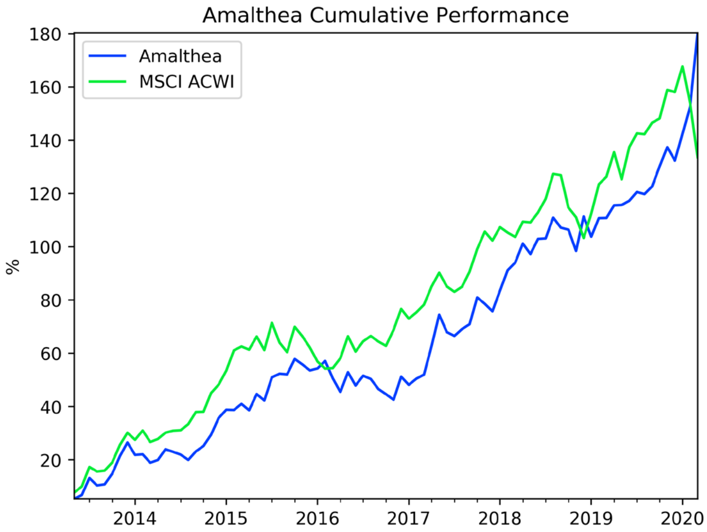
Bronte Capital

Amalthea Fund – March 2020

The Bronte Amalthea Fund is a global long/short fund targeting double digit returns over the long term, managed by a performance orientated firm with a process and portfolio that we feel is genuinely different. Objectives include lowering the risk of permanent loss of capital and providing global diversification without the market/drawdown risks typical of long-only funds. We believe a highly diversified short book substantially reduces risk and enables profits to be made in tough markets

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY13											5.4%	1.3%	6.8%
FY14	6.0%	-2.5%	0.4%	3.6%	5.7%	4.3%	-3.7%	0.2%	-2.6%	0.9%	3.4%	-0.8%	15.2%
FY15	-0.9%	-1.6%	2.7%	1.7%	3.4%	4.9%	2.3%	-0.1%	1.7%	-1.7%	4.4%	-1.7%	15.6%
FY16	6.1%	0.9%	-0.2%	3.8%	-1.3%	-1.4%	0.5%	1.8%	-4.1%	-3.4%	5.1%	-3.4%	3.8%
FY17	2.5%	-0.8%	-2.5%	-1.3%	-1.5%	6.1%	-2.0%	1.6%	1.0%	7.0%	7.2%	-3.7%	13.6%
FY18	-0.9%	1.5%	1.1%	5.9%	-1.3%	-1.6%	4.4%	4.1%	1.5%	3.7%	-2.0%	2.9%	20.8%
FY19	0.1%	3.8%	-1.8%	-0.4%	-3.9%	6.5%	-3.6%	3.4%	0.0%	2.2%	0.1%	0.7%	7.1%
FY20	1.5%	-0.4%	1.3%	3.4%	3.1%	-2.1%	4.3%	4.2%	11.0%				29.0%



The fund was up 10.97% in March, whereas the globally diversified MSCI ACWI index (in $A) fell by 8.00%.

Last month we wrote a letter explaining our thoughts on coronavirus and how we had positioned the portfolio. In February we purchased some puts on selected stocks and indices to protect our clients against what we thought *might* happen with COVID-19. At the time we thought the puts were cheap. Market volatility was low. And we thought the world was *especially* risky. (see over)

Fund Features		*Portfolio Analytics*[1]		
Investment Objective	Maximise risk-adjusted returns with high double-digit returns over 3-year periods.	*Metric*	*Amalthea*	*MSCI ACWI (in AUD)*
Min. initial investment	$100,000 (for qualifying investors)	Sharpe Ratio[2]	1.28	1.04
Min additional investment	$50,000	Sortino Ratio	2.84	1.80
Applications/redemptions	Monthly	Annualised Standard Deviation	10.91%	10.97%
Distribution	Annual	Largest Monthly Loss	-4.13%	-8.00%
Management fee	1.5%	Largest Drawdown	-9.70%	-12.73%
Performance allocation	20%	Winning Month Ratio	0.63	0.64
Administrator	Citco Fund Services	Cumulative return[3]	180.26%	133.59%
Auditor	Ernst & Young	1-year annualised return	32.93%	3.22%
Custodians/PBs	Fidelity, Morgan Stanley, JP Morgan	3-year annualised return	22.62%	9.43%
		5-year annualised return	14.72%	7.52%
		Annual return since inception	16.07%	13.05%

1 Performance and analytics are provided only for Amalthea ordinary class units. Actual performance will differ for clients due to timing of their investment and the class of their units in the Amalthea fund
2 Sharpe and Sortino ratios assume the Australian cash rate as the applicable risk-free rate
3 Returns are net of all fees

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There was a wide divergence between what was being said in the popular press (and implied in market prices) and what you could read freely in reputable journals like *The Lancet*.

