

The McElvaine Investment Trust

To my partners:

For the six months ending June 30, 1997, The McElvaine Investment Trust's net asset value per unit increased by 3.1% after fees and expenses versus a total return for the TSE of 9.6%. During July, the Trust's net asset value per unit increased by a further 3.1%. I think in describing my performance I will borrow the words of that good-natured 100 yard sprinter Michael Johnson and declare: "I pulled a hamstring!"

Simply put, our equities and workouts performed well. Our weak performance was primarily due to the high level of cash and a modest loss on the put options. I will leave a detailed portfolio review to year-end.

Portfolio structure

As of the third week of August, the Trust's assets are as follows:

Investments - 10 positions	41%
Workouts - 2 positions	17%
Derivatives	1%
Cash/short term - net	41%

This evening one of our workouts declared a distribution which will have the impact of reducing the workout position by 6% or so and increasing cash by somewhat more. It should also help August's performance.

View from the toadstool

Expectations do not equal outcomes. A case in point: recently Jeanne Calment, reputedly the world's oldest person, died at the age of 122. The following is an excerpt from her obituary column:

Mrs. Calment left no heirs. She also outlived Andre-Francois Raffray, a lawyer who, 32 years ago, when she was 90, bought the apartment she used to live in on a contingency contract. He would pay her 2,500 francs (now about \$400 US) a month until she died, and then the apartment would become his. Mr. Raffray died a year ago at 77, after paying Mrs. Calment more than \$180,000, more than double the apartment's market value. His family was still paying when she died. "In life, one sometimes makes bad deals" Mrs. Calment said.

Obviously few people enter into a transaction expecting it to be a bad deal. Perhaps the current market is the financial equivalent of a Mrs. Calment, I do not know. The issue I think is that people still view our financial Mrs. Calment as a 20 year old when, unfortunately, a stiff breeze or a spot of ice could make even her trip across the street somewhat hazardous. My point simply is, at today's prices, I would rather be Mrs. Calment's beneficiary than her life insurer.

That got me to thinking about things that people take for granted. For example:

*A stock buyback is an efficient and effective means of returning capital to shareholders.
Increasing savings, especially by Baby Boomers, will continue to propel the market.
The price-earnings multiple is not unreasonable given low interest rates.
Shareholders today are in for the long term and will not be panicked by a sell off.
The market is high but cash returns less than 5%. Who knows how long it can last.*

These are all fine comments made after many years of a great bull market but imagine if you lived instead in Tokyo, would your expectations differ?

As an aside, the Trust has established two small positions in Japanese securities. I do not know if Tokyo as an index is cheap. I do know we were able to purchase these positions at approximately their net cash. We paid nothing for their profitable businesses. The comment might be made “but this is Japan and shareholder value is not appreciated”. The ironic part is that one of these two companies is repurchasing its own shares. So the question could be turned around and asked who is doing the shareholders a better service: the Japanese company with a buyback at below net cash or the US company with a buyback at a 30+ PE.

Conclusion

These days I feel like I have been invited to the party but forced to sit at the top of the stairs. Hopefully, after the guests leave, I can get some of the leftovers. The life of a value investor!

Nevertheless, I continue to look for undervalued situations but pickings are slim. If an individual security has an appropriate margin of safety, the Trust will invest regardless of the market level. Given my record, I obviously do not have any insight into the direction of the market. I do continue to be more concerned about the downside than the upside. Having said that, I also continue to be confident in the Trust's future and have recently added to my holdings. I appreciate your confidence and patience.

Tim McElvaine
August 21, 1997