LIGHTHOUSE ADVISORS
Keeping Your Capital Safe

Lighthouse Advisors Private Limited
Reg. No. 201212773E
Suite 1103, #11-00 The Octagon
105 Cecil Street, Singapore 069534
www.lighthouse-advisors.com

Public Newsletter for the period ended 31 Mar 2021

Welcome to the Lighthouse Advisors newsletter for March 2021. The format has been revised following client feedback.

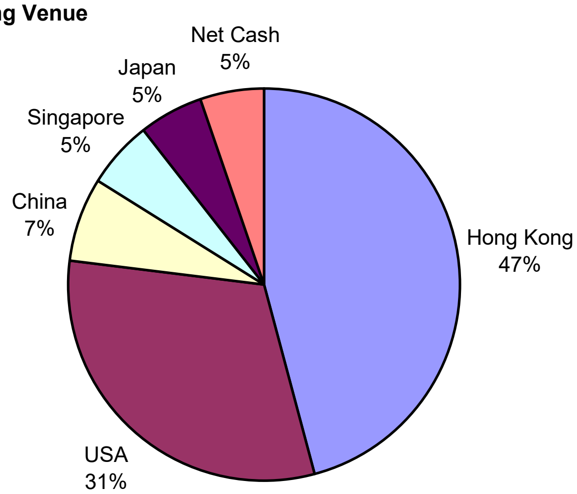
1. Summary

The NAV for March 2021 was USD 94.98 (SGD: 127.74). The year-to-date return was +1.9% (SGD: +3.7%).

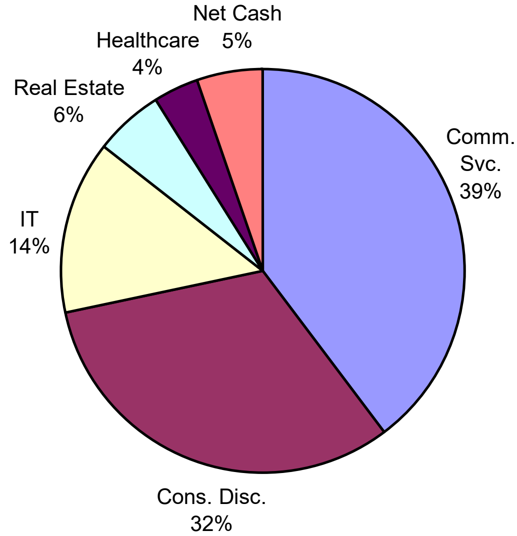
Market (Index)	1Q21
Singapore (STI)	+10.3%
Hong Kong (HSI)	+4.2%
Shanghai (SSE)	-0.9%
USA (NASDAQ)	+2.8%
Fund	**+1.9%**

23 securities made up 94.8% of the Fund's holdings, with the balance in cash and cash equivalents. The following charts show the approximate exposure by place of listing and sector (numbers may not add up or match exactly due to rounding).

Listing Venue



Sector Exposure



NAV values in both USD and SGD are tabled in Annex II.

Updated 4 May 2021

2. Market Commentary

The first quarter of 2021 continued the trends seen in the last months of 2020: vaccinations increasing, economies slowly reopening, and intermittent lockdowns to deal with outbreaks.

After years of underperformance, value stocks rallied, while large-cap tech stocks sold off amidst fears of regulatory crackdowns. However, the fines that have been announced, while large in absolute terms[1], are rounding errors relative to the offenders' earning power and market capitalization. In other words, regulators have decided such firms are "too big to fail". The message for investors is obvious: **BUY**.

Other noteworthy events in the stock markets included the rise of meme stocks such as GameStop (fueled by Robinhood – see later), and the fall of Archegos Capital, a US$20bn family office which disintegrated in just two days. The Fund was not involved in and not affected by either event.

The next newsletter will be written for the period ending 30 June 2021.

