RICHTWERT CAPITAL

Rational by Design, Fair by Choice

PARTNER’S MANUAL

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Rational by Design, Fair by Choice

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PARTNER’S MANUAL

The purpose of this document is to explain the mission, the objectives, the beliefs as well as the business and investment principles I use to manage Richtwert Capital ("Richtwert") and to make investments at Richtwert.

Although Richtwert is a corporation, my attitude towards Richtwert is that of a partnership. I view my customers as owner partners, and myself as managing partner.

My goal is to attract partners who share my purpose, beliefs, principles and expectations and to deliver on these expectations. With this manual, I would like to enable you to make an informed decision for or against Richtwert.

This way, I hope that you don't think of this partnership as a temporary investment that you will invest in today and that you may exit from because of some future economic or political event (e.g. recession, war, monetary easing or tightening, interest rates falling or rising) or because markets may move up or down significantly. Instead, I hope that you visualize yourself as a long-term business partner in a partnership that you expect to stay with for a long time, much like when you decide to own a home or an entire company.

Naturally, this is the way I look at our partnership. Therefore, in addition to being the owner and managing partner, I am also an owner partner (customer) of Richtwert just like you. And as an owner partner (customer), I have entrusted nearly all of my own as well as my family's wealth to Richtwert from the beginning. In short, I like and eat my own cooking. So, whenever I speak in the plural form (“we”, “us”, “our”), you know that I really do sit in the same boat with you as a true partner.

Throughout this manual I use quotes from people who I greatly admire for their timeless wisdom because I believe their words help me express what I would like my partners to know. None of them have a connection with me or with Richtwert. All quotes have been obtained from public sources.

WHY RICHTWERT

HELP PEOPLE INVEST INTELLIGENTLY SO THEY CAN LIVE THE LIFE THEY DESERVE

Dear Savers and Investors,

I founded Richtwert because I believe

- hard working people and families who have saved all their lives and those saving now for their future,
- businessmen and -women who have created wealth and
- endowments that do good

deserve better.

Richtwert's mission is to help you invest intelligently so you can live the life you deserve.

Our savings earn next to nothing because we have bailed out speculators and socialized the debt of irresponsible borrowers. Worse yet, people are forced into ever riskier investments to earn returns. This will lead to great pain again during the next crisis.

Pensions, insurance companies, advisors and their funds earn attractive fees, but have different self-interests than their clients. They rarely have skin in the game and create little value.

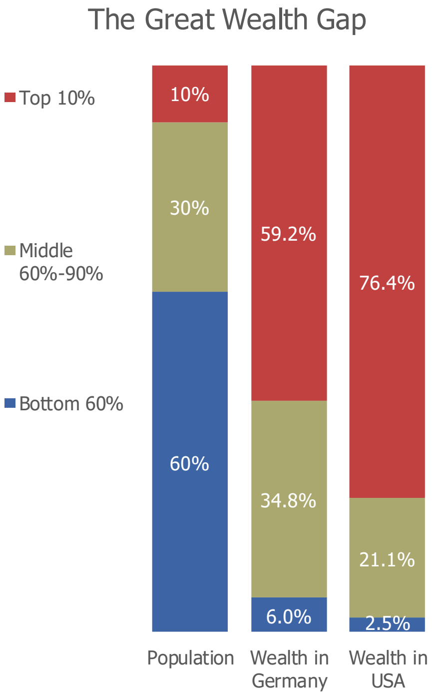
The wealthiest have become rich beyond imagination while the rest look to the future with unease or fear (see The Great Wealth Gap graph).

Why is that? Reality is

- most of us receive poor advice,
- therefore, we choose poor investments which produce disappointing results,
- so, we invest less than we could and should.

It is alarming and unnecessary for so many (incl. the middle-class) to be left behind. The negative consequences of inequality (uncertainty, fear, envy, resentment) are painfully visible around the world. It is also unfair for those who have created wealth and for endowments to have to choose between taking significant risks or accepting low returns.

Richtwert is my way of changing this for people who don't accept the status quo and are willing to question conventional wisdom.



Source: OECD Wealth Distribution Database, Year: 2010
Fig. 1: The Great Wealth Gap

BRINGING FAIRNESS AND BUSINESS OWNERSHIP BACK TO INVESTING

What is Richtwert's strategy and what makes Richtwert different?

