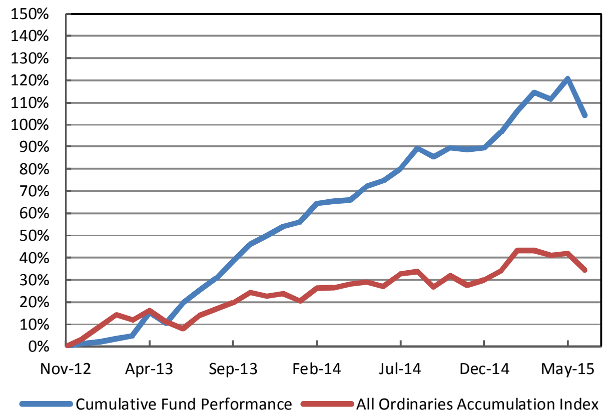
Auscap Long Short Australian Equities Fund Newsletter – July 2015

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 volatility in the context of recent market turbulence.

Fund Performance

The Fund returned negative 7.55% net of fees during June 2015. This compares with the All Ordinaries Accumulation Index return of negative 5.40%. Average gross capital employed by the Fund was 161.2% long and 26.2% short. Average net exposure over the month was 135.0%. At the end of the month the Fund had 37 long positions and 6 short positions. The Fund’s biggest stock exposures at month end were spread across the financials, consumer discretionary, healthcare, industrials and materials sectors.



Fund Returns

Period	Auscap	All Ords
June 2015	(7.55%)	(5.40%)
Financial Year to date	16.81%	5.67%
Calendar Year to date	7.68%	3.32%
Since inception	104.19%	34.28%

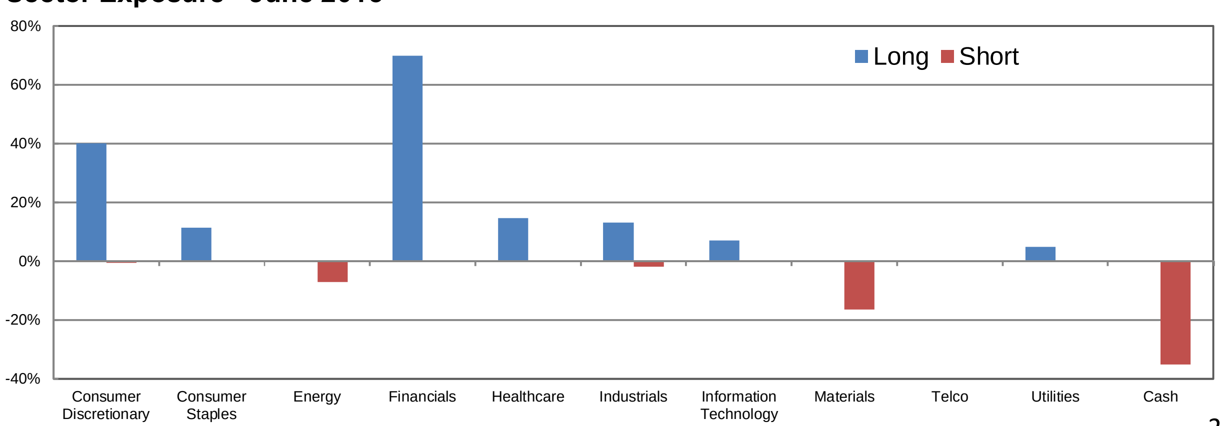
Fund Exposure

June 2015 Average	% NAV	Positions
Gross Long	161.2%	38
Gross Short	26.2%	8
Gross Total	187.4%	46
Net / Beta Adjusted Net	135.0%	92.7%

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

Sector Exposure - June 2015



A Good Year, A Volatile Month

The Fund had a strong 2015 financial year, finishing up 16.8%. This compares favourably with the All Ordinaries Accumulation Index return of 5.7%. June was a more volatile month than we would ordinarily expect for the Fund. Indeed there werenq many things that went the Fundõs way over this short period. It is important to note however, that we do not assess our performance on a month by month basis and would not encourage our investors to do so. As many investors who have met with us can attest to, we have been warning for some time that the low volatility and very steady returns demonstrated by the Fund to date were unlikely to continue indefinitely and are not a key focus for us. We are participants in the market, hence exposed to its ebbs and flows, and we focus on minimising the risk of permanent loss of capital, which we consider to be somewhat different from measured volatility. While we would expect the Fundõs volatility to be less than the market over time, we have been concerned that the steady nature of returns to date may have created unrealistic expectations amongst investors and observers.

