

POLE, POLE

Dear shareholders,

In the first quarter of 2013, the fund's NAV grew by 6,7%.

Several years ago when my brother and I climbed the slopes of Kilimanjaro, the local guides continuously repeated to us: "Pole, pole." In Swahili, it means something like: "Slowly, slowly". Flying in to Africa from almost zero elevation above sea level and immediately tackling a mountain almost 6,000 meters high requires a really slow pace. Those who followed this advice fared better than those who rushed upwards. We say "pole, pole" even when investing. But I mustn't get ahead of myself...

Five years later

The year 2008 is still so vivid in most investors' memories that one almost does not want to believe that we are already in the fifth year of the gradual recovery in markets and economies. We experienced a lot during that time. An unprecedented easing of monetary policy, massive printing of money and the historically lowest-ever interest rates, the associated inflation of the bond price bubble, a great surge and subsequent correction of gold prices, and strong growth in stock markets (even though only the American market has so far reached its historically highest level, and that is still without accounting for inflation). We also witnessed some smaller and some greater efforts to deal with growing state debts and the first actual bankruptcies (Greece, Cyprus). Even against the backdrop of what at first glance seems to be a very wild environment, attractive investments were, and still can be, found. Vltava Fund's NAV has increased by 242% since the beginning of 2009, and thus for each 1,000 crowns invested at that time, our investors have CZK 3420 today.

The economic and political development of the last five years suggests a lot about what may await us in future and what influence all of it can have on our investments. We will describe two highly probable and fundamental phenomena here: slow economic growth and financial repression.

Slow economic growth

Generally, we can expect much diminished economic growth relative to what we were accustomed to in the past. Through the last several decades, the global economy was largely driven by continuously mounting debt. Permanent and large state budget deficits in most large economies massively stimulated growth. The 2008 crisis had a sobering effect. It turned out that many countries had reached a ceiling beyond which the market would not be still willing to finance them, and others are quickly approaching that ceiling.

A breakthrough occurred and an effort (generally more verbal than factual) to economise came about. The accumulated debt suddenly became a brake on economic growth.

But it's not just about debt. There are other obstacles, too. These include a slowing in population growth, long-term decrease in the labour productivity growth rate, experiments such as the euro, rampant regulations and limitations on business, and various other artificially created inefficiencies.

When we put it all together, the probability is very high that economic growth in the following two decades will be much slower than in the decades before 2008. Countries that previously had a GDP growth trend of 3% will suddenly find themselves growing at only half that rate.

As investors, we are interested in what slow economic growth means for share prices. Paradoxically, this environment can be very favourable for shares. Many people believe that rapid economic growth is necessary for shares to appreciate more quickly. That, however, is not true. We do not as investors buy the economic growth of a country, but rather we buy the shares of individual companies. Their prices depend on their profits, or, to be more precise, the companies' profits per share.

Evidence clearly shows that companies in slower growing economies achieve faster profit growth per share. We can even call it a negative correlation in the

sense that the faster the economy grows, the slower a company's profits per share grow. How is this possible? Rapid economic growth requires greater investments from companies, and those are frequently financed by the issuance of new equity. Total profits may grow at a decent rate, but profits per share lag behind. Large investments also usually mean low free cash flow, and it is precisely in the magnitude of free cash flow that we see the main indicator of a company's value.

Companies' big investments based on expectations of sizable economic growth also produce a higher rate of error in the management's assumptions. For all of these reasons, we believe that **slower economic growth will bring a reduced need for investments, a lower risk of bad investments, higher profit growth per share and companies' greater free cash flow. This is certainly not a bad foundation for the growth in share prices.**

Financial repression

The world is changing. For a long time, it was true that state debt was a risk-free investment. I am not so sure that this is still true today... A month ago, it occurred to no one that bank deposits could be in danger. Nevertheless, depositors in Cyprus lost most of their deposits practically overnight. The confiscation of deposits came from the heads of EU politicians and was sanctioned by the International Monetary Fund. This is a very dangerous precedent. One would have to be very naive to believe politicians when they say this is an exceptional solution that will not be repeated.

