Auscap Long Short Australian Equities Fund Newsletter – April 2014

Welcome

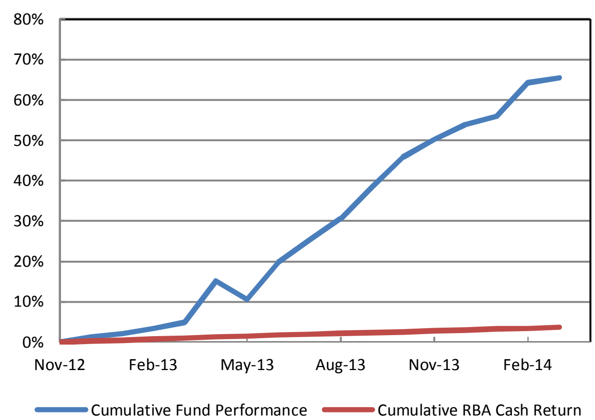
Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund ("Fund") to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we take a look at the real earnings and dividend yield on the ASX 200 and S&P 500 at the current time. We compare current and historic real yields and highlight the effect inflation has had on market multiples over recent decades.

Overview

The Fund was launched in December 2012 and targets strong absolute returns in excess of the RBA Cash Rate. The Fund focuses predominantly on fundamental long and short investments while utilising a multi-strategy approach to take advantage of shorter term market opportunities to increase returns, hedge the portfolio, protect capital and minimise volatility where prudent. The Fund will typically have 25-45 positions primarily in liquid stocks in the ASX200. Further information, including access for sophisticated investors to the Fund's Information Memorandum, is available at our website www.auscapam.com. Enquiries can be directed to info@auscapam.com.

Fund Performance

The Fund returned 0.70% net of fees during March 2014. This compares with the benchmark return of 0.21%. Average gross capital employed by the Fund was 107.4% long and 32.1% short. Average net exposure over the month was +75.2%. At the end of the month the Fund had 35 long positions and 5 short positions. The Fund's biggest stock exposures at month end were spread across the consumer discretionary, financials and telecommunications sectors.



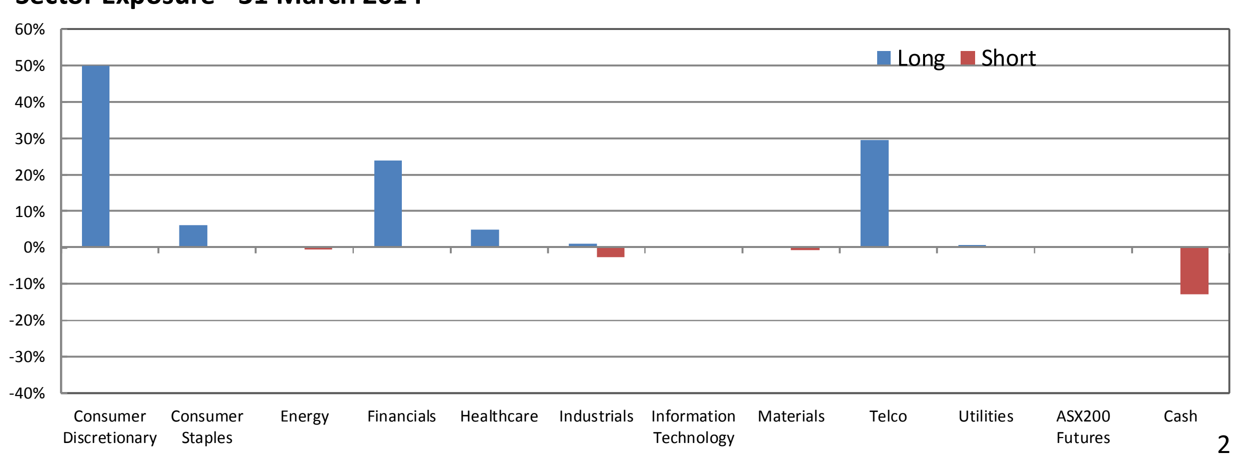
Fund Returns

Period	Auscap	Benchmark
March 2014	0.70%	0.21%
Financial Year to date	38.18%	1.92%
Since inception	65.43%	3.67%

Fund Exposure

March 2014 Average	% NAV	Positions
Gross Long	107.4%	36
Gross Short	32.1%	6
Gross Total	139.5%	42
Net / Beta Adjusted Net	75.2%	50.6%

Sector Exposure - 31 March 2014



INVITATION │ Auscap Events in May: Food For Thought

Auscap will be presenting our thoughts on equities and markets during May.

