QUARTERLY INVESTOR COMMENTARY
31 DECEMBER 2018

CONTRARIUS GLOBAL EQUITY FUND

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The Fund aims to earn a higher Total Rate of Return than the average of the world's equity markets, as represented by the MSCI World Index, including the reinvestment of dividends net of withholding tax ("MSCI World Index", "Benchmark"). It aims to achieve this without greater risk of loss, over the long-term. The Fund is an actively managed fund, and as such does not in any way seek to replicate its benchmark index, but may instead differ materially from the performance benchmark in order to achieve its objective.

CONTRARIUS GLOBAL EQUITY FUND AT 31 DECEMBER 2018

Total Rate of Return in US Dollars	Class [1]	Since Inception on 1 Jan 2009	Latest 10 Years	Latest 5 Years	Latest 3 Years	Latest 1 Year	Latest Quarter
		% Annualised				*% Not Annualised*	
Contrarius Global Equity	**Investor**	**15.0**	**15.0**	**2.5**	**12.4**	**(19.4)**	**(25.9)**
MSCI World Index		9.7	9.7	4.6	6.3	(8.7)	(13.4)
Average Global Equity Fund		7.8	7.8	2.8	4.9	(9.9)	(11.4)

Past performance is not a reliable indicator of future results. The Fund's share prices fluctuate and are not guaranteed. Returns may decrease and increase as a result of currency fluctuations. When making an investment in the Fund, an investor's capital is at risk.

[1] *Performance of other fee classes are available on our website.*

The Fund's Investor Class shares returned (25.9%) for the quarter versus (13.4%) for the benchmark MSCI World Index, including reinvested net income. For the year the Fund's Investor Class shares returned (19.4%) versus (8.7%) for its benchmark index. As we have highlighted previously, our investment philosophy is not benchmark cognisant and our portfolios would normally vary materially from the benchmark. The Fund's returns are therefore likely to deviate from those of the benchmark. Investors are reminded that given the long-term, contrarian, valuation-based investment philosophy, there will be times when the Fund will materially underperform its benchmark in the short-term in order to achieve its objective of long-term outperformance. The latest year, we believe, is an example of such times. Over the last several months a number of the Fund's holdings fell further out of favour with investors, despite our belief that these holdings offer excellent value to the long-term investor.

The Fund is overweight Materials, Energy, Consumer Discretionary, and Communication Services stocks. In terms of geographic exposure, the Fund continues to be overweight shares in North America.

Sector Exposure 31 December 2018	Weighting (%) Fund	MSCI World Index [1]	Over/(Under) Weight
Communication Services	19	8	11
Consumer Discretionary	24	10	13
Consumer Staples	9	9	(0)
Energy	20	6	14
Financials	1	16	(15)
Health Care	1	13	(13)
Industrials	0	11	(11)
Information Technology	1	15	(14)
Materials	24	5	20
Real Estate	0	3	(3)
Utilities	0	3	(3)
Total Shares	**99**	**100**	
Net Current Assets	1	-	
Net Assets	**100**	**100**	

[1] *Source: MSCI (attention is drawn to MSCI disclaimer in 'Notices')*

Geographic Exposure 31 December 2018	Weighting (%) Fund	MSCI World Index [1]	Over/(Under) Weight
North America	81	65	16
Europe	9	22	(13)
Japan	0	9	(8)
Asia ex-Japan	2	2	(0)
Other	7	3	4
Total Shares	**99**	**100**	
Net Current Assets	1	-	
Net Assets	**100**	**100**	

[1] *Source: MSCI (attention is drawn to MSCI disclaimer in 'Notices')*

FACEBOOK

From One Extreme To The Other

Every contrarian investor should have in his scrapbook the cover of *The Economist* newspaper of 9 April 2016. It shows a statue of an imperial Mark Zuckerberg (Facebook's CEO and co-founder), enrobed, enthroned, and enwreathed. And yet, just two and a half years later, the company's main product is linked to mental illness, and has been compared to sugar and tobacco. The company itself thinks it may not be good for you. It has experimentally manipulated its users' emotions. It is blamed for empowering radicals and damaging democracy. Accused of censoring free speech. Accused of recklessly not censoring speech that is *too* free. It is castigated for its approach to privacy. A number of senior executives have left, and revenue growth is falling. It is not immediately obvious that paying $377 billion for all of that is a bargain.

