Auscap Long Short Australian Equities Fund Newsletter – December 2015

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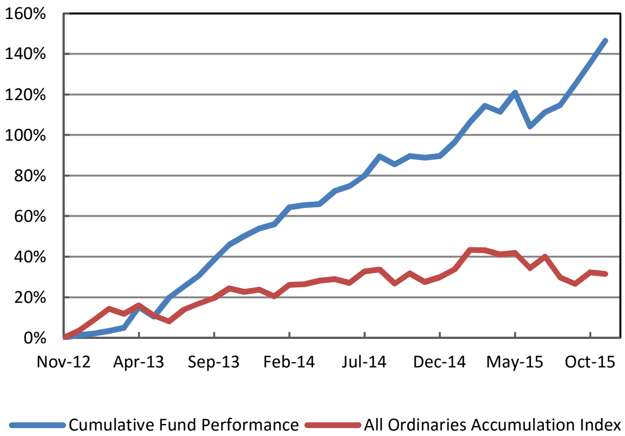
Welcome

Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund (Fund) to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we discuss the concept of timing the market and how it relates to our investment process as a value-based manager.

Fund Performance

The Fund returned 4.69% net of fees during November 2015. This compares with the All Ordinaries Accumulation Index return of negative 0.69%. Average gross capital employed by the Fund was 100.4% long and 23.6% short. Average net exposure over the month was 76.8%. At the end of the month the Fund had 29 long positions and 8 short positions. The Fund's biggest stock exposures at month end were spread across the financials, consumer discretionary, consumer staples, healthcare and materials sectors.



Fund Returns

Period	Auscap	All Ords
November 2015	4.69%	(0.69%)
Financial Year to date	20.76%	(2.15%)
Calendar Year to date	30.04%	1.10%
Since inception	146.59%	31.39%

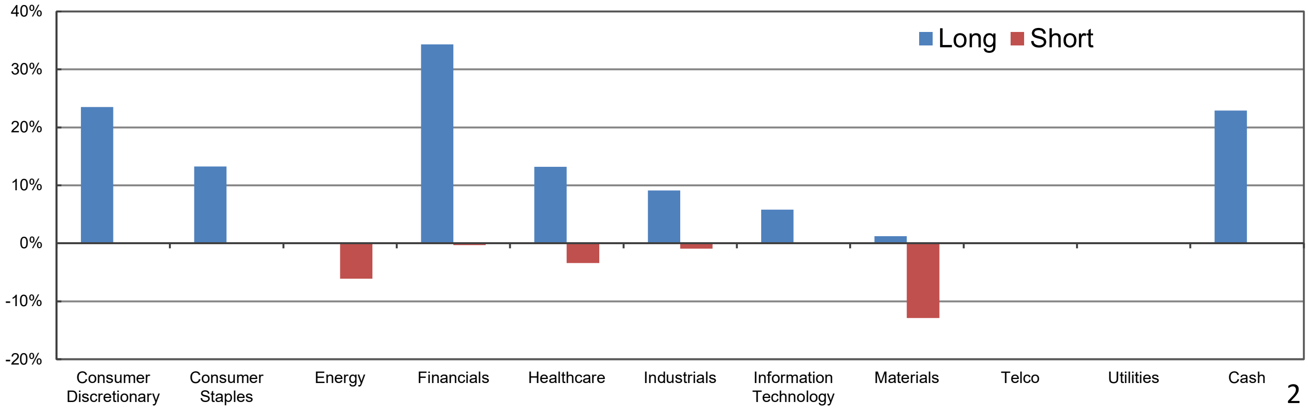
Fund Exposure

November 2015 Average	% NAV	Positions
Gross Long	100.4%	28
Gross Short	23.6%	7
Gross Total	124.0%	35
Net / Beta Adjusted Net	76.8%	39.9%

Fund Monthly Returns

Year	Jul %	Aug %	Sep %	Oct %	Nov %	Dec %	Jan %	Feb %	Mar %	Apr %	May %	Jun %	YTD
FY13						1.35	0.74	1.23	1.46	9.83	(4.05)	8.32	19.72
FY14	4.70	4.28	5.84	5.46	2.86	2.57	1.32	5.32	0.70	0.29	3.82	1.48	46.01
FY15	2.95	5.24	(2.09)	2.25	(0.43)	0.44	3.65	4.90	3.98	(1.36)	4.43	(7.55)	16.81
FY16	3.46	1.64	4.82	4.65	4.69								20.76

Sector Exposure - November 2015



Is Timing The Market Important?

