



Bronte Capital

Amalthea Fund

15 October 2015

Investors' Letter for September 2015

We beat global markets (again) this month by more than 1.5%. But we were still down, and whilst this is "out-performance" it is not enjoyable.

S&P earnings

Here is the S&P since 1960.

Note these numbers contain no inflation adjustment. Returns in the 1970s really were atrocious

Year	Earnings Yield	Dividend Yield	S&P 500	Earnings	Dividends	PE ratio
1960	5.34%	3.41%	58.11	3.1	1.98	18.75
1961	4.71%	2.85%	71.55	3.37	2.04	21.23
1962	5.81%	3.40%	63.1	3.67	2.15	17.19
1963	5.51%	3.13%	75.02	4.13	2.35	18.16
1964	5.62%	3.05%	84.75	4.76	2.58	17.80
1965	5.73%	3.06%	92.43	5.3	2.83	17.44
1966	6.74%	3.59%	80.33	5.41	2.88	14.85
1967	5.66%	3.09%	96.47	5.46	2.98	17.67
1968	5.51%	2.93%	103.86	5.72	3.04	18.16
1969	6.63%	3.52%	92.06	6.1	3.24	15.09
1970	5.98%	3.46%	92.15	5.51	3.19	16.72
1971	5.46%	3.10%	102.09	5.57	3.16	18.33
1972	5.23%	2.70%	118.05	6.17	3.19	19.13
1973	8.16%	3.70%	97.55	7.96	3.61	12.26
1974	13.64%	5.43%	68.56	9.35	3.72	7.33
1975	8.55%	4.14%	90.19	7.71	3.73	11.70
1976	9.07%	3.93%	107.46	9.75	4.22	11.02
1977	11.43%	5.11%	95.1	10.87	4.86	8.75
1978	12.11%	5.39%	96.11	11.64	5.18	8.26
1979	13.48%	5.53%	107.94	14.55	5.97	7.42
1980	11.04%	4.74%	135.76	14.99	6.44	9.06
1981	12.39%	5.57%	122.55	15.18	6.83	8.07
1982	9.83%	4.93%	140.64	13.82	6.93	10.18
1983	8.06%	4.32%	164.93	13.29	7.12	12.41
1984	10.07%	4.68%	167.24	16.84	7.83	9.93
1985	7.42%	3.88%	211.28	15.68	8.2	13.47
1986	5.96%	3.38%	242.17	14.43	8.19	16.78
1987	6.49%	3.71%	247.08	16.04	9.17	15.40
1988	8.69%	3.68%	277.72	24.12	10.22	11.51
1989	6.88%	3.32%	353.4	24.32	11.73	14.53
1990	6.86%	3.74%	330.22	22.65	12.35	14.58
1991	4.63%	3.11%	417.09	19.3	12.97	21.61
1992	4.79%	2.90%	435.71	20.87	12.64	20.88
1993	5.77%	2.72%	466.45	26.9	12.69	17.34
1994	6.91%	2.91%	459.27	31.75	13.36	14.47
1995	6.12%	2.30%	615.93	37.7	14.17	16.34

1996	5.49%	2.01%	740.74	40.63	14.89	18.23
1997	4.54%	1.60%	970.43	44.09	15.52	22.01
1998	3.60%	1.32%	1229.23	44.27	16.2	27.77
1999	3.52%	1.14%	1469.25	51.68	16.71	28.43
2000	4.25%	1.23%	1320.28	56.13	16.27	23.52
2001	3.38%	1.37%	1148.09	38.85	15.74	29.55
2002	5.23%	1.83%	879.82	46.04	16.08	19.11
2003	4.92%	1.61%	1111.91	54.69	17.88	20.33
2004	5.58%	1.60%	1211.92	67.68	19.41	17.91
2005	6.12%	1.79%	1248.29	76.45	22.38	16.33
2006	6.18%	1.77%	1418.3	87.72	25.05	16.17
2007	5.62%	1.89%	1468.36	82.54	27.73	17.79
2008	5.48%	3.11%	903.25	49.51	28.05	18.24
2009	5.10%	2.00%	1115.1	56.86	22.31	19.61
2010	6.66%	1.84%	1257.64	83.77	23.12	15.01
2011	7.67%	2.07%	1257.6	96.44	26.02	13.04
2012	6.79%	2.13%	1426.19	96.82	30.44	14.73
2013	5.81%	1.89%	1848.36	107.3	34.99	17.23
2014	5.57%	1.87%	2058.9	114.74	38.57	17.94

The blue shaded areas were not exactly good times to buy. Returns over even quite long periods were not acceptable if you bought then.

However the price-earnings ratios in most market peaks (excepting dot-com) were not nose-bleed high. Typically about 18 times. This is not substantially different from PE ratios in many good-buying times.

Most of the time buying equities worked out okay. Some times were especially good with the pink-shaded areas providing excellent opportunities.

The early 1980s were characterised by very low PE ratios (around 10) whereas the financial crisis had a high PE ratio (around 18). But both proved good times to buy equity.

The PE ratio is, it seems, not a very good indicator of future returns. The basic problem is that the earnings number is highly variable. The profitability of business is far more variable than the market PE ratio.

Profitability is abnormally high at the moment. Demand has been good. Financing costs low. Wage pressure (particularly at the bottom end) has been abnormally low. Profits have thus been strong.

S&P profitability however is clearly slowing. Goldman Sachs has sharply [downgraded their estimate for S&P earnings in 2015](#) to 114 (only a small rise on 2014). It is possible earnings estimates are still too high. This may be the first year since the crisis that S&P earnings are flat or might decline somewhat.

What is happening in the market is stocks stay high until they “disappoint”. When they disappoint (and many stocks will) they de-rate sharply. Alas quality stocks (mostly those with fairly stable earnings) tend to fess up fairly promptly and de-rate quickly. The “hope stocks” maintain hope for a long time. Monetary policy is still loose – so people want to buy

– and they can't buy earnings growth (because it is not there in aggregate) so they buy hope. As we are long quality and short hope the present trend is not good for us; but these days will end and we will outperform. We just can't identify when.

The expanding Bronte team

We have hired and we are thrilled at what we got.

Luke Ryves joins us with enormous engineering and science knowledge. He has a university medal and a PhD in physics but is surprisingly broad. He has largely worked for high tech solar and medical device companies and has thought about them both in technical terms and as businesses. We like this – a technologist first – a businessman second – but still both.

We are looking at some beaten down material science based companies. Think the sort of thing that the Chinese Government spies have tried to hack. Many of these companies sell some kit to the oil industry (e.g. deepwater oil pipeline technology) and they have missed earnings and the stocks are “beaten up”. We think this is an opportunity.

The highest quality metallurgy based company we know (Precision Cast Parts) just got purchased by Berkshire Hathaway. These companies can be surprisingly good businesses – and their relatively low prices at the moment are attractive.

There is a lot of good science and engineering in these businesses – and Luke is just the guy to understand it.

Thanks again

The Bronte Capital Team



Performance (Net of all fees)

Last 12 months	23.4%
Since inception (annualized)	18.9%
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%	0.9%	-0.2%										6.9%

