

7 December 2009

## **Client Letter for Month Ending 30 November 2009**

Last month was the first less-than-stellar month of performance for Bronte. This month was the first outright poor month. Our performance was 6-7 percent below indices for all accounts. Actual performance was low negative single digit – but we are not happy with the results. Absolute performance was better than last month – but only slightly. Our relative performance was worse.

More than half the underperformance was weakness in our most speculative position (the position in Fannie Mae and Freddie Mac defaulted preferred shares). The rest of the underperformance was scattered across the portfolio. We had no big wins in the month. We had two stocks from the original portfolio turn a little sour in the month – most notably Jacobs Engineering – a very well run engineering contractor which promised not a lot of earnings into next year. The other was a small decline in a French regional bank we own. The Jacobs result is more significant, driven mostly by over-supply (and hence reduced construction) in petroleum and chemicals refining. This is significant to our portfolio as we are also exposed through Conoco Phillips – a company with significant refining interests.

The underperformance of the Frannie preference shares is harder to explain. Fannie Mae had bad looking results – though Freddie Mac's results were excellent. Fannie called on government support. Freddie did not. This however was not the driver as the stocks did not perform significantly differently.

There were real negatives though. Freddie Mac has some (serious) accounting issues with the change of rules for accounting for off-balance sheet securitizations. These rule changes could bring forward considerable losses (offset by increased profits in the out-years). The change of timing of reported income could be very significant indeed (certainly tens of billions of dollars in "earnings" shifted between quarters). This is highly negative for the stock because if the losses are brought forward under the terms of the government preferred shares the amount of government support will ratchet up – and the costs to the common and preferred shares (presuming they have some value) will also ratchet up.

Possibly more significant – the FDIC confiscated its first banks where the reason given for confiscation was significant losses on Frannie preferred stock. The first thing the regulator does when she confiscates a bank is sell all the tradeable securities on the bank's balance sheet. There has been massive supply of Frannie preferreds with some issues becoming extremely liquid (presumably the ones being sold by the regulator are liquid).

In all honesty we cannot pick apart the significance of these effects. We remain convinced that the Frannie preferreds are a very good but highly speculative investment. Many of the political issues involved in this trade are coming to a head and we will report in later months.

### **Idea generation**

We have begun to generate new ideas for the portfolio – particularly focused on the smaller regional banks in the US. Many small regional banks have been recapitalized and then the stocks have

continued to fall. We think some of these banks do not require a second recapitalization. Survival is sufficient to profit, because these are very beaten up stocks.

## Returns

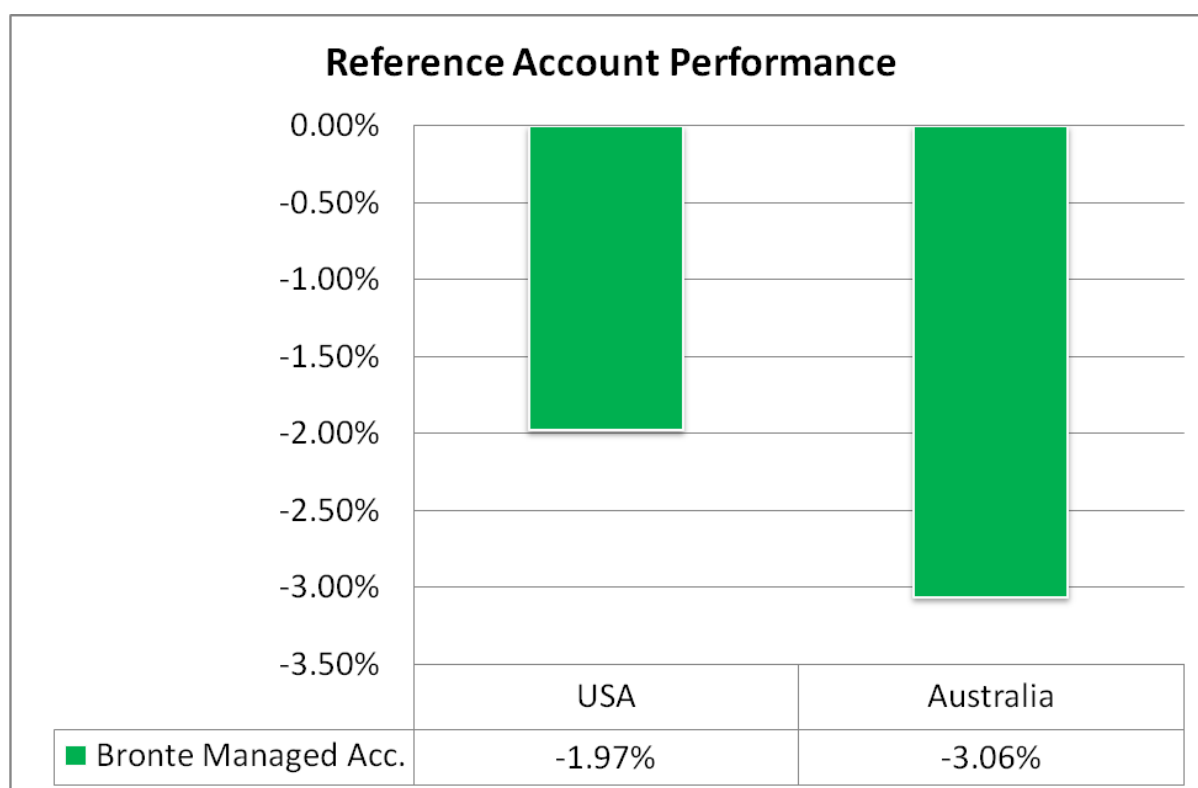
The US reference account returned -1.97 percent and the Australian account -3.06 percent over the past month. In all cases these returns are after base and performance fees<sup>1</sup>.

## Portfolio Management

	Long	Short	Net Long
USA Reference Account	104.0%	30.7%	73.3%
Australian Reference Account	102.2%	29.0%	73.2%

## Performance data<sup>2</sup>

### Monthly return



<sup>1</sup> As returns were negative for the month the overall accrual for performance fees was reduced. This acted to offset, to a limited extent, the negative performance.

<sup>2</sup> All performance data is adjusted to allow for an accrual of the annual performance fee

## *Since inception*