In retrospect, some of those puts were astonishingly good purchases. We had at least one fifty bagger – albeit on a tiny position. Several other positions produced attractive results.

In the past month some of those puts and some of our short book has turned into cash (or cash-equivalents). Overall, we made a small net profit in February and now in March.

Where we stand

The result is that our funds are today less invested than they have ever been, with the net effect of reducing our risk profile. We have generated a lot of cash and we have a limited desire to deploy it.

Looking forward, we are not taking outsized bets where we do not have an edge and where we think the range of outcomes skews towards the downside. If we could buy hedges cheaply we would be willing to take (much) larger positions. But the sort of protection we bought for very low prices in February is only available at nose-bleed prices now.

Alas there is a corollary. Our potential for very high profits at the moment is also low. If the market roars back, we are going to feel like we have missed out.

We are still trying to fine tune the portfolio, to short crappy stocks and buy high quality ones – but our desire to take *directional bets* is low.

Things we did wrong

When your returns are so (relatively) good it seems churlish to talk about the things we did wrong. But we should because you pay us to get it right.

In mid-February we *really* had an edge on the market. We were reading the *New England Journal of Medicine*, *The Lancet* and the like and we had a better hold on the situation than many, if not most, market participants.

We did enough hedging to protect you – to make sure you did not lose much money – but we should have pushed it. One does not get an edge often – and we should be more prepared to lose money when we really think we have an edge. We were cowards who doubted our own judgement and it cost you outsized returns this month. We purchased enough cover to (approximately) protect the funds but not enough that outsized profits were likely.

This is a repeated issue. We made exactly the same complaint about our trading in 2011 when we also had some outsized edges and did not fully exploit them. A trade like this comes a couple of times a decade if we work really hard to find them. *We thumb-sucked*.

But the portfolio did work as expected

Self-criticism (as per above) is a feature of Bronte. We are always trying to get better – and we can't get better without a realistic analysis of our mistakes.

That said, it is fair to say our portfolio worked more or less as expected. Many of our shorts were pummeled, faring much worse than the market, while most of our longs were not.

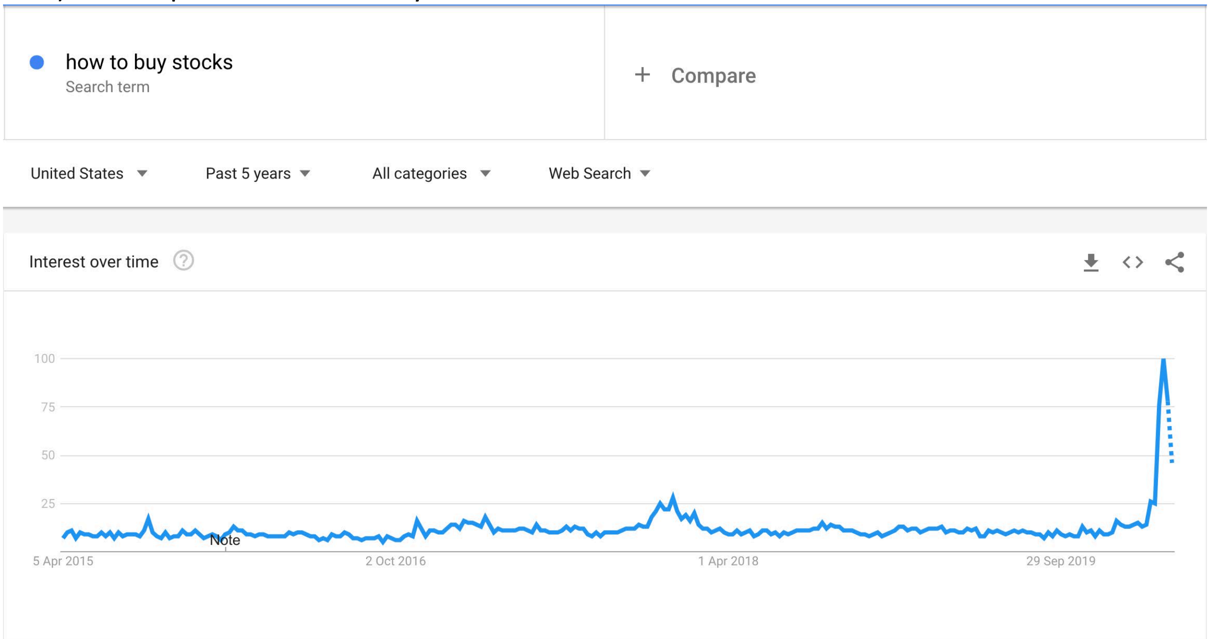
One recent day our longs were down just over three percent, slightly better than market. Our shorts were down over eight percent, more than double market declines. We managed to score a small profit, but the limits of this are obvious. If our shorts go down this sharply we need to replace them *and replacing them is hard work and getting harder*. We are finding ourselves working extremely hard just to stay still.