We will be discussing the following topics:

- Australia's growth path and the business cycle
- Can traditional retail have a renaissance?
- Does China's shadow finance loom large over Australia?

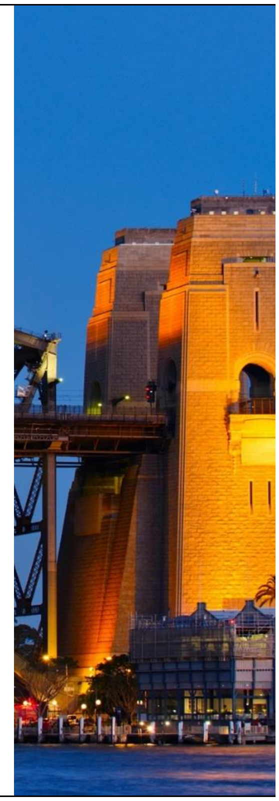
There will also be general Q&A on stocks and markets.

The dates for the events are as follows:

- Brisbane – Thursday 1st May 2014 – 5.30pm
- Sydney – Wednesday 7th May & Thursday 8th May 2014 – 5.30pm
- Melbourne – Thursday 15th May 2014 – 5.30pm
- Perth – Thursday 22nd May 2014

You're invited! We would like to extend an invitation to these events to our investors and newsletter subscribers.

If you wish to attend please email info@auscapam.com and we will send you further information. We look forward to seeing many of you at the presentations.



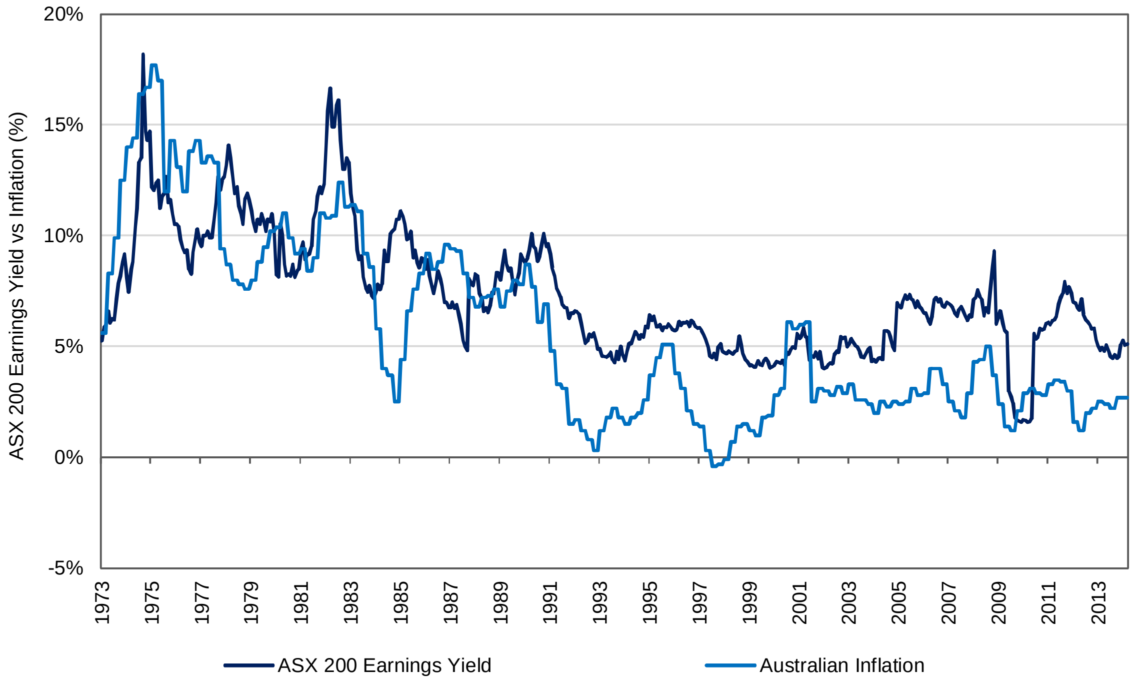
Does The Real Yield On Equities Represent Relative Value?