Benjamin Koh
Chief Investment Officer
Lighthouse Advisors
4 May 2021

3. Portfolio Review

To protect the interest of clients, detailed discussion is confined to the client-only version of this newsletter. Client newsletters are embargoed for one year, after which they are made available online.

4. Robinhood Financial

During the first quarter of 2021, the sudden surge of "meme stocks" promoted on **Reddit** (specifically the **WallStreetBets** subreddit) drew attention in the mainstream media. Forgotten and left-for-dead companies like **GameStop** (a retailer of used videogames) and **AMC** (a cinema operator) rocketed to multiples of their pre-mania prices.

Many theories were advanced, some claiming that "finance has been democratized" and that market-moving power had now shifted back to the small traders instead of the large funds that formerly dominated the market.

After-the-fact analysis showed, however, that *institutions* were big drivers of the price action[2]. In other words, it was not "David and Goliath", but "King Kong versus Godzilla". One fund earned US$700m on GameStop, while another made US$200m on AMC[3].

In the centre of the maelstrom is the company that enabled the retail trading frenzy, **Robinhood Financial**. *Robinwho?*

Robinhood Financial is a discount brokerage formed in 2013. It launched its app in 2015, offering commission-free trades for stocks and exchange-traded funds (ETFs). Its site says:

We're on a mission to democratize finance for all.

"Free" is a powerful word, and Robinhood quickly attracted users. By May 2020 it had over 13 million user accounts. Other service providers like **E-Trade**, **TD Ameritrade**, **Fidelity**, **Vanguard** and **Charles Schwab** have also moved to no-fee trading. So it seems Robinhood is indeed upending the industry and lowering costs for everyone.

But employees at said companies (including Robinhood) do not work for "free", so how do these companies make money?

[1] *China readies Tencent penalty in antitrust crackdown*, **Reuters**, 29 Apr 2021.

[2] *GameStop mania may not have been the retail trader rebellion it was perceived to be, data shows*, **CNBC**, 5 Feb 2021.

[3] *This Hedge Fund Made $700 Million on GameStop*, **Wall Street Journal**, 3 Feb 2021.

Robinhood portrays itself as an ally of the ordinary investor, the novice investor's friend against the wolves of Wall Street. So it is inevitable that it should face the most scrutiny.

How does Robinhood make money? Four main ways:

1. Interest income on customer deposits
2. Subscription services
3. Options trading
4. Payment For Order Flow (PFOF)

Interest income and subscription services are perfectly normal, and until about 2018 they were all that Robinhood disclosed about its income streams.

Options trading on Robinhood is *not* free, so Robinhood earns money when its users trade options instead of stocks or ETFs. This is fine, but Robinhood has been accused of using "gamification" to lure users into trading excessively[4]. Indeed, in the first quarter of 2020, relative to the money in their account, Robinhood users traded more than *10 times* as many options contracts as users of TD Ameritrade and E-Trade[5]. Events took a tragic turn in June 2020, when a young Robinhood trader killed himself when he mistakenly thought he'd lost a large sum of money[6].

Even more problematic is PFOF. PFOF means that instead of executing the trades placed by its users, Robinhood instead sells *the right to execute these trades* to other market makers. As early as 2018, it was reported that over 40% of Robinhood's revenues came from selling orders to high frequency traders[7].

Why do other market makers pay for these orders? *Because they profit from trading against them.*

	Fees earned per 100 shares	
Broker	**1Q 2020**	**2Q 2020**
Robinhood	US$0.24	US$0.17
Charles Schwab	US$0.11	US$0.11
E-Trade	US$0.16	US$0.15
TD Ameritrade	US$0.15	US$0.15

The table above shows Robinhood received significantly more per 100 shares traded than its three rivals. Clearly, orders from Robinhood users were more valuable, attracting a 13%-118% premium.

Why were such orders more valuable? Some clues: Robinhood discloses that the median age of its users is 31, and that half of them are first-time investors. Bluntly put, as a group, Robinhood users are "dumb money".

