



## **Auscap Long Short Australian Equities Fund Newsletter – August 2016**

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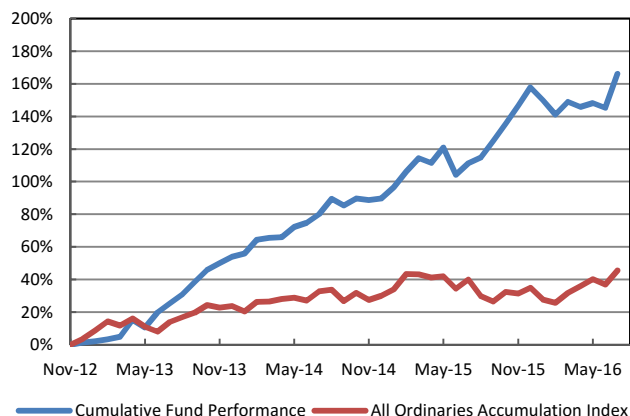
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**Welcome**

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 our views on the importance of ignoring market noise and focusing on facts when making investment decisions.

**Fund Performance**

The Fund returned 8.48% net of fees during July 2016. This compares with the All Ordinaries Accumulation Index return of 6.29%. Average gross capital employed by the Fund was 97.7% long and 11.4% short. Average net exposure over the month was 86.3%. At the end of the month the Fund had 32 long positions and 5 short positions. The Fund’s biggest stock exposures at month end were spread across the financials, consumer discretionary, consumer staples and materials sectors.



**Fund Returns**

Period	Auscap	All Ords
July 2016	8.48%	6.29%
Financial Year to date	8.48%	6.29%
Calendar Year to date	3.20%	7.95%
Since inception	166.09%	45.55%

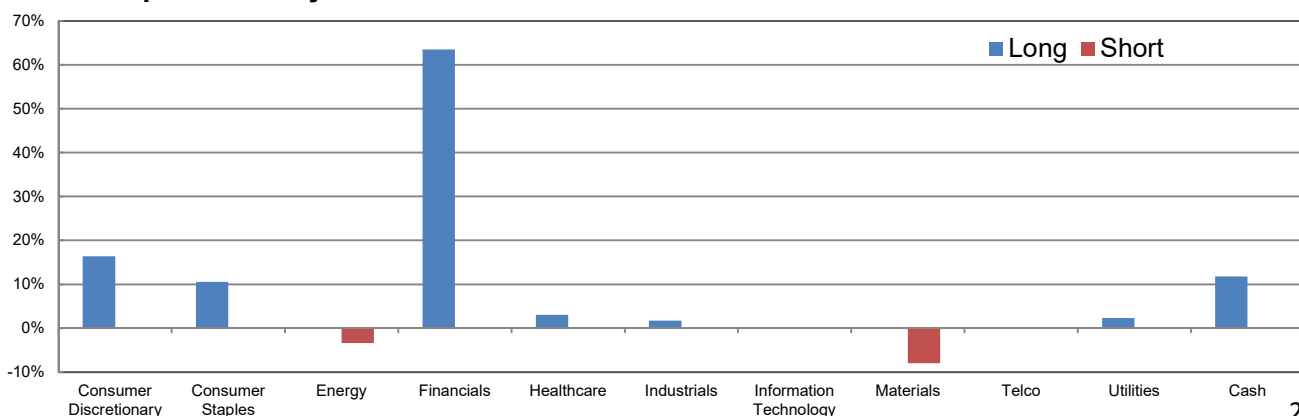
**Fund Exposure**

July 2016 Average	% NAV	Positions
Gross Long	97.7%	31
Gross Short	11.4%	7
Gross Total	109.1%	38
Net / Beta Adjusted Net	86.3%	73.1%

**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	4.56	(3.01)	(3.54)	3.22	(1.24)	0.96	(1.19)	20.13
FY17	8.48												8.48