Relative value is the process of determining the attractiveness of one asset by comparing it to the price of other similar assets. Generally speaking, we find relative value arguments dangerous, especially if there is no consideration of absolute value measures in the assessment process. To give this some context, we see little merit in an argument that suggests that solely because Company A in a particular sector is trading on 30x prospective earnings that Company B is therefore "cheap" because it only trades on 23x prospective earnings and has a similar growth outlook. It might be a useful analysis for shareholders in Company A, who might want to consider switching into Company B if they want the particular sector exposure, assuming no tax or other implications from a sale and repurchase. But the analysis is not at all helpful to an investor who has no exposure to Company A, because clearly both companies might be expensive. As a result, our first consideration in assessing the merits of an investment are the absolute rewards and risks associated with it.

We analyse relative value as a secondary consideration for our investment decisions, because we want to be purchasing the cheapest asset amongst alternatives that we consider offer the same potential investment rewards. We assess relative value both across assets at a particular point in time and for a single asset across a period of time. In this edition we look at the real yield currently offered by the equities market compared to recent history, both from an earnings and a dividend perspective.

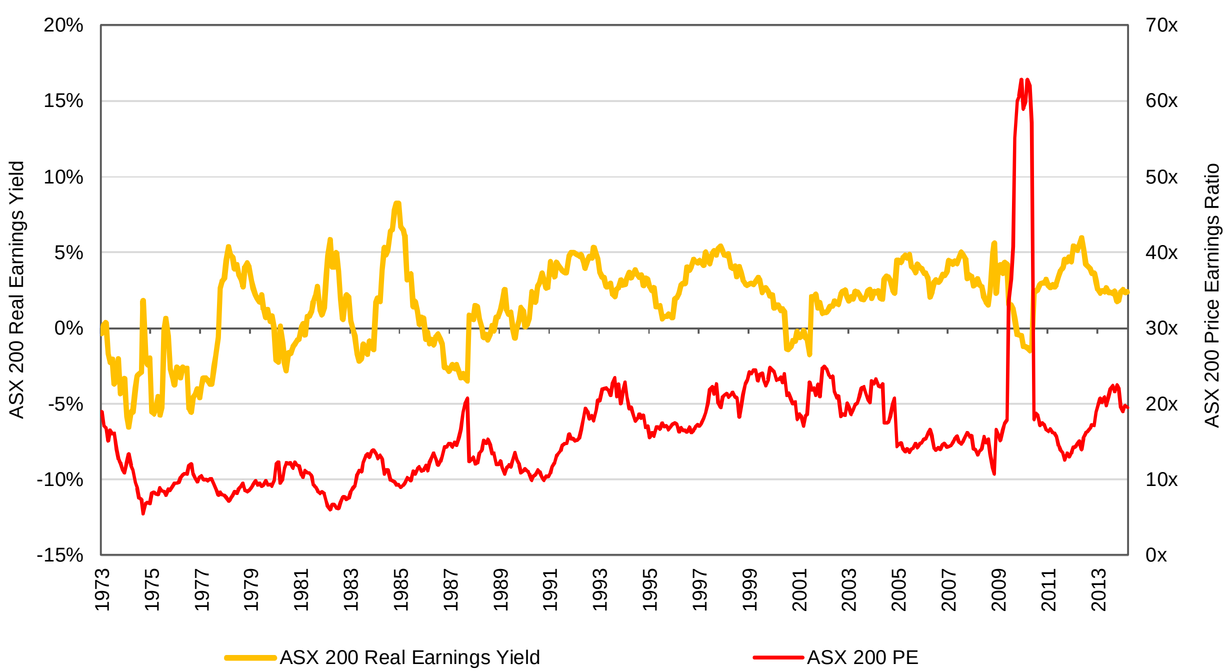
Over the last forty years the trend in inflation has been downward and the nominal earnings yield offered to investors by equities has also, and we would suggest consequently, fallen. That is, investors have implicitly focused on the real yield (nominal yield less inflation) offered by equities as an asset class rather than the absolute yield. The real yield is perhaps the better measure for investors to focus on because it reflects the returns that are generated that in turn increase the investors' purchasing power.