PFOF is not new: it was pioneered by none other than Bernie Madoff, whose Ponzi scheme was discussed in the first edition of this newsletter.

PFOF proponents argue that only the most efficient (lowest-cost) market-maker can pay the highest fees for order flow. Such a market maker attracts the highest volume, allowing it to fill all the orders at the lowest cost. In theory this creates a virtuous cycle which results in the narrowest spreads for buyers and sellers alike i.e. an efficient market.

In practice, it is the *most profitable* market-maker that pays the highest fees for order flow. And the biggest profits come from the widest spreads, not the narrowest ones.

A simple example: Bayer places a buy order for 100 shares of Tesla at $100, and Sella places a sell order for 100 shares of Tesla at

[4] *Massachusetts Regulators File Complaint Against Robinhood*, **Wall Street Journal**, 16 Dec 2020.

[5] *Robinhood Has Lured Young Traders, Sometimes With Devastating Results*, **The New York Times**, 8 Jul 2020 and 2 Feb 2021.

[6] *20-Year-Old Robinhood Customer Dies By Suicide After Seeing A $730,000 Negative Balance*, **Forbes**, 17 Jun 2020.

[7] *Robinhood Gets Almost Half Its Revenue in Controversial Bargain with High-Speed Traders*, **Bloomberg News**, 16 Oct 2018.

$98. In theory, the shares should cross at the mid-market price of $99, so that Bayer and Sella split the difference and each does a little better than expected, a "win-win".

In practice, the market maker buys from Sella at $98 and sells to Bayer at $100, pocketing the $2 difference. It is of course able to pay far more to obtain such order flows versus a "fair player" who tries to deliver a narrow spread.

Is there any proof that this is happening? **Yes**.

In December 2019 the regulator FINRA fined Robinhood Financial US$1.25m for failing to ensure its customers got the "best" prices[8].

In December 2020 the SEC fined Robinhood Financial US$65m for causing its users to be overcharged[9]. The SEC report states:

"Robinhood customers' orders were executed at prices that were inferior to other brokers' prices. Despite this, according to the SEC's order, Robinhood falsely claimed in a website FAQ between October 2018 and June 2019 that its execution quality matched or beat that of its competitors. The order finds that Robinhood provided inferior trade prices that in aggregate deprived customers of $34.1 million even after taking into account the savings from not paying a commission."

In February 2021, it was reported that Robinhood was setting aside US$26.6m in fines yet again, this time over its options-trading practices and the halting of trading in certain stocks, including GameStop[10].

Clearly, history suggests that Robinhood Financial is a repeat, recalcitrant and unrepentant offender. The fines are having no effect: it is clearly more profitable to "sin first and ask for forgiveness later".

Fee-Free is not Cost-Free. There is no free lunch, etc.

Robin Hood fought injustice by robbing the rich to give to the poor. Robinhood Financial is perpetuating injustice by *helping the rich to steal from the poor*. A better name for it might be **Sheriff of Nottingham Financial**.

~ End ~

[8] *FINRA Fines Robinhood Financial, LLC $1.25 Million for Best Execution Violations*, **FINRA**, 19 Dec 2019.

[9] *SEC Charges Robinhood Financial With Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution*, **U.S. Securities and Exchange Commission**, 17 Dec 2020.

[10] *Robinhood in Talks to Settle Finra Probes Into Options-Trading Practices, Outages*, **Wall Street Journal**, 26 Feb 2021.

