

14 April 2014

Investors' Letter for March 2014

This is a month in which some bad things happened in our portfolio and the resurgent Australian dollar was an additional headwind. The overall results are nonetheless in line with global markets (when evaluated in Australian dollars).

In keeping with our tradition of self-flagellation we wish to outline the things that went wrong.

A: We are significantly long in Herbalife – and the stock reacted very badly to the news of a Federal Trade Commission inquiry into their business and the news this month of interest by the Department of Justice and the FBI in Manhattan. This cost us a few percent of the portfolio.

B: We had another position – an asymmetric bet on which we did a large amount of high quality work. We thought it *might* work – and the pay-off if it did work was as much as 50 percent of the portfolio. It didn't work which means we lost you over one percent of the portfolio. John wants to go on record praising the staff for the quality work they did on this name even though it did not work out. [Alas, and after some consideration, we are not willing to name the company publicly.]

C: As a global fund denominated in Australian dollars we are also short the Australian dollar which climbed from 89 to 93 US cents over the course of the month.

Notwithstanding these losses we matched the market and the rest of the portfolio is doing fine or better than fine.

Our increased biotech exposure

We short frauds and promotes. Biotech is full of frauds and promotes. This is natural – the area has very asymmetric pay-offs which attracts gamblers who tend to be willing to bet and lose considerable money. The area is incomprehensible even to most experts and hence it is very hard to tell a real biotech stock from a no-hoper promote. Finally, and related to the incomprehensibility of the area – virtually nobody is ever prosecuted for fraud in biotechnology. This means that promoters can sell dodgy biotechs (“biodrecks”) free from risk of prosecution.

Despite taking losses in January on shorting biodrecks we have returned to that table adding about four percentage points of the portfolio to our position. They should be good shorts – in many of them the science is so silly as to be comical.

Moreover we think we have got the timing right. Since we put this position on it has done very well. However we tend to lose money on promotes that go from \$5 to zero via \$50, and

promoted “biodrecks” have an alarming tendency to do this. Even if we are right that the companies have no prospects we can be wrong on the timing. That is why our positions are so small in aggregate and so diversified. [Our new position included almost 20 stocks.]

This current month we are continuing to do well - relatively. The asymmetric loss (b) above isn't happening twice. Alas Herbalife came back and clobbered us for a second time mid-April when the Financial Times reported the criminal investigation into the company. [We believe the company is doing nothing wrong prospectively but some former distributors are more than questionable and the company might be vulnerable on their behavior.]

We have a deep desire to make some serious money for clients. We think it will happen but we can't say when. There will over-time be a correlation between quality research and returns – but that isn't seeming to happen now. I discussed (B) above by name with a big name New York hedge fund manager. Quick as a flash he quipped “Dear Limited Partner, let me tell you about the fine research we are doing”. We almost wanted to start our letter that way.

But it's true. There is good stuff going on at Bronte and one day we will show it in returns.

Until then it is just getting positions right most the time and managing the risk for the times we are wrong. It's hard work. But we are thankful you entrust us to do it.

Simon and John

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%		1.6%
FY14	6.0%	-2.5%	0.4%	3.6%	5.7%	4.3%	-3.7%	0.2%	-2.6%				11.4%	

