Bronte Capital
Amalthea Fund

17 August 2015

Investors' Letter for July 2015

The fund achieved a 6.12% net gain in July, our largest individual monthly gain to date and keeping up with global broad based indices when measured in Australian Dollars. We have beaten the market for many months now but not by an amount that is exciting. We would like more – but not at the expense of raising our risk tolerance. Of course the steep decline in the Australian Dollar contributed substantially to the large monthly gain.

The market is becoming increasingly difficult. Whilst the aggregates have not done much, individual stocks have had large movements on relatively small underlying changes. In a small way we have been both a beneficiary (Google) and been hurt a little (Henkel).

Let's look at some recent moves.

Google is – as almost everyone with a computer or an Android phone knows – a very powerful business. Revenue is large and grows fairly nicely albeit at a slower rate. Revenue is now larger than US broadcast television. This is significant when you consider all the costs that broadcast TV supports (all that production, all those stars and their expensive lifestyles).

Google also supports a lot of costs – e.g. development of self-driving cars and a huge number of other research projects – and for about 18 months it seemed like Wall Street was focusing a lot on these (optional) costs and less on the growing underlying business.

Then there were results which showed the revenue still growing for the underlying business and the optional costs stabilizing – and lo – the stock took off. We owned the stock and it has been a big performer – but the change in fundamentals over the past two months is less dramatic than the stock move.

On the other side since the foundation of Bronte in 2009 we have owned Henkel – a German industrial chemicals and consumer goods conglomerate. The stock has been very good indeed and we have sold some along the way. Its not exactly cheap but in the relative value game that is Wall Street it is not diabolically expensive either. It dropped ten percent on pretty good results – primarily we think just because it was over-owned.

This is top-of-the-market behaviour. Momentum has been a good strategy and momentum managers have outperformed. The outperforming managers have attracted new funds to manage which fed the cycle. However they have crowded into relatively few "unbroken" stories. And when one of those stories "cracks" even a little bit they get skittish. As they crowd into the remaining unbroken stories the market becomes narrower (and probably more skittish).

Apple (which we do not own) is the ultimate hidey-hole for a lot of managers. The business (and the stock) has been fantastic but the new product this year (a watch) has underwhelmed (at least by Apple's standards). Apple has started moving as much as 5 percent in a day without news. These are $30 billion market cap swings on nothing. That is a skittishness in the market you can't see in the underlying aggregates.

[For our Australian investors we should note that we are talking mostly about the US market. Europe and Australia in particular have had more notable moves in the aggregates.]

Our particular favourite chart at the moment is Sun Edison – a high quality solar project company. This has been a great business. The cost of panels (the main input cost) has gone down (and then down further). Debt has become cheaper (which matters in 25 year debt-financed projects) and it has been possible to drop finished projects into yield-companies sold on relatively low yields to yield-hungry investors.

So the stock went up-and-up.

Recently Sun Edison announced that they were buying Vivint Solar.

Vivint has many small rooftop projects – worthwhile projects. And a solar developer needs a huge pipeline of projects - the acquisition has a purpose. Vivint however is a multi-level marketing company like Avon, Mary Kay cosmetics or Herbalife. To quote a (mostly favourable) Reuters article :