I have designed Richtwert to focus on two essential qualities that have been neglected in investment management. You may think this is obvious and therefore common practice but sadly it's not. In fact, it's very rare.

FAIRNESS

- **I Like and Eat My Own Cooking:**
  You and I sit in the same boat because in addition to managing Richtwert I am also a customer at Richtwert just like you. And as a customer I have entrusted nearly all my and my family's net worth to Richtwert.
- **No Fees:**
  I don't charge you any fees. I only receive a share of the profits that exceed a predefined annual hurdle of 6%. Any loss is carried forward and thereby effectively increases the annual hurdle rate.
- **Honesty:**
  I tell you the facts I would want to know if our positions were reversed.

INVESTING WITH THE MINDSET OF A BUSINESS OWNER

- **I Invest like a Business Owner:**
  I invest with patience and discipline in great businesses, run by honest, capable and motivated managers, when they are underappreciated or out of favor and therefore cheap. Our goal is to achieve superior returns from owning these businesses rather than from trading them.
- **I Do Not Try to Be Smarter than Others:**
  Just less emotional, more rational, more disciplined, more long-term focused and fairer to you.
- **I Operate Alone:**
  Great investment ideas are rare and unpopular. Teams are not good at waiting and making unpopular decisions. Moreover, one can't delegate risk management to others.

Although I am solely responsible for decisions at Richtwert, Richtwert's objectives and principles are stated in plural form ("we", "us", "our") because you should only join Richtwert if you share these goals and principles.

OBJECTIVES

Successful partnerships rest on common goals and common understanding. I believe in measuring our progress based on benchmarks agreed upon before we start our partnership. Therefore, I lay out what our partnership's goals are, and which benchmarks we will use to measure our success. You should only join Richtwert, if you share these goals and the principles outlined in this document.

I can't promise any rate of return or result to you. But what I do promise is that:

1. I will invest your and my family's wealth based on the principles explained in this partner's manual to the best of my ability.
2. I have entrusted nearly all my own wealth as an owner partner (customer) to Richtwert.
3. Richtwert's partnership model detailed under *"No Fees – Percentage Share of Profits"* ensures that our interests are fully aligned and that I will only do well when you do well.

Our partnership's goals are *first to protect and second to maximize the purchasing power of our wealth over the mid- and long-term*.

Mid- & Long-Term:

I define mid-term as five years and more and long-term as ten years and more. Judging our performance ideally requires a full business cycle but five years should be the absolute minimum. Any shorter time period is practically meaningless.

1. Protecting Purchasing Power:

As explained under investment principle *"No Dancing to the Market's Tunes – The Market Is There to Serve Us, Not to Instruct Us"*, investment prices fluctuate substantially more than their underlying values for various reasons. Many of them are emotional, not rational. In fact, investment prices can fluctuate greatly and not be risky as long as they are reasonably certain to deliver increased purchasing power over time. And non-fluctuating assets can be very risky if they fail to retain purchasing power over the mid- & long-term.

Protecting our purchasing power requires us to focus on intrinsic values in the mid- & long-term and not on price fluctuations in the short-term (volatility). Therefore, we define risk as a permanent loss of purchasing power rather than the conventional wisdom, which regards volatility as risk. As a matter of fact, we regard volatility as an opportunity to potentially do something smart.

2. Maximizing Purchasing Power:

Our mid- & long-term goal is to

A) To achieve average annual rates of return before profit-share and taxes of at least 10%

or

B) to exceed the S&P 500 index performance (hedged in our reference currencies) by 3% on average before profit-share and taxes.

Ideally, I would like us to meet both goals, but I will be satisfied if we meet either goal. If we achieve goal A) but fail to meet goal B), I believe that the performance of the S&P 500 index is exaggerated and that future returns from the S&P 500 will be lower, allowing us to meet goal B) in the future. On the other hand, if we achieve goal B) but fail to meet goal A), I believe that the performance of the S&P 500 index has been too low and that it will improve over the course of the next years. Our performance should also improve in absolute terms as long as we continue to perform better than the S&P 500 index.

Therefore, if our record is better than any of the targets mentioned above, I believe we've been successful. If our record fails to meet both targets for a period of five years and more, I believe we should look for alternative ways of investing our capital.

HOW RICHTWERT DIFFERS

"Today we have more of everything. More brands. More products. More choices. But it all just feels like more of the same. A great big blur of similarity." –Youngme Moon, Different: Escaping the Competitive Herd. Crown, 2010

Youngme Moon is Professor and Senior Associate Dean of Strategy & Innovation at Harvard Business School. I enthusiastically recommend her book to anyone interested in business, strategy and competition.