ASX 200 Historical Earnings Yield & Inflation



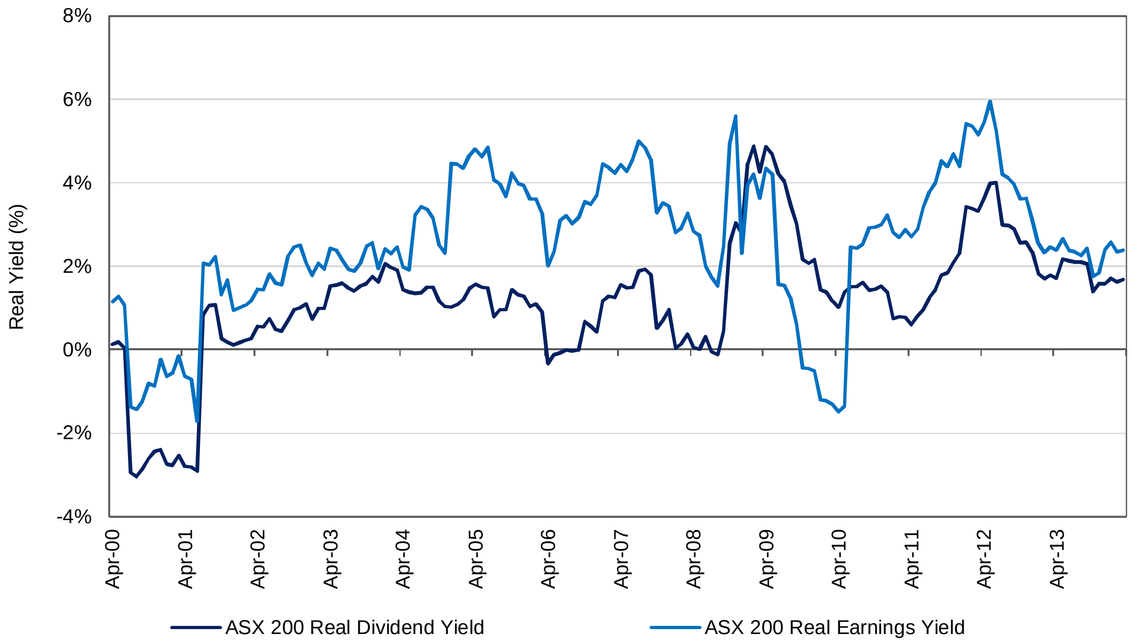
In recent history, times of lower inflation appear to have corresponded with periods when the ASX 200 has traded on a higher price earnings multiple. Analysing the current real earnings yield offered by the ASX 200 on a historical basis leads us to the conclusion that although the market multiple looks somewhat high, especially compared to the last decade (excluding the period of the global financial crisis), the real earnings yield is relatively, but not materially, lower than previous years.