Facebook certainly has unique challenges. But it also has a unique asset: a network effect that might well be the greatest in history. At quarter-end, Facebook is the fund's largest holding.

Network Effects – Like!

Size Counts

It's unclear when the term "network effect" was coined, but the idea was discussed in Bell Telephone's 1908 annual report. It was inducted into the business-speak Hall Of Fame, originally as "Metcalfe's Law", in the 1980s by Robert Metcalfe, co-inventor of Ethernet (probably the most widely used family of networking protocols), and has since become something of a "golden ticket" for businesses. The idea is that, for certain products, when a prospective user is weighing up options, he will tend to prefer the one that already has the most users. The simple one-sided form is to 'demand' what "economies of scale" is to 'supply'. Network effects tend to protect big businesses from competition, making them still bigger.

Most executives hanker for just one. Facebook has at least three, intertwined:

- **Scale**: The technology behind its products is immensely complex and expensive, made possible by the sheer quantity of users and advertising. It has one of the world's premier artificial intelligence research labs. There are only a handful of companies with the financial or intellectual resources to attempt this. This is the vanilla one-sided demand effect mentioned above. It is also the least relevant.
- **One-sided network**: For social networks, the technology is less important than you might think. The crucial thing is whether your friends and family use it. In all likelihood, most of *your* friends and family are on Facebook, busily chronicling *your* world while you work and sleep.
- **Two-sided network**: These human connections – in aggregate, the "social graph" – and the data they generate are fantastically valuable for advertisers. Why would an advertiser use a provider with neither the reach nor the accuracy?

For Facebook this means low costs (per user); for users it means the best user experience and high barriers to switching; and for advertisers it means the most concentrated and relevant customers. If you want to advertise online these days, you typically need make only two stops: Google and Facebook.

Value To Users

Facebook is a ready-made scrapbook and photo album. It is a web of intersections between your life and hundreds of others'. It is a catalogue of memories, enriched with names, labels, and linked events. Perhaps you remember when people curated photo albums by hand, writing the names and descriptions below each shot. These days you don't even need to take your own photos: in five minutes you can sign up, link one friend, and have a mesh of personally relevant content delivered right to you.

Even for passive users the benefits are great: a contact book for you to find others; a reverse contact book for others to find you (if you're not on Facebook, you don't get invited to the party); and an on-demand nostalgia-fuelled shot of dopamine.

Value To Advertisers

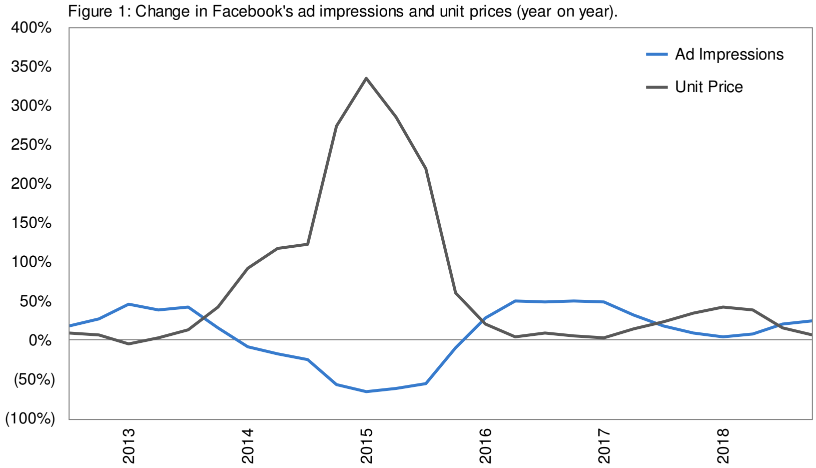
Google and Facebook have made advertising affordable for small businesses that previously were limited to the classified section. Google is well suited to direct response advertising: making a buyer out of someone who has already expressed a related interest.

This competes with coupons, for example. Facebook is well suited to brand advertising: burning imagery into your memory to build long-term brand recognition and affinity. This competes with billboards and television. It is much easier and cheaper to experiment with online ads than with coupons, billboards, or TV productions.

