FIRST TEN YEARS

Dear shareholders

In the third quarter of 2014, the Fund's NAV grew by 1.6 %.
Since the start of the year, it has expanded by 7.2%.

First ten years

Last month, Vltava Fund entered the second decade of its existence. On the occasion of this anniversary, we took a little look back. I must say that the decade had been a fascinating one. We experienced enormous growth in markets, their spectacular crash, and a subsequent unexpectedly long and strong recovery. We had first row seats for it all as direct market participants. From a purely academic perspective, one would say it was an exceptionally fruitful period. Investors received one lesson after another.

Over this time, we succeeded in making many good investments, but we also made plenty of mistakes and it was our errors upon which we dwelt most during this retrospective self-examination. One's own mistakes are often the best source of lessons, and we would like to share the main ones with you.

We had begun excellently. From our foundation in 2004 until the end of 2007, we beat the global market by an approximate 2:1 margin. This means that our returns were approximately twice as great as those for the market as a whole. Looking back, it is clear that some of our results came at the expense of excessive risk. The high returns went to our heads a little, and we got the impression that we could do no wrong. We increasingly were led astray by excessive self-confidence, by haste, and by efforts to make money too quickly and beat the market by even greater margins. We began to be needlessly creative, absolutely underestimated the amount of risk, and, in certain investments, strayed far beyond our area of expertise.

In 2008, we met with a day of grim reckoning. While it is true that all investors were hit very hard in that year, our own bad results were due only in part to external influences. The other part was the consequence of our own mistakes. This came as a shock to us and to our investors at that time. All our missteps became plain to see, and we were dealt a harsh lesson in humility. Time cannot be turned back, however, so there was nothing to do but learn from those mistakes and move on. They must not be repeated, and perhaps they may even be turned to our advantage. Certain things perhaps need to be experienced first-hand in order finally to understand them.

At the start of 2009, we entirely changed our strategy. We realised that beauty lies not in attempts at complexity, but in simplicity. We perceive and define risk entirely differently, we are more patient, we are not in a hurry, and capital preservation is now more important to us than beating the market. The quality of the portfolio and of individual positions is our first priority. To our pleasant surprise, all these changes have had no negative effect on the Fund's results. From the start of 2009 until today, we are again beating the market by a 2:1 margin. Just what all this means cannot be known with certainty. Chance may be playing a large role, but, in any case, it is very encouraging.

Almost all our investments are now in developed markets. This fact stems from our considerable and far-too-frequent earlier negative experience with the level of corporate governance in emerging markets. We also are concentrated in fewer sectors, and predominantly in those sectors offering investors attractive characteristics over the long term. This is again the result of accumulated knowledge and a heightened focus on high quality and low risk.

None of this means that the value of our portfolio is immune to sharp decline. That can happen, of course, and sooner or later we can expect to see a considerable decrease. Such is almost unavoidable, and that is true of all equity portfolios, not just ours. We have every reason to believe, however, that when it comes the correction will be substantially much smaller than the drop in 2008 and it will be only temporary in nature. In an odd way, we are sort of looking forward to a larger market decline, as we believe the quality of our portfolio would stand out in such a state of affairs.

Changes in the portfolio

We sold one title and bought one.

We sold Imperial Tobacco. Cigarette producers have long been in our wide-range viewfinder. Last autumn's purchase of Imperial Tobacco shares was part of our endeavour to understand the sector better. Even after a year of further effort, however, we unfortunately are unable to anticipate how the sector will develop overall. Although certain tobacco companies seem to be at acceptable share prices, that is not enough for us. In the end, we threw in the towel and sold the shares with an 18% gain. We prefer to move the money to someplace where it will be more predictable for us.

We bought one US company. It is one of the best-known global brands and an excellent company from all viewpoints. We would love to own the whole thing, but we are too small for that. Its business is cyclical, and it is currently in the third year of a declining phase. It seems to us that the market is short-sightedly undervaluing the fact that it represents a very attractive opportunity from a long-term perspective. We began building our position slowly because we know we cannot exactly pinpoint the bottom of the cycle.

Equity markets as a whole are not experiencing a bubble (bond markets are much closer to that), but neither are they bargain-priced overall. The US market is probably the most expensive of the large markets, while the UK and Japanese markets, for example, are priced very reasonably. In general, this would urge caution, and we are in fact trying to be careful. At the same time, however, there are still a number of very attractively priced titles out there, and many of these are very high-quality and well-established companies with relatively low risk (the most risky stocks on the market are at the same time the most expensive ones). So, we are a bit on the horns of a dilemma. On the one hand, we realise how expensive markets are overall, and, on the other hand, we still see good investment opportunities available. We are attempting to find the golden mean. We are carefully buying here and there while holding reasonable cash in reserve for potentially more-distressed times.

Daniel Gladiš, October 2014