



Auscap Long Short Australian Equities Fund Newsletter – August 2013

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Welcome

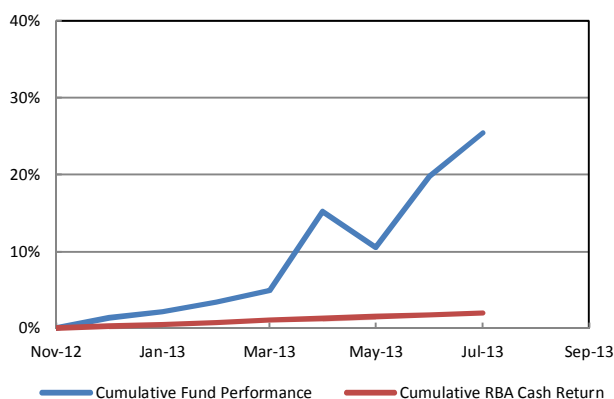
Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund (“Fund”) to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we discuss the importance of relevant and timely data and how independent data analysis assists us in evaluating circumstances objectively. We demonstrate how data can be a predictor of both company performance and stock price movement.

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 4.70% net of fees during July 2013. This compares with the benchmark return of 0.23%. Average gross capital employed by the Fund was 107.1% long and 54.0% short. Average net exposure over the month was +53.1%. At the end of the month the Fund had 22 long positions and 11 short positions. The Fund’s largest exposures were spread across the consumer discretionary, telecommunications, healthcare and industrials sectors.



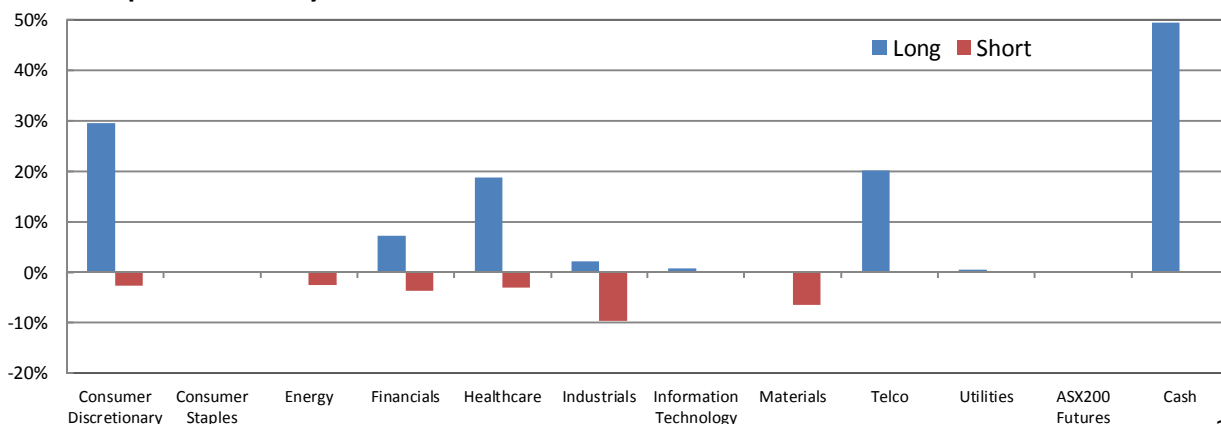
Fund Returns

Period	Auscap	Benchmark
July 2013	4.70%	0.23%
Financial Year to date	4.70%	0.23%
Since inception	25.35%	1.95%

Fund Exposure

July 2013 Average	% NAV	Positions
Gross Long	107.1%	23
Gross Short	54.0%	18
Gross Total	161.1%	41
Net / Beta Adjusted Net	53.1%	11.7%

Sector Exposure - 31 July 2013



A Numbers Game: Why We Analyse Data

For a fund manager, having subjective views can be a dangerous pastime. There is no doubt that we all have a predisposition to certain views as a function of our experiences, influences and behavioural biases. But it is important that we do not let these predispositions affect our investment decisions. At Auscap, we spend a significant amount of time trying to analyse data in an objective manner so that our views and investments are based more on fact than opinion.

