

Selected Highlights of the Annual Letter of Saber Capital

This article by MOI Global instructor John Huber, managing partner and portfolio manager of Saber Capital Management, was excerpted from the [2019 annual letter](#) of Saber Investment Fund. John is a featured instructor at Best Ideas 2021.

Marv Levy, my favorite all-time football coach often [said](#), “When it’s too tough for them, it’s just right for us!” The Hall of Famer’s motivational saying didn’t get my beloved Buffalo Bills to the pinnacle of the NFL, but it’s the attitude our partnership takes when stock prices are falling, and a year ago we made two investments in great businesses when the market got “tough”.

In total, we had five main holdings which made up about 80% of the fund’s assets. Each meaningfully contributed to our returns last year, which wasn’t surprising given the market’s tailwind, but it is nice to get production from a number of hitters in the lineup.

Our results over the years have been earned by investing in stocks of great businesses when they become temporarily mispriced. Though success going forward will not be easy, our approach is very simple. I’m convinced that long-term results don’t need to come from being original, finding underfollowed companies, solving complicated situations, or even generating unique insights. Great results come from acting on the very rare ideas that seem obvious, without diluting those great ideas with mediocre or even “good” ideas. When it comes to picking stocks, Good is the enemy of Great, not the other way around as Voltaire suggested.

So, we like the simple principles that are hardly unique: stick exclusively to businesses that are easy to understand, invest in companies that generate lots of free cash flow, partner with good management teams, and then the most important ingredient: wait, wait, wait. I think this last part – the waiting – is what separates the good from the great.

In his talk “The Art of Stock Picking”, Charlie Munger said the best investors “bet very seldom”. This remains the best piece of advice I’ve ever come across on the subject of portfolio management.

Opportunity Costs

Homebuilders tend to have cash flow statements that look a lot like energy producers: they earn cash from the sale of a finished home, but that home sits on land that has to be replaced, and so the profit has to be constantly reinvested into new land. Like an oil well that slowly bleeds dry and requires a new well to maintain production levels, builders are constantly pouring their cash flow back into the ground in order to stay in business. I think of these types of business models like hamster wheels: the minute you stop running, the wheel stops turning. Businesses like homebuilders, energy producers (and maybe even video streaming companies) have to keep pouring cash in or else their business “wheel” stops turning.

NVR gets away from this depletion problem by utilizing a different business model that avoids land development (the segment that consumes cash) and focuses on building and selling of homes (the business that produces cash). As a result, NVR makes much more efficient use of its capital, generating higher turnover and better returns, and as a result it is one of the only businesses that actually generates free cash flow. NVR also has a great culture with proper incentives and a long-term

oriented management team that owns a big chunk of stock.

In the fall of 2018, homebuilder stocks were beaten down. We used a small amount of cash from new incoming partners to buy NVR, but because we had limited cash and I chose not to sell anything, the result was a meaningless position. Furthermore, I refused to buy more after it appreciated a bit.

Lesson: Anchoring on a previous price is a mistake that I've often made, and I hope to do a better job guarding against this bias going forward.

The bigger mistake was overestimating the value of a couple other holdings while underestimating the value in NVR. It's unlikely the stocks we didn't sell will make up for the returns we passed up by not buying more NVR, an example of how mistakes of omission have a real economic impact, even when they don't show up in the fund's trading reports. There will be lots of mistakes going forward, from stocks we missed and also from stocks we did buy but shouldn't have, but I try to think of mistakes like capital expenditures that are necessary education costs that pave the way to greater returns in the future (I'll be sure to remind you of this glass-half full mindset next time our fund has a bout of underperformance).

The good news is that our preference for owning profitable and durable companies reduces the likelihood of major permanent losses. Of course, this also means we don't own the type of stocks that can rise 10-fold in a short period of time - our distaste for strikeouts is stronger than our desire for home runs.

All of this means missed opportunities will be our biggest source of mistakes, and I'll do my best to minimize this cost going forward.

Portfolio

Slugging percentage is a better measure of a hitter's productivity than batting average, and the fund had a few extra-base hits in 2019 (for portfolio analysis, I like baseball metrics over betas and Sharpe ratios). Our two best performing stocks were also the two largest positions at the beginning of last year.