The mobile format is particularly amenable to brand advertising because media snippets occupy the whole screen, making them unavoidable (unlike on a PC). Investors often think of online ad space as being limitless and conclude that prices should trend towards zero, but when Facebook stopped increasing the "news feed" ad load in 2017, prices promptly shot up. Online ad spending continues to grow at more than 20% per year, with almost all of the growth going to Facebook and Google.

Ad Space is Finite – Even Online

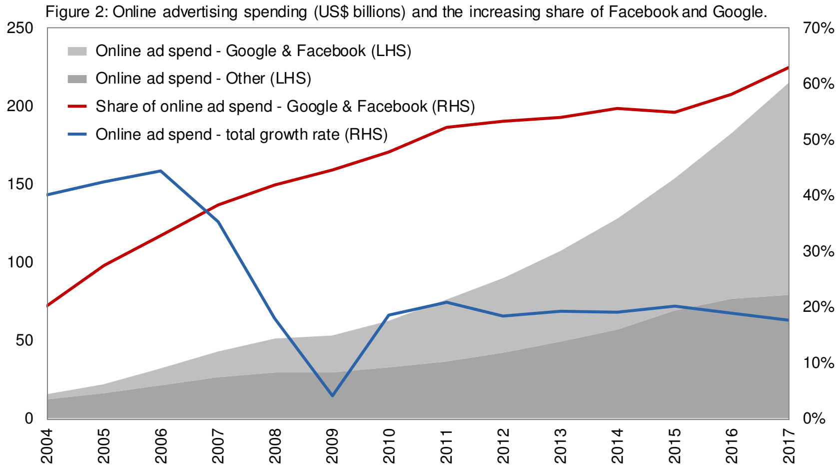
Figure 1: Change in Facebook's ad impressions and unit prices (year on year).



Sources: Facebook; Contrarius Research

Online Advertising

Figure 2: Online advertising spending (US$ billions) and the increasing share of Facebook and Google.



Sources: Facebook; Alphabet; Bloomberg; Magna; Contrarius Research

Competitive Position: Pro-moated

Imagine you were trying to start a new social network. By far the strongest predictor of whether someone will sign up is whether their friends already use it. So you will need to pull in users quickly, which means offering something really compelling, and probably expensive to build. Since humans are notoriously averse to even trivial costs, you'll probably also have to be free, which leaves you few funding options other than advertising. But why would advertisers come to you when you have negligible reach or targeting?

Although online ad space may in theory be limitless, there is a finite amount of human attention to go around. The voraciousness with which Facebook has vacuumed up attention has created a dead zone around it. Instagram and WhatsApp, which are owned by Facebook but are conceptually distinct from the core Facebook application, are worth multiples of their purchase prices ($1 billion and $19 billion, respectively) in 'scorched-earth' value alone. This is clear in Snapchat's user numbers when Instagram launched its competing "Stories" feature: it sucked the oxygen out of Snapchat's growth, preventing it achieving critical mass.

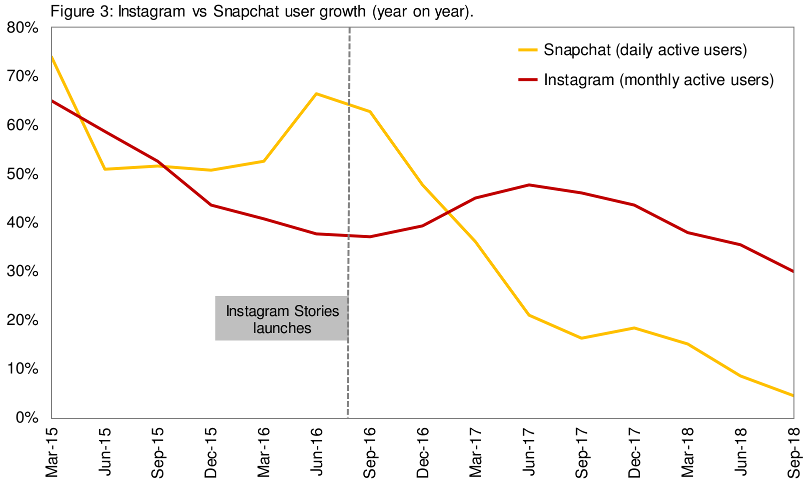
Facebook has one of the world's biggest social graphs, data libraries, and photo repositories; the world's top *two* communication tools; and the 2nd biggest advertising machine. When Warren Buffett coined the term "economic moat", he probably did not imagine a company with more than two billion people using its products every day.

