BronteCapital
Amalthea Fund

14 August 2014

Investors' Letter for July 2014

Dear Amalthea Investor,

Global markets were down slightly in July and so too were our funds. We chose to reduce our gross exposure (sum of long and short positions) throughout the month and this mitigated losses somewhat but as a long/short fund with a portfolio beta[1] below 0.5 we should "typically" do better in these circumstances.

We say "typically" very carefully because our portfolio and the strategy used to create it has some nuances. At present we are approximately 125% long and 45% short for a net exposure of 80% but the long and short portfolios are very different and when we adjust for beta our net position is much lower.

The longs are heavily researched, value oriented positions. Some we think are mispriced growth stocks – e.g. Verizon. Some might view it as a utility or grandma stock but we see it as a rare high dividend paying growth stock in an expensive market and we think, with good reasons, that it has much more pricing power than the market gives it credit for.

The price to book on our long portfolio is only 1.38x and the trailing price to earnings ratio 13x - however this is somewhat affected by our large positions in very low PE stocks like Herbalife and some phone companies.

Our shorts are very different. As a general rule we are looking here for frauds, fads and promotions. Hope and dreams keep these stocks alive and often times they are exceedingly (and purposely) difficult to analyse because they operate in opaque fields of new technology (e.g, biotech), or in remote locations, or in legally and politically tenuous foreign jurisdictions (the China reverse merger company's that blossomed on US stock markets are typical). Price to book at 2.67x and price to earnings of 23x on our short portfolio are both roughly twice that of the longs.

One of the outcomes of having mismatched long/short books is that we don't get quite as good a risk offset. Our shorts aren't paired with our longs on industry or any other lines. This is a function of seeking value in both our long and short portfolios. Whilst our short book provides a good hedge to our long book it does not provide a perfect one – especially over shorter time periods. We wish the hedge were better because then we could take larger positions. Alas it is not.

We are seeking to make money from our short book in its own right and the hedge that it provides is a valuable additional benefit but not the primary driver in portfolio construction.

[1] A measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole

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So our returns will be a little bumpier but the gains should flow from a strategy that prioritises value from both legs but still captures a substantial benefit from long / short portfolio offsets over time.

Geopolitics and Virulent Exotic Diseases

Major World events brought both gains and losses to the funds. We have significant holdings in German consumer and industrial businesses. German companies are major players in Russia as both exporters and asset owners. The Ukrainian conflict (and some worse economic data) has seen German markets fall some 20% off their highs. Our companies were not immune to falls albeit our (far fewer) German shorts fell more.

Meanwhile the Ebola virus has emerged again on the West Coast of Africa, causing deaths and growing fear - and significantly impacting the vulnerable local economies. We have a small short exposure here to the iron ore mining industry. This short was never based on such a "black swan" occurrence. Our analysis suggests the circumstances of the businesses would have given rise to financing problems – but a virulent disease provided some modest immediate gains. We take no pride in that.

Still - after a torrid 18 months in which shorts have provided nothing but pain - we were pleased to get one right even if it was for the wrong reasons.

Thanks again

John and Simon

Performance

Current financial year return	-0.9%
Last 12 months return	7.5%
Return since inception (annualized)	17.2%
Cumulative Return since inception	22.0%

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
FY13											5.4%	1.3%
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%
FY15	-0.9%											