**Sector Exposure - July 2016**



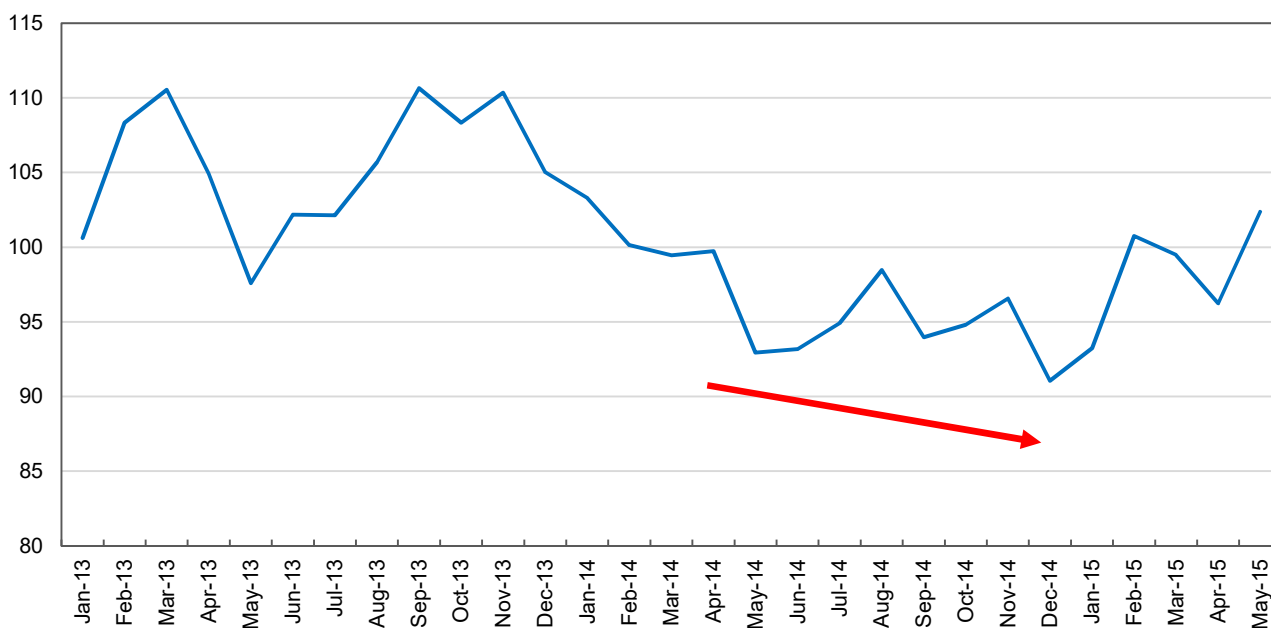
## Investing with earplugs: the struggle to avoid the noise

We have found that sharing a consensus opinion on the merits of an investment with the majority of the market is rarely a good way to generate strong returns. In fact, if the opinion is sufficiently consensus and positive, it normally guarantees that the return from the particular investment will be unremarkable at best and the risk of capital loss elevated. This leads to the obvious corollary, which is that in order to generate returns over and above what the market might deliver over a sensibly long time horizon, an investor needs a differentiated view. But the differentiated view needs to be correct, so that the number of buyers of a particular stock in which one is invested grows as more investors become aware of and attracted to the opportunity.

Having a differentiated view, even when you are confident in your analysis and assumptions, can be a particularly difficult thing to do. Investing when the majority of investors hold a contrary opinion is not a comfortable mental exercise. While we find contrary opinions useful in testing our investment thesis, preventing this noise from affecting our investment decision making process is important. It is typically very difficult to go against the crowd, to invest when many highly intelligent analysts are suggesting you do the opposite, but if our thesis has held up against the weight of opinion by the weight of the facts, this is exactly when we have found our best investment opportunities. At Auscap we rely on the facts as the basis for allocating capital to what we believe to be attractive investment opportunities.