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Annex I

NAV in USD (Official)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										34.16	33.49	35.62	**4.3%**
2009	34.57	33.52	33.37	36.69	46.20	46.00	50.06	49.68	52.66	54.17	56.68	59.94	**68.3%**
2010	59.05	61.09	65.17	68.27	64.14	65.69	70.65	72.24	81.06	83.56	85.10	90.30	**50.6%**
2011	87.21	86.29	88.13	92.81	90.85	91.35	91.17	83.69	69.04	78.23	73.00	72.88	**-19.3%**
2012	77.40	82.90	82.52	83.32	76.36	77.25	77.27	77.91	80.57	79.44	82.70	84.92	**16.5%**
2013	91.43	97.36	99.96	100.24	99.14	95.09	98.50	100.00	100.86	102.24	102.63	102.93	**21.2%**
2014	99.15	101.78	99.80	101.84	105.45	106.57	109.05	108.58	103.60	103.91	101.87	99.94	**-2.9%**
2015	97.97	98.16	97.74	103.80	103.69	100.99	96.17	85.91	84.17	88.91	86.20	86.35	**-13.6%**
2016	81.56	83.81	88.82	92.18	91.50	91.52	94.48	94.86	94.87	93.34	91.92	90.20	**4.5%**
2017	93.18	97.08	101.10	101.39	105.74	107.11	109.67	108.57	109.35	112.57	108.28	109.41	**21.3%**
2018	113.04	109.56	109.03	105.39	109.62	104.37	101.26	93.71	94.25	85.19	86.83	86.66	**-20.8%**
2019	91.98	92.36	90.04	90.21	82.80	84.21	82.57	78.45	76.52	77.82	78.75	82.80	**-4.5%**
2020	78.58	75.37	67.15	71.23	70.50	77.22	82.23	88.36	84.97	86.77	90.34	93.20	**12.6%**
2021	99.54	99.36	94.98										**1.9%**

Note: The Net Asset Value of the Fund has been linked to the rebased NAV of the Reference Account, which had the same investment style. Until the launch of the Fund, the Reference Account served as the model portfolio for all the separately-managed client accounts. Its trading records were distributed to clients as proof that the Manager's interests were fully aligned with those of the clients. The Reference Account was started at the end of 2008 and became inactive following the launch of the fund on 1 September 2013.

The following data is for the convenience of SGD-based investors and is for reference only.

NAV in SGD (for reference only)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										50.68	50.69	51.20	**2.4%**
2009	52.22	51.91	50.74	54.21	66.70	66.59	72.06	71.60	74.19	75.67	78.50	84.15	**64.4%**
2010	83.11	85.83	91.17	93.55	89.79	91.72	96.10	97.84	106.70	108.12	112.34	115.86	**37.7%**
2011	111.57	109.76	111.06	113.64	112.11	112.14	109.75	100.70	89.85	97.91	93.64	94.48	**-18.5%**
2012	97.39	103.46	103.79	103.05	98.44	97.76	96.12	97.20	98.89	96.95	100.95	103.74	**9.8%**
2013	113.19	120.44	124.03	123.50	125.34	120.54	125.55	127.49	126.57	126.83	128.86	127.81	**23.2%**
2014	124.51	128.55	125.58	127.84	132.26	132.85	135.95	135.58	132.14	133.61	132.91	132.34	**3.5%**
2015	132.68	133.74	134.11	137.66	139.74	136.08	131.71	121.30	119.78	124.68	121.53	122.26	**-7.6%**
2016	116.13	117.82	119.59	123.86	126.08	123.36	126.71	129.30	129.32	129.95	131.79	130.54	**6.8%**
2017	131.35	135.81	141.22	141.04	146.29	147.44	148.75	147.28	149.30	153.38	146.00	146.32	**12.1%**
2018	148.13	145.04	142.95	139.64	146.74	142.24	137.76	128.59	128.83	117.98	119.13	118.06	**-19.3%**
2019	123.77	124.86	123.01	122.81	113.88	113.93	113.02	108.85	105.83	105.92	107.71	111.33	**-5.7%**
2020	107.23	105.02	95.47	100.41	99.64	107.68	112.93	120.15	116.02	118.55	121.20	123.14	**10.5%**
2021	132.30	132.32	127.74										**3.7%**