What does it mean to be DIFFERENT as an investor?

- Being IN THE SAME BOAT with clients instead of pretending to be.
- THINKING INDEPENDENTLY when everyone is mindlessly following others.
- Having conviction and courage to say NO when everyone is saying yes and to say YES when everyone is saying no.
- Being UNCONVENTIONAL when everyone is conventional.
- Focusing on underlying VALUE when everyone is focused on price trends/momentum.
- Focusing first on NOT LOSING, when everyone is focused on winning.
- Focusing on the LONG–TERM when everyone is in a hurry.
- CONCENTRATING ON THE BEST IDEAS while everyone is over-diversifying.

I believe being DIFFERENT is all about making difficult trade-offs. It's about deciding what NOT TO DO more so than about deciding what TO DO and that's reflected in Richtwert's principles.

BUSINESS PRINCIPLES

No Customers – Partners

I strongly believe successful business is about forming strong partnerships. I view you not only as customers but also as my partners and treat you accordingly.

No Conflicts of Interest – I Like & Eat My Own Cooking

True partners sit in the same boat with aligned interests. At Richtwert, I like and eat my own cooking. In addition to being the owner and the managing partner, I am also a partner/customer at Richtwert just like you and have entrusted nearly all of my and my family's net worth to Richtwert from the beginning.

No Fees – Percentage Share of Profits

I believe the best way to earn something is to actually deserve it. Therefore, I don't charge you any fees.

I only receive a share of the profits that exceed a predefined annual target of 6% (hurdle rate). If I fail to reach the annual target, I earn nothing. Moreover, losses are carried forward and added to the hurdle rate (high watermark), thereby increasing the hurdle rate for the following years. Please see section Sharing Profits Fairly for more details.

No Salespeople – Partners Encourage New Partners

I don't view investment management as a job but rather as a profession. As such, I don't believe in actively selling my services. If I do a great job for you, you may encourage other like-minded partners to join Richtwert. Besides there is much more capital available than capable investment managers. This allows me to focus on investing and keeps costs low for you.

No Hiding – Honesty

I will tell you the facts that I would want to know if our positions were reversed by accurately reporting my achievements, neither hiding mistakes nor taking credit for being lucky.

No Harming – We Invest with Integrity

I firmly believe that we don't need to be unethical to earn attractive returns. There will be attractive investment opportunities that I will not undertake because I think they are below our ethical standards. Businesses that have significant exposure to activities involving weapons, tobacco or gambling fall into this category, as well as businesses that obviously and repeatedly act irresponsibly.

INVESTMENT PRINCIPLES

No Dancing to the Market's Tunes – The Market Is There to Serve Us

"Price is what you pay, value is what you get." – "Investment is most intelligent when it is most businesslike."
– Benjamin Graham, Father of Value Investing & Warren Buffett's Mentor

A stock is a part ownership in a business that has an underlying value and not a piece of paper or a ticker symbol. This underlying value is the value of a business to an informed and rational business owner. Therefore, I focus on two questions:

1. What is the business worth – its intrinsic value – to an informed and rational business owner?
2. Can I buy a piece of the business at a price below its intrinsic value?

I can only estimate the intrinsic value of businesses that I understand well. They usually fall into two categories that I describe in the section Investment Approach.

Many more businesses are outside my circle of competence and I try to avoid investing in them because I can't estimate their intrinsic value. I don't worry about businesses that I can't value because there are enough businesses that I can value. Tom Watson Sr., Founder of IBM put it best when he said: “I'm no genius. I'm smart in spots - but I stay around those spots.”

The market is different. It acts like a voting machine in the short-term and creates significant volatility reflecting the emotions (fear & greed) of market participants rather than intrinsic values. But in the long-term the market behaves like a weighing machine reflecting the true economics of businesses. In academics and in investment management, the majority believe volatility equals risk. For a business owner, volatility has nothing to do with risk. Quite to the contrary, volatility represents opportunity. Therefore, I treat the market and its short-term volatility as a friend or a servant who lets me buy or sell at my discretion and not as an enemy or an instructor who tells me what a business is worth. Instead of fearing volatility, I welcome and try to prepare for it. This allows me to buy pieces of businesses at a discount or to buy more of what we already own and like at a larger discount, or to sell what we own, when its market price is higher than can be justified based on its underlying value.

