BronteCapital
Amalthea Fund

15 June 2015

Investors' Letter for May 2015

Net performance was 4.36% this month, continuing our recent run of good returns and ahead of global broad based indices when measured in Australian dollars.

European Investment Appraisal

John and David (one of our analysts) have just spent a week travelling around Germany and Italy visiting potential investments. As is often the way, the companies the tour was built around turned out to be of only middling interest but at the companies used to fill out the trip we found some interesting stuff. Serendipitous discoveries often make these trips so worthwhile.

A general impression though:

a) The equities were not cheap – but they were not nose-bleed expensive either. They are clearly cheaper than their USA peers.
b) Margins the companies were earning were higher than normal – but if anything the margins were going up (with the weak Euro) rather than down.

All in all we thought most prospects would provide adequate returns but they were relatively unexciting. This might however be over-intellectualizing it. Quantitative easing is just beginning in Europe whereas it is ending in America. Profits are going up and there is so much liquidity that people will chase stocks. We would however like to pick the better stocks in those countries with downside protection at least to mitigate the risk that the situation turns really ugly.

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One surprise was the companies we visited previously owned by private equity. They were really well run – and we believe they had come out of private equity as substantially better institutions than they went in. This is contrary to much of our pre-existing "strip-it-and-sell-it" negative impression of private equity operations.

Perhaps these were the successes – the ones that could be resold to the market at substantial profits. But, regardless – the impression was good. These previously private equity owned stocks have not performed brilliantly since they were relisted – but that was generally not because the business was poor. Rather it was simply that the PE guys extracted good (i.e. high) prices on relisting.

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John and David also went to Germany to look at the land of discount retailers. Aldi-Lidl formats have 45 percent shares in groceries there - and it is not uncommon to see high end Mercedes parked at Aldi buying discount groceries. [One alcohol producer winced to us that the only things Germans would buy are holidays and cars. In Germany the spirits business is 90 percent at home (rather than on premises) and dominated by no-name brands sold without premiums.]

Whatever - we were trying to work out how far could the discounters roll out in other countries and hence what the downside was for discounter-challenged retailers in the UK (e.g. Tesco) or for ones that have not seen discounters do serious damage yet (such as Woolworths in Australia).

Trust us - the extreme German case is not pretty. One percent margins seem to be the new-normal. We are not sure it will get that bad in the rest of the world. Germany, relative to income, is probably the world's worst consumer market. But the safety cushion in our European retailers is much thinner than we would like. [And most of these own billions of Euros worth of property.] And the safety cushion for something like Woolworths in Australia - which by-and-large does not own its property - is very thin indeed.

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One company we met in London had observed a "hypothetical competitor": a junior mining company listed on the TSXV/OTCBB. We'd run into the junior miner in our short research. It had appeared on the website of a stock promoter we track. The company we met - which operates a very successful mine for a highly specialized mineral they use as an input and couldn't understand the claims the Canadian company was making for their products. We shared what we knew of its dodgy origins and matched what their more thorough and different checks told them.

We prefer confirmation in the market - but this was pleasing nonetheless.

Portfolio Commentary

Recently bond and currency markets have exhibited significant volatility. Should these market risks extend to other markets the rewards from being a naïve index investor will be challenged (we define an index investor as an investor who doesn't do any due diligence on their individual investments but relies instead on "Wall Street" to price everything correctly for them).

In this scenario the most obvious opportunity lies in our short book. There are valuations on many stocks which have benefitted from years of excess liquidity and a lack of investor understanding about their true characteristics. Our investors can benefit from a fall back to earth of these stocks.

In relation to cash positioning, we are holding our cash balance in US dollars and, of course, the vast bulk of the funds securities are non Australian.

In summary, this has been a long bull market and it is a brave person now who is betting only on equity market appreciation. That said, and as described in our trip notes above, we continue to research diligently to ensure our long book has attractive long-term prospects.

Thanks Again

The Bronte Capital Team

Performance (Net of all fees)

Last 12 months	16.7%
since inception (annualized)	19.4%
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%	4.4%		17.6%