ASX 200 Earnings Yield & Price to Earnings Multiple



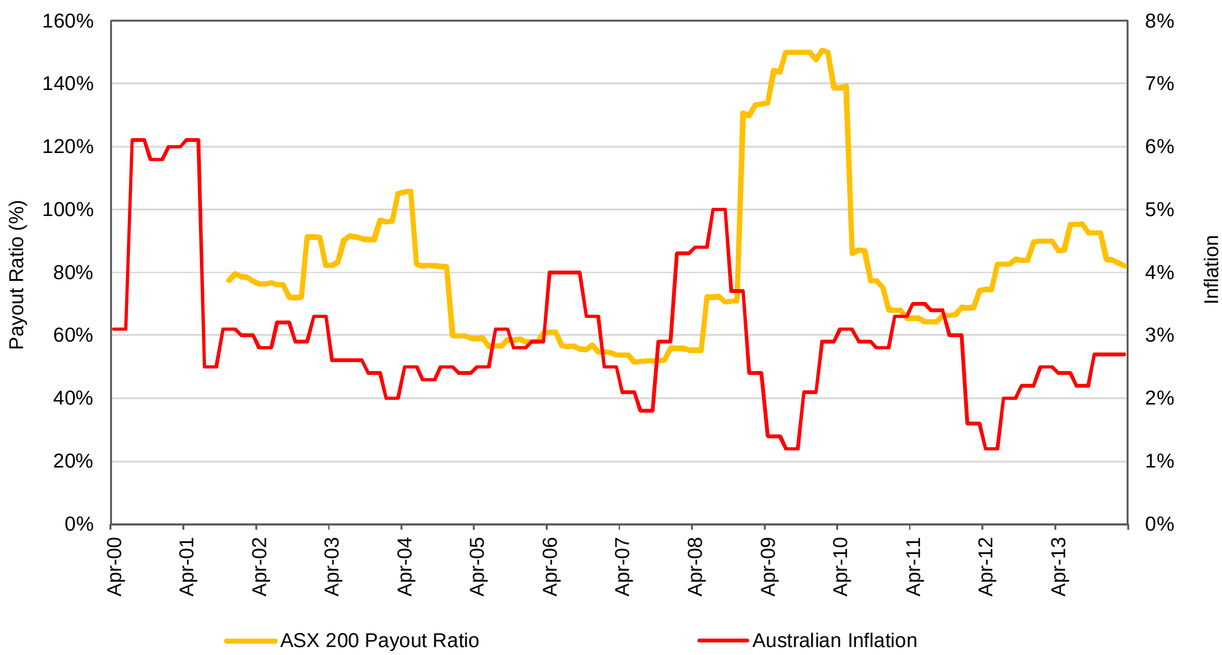
By contrast, the real dividend yield offered by the market appears relatively high compared with the last decade if we exclude periods of financial stress.

ASX 200 Real Earnings & Dividend Yield



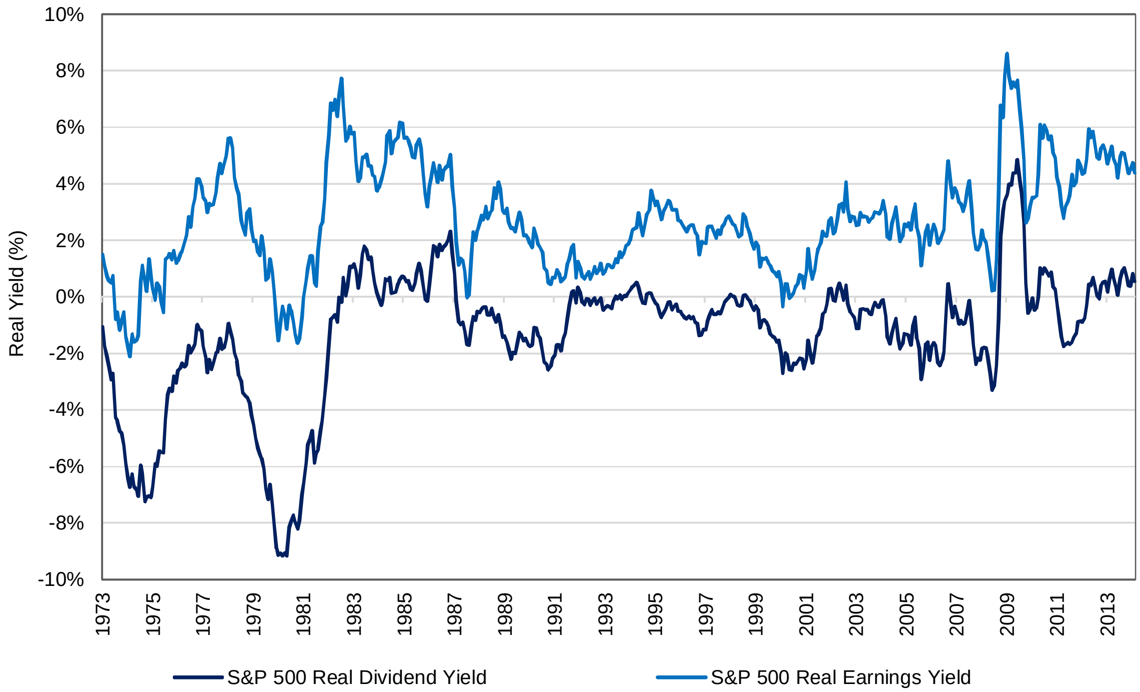
This is a function of the payout ratio, or the dividends that are being paid as a percentage of earnings, which for the ASX 200 currently exceeds 80%. A high payout ratio has the potential to decrease future earnings growth if it represents a lack of investment in new projects. That being said, viable options for growth need to be present to justify investment, otherwise often the best use of excess capital is returning it to shareholders.