Most publishers, whose material is distributed via Facebook, are fairly powerless. Very few readers go directly to publishers' own properties: Facebook and Google together source about 70% of traffic to the average news site (their relative positions are sensitive to algorithm tweaks and to what exactly is being measured). Publishers have little option but to distribute through Facebook, even though that means that their readers will associate with Facebook's brand rather than their own.

Users are also powerless because their friends, and the content, is all in this one place. That so many people express distaste for the product and use it anyway is testament to how desirable it actually is. A September 2018 Pew survey indicated that 26% of US adults said that they deleted the app—but Facebook reported flat user numbers and ad revenue even increased. Of the top 6 mobile apps by monthly active users, four are owned by Facebook and two by Tencent, a Chinese technology monolith. Of the top 6 social media or messaging platforms by monthly active users, four are owned by Facebook (Google's YouTube and Tencent's WeChat are the other two).

The Attention Vacuum

Figure 3: Instagram vs Snapchat user growth (year on year).



Sources: Facebook; Snap; Contrarius Research

Network effect business models do, however, face a unique risk. If something triggers a reversal of the network effect, it can unwind with the same alacrity that it wound up. For Facebook, the two clear risks are regulation and mass desertion.

Regulation And Its Paradoxes

Regulators have four main concerns: monopolies, antisocial behaviour of users, privacy, and health/safety.

Social networks are a quandary for antitrust enforcers. Facebook does not control supply in the way that Standard Oil or the American Tobacco Company did, nor infrastructure in the way that Northern Securities (railroads) or AT&T did. Rather, its users create the monopoly of their own volition because the product is so desirable and such good value. Big network effects create natural monopolies, because the bigness is itself appealing to prospective users. That's what at one time made local newspapers such valuable businesses. Their monopolies were local, though, because of the cost of distributing paper and ink further afield—but when the cost of distribution is essentially zero, the whole world is "local".

US antitrust looks at consumer harm, which does not fit well with a service that consumers love, costs nothing (in direct monetary terms), and is continuously improving. European law, though, takes a broader perspective and is more of a threat. Even so, it is not clear that the consequences are desirable. Breaking up Facebook would degrade the service. Moreover, other issues, like antisocial behaviour and political interference, would become harder to police across many independent entities. And the ever-gluttonous network effects would likely make one of the fragments dominant again.

Regulation in the US would likely take a long time. Congress does not currently have much appetite for cooperation. The "Honest Ads Act", a bipartisan US Senate bill to increase online political advertising disclosure, has not been granted a hearing despite being proposed in October 2017. Moreover, legislators seem not to know what they want: they demand both more censorship and less censorship; they want Facebook to promote free speech, and also decide which "free speech" merits promotion. And the discussion in Congressional hearings has repeatedly betrayed a lack of understanding of the technology. Sensible regulation does not appear to be imminent.

In any event, regulation tends to favour incumbents. Prescribing rules stifles experimentation and makes compliance costly: problems that large profitable companies find much easier to deal with. These concerns are not specific to Facebook and remedies would presumably apply to other technology companies—entrenching all of them further, but not necessarily giving any an advantage over the others. Facebook's biggest asset is the social graph, and so the biggest threat would be replicating that on another platform. But the General Data Protection Regulation (GDPR) that came into effect in Europe in 2018 prohibits exporting the social graph since it contains information about other people. Facebook, though, can share that data within its own properties, giving its own products an enormous advantage. Instagram bootstrapped itself by importing Twitter's social graph, but that is no longer possible (long before GDPR, social networks recognised the value of this asset and stopped giving it away).

Wholesale Desertion

The more salient threat is that the virulent commentary around privacy and safety could unleash a wave of defections big enough to spark the unravelling of the network effects. Nonetheless, we believe that a few things make this unlikely.

There appears to be scientific consensus that our craving for sugar is because for the vast majority of human history sugar's deliciously dense calories were scarce. So your genes were much more concerned with getting more than holding back. That biological programming is problematic when we can mass produce cheap calories. Similarly, our social cravings were programmed at a time when communities were small, and anonymous and distant communication almost impossible. As with problematic sugar consumption, managing problematic social media behaviour is important and hard, but that does not mean that idea itself is "bad". Instead, we need to develop the insights, tools, and regulatory infrastructure to promote healthy habits. There have been similar safety protests against cars, planes, television, ATMs, and e-commerce.

