



## **Auscap Long Short Australian Equities Fund Newsletter – February 2018**

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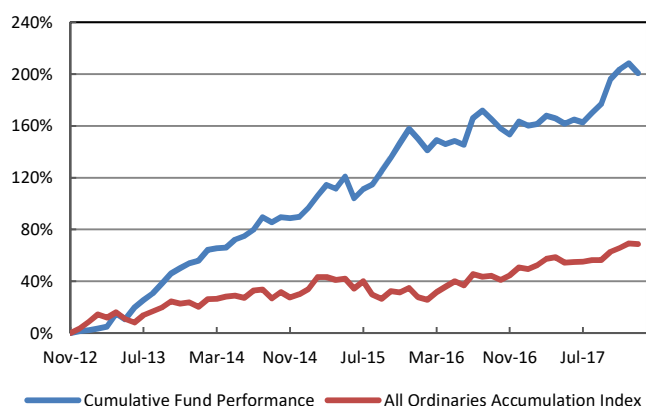
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**Welcome**

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 the recent pullback in global stockmarkets and what it means for the Auscap portfolio.

**Fund Performance**

The Fund returned negative 2.50% net of fees during January 2018. This compares with the All Ordinaries Accumulation Index return of negative 0.33%. Average gross capital employed by the Fund was 117.4% long and 4.5% short. Average net exposure over the month was 112.9%. Over the month the Fund had on average 26 long positions and 6 short positions. The Fund’s biggest stock exposures at month end were spread across the financials, consumer and real estate sectors.



**Fund Returns**

Period	Auscap	All Ords
January 2018	(2.50%)	(0.33%)
Financial Year to date	13.57%	8.95%
Calendar Year to date	(2.50%)	(0.33%)
Since inception	200.79%	68.68%

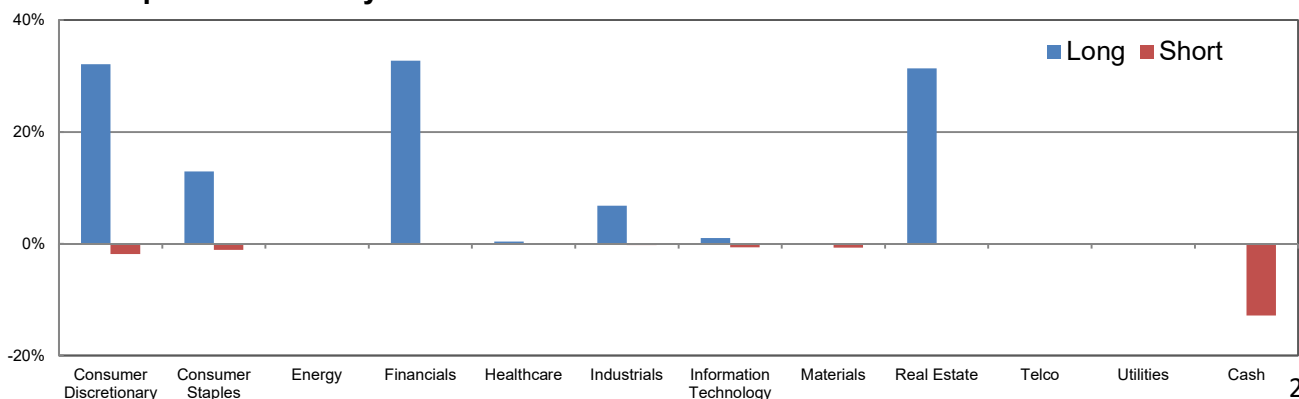
**Fund Exposure**

January 2018 Average	% NAV	Positions
Gross Long	117.4%	26
Gross Short	4.5%	6
Gross Total	121.9%	32
Net / Beta Adjusted Net	112.9%	80.2%

**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	2.13	(2.37)	(2.72)	(1.83)	4.00	(1.20)	0.42	2.52	(0.81)	(1.53)	1.18	7.97
FY18	(0.77)	2.75	2.53	6.96	2.58	1.56	(2.50)						13.57