We've owned Apple for four years, but made it a [larger position last January](#) (roughly a third of the fund). The stock was trading close to 10 times free cash flow, and I felt the market was overly concerned about near-term iPhone sales and the impact of tariffs, both of which I thought would impact the short-term results but not the long-term value of the brand. Five years from now, people will still be waiting in lines to buy whatever product Apple is selling. Apple had a \$100 billion cash hoard that grows \$60 billion each year from Apple's annual free cash flow. Most of this was earmarked for buybacks, which I thought was a great use of cash at those levels.

The stock had a great year, but it wasn't a one-hit wonder. Apple has compounded at 36% per year since we first invested in the company 4 years ago. It's a result I'm very happy with, but I will also point out the humbling fact that every other decision I made detracted from, and not added to, this result. To use one of those Greek letters, Tim Cook offered more alpha than Saber.

But misery loves company, and fortunately we have some. Over the past 5 years, with exceptions that you could probably count on two hands, Apple has outperformed the entire hedge fund industry, every one of the 10,000+ mutual funds, the passive funds at Vanguard and Blackrock, the most prestigious private equity funds, and the vast majority of venture capital funds in Silicon Valley. We're talking about many trillions of dollars in all kinds of investment vehicles with all kinds of fees, managed by

extremely smart people with unlimited research budgets and super smart employees, who all work extremely hard, and are all highly incentivized to produce great results. And Apple beat nearly every last one of them, including Saber Investment Fund, LP.

I've compiled a lengthy investment journal devoted solely to Apple in my files, with many different observations on the business, its products, its customers, the competition, its competitive advantages, and its vulnerabilities. But one overarching takeaway is humans overreact to short-term news, forcing stock prices away from their true value – even when the company is the largest in the world.

Of course, there will always be stocks that outperform the portfolios of virtually everyone at times, but it's *important to remember that these outperformers don't necessarily have to come from the best hidden, most complicated, or least understood companies*. Sometimes bargains hide in plain sight.

Facebook had a great year, as revenue grew by nearly 30%. I wrote about an [email that Jeff Raikes sent to Warren Buffett in 1996](#), outlining why Microsoft was such a great business. One factor was that Microsoft was able to earn profits off of capital investments that someone else (IBM) made. Facebook is a modern day example: Verizon and AT&T spent tens of billions to deliver internet to our homes, and Facebook (among others) took the lion's share of the profits that stemmed from that invested capital. But Facebook goes one step further because not only does it leverage someone else's capital, but it also has a business model where its own users produce their own content for each other to consume. Facebook jumped off the hamster wheel years ago but it still spins off cash, and the wheel actually keeps accelerating each year. The network effect Facebook has is unlike any other in the world, approaching 3 billion people, resulting in a business with huge profit margins and lots of free cash flow. The company continues to generate lots of headlines, but those headlines also were our opportunity to buy a great business when it was cheap. The stock was up 56% in 2019.

I outlined my thesis for Facebook a year ago ([see this writeup](#)), and I also [discussed the company in more detail on a podcast](#) last year.

It's interesting to note that NVR got cheap because of the fear that interest rates were heading higher, thus hurting demand for their homes. Just 9 months later, bank stocks got really cheap for the exact opposite: fear of low interest rates, and their potential impact on bank profit margins.

We missed the opportunity to take advantage of NVR, which is up 75% from the fall of 2018, but we did take advantage of the banks, which traded down as low as 8 times earnings in August. Banks continue to mint money and the stocks still offer outstanding 12-15% buyback + dividend "yields". I wrote some [thoughts on the banks in a recent letter](#) and also in [this writeup on WFC](#).

The content of this website is not an offer to sell or the solicitation of an offer to buy any security. The content is distributed for informational purposes only and should not be construed as investment advice or a recommendation to sell or buy any security or other investment, or undertake any investment strategy. There are no warranties, expressed or implied, as to the accuracy, completeness, or results obtained from any information set forth on this website. BeyondProxy's officers, directors, employees, and/or contributing authors may have positions in and may, from time to time, make purchases or sales of the securities or other investments discussed or evaluated herein.