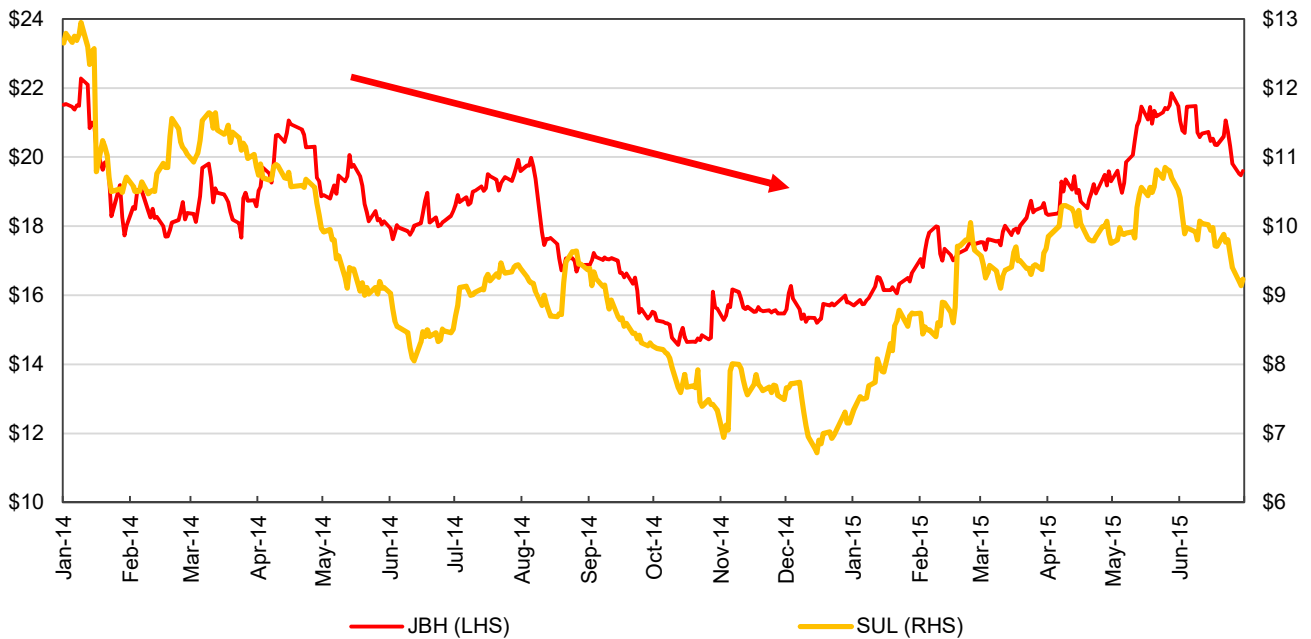
One recent example of such a situation (which we discussed at the time in the May 2014 newsletter) stemmed from the Abbott-Hockey Australian Federal Government budget that was presented on 13 May 2014. It was immediately criticised as too austere and faced enormous backlash from the community given the widespread spending cuts it contained. The investment community were quick to make their own assessment of the budget as being particularly hurtful to the consumer, with many retail stocks marked down immediately. Consumer sentiment fell in the immediate aftermath and continued to be poor until the new year.