The difference between market price (what we pay) and value (what we get) is our margin of safety. A wide margin of safety eliminates the need for accurate forecasting. It provides us a degree of protection against losses when I make mistakes and it rewards us richly, when my estimate of intrinsic value turns out to be approximately correct.

When a business inside my circle of competence is cheap (wide margin of safety) and thereby promises attractive future returns to us as business owners, I neither hesitate nor speculate on even cheaper prices. It's foolish and greedy to forego attractive returns that are reasonably certain for even more attractive returns that are uncertain. Consequently, I am neither afraid, nor worried that market prices could fall after I invest. I know I'm not able to time the market perfectly and I strongly doubt that countless others who try, succeed at it reliably. Of course, the same applies to speculating and market timing when selling.

At times, I will surely buy too early while prices continue to fall and at times, I will sell too early while prices continue to rise. Being early usually looks like being wrong but is not necessarily so. As long as we're getting our money's worth – that is an attractive rate of return on our capital – I don't mind being early.

<u>Very few people think and act like business owners when it comes to publicly listed businesses (stocks and bonds). This is our biggest and most enduring competitive advantage over time.</u>

No Speculating, No Economic Forecasting, No Market Timing, No Trading – We Invest Like Business Owners & Insist on Margin of Safety

"We've long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children". – Warren E. Buffett

I ask you to count the number of economists or traders who became millionaires following their own advice and the number of business owners who became millionaires or billionaires and you will know why this principle is key at Richtwert.

Most people either like to or believe they must predict the future (especially the economic development in the near future) before making investment decisions. In doing so, they focus on things that are important but not knowable. It's much more productive and rewarding to focus on things that are both important and knowable.

To me, the intrinsic values of some businesses are knowable, and they become important when prices fall below intrinsic values. A sufficiently attractive price takes care of the future and makes accurate forecasting unnecessary. Hence, I focus on individual businesses and restrain from forecasting what the economy, the market or individual stock prices might do in the short-term. I believe it's a mistake to forego investing in attractively valued great businesses whose long-term future is predictable, because of potential short-term events that are not predictable. Instead of timing the market or timing the investment in a stock, I let the price of the investment determine my actions.

No Short-Term Thinking – We Invest with a Mid- & Long-Term Horizon

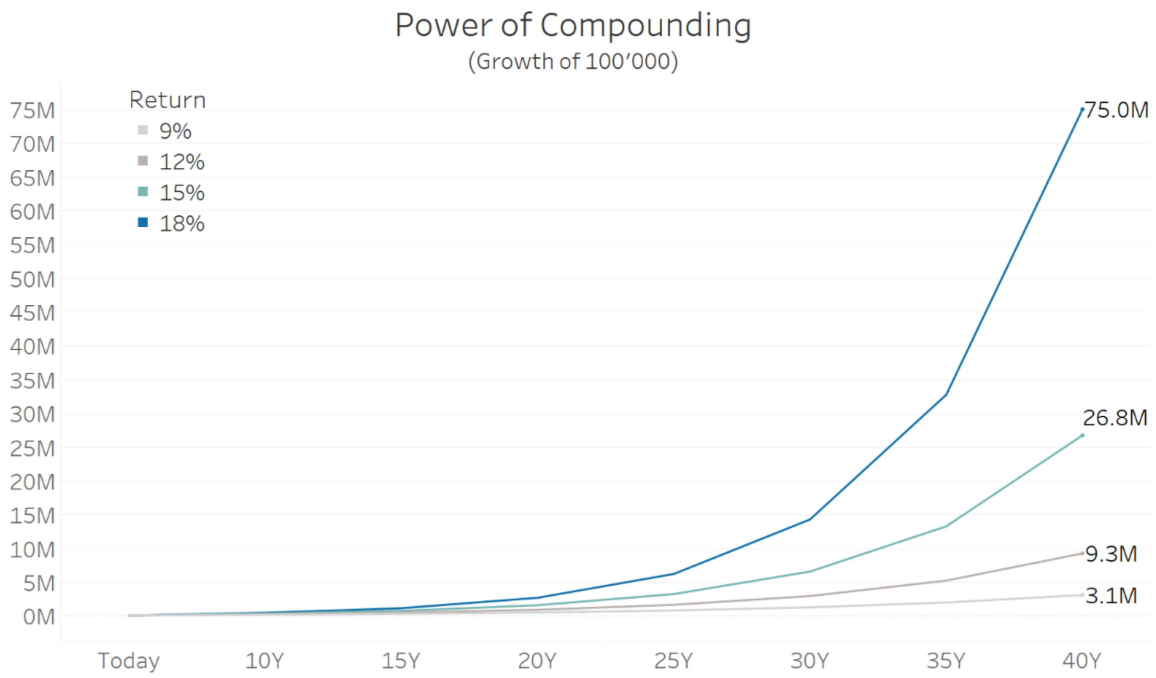
"I can calculate the motion of heavenly bodies, but not the madness of people." – Isaac Newton