**Sector Exposure - January 2018**



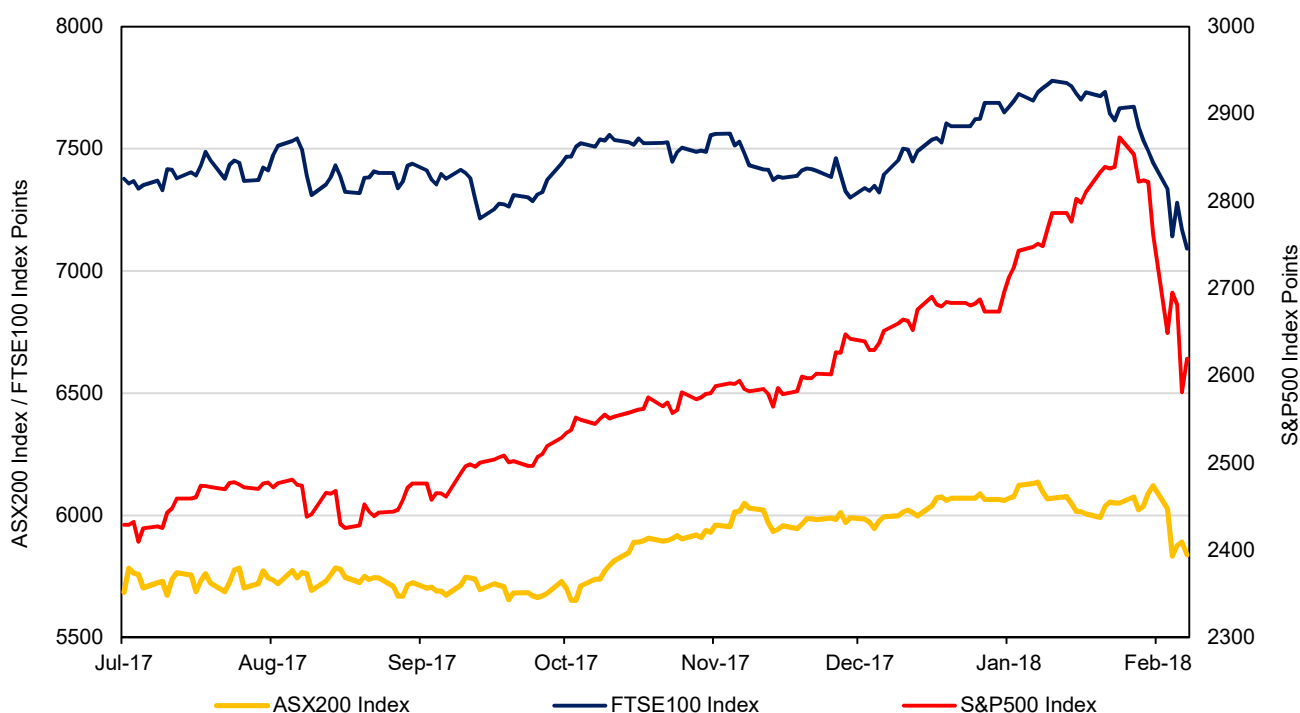
## What to do in this market sell-off?

*“In the short run the market is a voting machine but in the long run it is a weighing machine.”*

Benjamin Graham

The father of value investing, Benjamin Graham, said it so eloquently. In the short run many different things seem to matter. Investors focus on reports from journalists, brokers, market commentators and anybody else trying to explain short term gyrations in markets and prices. The *post hoc* causes of the dramatic recent market sell-off that we have read about include rising bond yields, inverse volatility exchange traded notes, rising wages, the US Government deficit, computers running complex mathematical algorithms, profit taking after strong global markets and the list goes on. In the short run all of these factors seem to get a vote. We do not spend a lot of time on these factors. We focus on whether the companies that we own represent an attractive use of our investors’ capital. Our focus is on earnings and valuation.