### Westpac Consumer Confidence



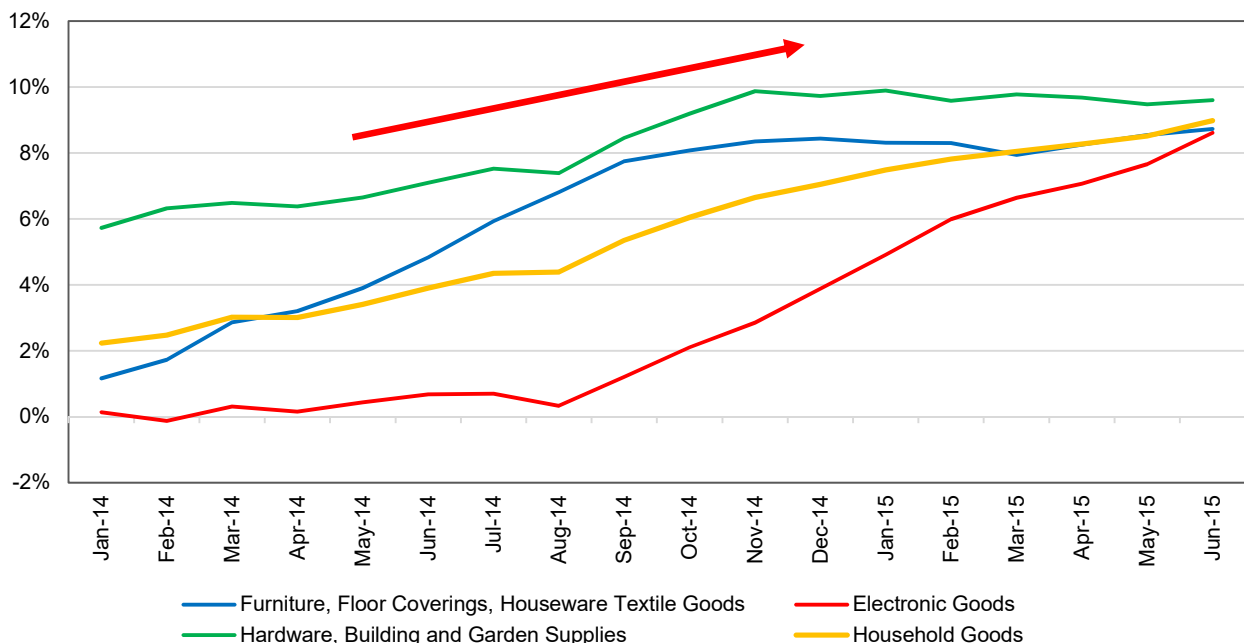
Stock prices generally followed consumer sentiment, especially in the months immediately after the budget. Bellwethers such as JB Hi-Fi (JBH) and Super Retail Group (SUL) fell significantly.

**Select Retailers Share Price Performances**



Sensing an opportunity, we tried hard to ignore the negative publicity, which continued through to Christmas 2014, and instead focused on the facts, as presented by the Australian Bureau of Statistics in the form of the monthly retail sales figures. We suspected that the real impact of the budget would be small in percentage terms. Annual household expenditure at the time was approximately \$880bn and growing by more than \$20bn a year. Even the most pessimistic of analysts assumed a ‘budget drag’ on sales of less than \$5bn per annum. A focus on these numbers would have immediately provided an investor with some important context. What we noticed in the months after the budget was that there was no meaningful deterioration in broad retail sales. In fact, in the midst of falling share prices for many retailers, annualised retail sales growth had actually accelerated across various categories.

**ABS Retail Sales Category Growth YoY**



The data wasn't indicating that the retailers were suffering, despite the newspaper headlines that continued for six months after the budget. In fact, it was only when commentators realised that the Christmas sales period had been relatively strong for many retail categories that we stopped noticing the negative commentary. It proved an opportunity, with the share prices of the retailers that we had invested in rising strongly as they reported their half year results in February and March of 2015. We highlight this example primarily to provide our current and prospective investors with a case study into our investment activities and to increase their understanding of the way in which we operate as investment managers.

We think it also illustrates an important point. Standing against a wave of negativity is a difficult thing to do. But if the facts are supportive of making an investment, such opportunities are typically the most profitable ones for the value investor. Each opportunity that we assess will have very different characteristics, and we are certain to make our fair share of mistakes along the way, but our margin of safety increases when the facts are supportive of investment and the majority of market participants are convinced otherwise. We will continue to rely heavily on data, test our investment theses against contrary viewpoints, employ the investing earplugs where necessary and allocate capital when we think it is prudent to do so.

***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](http://www.auscapam.com/information-memorandum). We welcome any feedback, comments or enquiries. Please direct them to [info@auscapam.com](mailto:info@auscapam.com).

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