16 June 2014

Investors' Letter for May 2014

Our numbers are good this month – a couple of percent ahead of indices. Most of that happened in the first two weeks of the month when the market went nowhere. In the second two weeks the market rose (hitting new highs daily) and we underperformed.

To be blunt about it – this year we have – measured in US dollars – achieved little. We are not losing money in any meaningful way and we look at the portfolio and believe it to be pregnant with profit – but the day-to-day results don't feel exciting.

In the history of Bronte we have had three periods where we went up for many months in a row, earning super-normal looking returns and we have had two periods, both of eleven months, where we went sideways with little volatility. By month ten we were getting more-than-a-little sick of it – but we maintained the discipline and it worked well in the end.

It is now almost six months since the third of our good runs ended. That said, we don't think we are doing anything wrong as such and so we go about our business of seeking value on the long side and rifling through the low quality refuse of the capital markets for our shorts.

Simon is given to describing our work as most similar to that of truffle pigs. There is an oak-forest of opportunities out there and so with unremitting enthusiasm we trot around, chasing down rogue scents, scooping up the undergrowth with our snouts and sometimes unearthing a steaming, buried treasure. The analogy works for both longs and shorts, although their scents can be characterised differently. One thing that is helping us is the fervour for this kind of work from our new team member, David Sachs, who has a particular eagerness for foraging amongst the shorts.

We have a modestly oversized short position in Valeant Pharmaceuticals – a market-favorite – and a giant pharmaceutical company roll-up. Valeant is currently bidding for Allergan (the maker of Botox). The short includes long dated put options that only really work if Valeant implodes. Beyond that the portfolio is roughly unchanged.

The story of our year is in some sense given in a single chart – the chart is of the equal-weighted biotech index.

Bronte Capital Management Pty Ltd (AFS License: 334325)
Suite2101BTower 1, 520 Oxford Street, Bondi Junction, Australia.
ph: +61 2 9389 3293 • e: investor.relations@brontecapital.com

Volatile is an understatement – this index is heavily weighted by small cap biotechs – and those are usually speculative companies developing a drug that *might* work. Every now and again one looks promising and is taken out by large pharma at a huge premium. This is the very definition of speculative.

We are short a high single digit percentage of our fund in members of this index. However the ones we are short are even more speculative than the index. These are the trust-me stories where we can't find a decent scientific reason to buy them and we can find people associated with them that we find unseemly. [We will take a small position short the most speculative of biotechs if we can determine the chief scientist is faking his PhD qualification.]

This relatively small position in speculative stocks has been the single largest determinant of day-to-day volatility this year.

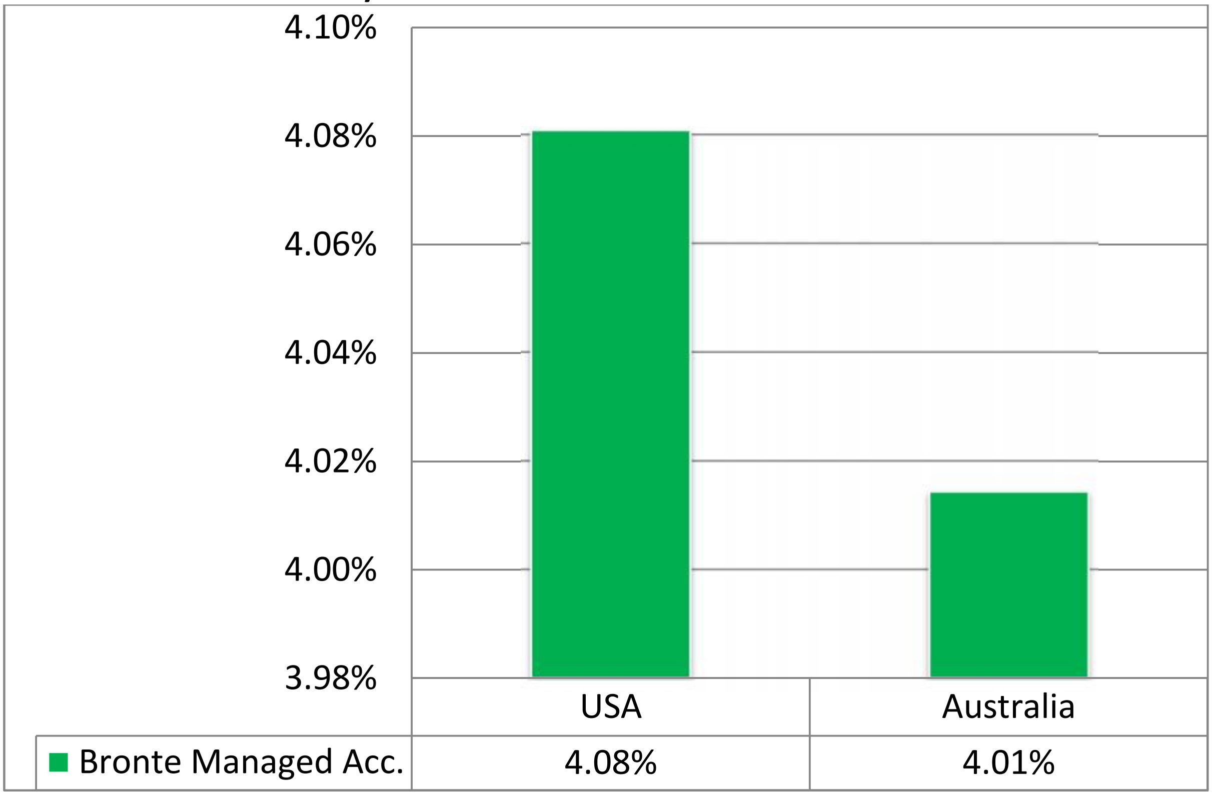
There are other issues that matter day-to-day - notably currencies (we are alas net long the Euro and short the AUD) and our two volatile longs (Herbalife, Senomyx). Even these however constitute a small part of the portfolio. Most of the portfolio is simply not volatile. This reflects both the markets (where volatility is at an historic low) and our hedging approach (we are long-short). There can be a tendency to increase the size of positions in this period of low volatility. It’s a tendency Simon helps John to fight. Whatever, that is his job - and it is John's job to hunt for truffles.