ASX 200 Payout Ratio & Australian Inflation



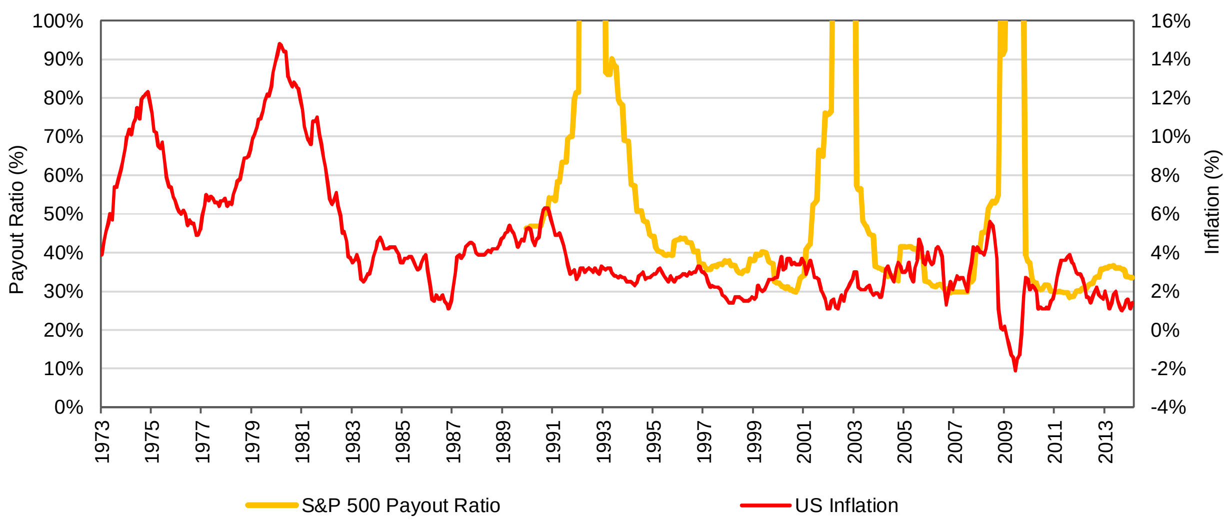
It is perhaps not surprising that post the peak in the mining capital expenditure cycle, given the weighting of mining and mining related stocks in the index, there is an absence of compelling growth options for the market as a whole and many companies are choosing to return capital to shareholders. Australia's earnings yield is lower than that of the S&P 500, while its dividend yield is higher.