Also, this sort of result makes our "formula" rather difficult to implement. We own a fair few longs that are very good businesses but are far from cheap. Owning them is unlikely to be disappointing over a decade but, priced as they are, is also unlikely to be exceptionally good.

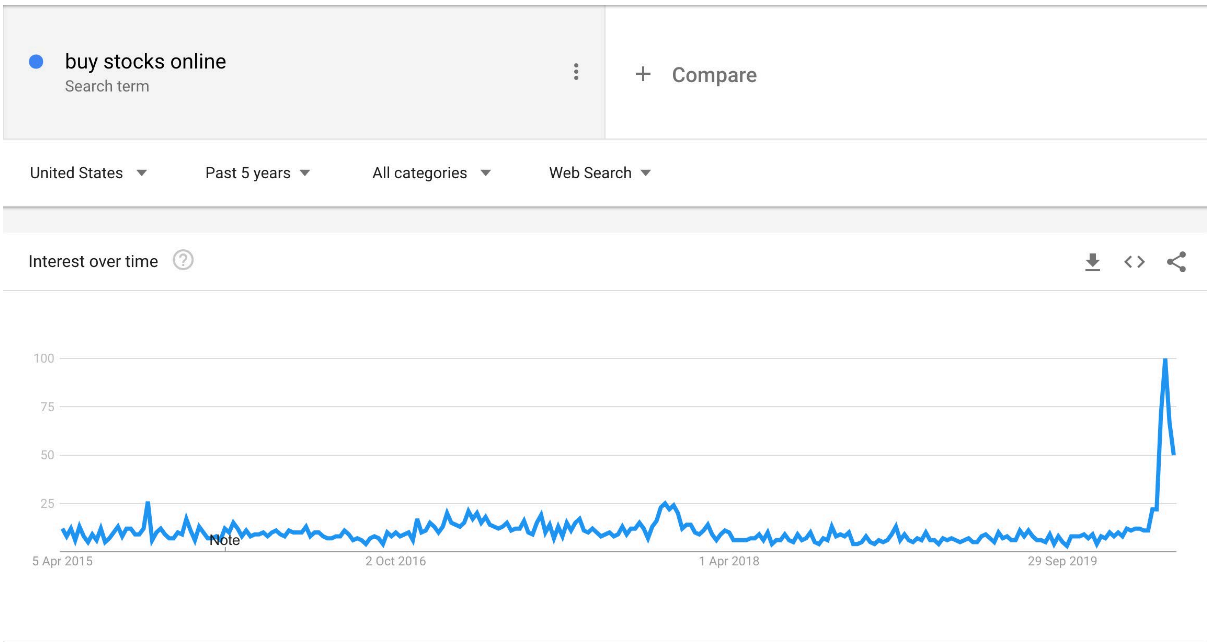
We hope for market declines so our shorts give us cash with which to buy more longs. We hope to buy those at attractive prices – but for the most part our longs (and most of our potential longs) have not fallen far enough to be attractive. We thus have a lot of firepower in cash and equivalents. We do not feel any particular rush to invest.

The market is down a lot – surely there are things to invest in

There is a knee-jerk reaction of amateur investors and stock commentators. That is to think the market is down 20-30 percent therefore it is cheap. We do not think this is true.
Here is some Google Trends data to illustrate. First five years of search frequency (in the USA) for the phrase "how to buy stocks".



