14 May 2015

## Investors' Letter for April 2015

The steep rise in the Australian dollar disguises what was a good month for us against a bad trend for the hot hedge funds of the moment. With almost all of our assets held in non-Australian stocks and currencies the 4% rise in the Aussie dollar resulted in the fund declining over April, but reduced by some good stock picking. The turnaround in the Australian dollar reflects other trend reversals over April as we describe below in the same text we provide to overseas investors in our non-Australian dollar denominated funds.

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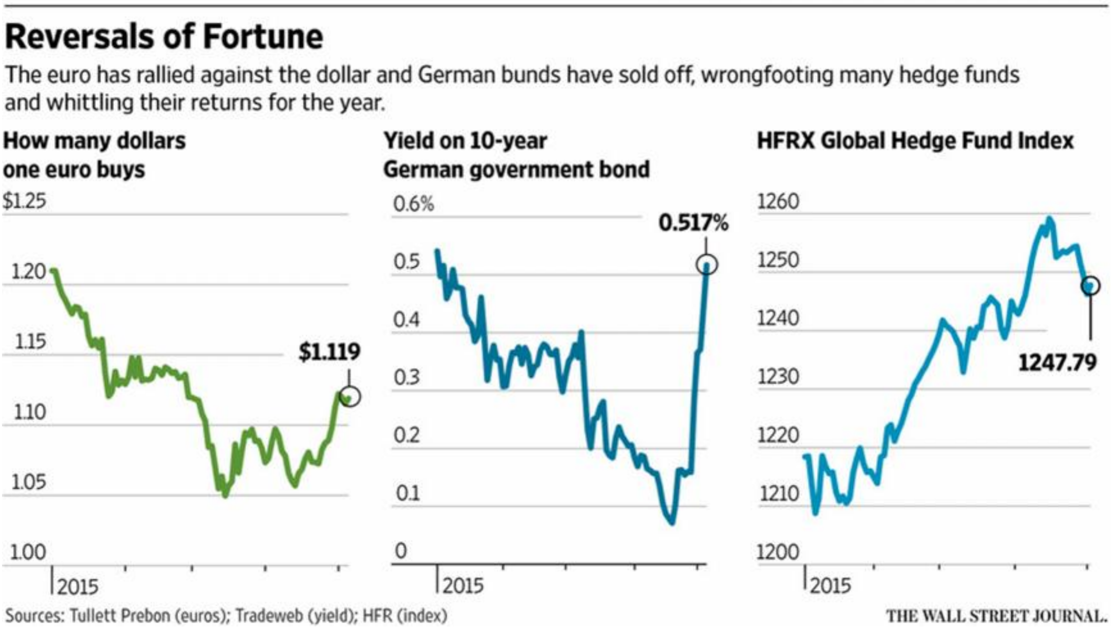
April was a month in which some of the strongest market trends reversed. Funds that had been trend-following were exposed. The WSJ (quoting Morgan Stanley) reported some ugly losses due to sharp turns in the Euro/Dollar exchange rate and Bund yields.

This was the graphic from the WSJ…




The WSJ similarly could have noted the oil price movement against trend.

Our relatively good performance is unsurprising when a momentum driven market breaks. Sitting down here in Australia we do our own work and we are right or wrong in our own ways. For better or for worse we are congenitally anti-momentum.

For the past 18 months that has – generally – been a bad idea. Momentum has worked very well – the best stocks being businesses not very amenable to traditional valuation such as biotech and some Chinese internet names.

Our anti-momentum predisposition may not – over a very long term – be correct. There are some studies that suggest momentum has worked quite well if your time-frame is 100 years.

But momentum is a dog of a strategy at the top and so it leaves you forever wondering when to get off.

We think many momo strategies have produced portfolios that are now very dangerous. We look at the portfolios of some very well regarded funds with concern.  Often we find a collection of expensive stocks with end-games covering the spectrum from being competed away to world dominance, and stock promotions with identifiably fake accounting. In other words things that you can't value and things that can only support their current valuation if you accept their elevated claims and obscure accounting.

We hope our relatively good performance will continue - but we are still deeply uncomfortable with this market. The concerns we spelled out in the last letter still apply.

