Bronte Capital
Amalthea Fund

14 January 2014

Investors' Letter for December 2013

We had a good month (+4.3%), and all-up it's been a satisfactory start for the fund which only opened in May 2013. Since then (net of all fees) we are up 26.5%, and for the 2014 financial year we are up 18.5% (again net of all fees). We are a long fund that shorts on the side and we have stated many times that the goal is to more or less keep up with up-markets and not to hurt too badly in down-markets. And 2013 was a rip-snorting up market – and we more or less kept up.

We are trailing US equity indices (after converting to Australian dollars) – but given the carnage to other short-sellers we are happy enough with more or less keeping up. There are relatively few long-short funds that did better than us and plenty we respect who did much worse.

Since the start of 2013 the Aussie dollar fell some 13.8% (and 13.7% since inception of the fund). As a global investor this has provided a tailwind for our returns and enabled Amalthea's own investors to keep up with their global peers. It won't always be so, and sometimes movement in the local currency will appear more like a curse than a blessing. But, generally speaking, some diversification away from our volatile (and we believe overvalued) currency is prudent risk management.

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Over December we had our usual collection of small calamities. One short went up 150 percent very quickly for instance. It was only a 40bps position – but is now a 100bps position and so somewhat less comfortable. We have covered none but if it were to go up another 150bps we would have to take our medicine (which means booking losses for you, dear clients). The company will go to zero but that is no guarantee we will make money on the short.

Despite our debacles most things went okay, especially from the middle of the month. The beginning of the month was not great (we reported that in our last letter) but then John went on holidays and our results improved. We are not sure of the correlation but this is a repeated pattern.

The generalized short-selling debacle of 2013

In 2013 overconfident shorts in several stocks were exposed. When the year begun there were large short positions in Herbalife, Tesla, Netflix and a few other stocks <u>where the shorts have now been categorically shown to be wrong</u>. When short-sellers are wrong on a crowded trade in a bull market they get cruelly and unusually punished. But cruel and unusual punishment was not confined to situations where the shorts were wrong. The emblematic loss of the year was Uni-Pixel – a highly promotional touch-screen

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manufacturing company. We shorted our typical sub 1% position at 12 and it went into the mid 40s. We were forced out of the short by lack-of-borrow in the low 30s. The stock is now trading below 10. Even if the stock goes to zero (which is a distinct possibility) we have no chance of making up our losses.

By year-end it became fashionable to go long stocks because they had high short interests. Squeezing shorts has become the big game. After all, our loss on Uni-Pixel was someone else's gain.

We have ducked the squeezes mostly by being short less crowded names and by being long one high short interest stock (Herbalife was our best stock of both the month and the year).

That said, we are now seeing people pile into worthless stocks on worthless analysis and being fooled by momentum into believing they are geniuses. This will end sometime and short-sellers will again have their day. We look forward to making real alpha on the short-book again.

We are now getting long a few high-short interest names though as a hedge against a further generalized squeeze. We are rigorous about investigating the short thesis. Only one name springs to mind – Blue Nile. Blue Nile is an online jeweler and a very fine company sporting a very high valuation. The short-thesis is essentially a valuation thesis. We think the short-thesis is only marginally wrong – but the high short-interest skews the trade in our favor. Still this sort of “trade” warrants only a single digit percentage of our portfolio. It’s just a little “spivvy” for us. Still it’s not a bad place to be. We are buying high-quality companies at the wrong price but as a necessary hedge against crappy companies shorted at even more egregious prices. We stress however that typically the long portfolio stands on its own merits.

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Over the next year we suspect we are going to make very good money in seemingly boring stocks like Verizon. These have underperformed the bull market and we think they are reasonably valued. And we hope one day to make money shorting again.

We have the odd Bronte-secret bet which is a little “out-there”. One for instance has us risking less than 1 percent of the fund to make a (very) solid double-digit return if we are right. We will let you know about them if they pan out (and will confess our unnamed losers if they do not).

Asset markets are expensive now. This does not mean they can't go up further – but if you hold most asset classes for long periods you should expect real returns in the low single digits or even perhaps negative. Our strategy aims to do very much better than that, and much better than many other places to entrust your capital.

Thanks again

John and Simon

Performance

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin Year to Date Return	Average Monthly Return
FY13											5.4%	1.3%		3.0%
FY14	6.0%	-2.5%	0.4%	3.6%	5.7%	4.3%							18.5%	