S&P 500 Real Earnings & Dividend Yield



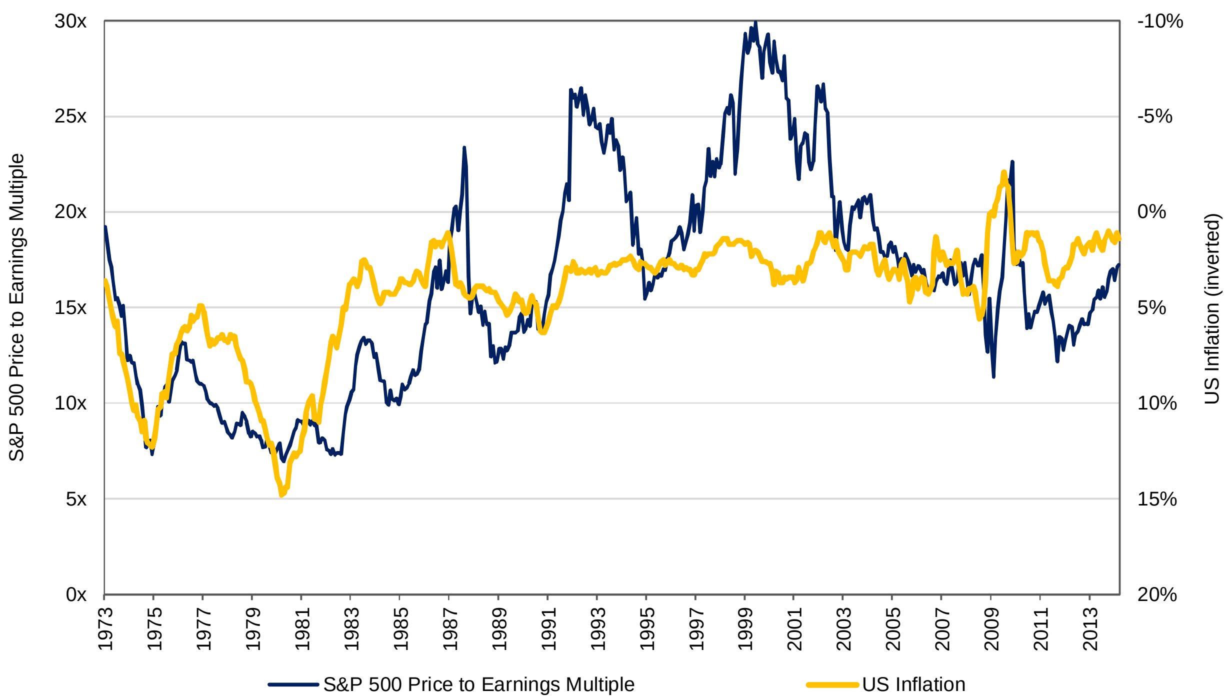
This reflects the fact that the companies within the S&P 500 pay out materially less in the form of dividends, with their current payout ratio circa 34%. This is in part due to the different tax treatment afforded to dividends, with the tax benefits encouraging Australian companies to pay higher dividends to pass on the franking credits to investors.

S&P 500 Payout Ratio & US Inflation



Clearly inflation in the US is also benign. The chart below demonstrates the inverse relationship between market multiples and inflation over time. Lower inflation appears to have led to higher market multiples in the US.

S&P 500 - Price to Earnings Multiple vs US Inflation



While we prefer to let readers draw their own conclusions about these charts, we do think that real yield is a relative measure worth reflecting on to assess the merits of an investment in equities at a given point in time. While the current position of the market does not lead us to a definite conclusion about its direction, it does highlight the significance of a few factors that are worthy of the attention of investors. As many market commentators would suggest, particularly those who are critical of the various central banks currently engaged in quantitative easing, any material change in the rate of domestic and/or global inflation could have a material impact on the market.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to www.auscapam.com and follow the registration link.

Interested wholesale investors are encouraged to download a copy of the Information Memorandum from the website, www.auscapam.com/information-memorandum.

We welcome any feedback or comments you have. Please direct them to info@auscapam.com.

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