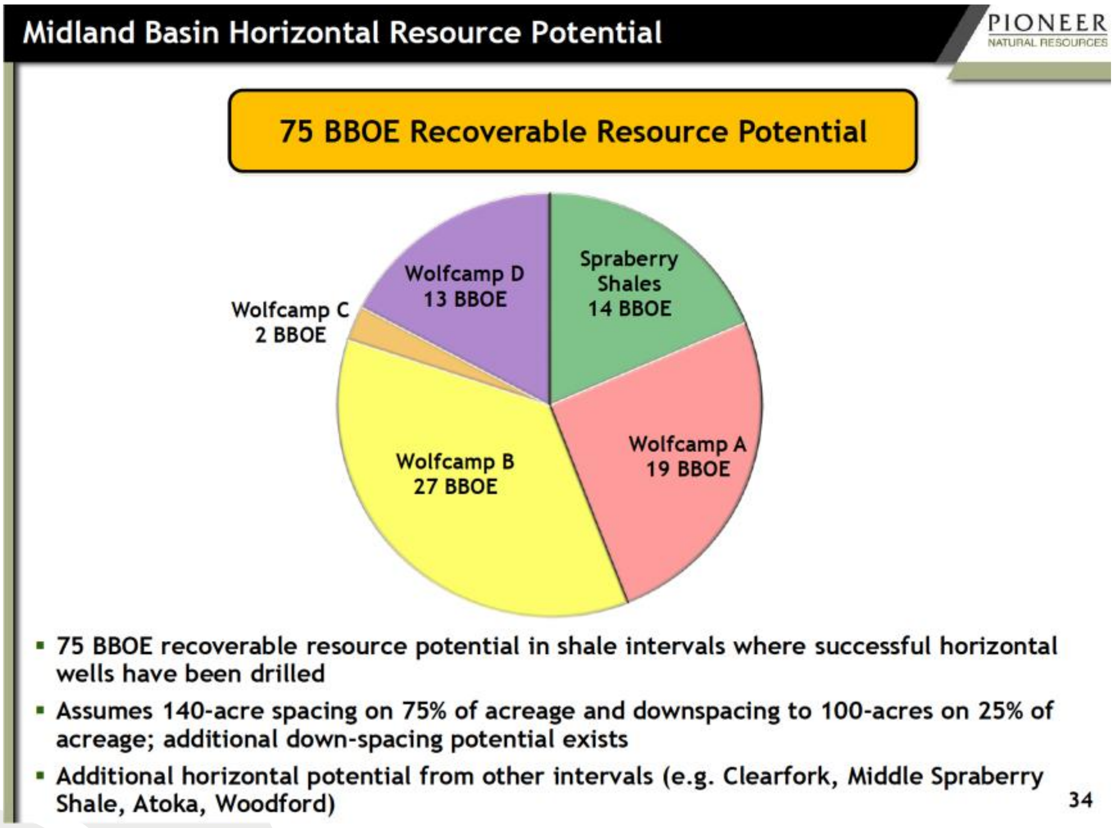
Early this month David Einhorn presented the bear case on US shale stocks in general and Pioneer Natural Resources in particular. [You can find a copy of the presentation at http://www.marketfolly.com/2015/05/david-einhorns-sohn-conference.html.]

We have been short many shale oil companies including Pioneer for some time with only marginal levels of profit.

If anything on Pioneer we think that Mr. Einhorn (mostly) understated the case. [There is one slide we think he overstated – but it is trivial in the scheme of things.]

Our observation was of a large disconnect between what Pioneer says – and what they do.

Pioneer have been more than willing to tell you about the jaw-dropping size of their oil play in the Wolfcamp Texas. This slide is a recent example (though there are many similar slides).



75 billion barrels has to be put in perspective. The daily output of Saudi Arabia is under 10 million barrels per day - so this is about twenty years of output of Saudi Arabia. Wolfcamp is slightly larger than the largest oil field ever discovered (Gharwar in Saudi Arabia).

Despite this enormous discovery they have merrily sold stock (in the billions) thereby diluting this enormous asset. Insider selling has also been phenomenal.

Diluting your ownership is not what you do when you have a resource like that.

We did a check of the oil industry blogs (mostly places engineers like to talk about technical issues). There is some evidence that wells Pioneer has described as enormous have very rapid declines.

David Einhorn did some maths on what Pioneer was worth - and how much value he thinks it has destroyed. The numbers are in the same ball-park as our back-of-the-envelope figures.

We only raise Pioneer though because it is in-the-news. Our favorite shorts in this space are smaller companies we believe have far more specious claims - rather than being merely promotional. But, as the stocks are less liquid and the borrow to short them much tighter, we are unwilling to describe them here.

We hope for a continuation of this recent stock-pickers' market rather than a return to a momentum market. In such circumstances we tend to do well.

Thanks Again

The Bronte Capital Team

**Performance (Net of all fees)**

| | |
|---|---|
| Last 12 months | 15.6% |
| since inception (annualized) | 17.8% |
| Largest Monthly Gain | 6.0% |
| Largest Monthly Loss | (3.7%) |
| Max. consecutive Gain | 15.7% |
| Max. Drawdown | (6.0%) |

| | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 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% | | | 12.6% |