While we do not want to dwell overly on what has been a pullback after some very strong performance, and noting that the All Ordinaries Accumulation Index also had a poor month returning negative 5.4% in June, we do recognise the need to increase our transparency and disclosure during periods of meaningful negative performance. We will always try to treat all investors fairly and in a manner that we would find appropriate were our positions reversed. Significantly, much of the Fundõs strong performance in May (+4.4% compared to +0.6% for the Index), occurred towards the end of the month. Many of these gains were quickly reversed in early June. Across the two month period the Fund returned negative 3.5% compared to the marketõs negative 4.5%. That being said, we do wish to share some broad observations below on the causes of this pullback in the interests of transparency. We would add that, in the ordinary course of business, investors should not expect such extensive disclosure.

Part of the Fundõs poor performance in June was our overall exposure. Our net long bias, which averaged 135.0% and 92.7% in beta adjusted terms, left the portfolio vulnerable to a market pullback. This was not a function of any deliberate positioning or positive view on the marketõs direction. Our net exposure has historically been a function of the individual stock opportunity set. We evaluate every opportunity in absolute terms and our gross and net exposure is a function of this. In this instance such an approach left us quite net long and hence exposed to broad market moves and the geopolitical machinations that are affecting global markets. However, we would also point out that the positions that had been added to the portfolio in recent months, which resulted in this increase in exposure, were not material detractors from performance. Our exposure had increased most noticeably in the financials space, with the addition of a few of the major banks after their significant May sell-off prior to their ex-dividend dates towards the end of May. The addition of an exposure to the large banks improved the performance in May and detracted from it in June, with no net effect. It represented almost the entire increase in the Fundõs average exposure from May to June.

What was more significant for performance were the pullbacks in some of the substantial long positions in the Fund. The 20 largest long positions in the Fund all had a negative return in June. Many stocks that the Fund holds significantly underperformed the market, the worst of which were: Ansell (ï 9.9%); Automotive Holdings Group (ï 13.3%); Computershare (ï 9.1%); Dexus (ï 8.9%); Duet Group (ï 9.4%); FlexiGroup (ï 19.2%); JB Hi-Fi (ï 10.8%); and Monash IVF Group (ï 20.2%). Five of these stocks occupy a place in the ASX100. We have not previously identified stocks held by the Fund and we are very unlikely to do so in the future. However we want to highlight the nature of the stocks that most significantly affected performance. We constantly reassess all of our positions. We are not currently of the view that circumstances for these companies have recently and materially changed. If the facts have changed or do change, then we will modify our positions accordingly as and when we become aware of any new considerations. It is an opportune time to remind investors that the Fund, like any equities exposure, will experience periods of volatility.

We would also distinguish volatility from risk. Volatility is a historical measurement of the degree of fluctuation in stock prices or fund performance. Quite often a stock whose price has been in decline for some time will display considerable volatility, especially as it approaches bargain territory. The volatility of the security will not stop us from investing in a quality company at an attractive price. By contrast, stocks that display low volatility are not necessarily safe investments. Significantly overpaying for a stock that has exhibited low volatility historically does not make it any less risky an investment, nor does it reduce the risk of permanent loss of capital should the security in question revert to a fair price.

As Howard Marks of Oaktree Capital Management, L.P. recently stated in a memo to clients dated 8 June 2015, risk can often be counterintuitive:

- *"Fear that the market is risky (and the prudent investor behaviour that results) can render it quite safe."*
- *"As an asset declines in price, making people view it as riskier, it becomes less risky (all else being equal)."*
- *"As an asset appreciates, causing people to think more highly of it, it becomes riskier."*

At Auscap we will continue to invest in accordance with our investment principles and philosophy. We will continue to target lower-than-market risk 10-15% type returns on an individual security basis. If we can do this with a level of proficiency our investors should do sufficiently well over time. We will continue to focus on value-based opportunities in companies that produce a large amount of cash flow, so that each day the business is more valuable to us than the day before. We will continue to evaluate and re-evaluate every opportunity that comes before us with caution. And we continue to look for like-minded investors who want to co-invest with us for a long period of time. We thank our investors for their support over FY15, and while it did not end on the note that we might have hoped, we are pleased with the performance of the Fund, which outperformed the All Ordinaries Accumulation Index return by over 11%. We look forward to continuing to work hard for our investors in FY16.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to the website 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.