Historically, many successful investors have been quoted as saying that they do not try to time their investments. This has led to the common belief that it is time in the markets and not timing the markets that is crucial to success. While we wholeheartedly agree that trying to time any financial market is a futile exercise, and time in the market is important for any long term wealth creation, we would suggest that time in the market alone does not guarantee satisfactory returns. A focus on “not timing the market” should be distinguished from waiting for attractive investment opportunities. The consensus opinion that “time in the market” should be the centrepiece of any investment downplays the significance of two very important aspects of investment management, the investment process and risk management. From our perspective, the concept of “time in the market” is almost as foreign as “timing the market” if no consideration is given to the quality of the companies invested in or to the price paid for each investment.

Value investors, ourselves included, typically share some common characteristics from an investment process perspective. They are focused on businesses that generate significant cash flow. They value a company based on a number of measures that attempt to discount the future cash flows derived from the operating business. They focus on a company’s return on invested capital (ROIC), because those companies with high ROIC metrics are superior to low ROIC businesses. High ROIC businesses can invest profits into new activities and achieve high returns on additional deployments of capital. Value investors focus on the balance sheet because excessive leverage has the potential to destroy even the mightiest of businesses in periods of credit contraction, be they the consequence of the business cycle or a black swan event.

Focusing on these attributes is common amongst many investors, value-based or otherwise. However, the value investor is also greatly concerned with price. While value investors do not try to time their investments in terms of predicting when they might profit from them, they most certainly do try to time their investments from one particular and very important perspective. They wait for occasions when higher quality companies trade at unusually attractive prices, below what they calculate to be their intrinsic value. Value investors want to make sure they are buying stock at a discount. To that extent they are most certainly trying to time the market. Having the patience and discipline to wait until these opportunities come along can be difficult. To then transact at the appropriate time after prolonged periods of inaction is also not an easy task. As many have suggested, value investing is simple, but not easy.

To use a housing analogy, we would all like to buy one of the best houses in the best street in our favourite suburb at a significant discount to what it is worth using standard valuation principles such as rental yield or recent comparative sales. But how many are prepared to wait for that opportunity to present itself when it might only happen once every business cycle or even once in our lifetime or potentially not at all?

In a similar vein there are many high quality stocks that spend years and even decades at or above what value investors might consider to be fair value. They might still be great investments to those who hold them, but the value investor does not feel comfortable owning them. The value investor likes to know that they have bought an asset for less than what they believe it to be objectively worth.

Luckily, history suggests that there is significant volatility in financial markets caused by earnings cyclicality exacerbated by large swings in investor sentiment. This volatility gives patient investors sufficient opportunities over time to buy high quality stocks at attractive prices. Once purchased at an attractive price, the concept of "timing the market" flies out the proverbial window. A patient value investor is very comfortably invested in such a security even if it takes years for the price of that security to re-rate to what they consider to be fair value. Further, as a cash generating asset they are not often concerned with the absence of any re-rating, because the business will continue to generate growing cash profits that increase the value of the asset to its owners.

Indeed the concept of "timing the market" can actually re-enter the fray at a later point if the security moves beyond fair value into expensive territory. At this point the value investor might consider there to be better uses of investor capital than remaining in what is now a company trading above a reasonable estimate of its value, in which case the security is sold.

At Auscap we have no interest in owning a wide selection of stocks, even a wide selection of high quality stocks, at any price. We focus on buying stakes in what we believe to be high quality companies when we believe they are trading at attractive prices. From this point onwards we do not attempt to "time our investments". We are not concerned about an absence of obvious near term catalysts that will excite investors and see an appreciation in the prices of the stocks we own. We enjoy investing for long periods in companies whose value might be underestimated by the broader market but generate consistent and growing cash profits for the equity owners of the business. If sentiment swings too far in the other direction, investors once again become excited and price the stock beyond what we consider to be fair value, then we exit the investment and wait patiently for alternative attractive uses of the capital we manage.

Over time we hope to attract like-minded investors into the Auscap Fund. We look for strong businesses with most frequently modest but positive medium term growth prospects that will deliver sufficiently attractive returns to warrant investment for the risk being taken. We have and will continue to focus on our investment selection process and appropriate risk management, the outcome of which is the investment returns delivered to our investors. We would hasten to add that our return expectations are considerably lower than what has been achieved in the first three years of the Fund's operation, and in no way would we encourage any extrapolation of these historic returns.

On behalf of the Auscap team, we wish our investors, service providers and newsletter subscribers a very happy and safe festive season. We look forward to engaging with you in 2016!

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to the website http://www.auscapam.com and follow the registration link on the home page. Interested wholesale investors can download a copy of the Auscap Long Short Australian Equities Fund Information Memorandum at www.auscapam.com/information-memorandum. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

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