“The goal is to turn data into information, and information into insight.”

*Carly Fiorina
Former CEO of HP*

It is difficult to refute hard data, particularly if the data is independently collected and measures broad economic activity. When analysing information we focus initially on the broadest data set, before narrowing our search to measure how industries are tracking, and finally how individual companies are performing. Auscap's top down fundamental process focuses first on trying to understand the macroeconomic environment, the current performance of and growth outlook for the economy or economies in which our investment opportunities operate. Our macroeconomic analysis covers growth, inflation, unemployment, national income and output, consumption, savings and investment. It covers the impacts of international trade, currencies and the intermarket analysis of bonds, equities, commodities and cash investment alternatives.

“If you torture the data for long enough, it will confess”.

*Ronald Coase
British economist and
Nobel Memorial Prize in
Economics Recipient*

Next we look at the economic performance of particular sectors within the economy. Different parts of the economy are often going through different phases of the economic cycle. We analyse sectoral data to see if it supports our long term thesis for a particular part of the economy. Our preference is always to swim with the tide, not against it. This work feeds into our company analysis, which involves assessing which companies are generating superior sales growth, taking market share, discounting to keep clients, offering a differentiated service and most importantly generating superior margins and delivering a strong return on capital. Objective analysis will often either support or refute an investment thesis.

The important point here is to ensure that the analysis of the data is objective. As Ronald Coase eloquently makes the point, it is important not to manipulate the data. We strive to be as objective as possible. We look at data over different time frames. We start with the longest time frame over which data has been recorded and is available, and then look at shorter time periods from there. We don't look at data that is recorded more frequently than monthly, and even then we will study the data on a rolling year on year basis. This largely removes the influences on data of different events in different years, or at least makes one off events less significant to the data.

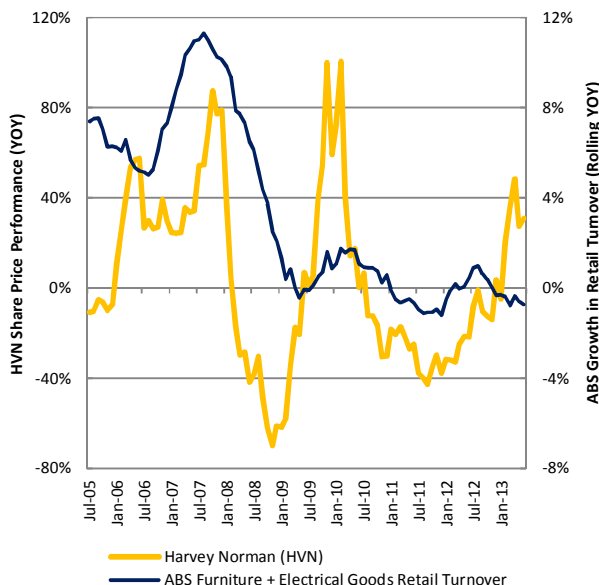
Obviously the data needs to be accurate, timely and relevant. There is no point collecting data if it is not relevant to a particular stock under investigation. That said, we have found a strong and somewhat obvious correlation between sectoral data and the performance of stocks within the particular sector. To that extent the data we analyse can act as a lead indicator for the performance of stocks in our investment universe. We will therefore pay close attention to any data that either supports or potentially refutes our investment thesis on a particular stock. To the extent the data is anomalous, interpretation and evaluation of the data become the critical elements of the jigsaw puzzle.