The global debt crisis is a long-term problem the resolution of which will require the application of financial repression. This can take a variety of forms, some of which play out inconspicuously in the background. For example, negative real rates of return over the long term constitute financial repression of all owners of bank deposits. Others can come along gradually, for example in the form of state bankruptcies and forgiveness or restructuring of their debts (Greece). Others can be in the form of assets confiscation (bank deposits in Cyprus) or absurd taxation (75% income tax in France).

The investor's consideration thus moves to a new position. **The question of the new era is which asset is the most resistant to the various forms of financial repression?** Which asset will resist inflation relatively well? Which asset is the least likely to be taken away from me, cancelled, restructured or excessively taxed? Which asset is far from politicians' influence and experiments?

Our opinion is that, if possible, it is best to avoid various types of debt (i.e. bank deposits and bonds), due to their low yields and much higher risk of non-payment than is apparent today. **It is not good to be a creditor during a debt crisis. Debt crises are resolved by cancelling debts.**

A better way is to own shares of high-quality companies. Today, these companies are achieving high real returns and above all have the financial strength and stability that enables them to navigate through difficult economic times. It is clear that holding them will bring greater volatility in our returns than if we were to hold cash, for example, but the alternative (i.e. holding cash) will have much lower real returns, and all the more so the longer the period of financial repression endures.

Changes in our portfolio

We sold three positions. Sanofi, Seagate Technology and K'S Holdings.

Sanofi was our largest position. We started buying the shares in 2009 for approximately seven times earnings. Like a number of other pharmaceutical companies, Sanofi was also facing the so-called patent cliff and the patent protection of some of its large branded pharmaceuticals was nearing an end. For this reason, investors passed over Sanofi shares as uninteresting in the short term and ignored their long-term potential. We prefer long-term potential to chasing a fleeting trend, and we happily collected dividends of 4–5% per year while waiting for the market to awaken and value Sanofi's shares more appropriately. The market did wake up last year, and we collected a 70% gain on the sale. There are several titles similar to Sanofi in our portfolio, i.e. those

with great long-term potential but that are currently overlooked by the market for some reason. We are happy to wait. Pole, pole.

In autumn, we bought **Seagate Technology** for the second time. The share price began almost immediately to rise swiftly, and we sold with a 32% gain in a relatively short time. Who knows, maybe we will take a gain on them for a third time.

K'S Holdings was our only Japanese position. Somehow we were not really convinced that it was a good choice, so we were glad to make use of the recent significant growth in the Japanese market and sold the shares with a 22% gain.

Exxon/Petrobras. For a long time, Brazil's Petrobras appeared to us to be a beautiful example of how to devalue an originally promising company when it gets into the hands of politicians. We finally decided to

try and make something of this and opened a short position in Petrobras shares. To eliminate the risk that even share prices of bad companies such as Petrobras can rise during an unexpected increase of oil prices, we combined a short position in Petrobras with an equally large long position in Exxon. We closed both with a nice little profit this year. For us, such transactions are rather exceptional and we do not seek them systematically. On the other hand, they do not require any capital and help us to continue developing as investors.

Pole, Pole.

We have had a good start to the year. We could have earned more if we had been a little more aggressive. But that is not our wish. We prefer to be more cautious, holding plenty of cash and patiently awaiting attractive opportunities. There is no rush. Pole, pole.

Daniel Gladiš, April 2013

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This letter to shareholders does not constitute or form part of, and should not be construed as, any offer for sale or subscription of, or any invitation to offer to buy or subscribe for, the securities of the fund.

Before subscribing, prospective investors are urged to seek independent professional advice as regards both Maltese and any foreign legislation applicable to the acquisition, holding and repurchase of shares in the fund as well as payments to the shareholders.

The shares of the fund have not been and will not be registered under the United States Securities Act of 1933, as amended (the "1933 Act") or under any state securities law. The fund is not a registered investment company under the United States Investment Company Act of 1940 (the "1940 Act").

The shares in the fund shall not be offered to investors in the Czech Republic on the basis of a public offer (veřejná nabídka) as defined in Section 34 (1) of Act No. 256/2004 Coll., on Capital Market Undertakings.

Historical performance over any particular period will not necessarily be indicative of the results that may be expected in future periods.