Indeed, the mental illness link is not as clear as it sometimes seems. Social media is also linked to higher social satisfaction. In neither case do we have causal evidence yet, which is not surprising since it is hard to design a double-blind randomised controlled trial.

Then there is the question of what is 'signal' and what is 'noise'. Are recent privacy and safety revelations new insights that will change how the future unfolds; or are they cyclical noise that will die down, so that sentiment reverts to the mean? The *New York Times* recently "exposed" Facebook's special relationship with some partners, giving them privileged access to user data. But in 2011-2012 some of these same partners flaunted their deep integration with Facebook on stage— and it is hard to imagine how such a degree of integration could be achieved without extensive data sharing. At the time, the user benefits were praised and privacy and safety got little attention. People *say* they want privacy, but their actions suggest that it is not a priority. Sentiment has swung so far that Sheryl Sandberg, number two to Mr Zuckerberg, has gone from being a celebrity of feminism to a pariah. Her book "Lean In", a trope to women's empowerment, topped the bestseller lists of the New York Times, Amazon, and Nielsen in 2013, and also spawned a tide of "Lean In Circles" women's meetups; but has more recently been described as naïve, irrelevant, and out-of-touch.

Nevertheless, because mass desertion could indeed undermine the business model, Facebook needs to get control of the image problem that groups it with smoking. Mr Zuckerberg admits to being behind on safety and security, and Facebook has escalated its investment in internal surveillance.

The Business Model

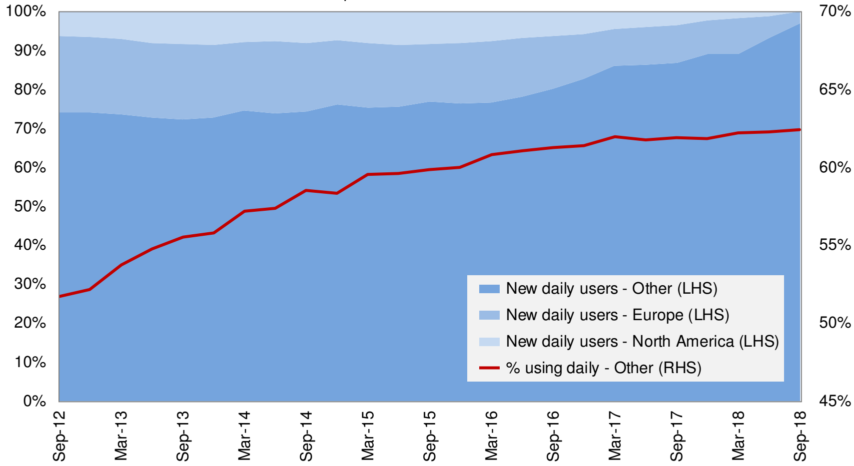
Core Facebook

The share has fallen in part because the CFO projected the operating margin to drop from 50% in 2017 to "the mid-30s". This is largely due to the accelerated investment in safety and security, which is a massive and expensive project, in terms of both technical and human investment. This is very different to a business that is forced to cut margins because of competitive pressure. Instead, it is a buttressing of the 'moat' that keeps potential competitors at bay. Who else has the financial, technical, or data resources to build this surveillance network?

The long-term profit potential is enormous. Facebook is going after brand advertising, competing head-on with TV, which is the biggest advertising category. Facebook accounts for about 9% of global ad spending compared to Google's 18%. User growth in North America and Europe has stagnated, but it is still growing rapidly in high-population developing countries like India, Indonesia, and the Philippines (only 27% of users are in North America and Europe).

A Friend In Every Port

Figure 4: Share of Facebook's net additional daily active users by region, and increasing engagement of users outside of North America and Europe.