Since the market acts like a voting machine in the short-term, I don't waste time predicting how others might react emotionally. My focus is always on the value of a business to an informed and rational business owner in the mid- and long-term and on maximizing the rate of return that can be expected from "owning" the business.

The Power of Compounding in the Long-Term

"Compound interest is the 8th wonder of the world. He who understands it, earns it ... he who doesn't ... pays it." – Albert Einstein

Compounding is the process of generated returns and reinvesting those returns in addition to the initial capital to generate exponential returns. It works exponentially, and this makes all the difference in investing, because small differences in returns result in enormous differences over time.



The Importance of Avoiding Losses

"To finish first, you must first finish." – Rick Mears (4-time winner of the Indianapolis 500)

Unfortunately, compounding works both ways. To be successful, one must first avoid costly mistakes. The following table shows the gains required to make up for a loss of capital and underlines the importance of investing like a business owner and the significance of insisting on a margin of safety.

Loss	Gain Required to Recover from the Loss
33%	50%
50%	100%
90%	1000%

No Index/Benchmark Hugging – We Think & Act Independently

"If you want to have a better performance than the crowd, you must do things differently from the crowd." – Sir John Templeton

Most investment managers earn fees regardless of performance. Their biggest risk *is not* generating losses or failing to generate attractive returns for their clients. Their biggest risk is that clients withdraw their money. Therefore, most investment managers can't afford to deviate meaningfully from indexes they use as benchmarks. This “index hugging” behavior is very expensive for investors because they can invest in indexes themselves at a fraction of the cost they pay their investment managers.

Since I don't charge any fees and only participate in profits that exceed a predefined annual hurdle rate, I'm free to think and act independent of indexes. Without this freedom, it is nearly impossible to compound wealth at above average rates long-term.

Of course, I can only act independently, if you also detach yourself from the market's temporary moods. That is, a) that you do not withdraw your capital when the market is too pessimistic and hence full of great opportunities to invest and b) that you do not expect me to invest all our capital when the market is euphoric, thereby offering great opportunities to sell some businesses and few opportunities to invest. I explain this in such detail to ensure that we'll stand together during the inevitable storms (market crashes) and during the times when I find limited opportunities to invest (booming markets).

No Excessive Diversification – We Focus on the Best Ideas

"The way to become rich is to put all your eggs in one basket and then watch that basket." – Andrew Carnegie
"Diversification is protection against ignorance. It makes little sense if you know what you are doing." – Warren E. Buffett

The conventional wisdom of diversification makes sense for investors who know little about businesses and investing. For the investor who understands business economics and who can estimate intrinsic values for some businesses, conventional diversification is a terrible mistake. Therefore, I focus on my best ideas and invest heavily when the odds of being successful are strongly in our favor. The more certain I am about the quality of a business and the wider the margin of safety available to us, the more aggressively I will invest. In general, I expect to invest in 10-15 businesses at any given time, with a significant portion of the investments concentrated in the top 3-5 businesses.

At the same time, I must avoid becoming overconfident. There'll be times when I make mistakes. To protect us, I make sure we have a satisfactory level of diversification during times when we are fully invested by limiting the maximum exposure to a single business to approximately 30% and by making sure that we're invested in at least six businesses and three different industries.

No Investment Styles – Just Rational Investing

Most professional investment managers ascribe to investment styles such as “Growth”, “Value”, “Quality”, “GARP”, “Momentum”, “Large Caps”, “Mid Caps”, “Small Caps” or a combination of these.

Styles may be good for marketing but only being rational can help in reducing risk and achieving above average results. I simply search for discrepancies between the value of a business and its price in the market. The higher the discrepancy the better the investment opportunity. If I had to use a term for it, I would say: I try to be "rational".

