership, has been 18.7% per annum, as of June 30th this year, whilst the average share, as reflected in the index above, would have seen a return over the same period of around 5.4% per annum. This thirteen percent or so annual advantage, multiplied out over many years, means that a dollar invested in Nomad all the way through has now grown to be worth $7.60, whilst a dollar invested in the index over the same period would now be worth around $1.86. Put a slightly different way, and in net asset value terms (i.e. after fees), Nomad has compounded at 16.3% per annum, whilst the index has managed 5.4%.

A Different Take on Incentives.

When is six percent, not six percent? Stuck? May we suggest an answer: when it is Nomad's performance fee hurdle? That raised an eyebrow here too, not least because the hurdle is always more than six percent, sometimes a lot more than six percent! Perhaps I should explain.

Zak and I sat down about ten years ago, over a sundown glass of Chardonnay at a bar in a Californian hotel and penciled the Nomad fee arrangements on a spare sheet of paper. It did not take long. We concentrated on the correct philosophical approach to incentives, and so the job was easy: the management fee should not be a profit centre as we do not create value through managing the Partnership per se (hence our break- even cost reimbursement management fee); the performance fee should respect the notion of the opportunity cost of capital (and long bonds had been six percent or so); and if we owned shares for long periods, then performance fees should be at risk for an extended period too. Done, now where did the waiter go?

We did not dwell too long on the heinously complicated practical implications of accounting and administering the arrangement, nor did we foresee the need for a new administrator, a new director associated with the administrator, huge legal fees, and that a six percent hurdle is hardly ever six percent. Oh well, the best laid plans etc.… The reason that six percent is not six percent is two-fold: a linked ten percent loss and a ten percent gain are not mathematically equivalent (duh), and Nomad's performance fee reserve is itself invested in Nomad shares and so is doomed to, in effect, buy high (accrue) and sell low (reimburse). Zak has set himself the task of finding a case when the six percent hurdle might be less than six percent. He may be some time.

If our naivety had been pointed out to us on that sunny evening, we would have recognised the issues but I don't think we would have changed anything. It is not very important to us that a six percent hurdle has been well over ten percent in the recent past, and we would certainly never do anything to lower it. Our slightly unconventional approach to being paid may be worth explaining, and so in this letter I will try to describe our attitude to the financial rewards that can come with running the Partnership.

We have written quite a lot about the power of financial incentives over the years, most recently the extent to which incentives (and rules) can de-moralise behaviour. You could describe the cause of the financial crisis in these terms. And whilst conventional wisdom has, in our view, quite correctly drawn a Pavlovian link between financial incentives and behaviour, money is not the only reason that people behave the way they do. Those tasked with setting compensation arrangements may first wish to ask themselves, why do people climb mountains? After all, it is not for the financial rewards – there is more to life than that.

The author, professor and founder of "The Institute for Advanced Hindsight", Dan Ariely, has studied the power of non-monetary incentives. In a recent talk (TED, Buenos Aires, Argentina, October 2012) he described how early academic experiments looking at motivation attempted to record the effect of taking the meaning out of work. This they did by asking people to build model robots from Lego-like blocks in return for a nominal fee. The fee was lowered for each successive robot built until the builder no longer wished to participate. For one group (the "rewards" group), the finished robots were placed carefully on a shelf for all to see.

For the other group (the "Sisypheans[1]") finished robots were broken up in front of the builder and the parts given back with the invitation to build the next robot (again for a lower fee). The researchers found that the Sisypheans built fewer robots and so stopped at a much higher price than the rewards group. This was broadly expected. What they had not anticipated was the magnitude of the difference, as the rewards group produced more than fifty percent more robots and for a much lower price compared to the Sisypheans. The researchers concluded that having their models destroyed took away some of the meaning the Sisypheans saw in their work, and that the lack of meaning was not outweighed by the pay. On the other hand, the rewards group did not see their role as pointless and were happier making models even though the pay was much less.

In the 1940s the food companies began manufacturing a new product, the powdered cake mix, which was marketed as a time saving innovation as the mix required only the addition of water before baking. To the marketer's great surprise - sales were terrible! Something had to be done and so, almost as an experiment, a new product was launched which required the cook to add fresh eggs, milk and sugar and although it took longer to make, paradoxically, sales

[1] In the Greek myth Sisyphus was tasked by the gods with rolling a boulder to the top of a hill. Each time he reached

the top the boulder rolled to the bottom and Sisyphus had to start again. As a punishment for deceitfulness, Sisyphus had to repeat the task for all time.

improved! Anyone who has laboured through assembling Ikea furniture may understand why. To the builder of flat pack furniture or the baker of cakes, the perceived value of the end product is influenced by the input of the consumer's own efforts. In doing some work themselves the builder, or cook, puts a little bit of meaning, perhaps even a little bit of love, into the product.