Sources: Facebook; Contrarius Research

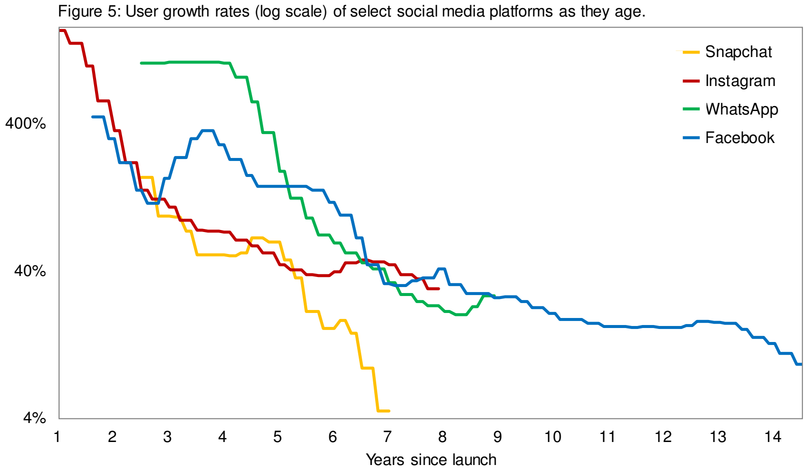
Most promisingly, Facebook is considering a paid-for ad-free version. This may be the start of a subscription bundle that could aggregate almost all digital media content. This could include everything available on pay TV, as well as personalised news from friends and family, newspapers, magazines, audio (like music and podcasts, which currently do not monetise well), and video (similarly to Netflix). Some startups have tried subsets of this, for example with newspapers or magazines, but getting it off the ground is daunting: publishers don't want to commit until there are users; and users don't want to commit until there are publishers. Facebook, though, already has the users.

WhatsApp and Instagram

Aside from being defensive outposts to the core Facebook application, WhatsApp and Instagram are tremendously valuable in their own rights. Instagram revenue is estimated to be $7.5 billion over the last four quarters (15% of the group total), doubling since the prior year. WhatsApp does not yet generate significant revenue, but it has 1.5 billion users and Facebook management has a lot of experience converting users into dollars. Messaging is the prime candidate for the next evolution of consumer technology, and WhatsApp is the world's #1 messaging system (Facebook Messenger is #2). WhatsApp users are so committed that 77% of them use it every day. In our view, Instagram and WhatsApp (as standalone businesses) make up a substantial portion of the group's total value.

Growing Older

Figure 5: User growth rates (log scale) of select social media platforms as they age.



Sources: Facebook; Snap; Contrarius Research

The World Needs Facebook

Facebook and Google are crucial for startups and niche businesses. The likes of Warby Parker and Dollar Shave Club would not be possible otherwise. Even if they do not want to advertise, many small businesses these days start with a Facebook page before a webpage.

Newspapers, in their heyday, performed a vital civic duty: they were a check on governments and other powerful bodies. The founders of the United States, having suffered British interference with the publication of unfavourable information, thought this important enough to enshrine a free press in the First Amendment to the US Constitution. But the traditional newspaper business model is defunct and, with only very few exceptions, struggles to fund this burden. It is not sustainable for access to credible news to be limited to the few percentage of people paying for subscriptions to large publications. Nor, for conflict reasons, is it desirable to leave this role to governments. When anyone in the world can say anything to anyone else in the world, quality control is a monumental task.

Experiments indicate that the average US user values the core Facebook application at about $1,000 per year, which may imply about $180 per year for the average user worldwide. Assuming a 35% operating margin and a PE multiple of 16 values Facebook at perhaps $806 per user, or $1.2 trillion on the current user base. Clearly this is a very crude estimate (in part because it does not distinguish between users' willingness to pay and what Facebook might hypothetically charge), but it does not appear to be unreasonable. Notably, this ascribes no value to Instagram or WhatsApp, nor to the latent potential discussed above.

At the time of that *Economist* cover, Facebook was valued at 60x earnings and 15x sales. Today those are 17x and 6.5x, respectively (all four multiples are after accounting for net cash, which was $41 billion in September 2018). Pessimists point out that revenue growth is plummeting – which is true: from 54% in 2016 to 42% in the last four quarters. How many $100+ billion companies are growing at more than 30% and selling for less than 20x free cash flow? People love ranting about Facebook… on Facebook (or Instagram or WhatsApp). We find it remarkable that a company that is used voluntarily every day by 27% of the world's population (33% if you exclude China) has so few friends.

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			Year	%	Year	%	Date
Contrarius Global Equity Fund	Investor Class	US$	2009	94.5	2018	(19.4)	01-Jan-09
	Institutional Class	US$	2009	95.1	2018	(19.1)	01-Jan-09

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