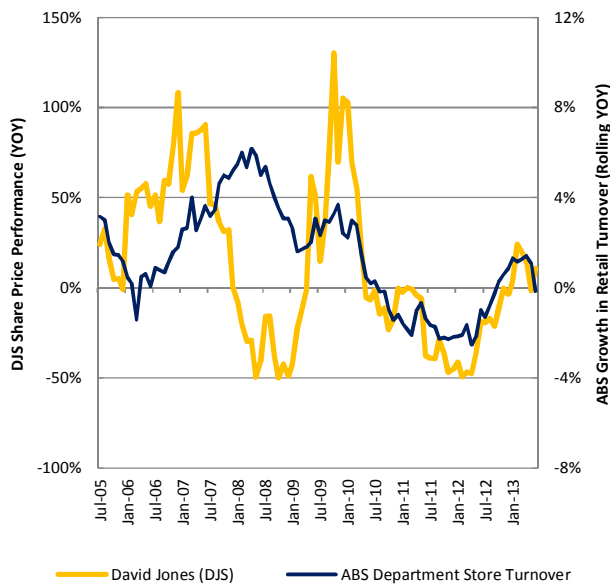
We highlight a few of the correlations between sector based data and single stock performance in the next few pages. We focus on cyclical sectors where, as would be expected, changing sectoral conditions have the greatest influence on earnings and hence the most significant impact on stock price performance.

Retail data that is category specific can often be a useful predictor of company performance. The lacklustre retail turnover statistics in furniture, electronics and department store sales have been reflected over recent years in the earnings and stock price performances of companies with those exposures.

ABS Furniture & Electricals Turnover vs HVN

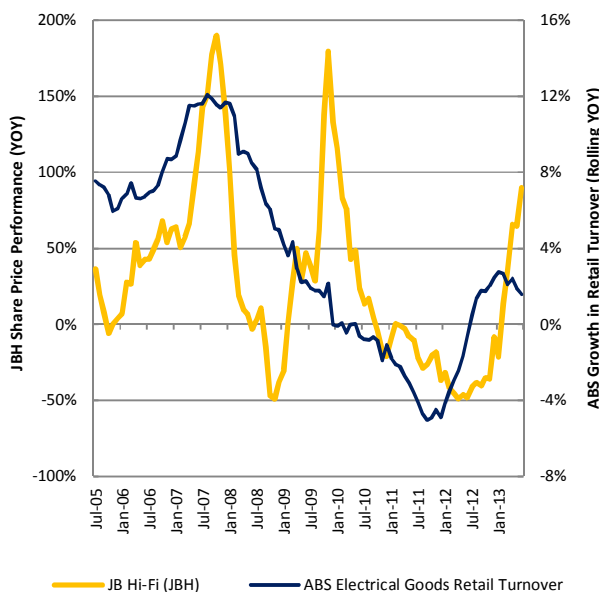


ABS Department Store Turnover vs DJS

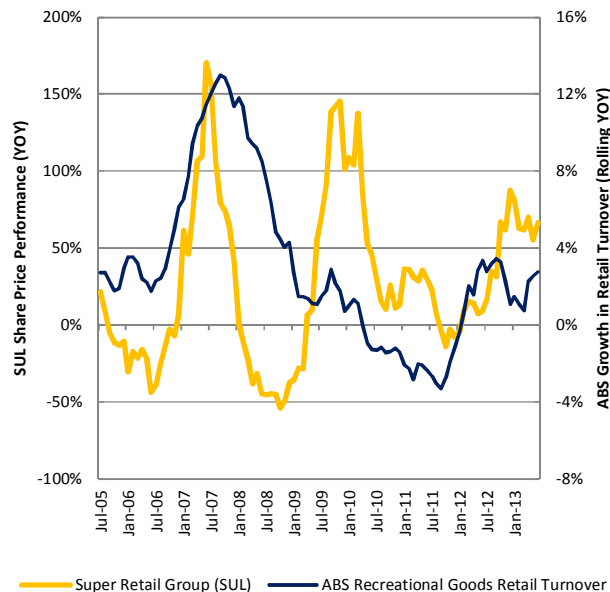


JB Hi-Fi's shareholders suffered as turnover in electronics and electrical goods retailing declined between 2010 and 2012, a function of both weak consumer spending and product deflation. By contrast, sales of recreational goods have been more resilient. While there have been many factors at play, this has no doubt contributed to the relative strength of the Super Retail Group stock price in recent years.