Thanks again...

John and Simon

Performance Data[1]

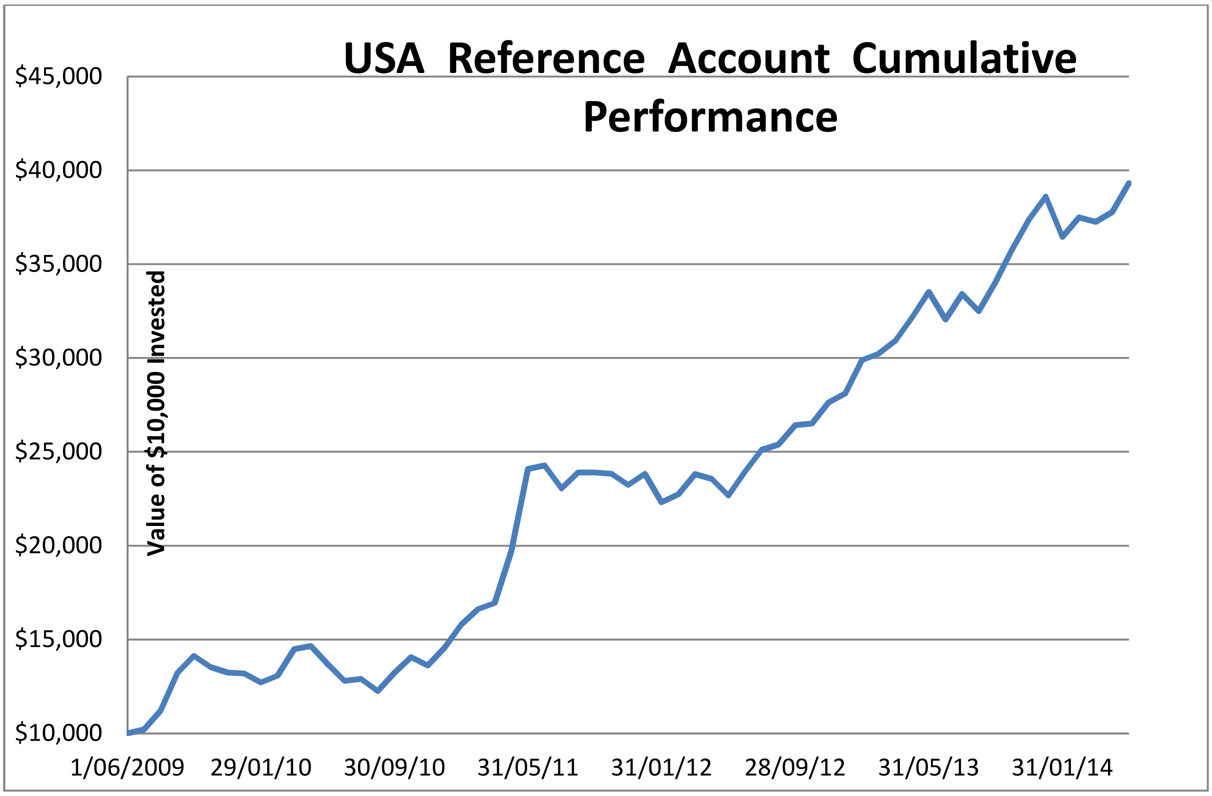
Reference Account Monthly Performance

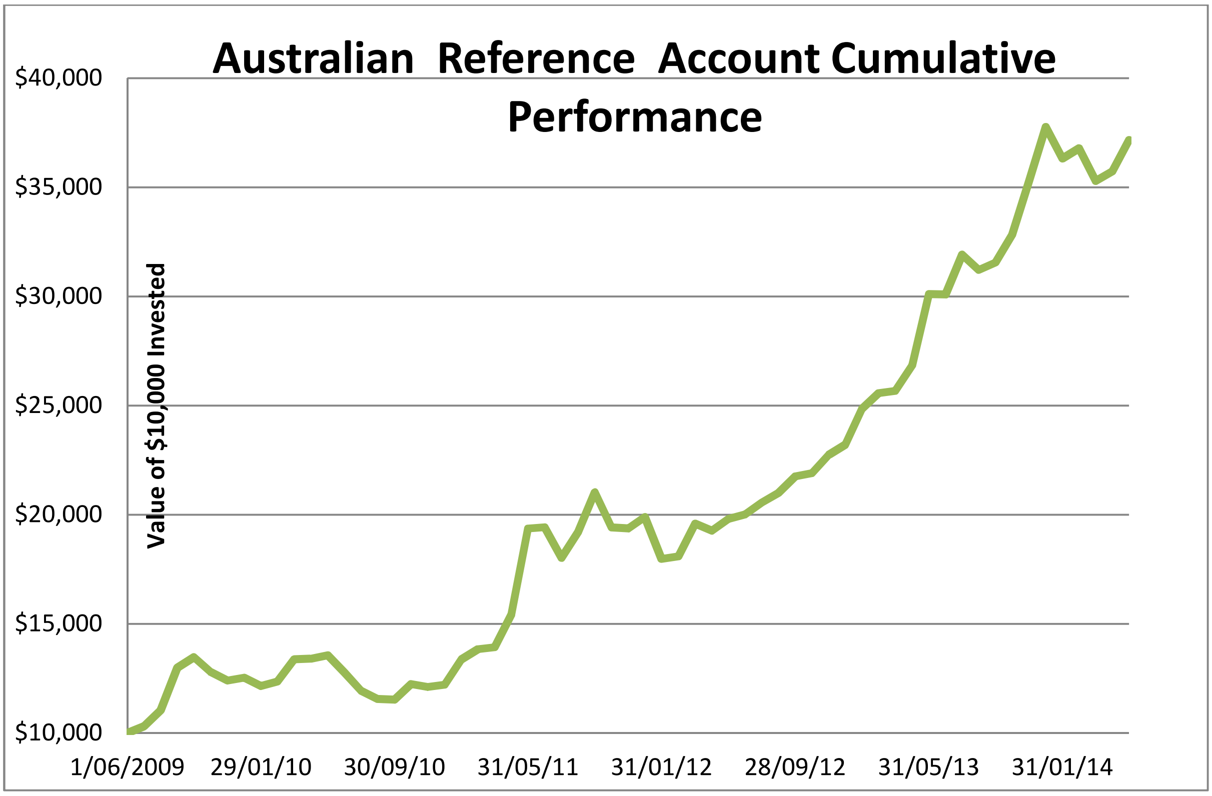


Reference Account Returns

	USA Reference Account	Australian Reference Account
Year to date	1.9%	-1.6%
12 month return	17.3%	23.5%
3 year annualized return	17.8%	24.3%
Since Inception annualized return	31.5%	30.0%

[1] All performance data is adjusted to allow for an accrual of the annual performance fee. All dividends received and earnings are retained and reinvested in the account. The volatility of the account may differ materially from comparable indices. The comparison index used by the advisor increased by 2.1% in USD and by 1.8% in AUD during the month and since inception of the account has increased by 90% in USD and 62% in AUD. Past results are not indicative of future returns. Fees charged on the separately managed accounts are 1.5% management fee and 15% annual performance allocation (with no high water mark) and differ from the standard terms for Bronte pooled funds which are 1.5% management fee and 20% annual performance allocation (with a high water mark). Moreover the separately managed accounts do not have incoming or outgoing flows which would incur trading costs.


USA Reference Account Cumulative Performance
$45,000
$40,000
$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
Value of $10,000 Invested
1/06/2009
29/01/10
30/09/10
31/05/11
31/01/12
28/09/12
31/05/13
31/01/14


Australian Reference Account Cumulative Performance
$40,000
$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
Value of $10,000 Invested
1/06/2009
29/01/10
30/09/10
31/05/11
31/01/12
28/09/12
31/05/13
31/01/14