Bronte Capital
Amalthea Fund

12 April 2016

Investors' Letter for March 2016

Last month's negative return (-4.1%) was explained by currency effects, with the underlying portfolio actually up for the month in USD. Over the quarter we helped protect capital well. In fact, in the down months of the quarter we did very well (relatively and absolutely) and in the spike up we still rose (at least when measured in USD).

It's an awful lot better than a lot of our competitors.

We could stop there and declare a low-level victory but that would be a little disingenuous. March 2016 was not a good month for Bronte on a relative basis and we were whipsawed a little as well - so it was not good measured the way we measure ourselves.

The Australian dollar spiked from US$0.7149 on 1 March to US$0.7668 on 31 March (about 7.3%). By the standards of monthly currency movements this was a very sharp movement against our Amalthea fund. Hence, measured in Australian dollars we were down. In hindsight we may have been better off hedging at least some of that currency movement – but it is Bronte's strong view that the Australian dollar will depreciate somewhat in the next few years.

We were and remain positioned for a weak market and the market was very strong in March. Despite a shocking start to the year the S&P ended up for the quarter. We beat the S&P and most other indices for the quarter, but we underperformed sharply in March.

The thing we got most wrong from a stock point of view was the thing we were obsessing about in earlier months and identified as the major risk in the portfolio. We were too short shale oil stocks - mostly what we consider "walking dead" shale oil stocks. These companies are likely to die an ignominious death at any oil price below about $70 a barrel - and they are just as dead at $40 a barrel as they were at $30 a barrel - but that did not stop them from doubling on us. In the first two weeks of March (and unfortunately a little bit in April) our short book was outright toxic.

We think these stocks will still collapse. But alas risk management dictated a small reduction in the short book that was probably ill-timed. Some of the underperformance this month was thereby made permanent. We had one very big win in the short book. We had a well-publicised position in Valeant Pharmaceuticals, a major US drug company. This stock collapsed taking many of the best-and-brightest on Wall Street down with it. Valeant has been coined the stock that ate Wall Street.

In particular, the Ides of March again proved to be a day for (corporate) empire-builders to beware. On March 15, Valeant held its long-delayed conference call to announce the results of the 4th quarter and the full year of 2015, though as-yet-unaudited and even today not filed with the SEC. An investigation of Philidor's accounting—which was not, in our view, the real crux of Philidor's machinations—revealed double-counting of revenue and resulted in disavowal of prior financial statements.

The company also disclosed a rare and very serious red flag, admitting it had a "tone at the top" problem, which is accountant-speak for "pressure to make the numbers and damn the consequences." For this and other omissions it sought the resignation of Howard Schiller, former CFO and recent interim CEO, from the Board of Directors. With Valeant's ills laid squarely at his feet, he declined, and, in the preferred Valeant fashion, issued a press release through his lawyer.

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On the call management also revealed that performance had not been up to expectations set at an Analyst Day held mere days before the end of 2015, and forecasts for the future were slashed. There being no greater crime on Wall Street than "missing expectations," the stock was cut in half.

Though it has sought waivers from lenders for the technical default arising from its delinquent filing of audited annual results, no firm details of their gracious forbearance have been released. (Press reports indicate Valeant has also sought waivers for debt and interest coverage ratios in its covenants, implying that reassurances on future profits previously provided to equity investors are also likely to be "waived.")

Since then, Mike Pearson, the auteur behind Valeant's nouveau company-building approach of buying old drugs and raising prices—who eschewed such careless, hidebound pharmaceutical company pursuits as research and development of new drugs—has himself been shown the door. As with all things Valeant, his departure is "pro forma" until a new executive can be found. Bill Ackman of Pershing Square, a large Valeant shareholder, also joined the Board.

It is a great pity however this turn of events did not happen some time ago - because we once had a large put option position on the stock. Only a small amount of that position was left at the end. With different timing we would have produced a high single-digit positive month in USD and been positive in AUD despite the massive adverse currency movement.

This alas is a problem with shorts generally. You need to be right - but you also need to be careful of all the intermediate positions - a stock which goes from $130 to $250 and then to zero (the path we expect of Valeant) doesn't do a short-seller many favours.

We remain short some Valeant - but the size of the position has been reduced. The stock going to zero remains our expectation. This is one of the two biggest junk debt issuers in the US. We think the default when it comes will have market-wide repercussions.

Longs

It's a long time now since we have utterly nailed a winning stock. Herbalife has been good and we have a few small winners. But 2013 was the last time we had stocks at Bronte that were rapid multi-baggers.

Markets are expensive and, at least for now, still going up. We are unwilling to take abnormal risks to produce short-term gains when prices are too dear. If the current valuation requires that everything must continue to "go right" for even a high-quality company to produce a reasonable long-term return for investors, we would prefer to look for other opportunities. We are just aware how tricky this market is.

<u>SunEdison</u>

Embarrassingly we had a small position in SunEdison and its associated companies. The (strong and well backed) rumour is that SunEdison is likely to file bankruptcy. We turfed the stock for a not-so-nice loss. But we have argued extensively within the firm about the position. We can't find a plausible explanation for a SunEdison bankruptcy consistent with statements made by management re their cash position and cash sources and uses. It is possible that Bronte, usually expert in detecting deception, were deceived. But we are uncertain whether that is the reason for our loss.

SunEdison has received subpoenas from the Justice Department so we may - in due course - find out what we did not know when we made the investment (and still do not know now).

We have spent some time trying to analyse our mistakes on this position and we are some way there.

Winners

Above we talk about our losers. That is our style. (If we can reduce our bad calls our good ideas will take care of us entirely.)

However during the month there were some winners. Herbalife continues to be good. There has been a bounce in a few of our other longs.

The small chemical company that we were buying in January (and mentioned in the January letter) has turned out to be a wildly good winner. Alas we were buying it with an eye-dropper when we should have been shoveling it into the portfolio. We still do not want to name it because at the right price we will buy more.

And there are a few really good opportunities in the portfolio - some on the short side, a precious few on the long side. Genuinely we are excited about some of the stuff we are working on. Not all of it will work - but there are opportunities here and we think we will continue to manage your money both well and with stronger than normal downside protection.

Thanks again

The Bronte Capital team

Performance (net of fees)	
1 Month	-4.1%
Calendar YTD	-1.9%
Financial YTD	5.9%
Since Inception (Annualized)	15.1%
Largest Monthly Gain	6.1%
Largest Monthly Loss	(4.1%)
Max. Consecutive Gain	15.7%
Max. Drawdown	(6.0%)

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
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%	3.8%	-1.3%	-1.4%	0.5%	1.8%	-4.1%				5.9%

Portfolio Analytics	
Sharpe Ratio[1]	1.2
Sortino Ratio	2.4
Annualised Standard Deviation	9.9%
% Of Positive Months	63%

Fund Features	
Investment objective	Maximise risk-adjusted returns with high double-digit returns over 3 year periods.
Inception	May 2013
Minimum investment	$100,000 (for qualifying investors)
Applications/Redemptions	Monthly
Distribution	Annual
Management Fee	1.5%
Performance Fee	20%
Administrator	Citco Fund Services
Auditor	Ernst & Young
Custodian/PB	IB LLC

[1] Sharpe and Sortino ratios assume Australian risk free rate of 2.5%