No Investment Committee – Richtwert Is a One Captain Ship

“I have this complicated procedure that I go through every morning, which is to look in the mirror and decide what I’m going to do. And I feel at that point, everybody’s had their say.” – Warren E. Buffett

Richtwert’s business and investment principles are “simple” and nothing but “common sense”. Yet, as a very happy and kind Buddhist monk who was driving me to the airport once told me: *"Being happy is simple. But being simple is not easy at all."*

Indeed, it's difficult for any individual to avoid conflicts of interest, to admit mistakes, to insulate oneself from the market’s moods and emotions, to think long-term when it is hurting in the short-term, to wait and be patient and to make unpopular decisions. But it's much more difficult when decisions are made by groups and not by an individual. Teams are not good at making unpopular decisions and group decisions are weak compromises. Moreover, it's an illusion to think one can delegate risk management.

Therefore, I decided to manage Richtwert alone. Don't get me wrong, I'm not smarter than others. Luckily, I don't have to be. Instead, I must be less emotional, more rational, more disciplined and more long-term focused. I believe, by operating alone, I'm better able to act on my convictions and you know exactly who is responsible for decisions and results.

INVESTMENT APPROACH

The investment approach I apply at Richtwert ties into Richtwert's investment principles. It is equally "simple" but not easy.

1. Do I Understand the Business?

To minimize mistakes, I focus on businesses I can understand and can therefore value reliably. They usually fall into two categories.

<u>"Simple" Businesses</u>
The first category are businesses where only few enduring variables determine investment success or failure. This does not necessarily mean that the business is not exposed to change. Rather it means that the critical factors that determine success today will also determine success in the future.

<u>Familiar Businesses</u>
The second category of businesses are those that I'm familiar with. Usually, these are businesses I've experienced as a consumer or businesses where I have industry experience either from having worked there or due to advising them as a consultant.

2. Does the Business Have Favorable Long-Term Economics?

In choosing investments, I primarily look for great businesses that can grow their intrinsic value over the mid- & long-term because they have sustainable or growing competitive advantages.

At times, I may also invest in businesses that can maintain but not necessarily grow their intrinsic value if their prices are sufficiently cheap. These investments play a less important role and have smaller weights.

3. Is the Business Run by Honest, Capable & Motivated Managers?

I focus on businesses that are run by honest, capable and motivated managers because we as business owners can't benefit from their intrinsic value otherwise.

The best managers are those who are not satisfied with sustaining their companies' competitive advantages and enthusiastically work on increasing those advantages over time.

4. Is the Price of the Business Attractive?

When I find a business that meets the first three criteria, I wait for it to be available at an attractive price in order to have a satisfactory margin of safety.

WHAT RICHTWERT DOES

At Richtwert, I apply proven and rational principles to invest the savings of individuals, families and endowments to protect and grow the purchasing power of their wealth over the mid- & long-term. I can invest worldwide and in all types of assets, but my focus is on publicly listed companies and their stocks.

I am often asked why I focus on stocks. Typically, the question goes like this: *"Why not invest in something tangible like gold, oil, currencies, art, collectibles, real estate, private companies or startups?"* This is an important question that I will address here in detail so that you can make an informed decision when it comes to investing your wealth.

I focus on investing in publicly listed companies (stocks) because:

1. **The vast majority of great fortunes have been created by owning great businesses.**

2. **Businesses are easier to value.**
   Businesses are productive assets and produce income for their owners. I can compare that to income from other sources to determine a justified value for a business. This enables me to pay or to demand a rational price for the business and its stocks. In contrast, currencies, commodities, art, collectibles are not productive. They produce very little or no income at all. Some actually consume income because they have to be transported, stored, protected and insured. It's much more difficult to determine a justified value for assets that do not produce income and it's risky to invest in assets one cannot value reliably.

3. **Stocks are part ownerships in businesses.**
   Businesses are tangible. They employ people to build products and services for customers.

4. **Public markets (stocks) offer much greater choice.**
   There are more than 80’000 publicly listed businesses (stocks) worldwide, some of which have wonderful characteristics and terrific management. In contrast, there are only a few hundred currencies & commodities and none of them have any sort of management. Moreover, at any given day, we can buy or sell an ownership interest in any publicly listed business, if it makes business sense to do so. This is certainly not possible with private businesses or real estate.