ABS Electrical Goods Turnover vs JBH

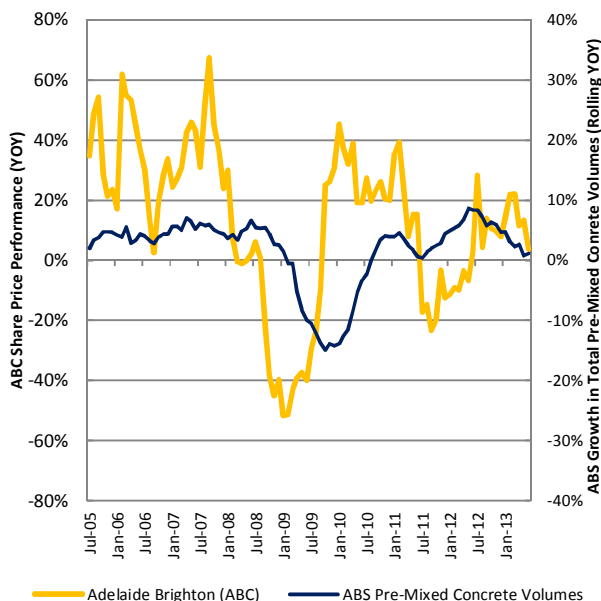


ABS Recreational Goods Turnover vs SUL

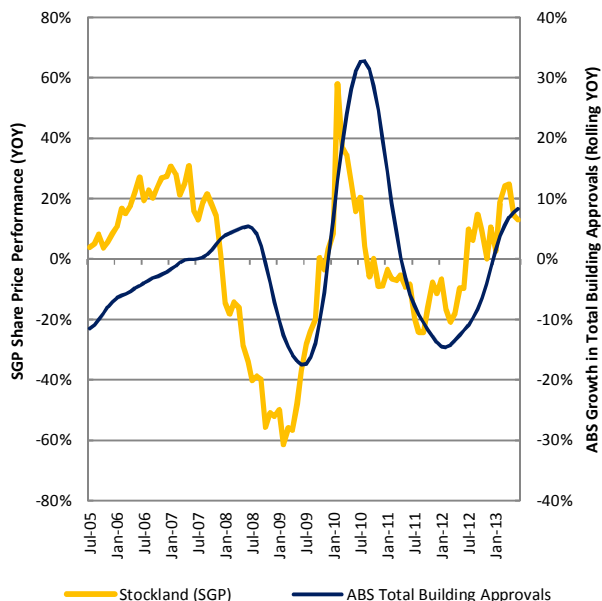


The construction data has also been relatively sluggish over recent years, but looks to be improving. Concrete consumption has held up well over the dataset, a function of investment in capital projects in the resources and infrastructure sectors. Adelaide Brighton has been one of the better performing stocks in the construction sector. By contrast, the housing construction sector has experienced weak conditions in recent years. As would be expected, the Stockland share price has closely followed the housing sector as reflected in the building approval data, a useful lead indicator for housing construction.

ABS Pre-Mixed Concrete Volumes vs ABC



ABS Total Building Approvals vs SGP



The charts above focus on turnover data, however it should not be forgotten that it is not all about the revenue line. The ability of a company to turn sales into strong, consistent returns on capital for investors is the most important feature of a good investment. The sector analysis gives us an understanding of potential top line growth, from which we begin an assessment of a company’s sustainable competitive advantages and ability to generate a return on invested capital.

Ultimately, data can be useful in predicting economic activity. Understanding what data is relevant and the way one interprets the data is critical. If we think that the data no longer supports our fundamental view, part of our risk management process is to look to reduce the position. If the data refutes our thesis entirely, we will not have a position unless we can explain the unexpected results and believe they are transitory in nature. The advantage of a high conviction strategy is that we can be and are selective about the investments we hold.

“Not everything that can be counted counts, and not everything that counts can be counted.”

*Albert Einstein
 Theoretical physicist and Nobel Prize in Physics Recipient*

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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