This sudden spike in retail interest is seemingly independent of the search term. Here it is for "buy stocks online".



Our inclination is to look at this data and say "thanks, sold to you". But less cynically we should observe that we do not think the (US) market is particularly cheap.

As of writing this letter (early April 2020) the S&P is just shy of 2500 points. The market was lower in December 2018 – and we did not think it was particularly cheap then. And it was this level again in mid 2017 and we did not think it was particularly cheap then. And in those times we did not have the sword of COVID-19 threatening to wreak havoc over the economy.

For us though, large profits on shorts and markets that are not particularly cheap is a problem. Our model is to deploy short profits into high-quality businesses at reasonable prices. *Alas we only have gains from our shorts now – not fully yet the high-quality businesses at reasonable prices*.

We have bought small positions during March, but none of them particularly excite us. We added a little to various stocks like Visa and Symrise, both exceptionally good businesses. We bought a small starter stake in Facebook, which we will sell whenever we find something we *really* like at a price we think attractive. We bought some small stakes in listed French companies. But we have not been buying with gusto.

Longs that performed badly

Only one large position, Herbalife, performed notably badly. We trimmed Herbalife very aggressively above $50 a share and have since bought back some of the position.

Herbalife gets much business with face-to-face community meetings. Obviously, the virus negatively affects business development. But Herbalife also sells weight loss food in long-life containers delivered via couriers. That part of the business should be doing very well. Our research suggests Herbalife sales will not be down much. We have added a little to the position and will probably add more.

Only one small position, Allied Irish Bank, appears as an unmitigated disaster. The bank remains well positioned (there is a strong oligopoly in Ireland), but a combination of Sinn Fein gaining political influence, coronavirus, a mortgage pricing scandal, the collapse in interest spreads, and general anti-bank sentiment has resulted in the stock losing over three quarters of its value over the last year. We have not bought more and are very unlikely to do so. Financial institutions are particularly levered to bad economic outcomes and we generally will not double-down on these stocks. John once wrote a blog post which explains our attitude to doubling down. AIB is a classic case where we should not double-down.

Currency hedging for Australian clients

Since inception Bronte has not hedged the foreign currency exposure of Australian clients. We have generally thought that the (long-run) direction for the Australian dollar was down – and that our Australian clients were over-weight Australian assets and hence it didn't seem sensible to turn their foreign assets (held in the fund) into effectively Australian assets by currency hedging.

When the Australian dollar hit 55c vs the USD during the month our attitude changed. At this point we thought that having the Australian clients completely unhedged was too strong a bet against Australia. We put on a partial hedge for the Australian dollar clients. As the currency almost immediately appreciated to 60c we took the hedge off again. The net effect was an extra half of a percent or so in performance for the Australian clients.

Should the Australian dollar weaken, you can expect the Australian fund to start currency hedging. This will cause a difference between the performance for Australian and US clients. We do not think this can be sensibly avoided, but we wish to explain it in advance.

Working from home

Bronte was aware of COVID-19 risk well before this was a popular topic of conversation. We took this risk into account operationally. We trialed working from home well before this was necessary and we ironed out most of the kinks. We have been working from home longer than most businesses.

It is mostly – but not entirely – seamless. All the work is done appropriately, portfolio meetings are smooth, and there is little hiccup in idea development.

We also use a number of service providers, most importantly being our external administrator Citco and the funds' prime brokers. We are monitoring their financial wellbeing as well as their operational capabilities. Our brokerage counterparties are Morgan Stanley, Fidelity and JP Morgan.

Future

The cliché is that past performance is no indicator of future performance – and alas that will be true over the next few months versus last month. Last month benefited from very cheap options purchased in February.

We cannot replace that cheap insurance. Insurance is now alarmingly expensive and that makes it hard for us to make outsized returns if the market falls. It also limits the extent to which we are prepared to bet on a market rally.

So, generally, we have pulled our horns in, and we are running less aggressively than we normally would. Effective gross and net positions are very low and our estimated beta is only about 10 percent.

That said, we are very cash-rich – and we seek opportunities. We expect to deploy the excess capital over the next year or so, though we stand ready to act substantially faster if good opportunities present themselves. We are also interested in participating in selective capital raisings in companies we know well. Our conservative positioning enables us to selectively participate in the recapitalization of global business.

Thanks for placing your trust in us

The Bronte team