5. **Public markets (stocks) are more often & more deeply mispriced.**
   The market tirelessly provides prices at which I can buy or sell pieces of businesses. Often, these prices roughly reflect business reality but from time to time – influenced by excessive fear or greed – market prices deviate significantly from business reality, providing us the opportunity to buy or sell stocks at advantageous terms. Real estate, private companies and startups are usually not publicly traded and illiquid. Moreover, their prices do not become as irrational as stock prices and thus provide less advantageous terms for us to benefit from.

6. **Public markets (stocks) provide low frictional costs.**
   The transaction costs associated with investing in pieces of businesses (stocks) are a fraction of the transaction costs necessary to invest in real estate, private companies or startups and transaction costs are a significant drag over time because they slow down the powerful effect of compounding.

EXPECTATIONS

In addition to the objectives mentioned in the beginning, it's important to keep the following expectations in mind.

We should expect markets to become very irrational and detached from reality from time to time.

At these times markets can be very volatile and result in substantial "paper" losses or gains. I welcome these market swings because they allow me to either invest more of our capital at bargain prices or to sell our investments at high prices turning "paper" gains into actual gains.

Contrary to common belief, we are also likely to benefit from market downturns when I've already invested all our capital. Consider this:

1. Stocks of great businesses often decline when there is wide-spread pessimism or fear or when the economy is slowing. During such times weaker businesses step on the brakes and stop investing in factories, talent, technology, intellectual capital, patents, distribution capabilities, product development, advertising, etc.. Yet managers of great businesses sense exceptional opportunity to widen the gap between themselves and the competition and do the opposite. Therefore, they benefit from tough times and come out even stronger than before.
2. Lower stock prices also mean they can potentially acquire their competitors at lower prices.
3. Finally, lower stock prices mean they can potentially repurchase their own stocks at undervalued prices. All else being equal, this increases shareholder value for existing shareholders.

Expect me to become more cautious when others are more optimistic and more optimistic when others are more pessimistic.

There will be years (maybe consequent ones) during which our performance will lag (significantly) behind our goals.

We may perform better than our benchmark during years of market weakness. But there is no guarantee, because we invest in great companies that are either underestimated or out of favor. When people become more pessimistic during phases of market weakness, it's quite possible that our investments will perform worse than the overall market. If we underperform during phases of market weakness, then I expect us to outperform significantly during the recovery phase in the following years.

On the other hand, we may lag the market during euphoric years when market participants engage in excessive risk taking.

In short, our performance versus the overall market and our benchmark will vary from year to year but this need not bother us as long as we meet our goals in the mid- & long-term.

SHARING PROFITS FAIRLY

Most investment management firms charge fees that not only fail to align the interests of the manager with those of their clients but also encourage them to act in a manner that goes against their clients' interest.

As explained under Business Principles, the best way to earn something is to deserve it. Therefore, I don't charge partners any fees. I only receive a share of the profits that exceed a predefined annual target of 6% (hurdle rate). If I fail to reach the annual target, I earn nothing. Moreover, annual losses are carried forward thereby effectively increasing the hurdle for future periods.

Annual profit share =

*Maximum of {[(Portfolio value before profit share and taxes and after transaction costs – (High Watermark * (1+6%))) * 25%]*

OR zero}

The high watermark refers to the highest portfolio value after costs, profit share and taxes adjusted for in- & outflows measured at each historic invoice date and ensures that in any given year investors only pay a profit share if their portfolio value is higher than at any historic invoice date plus the hurdle rate.

<u>Here is an example for illustrative purposes:</u>

Portfolio value after transaction costs, taxes and profit sharing at the end of 2001: US $ 5,500,000

High Watermark at the end of 2001 = 5,500,000 US dollars

Performance in 2002: -10%

Portfolio value after transaction costs, taxes and profit sharing at the end of 2002: US $ 4,950,000

High Watermark end of 2002 = $ 5,500,000 (remains unchanged)

Performance in 2003: +17%

Portfolio value after transaction costs, taxes and before profit sharing at the end of 2003: $ 5,791,500

Profit sharing 2003 = 0

(Despite the 17% performance in 2003, the portfolio value does not reach the high watermark of $ 5,500,000 plus the 6% hurdle rate. Therefore, Richtwert does not earn a profit share. Due to the high watermark the loss of -10% in 2002 was effectively carried forward and increased the hurdle rate in 2003 accordingly.)

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