> *Most of Vivint's growth has come from converting homeowners to solar customers on their front doorsteps and at kitchen tables in the same way the likes of Avon Products Inc and Mary Kay Inc won over cosmetics buyers.*
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> *"It's still a misunderstood or unapproachable product," Vivint Solar's Chief Operating Officer, Brendon Merkley, said in an interview. "When you can sit down next to someone at their home and say 'You can do this with zero money down and start saving immediately,' that works very well."*
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> *The financing schemes allow homeowners to avoid the $20,000 to $30,000 upfront cost to install a typical home system. Blackstone bought Vivint Solar's parent company, Vivint Inc, a year ago for more than $2 billion. Formerly known as AFX Alarm Systems, the Provo, Utah company started selling alarm systems door-to-door in 1999. Founder Todd Pedersen said knocking on 20,000 doors as a missionary in the Dominican Republic inspired the business plan. Vivint had $400 million in revenue last year. It does not disclose how much of that came from solar.*
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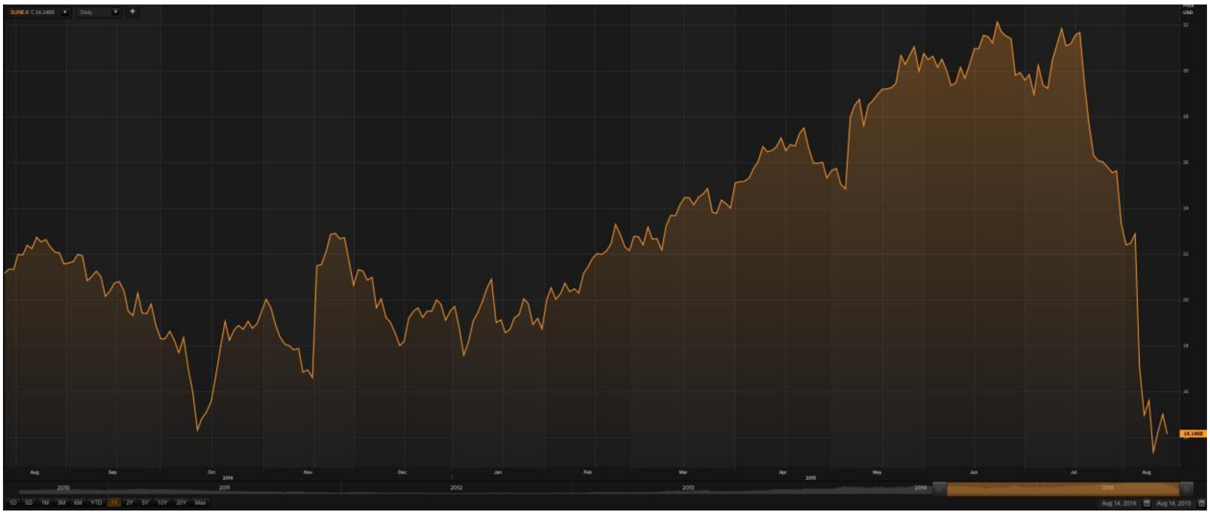
> *Blackstone saw Vivint's door-to-door sales strategy as "unique and attractive," enabling it to acquire customers at a low cost, Blackstone's Peter Wallace, who led the firm's investment in Vivint and sits on its board, said in an email.*

Even this did not drive the stock down even though multi-level marketing schemes are controversial on Wall Street. But it did make investors skittish. What drove the stock down are some (very) minor comments in a conference call. This was the result:



Once again, the comments were really minor compared to the stock move.

Famous hedge fund managers own this stock. That – plus momentum – gave momentum followers plenty of excuse to own the stock – and they did so in increasing quantity.

Then when the momentum looked broken they rushed for the exit. The stock chart and the fundamentals do not align. The associated yield company (TerraForm Power) was similarly smashed and we purchased a tiny stake.

Distance Can Be a Virtue

Every time we go to New York or London and meet with friends and acquaintances who work in the famous funds we are impressed – indeed sometimes staggered by their smarts. Partly it is that the people we wind up having dinner with work for the most successful funds in the world. Moreover they know a lot – the social networks are pervasive – and the quality of analysis is of the highest standard.

Yet there is also a sameness to it. They go to the same bars, the same restaurants and they talk with each other every day. Good analysis is common, but positional crowding is also common. It's the crowding that creates charts like Google (flat for a long time then rocketing up) or Sun Edison (rising for a long time then rocketing down).

There are disadvantages to running global money in Australia. We spend much of each year living out of suitcases and sitting in airport restaurants, with company reports our only companion. If you want to visit any large centre of economic activity you need to get on a plane for more than 12 hours. The time-zones make it harder to talk to company management. Apart from Asia, you can't watch market movements (although sometimes that is an advantage).

But there are advantages too. We don't get to ride the coat-tails of other people's analysis and that makes us less skittish and less prone to be in the momentum stocks. We think it is an advantage overall. During the last few months it clearly has been advantageous.

And it does make us work harder.

Recruitment

John has started recruiting for a new analyst mostly to help him out on a day-to-day basis on the long side. The number of applicants was enormous and the distribution of talent very large. But we have a handful of simply brilliant candidates and in the end are spoiled for choice. Australia can be a good place to run a fund manager after all.

Our plan is to gradually assemble a team of remarkably high quality. And, whilst the month to month results will jump around, we focus on sound processes that can deliver excellent long-run results.

Thanks Again

The Bronte Capital Team

Performance (Net of all fees) [unaudited and pre end of year distribution]

Last 12 months	23.7%
Since inception (annualized)	20.1%
Largest Monthly Gain	6.1%
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%	-1.7%	15.6%
FY16	6.1%												6.1%