Ariely was so taken with this observation that he developed a further experiment. One group was tasked with building a complicated origami model and were given instruction on how to do so. When the group had finished the researcher took the model away and asked the builders how much they would be prepared to pay the researcher to keep their model. A second group Ariely tasked with building an origami model, this time without instruction, and when they were finished, he asked them the same question: how much would you pay to keep your model? The findings were interesting: both groups were prepared to pay much more than the market price for origami models built by professionals, even though their own models were inferior. Moreover, those who had laboured without instruction (and built the worst origami!) were prepared to pay the most to have their models returned. In other words, the normal relationship between price and quality had been inverted by the value one placed on one's own work.

In traditional capitalist thinking, Ariely surmised, we tend to have Adam Smith in mind, and the gains from subdividing pin manufacturing into twelve distinct steps. The efficiency embedded in this approach won the day over Karl Marx's concerns about the estrangement felt by workers from becoming an anonymous cog in a larger process. The debate then, and ever since, has been the battle between efficiency and meaning.

The best entrepreneurs we know don't particularly care about the terms of their compensation packages, and some, such as Jeff Bezos (Amazon) and Warren Buffett (Berkshire Hathaway) have substantially and permanently waived their salaries, bonuses, or option packages. We would surmise that the founders of the firms Nomad has invested in are not particularly motivated by the incremental dollar of personal wealth. When we asked Nick Robertson, the founder of Asos, whose paper net worth has increased hugely since we have known him, whether, now he is a rich man, he has thoughts of leaving, his face lights up with the future possibilities of his firm and says he is having more fun now than ever before. In this aspect of his life he has moved on from monetary rewards driving his behaviour, and we are sure the business will be better for it.

The same is probably true for Jim Sinegal before his retirement (Costco), Lord Harris (Carpetright) and some of the other founders of the firms in which Nomad has invested. These people derive meaning from the challenge, identity, creativity, ethos (this list is not exhaustive) of their work, and not from the incentive packages their compensation committees have devised for them. The point is that financial incentives may be necessary, but they may also not be sufficient in themselves to bring out the best in people. In its own little way, this is why Zak and I are quite relaxed about six percent not being six percent. It was an arbitrary number in the first place, and we derive a great deal of value from the meaning of the work we do (challenge, sense of job well done, identity, creativity and so on) not just from the financial rewards (although we will learn to live with those too!). By having an attitude that is somewhat independent of financial rewards, we are sure that Nomad's performance in the long run will be far better too.

Inactivity as a Source of Value Added.

Our portfolio inaction continues and we are delighted to report that purchase and sale transactions have all but ground to a halt. Our expectation is that this is a considerable source of value added! At the time of our initial investments in Nomad's investee businesses, the firms were, on average, around fifteen years old. Take out the two grandparents (Berkshire Hathaway and Costco) and the average falls to twelve years. It is hard to know how this compares to businesses at large (what is the average age of a listed company?), but we do know that the average time S&P500 constituent stocks have been included in that index is twenty-five years. One could guestimate that those firms might have been say, twenty years old on inclusion? At any rate, the statistic helps to illustrate how youthful Nomad's firms are. The runway ahead for our businesses may be very long indeed. In action on our part is counter-cultural and deliberate and is easier said than done. Really. For those used to a more industry-standard level of trading activity, we hope to update you in real time on our level of inaction through our planned "Nomad Inactivity App.", available only in the Amazon App. store, of course. As Berkshire Hathaway Vice-Chairman, Charlie Munger, says, you make your real money sitting on your assets!

As always, we thank you for your gentle approach,

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 about 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 Grant Thornton. Each month statements of account are sent to you by Nomad's administrator (not us!), Phoenix Financial Services in Dublin, Eire. 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.

Clients 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 these letters already.

Legal footnotes

Performance numbers are produced by Phoenix Fund Services, Nomad's administrator, and have been audited by Ernst and Young to 2011, and from then on by Grant Thornton in their annual audits that follow 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 FCA and the Financial Services Compensation Scheme may be limited.