### Recent Stock Market Performances



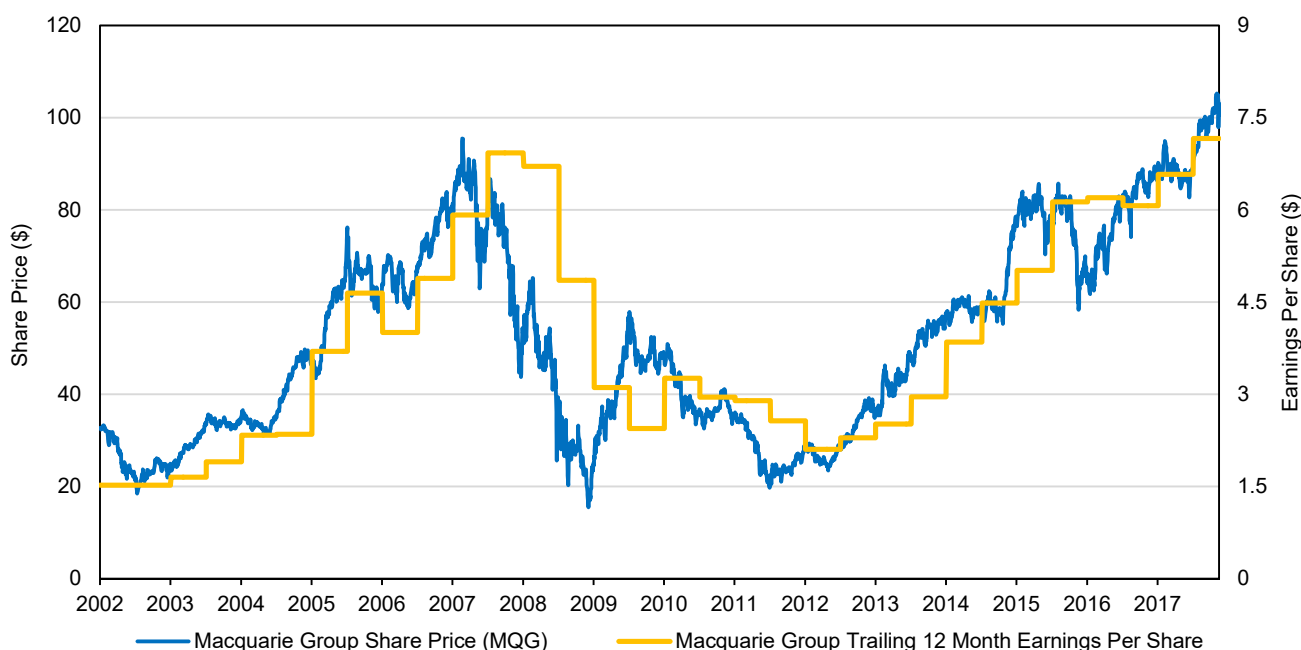
In the long run what is being weighed by the market are earnings, because ultimately earnings drive share prices. Earnings are what we focus on as long term investors in the businesses we own. We cannot predict short term share price movements. We cannot predict short term gyrations in the broader market. We are not aware of any person who has repeatedly and successfully predicted these short term movements. We are, on the other hand, aware of many investors who have unsuccessfully tried to “time” their investments.

To us, it is a futile exercise for any manager to try to predict short term movements in share prices and make investment decisions based on these predictions. Short term movements in share prices are often random. They can be a function of an investor that decides one morning to buy or sell. They can be in response to someone leveraging or deleveraging their portfolio. They can move because of macroeconomic events. They can move on changes in investor sentiment. The share prices of the companies we own move around frequently and sometimes to a large degree. Unless a negative market event is likely to impact the earnings of the companies we own, we typically see downward moves as an opportunity to buy some of our favourite stocks at marked-down prices.

At the Sohn Hearts and Minds Conference in November 2017 we presented Macquarie Group as a buy idea. Macquarie is a high quality business, with a strong return on capital, good cash generation and a sensibly geared balance sheet. It has exposure to a number of financial sectors that are experiencing strong tailwinds. We consider that its largest profit contributor, an asset management business centred around a global infrastructure portfolio, is implicitly undervalued by the market. Macquarie Group is a core position in the Auscap portfolio and has been for some time.

However, its share price moves around wildly. During the recent market sell-off, Macquarie Group announced a near 10% upgrade to earnings, yet its share price fell over 8% in a matter of a few days. Did the *value* of Macquarie Group fall over 8% in this period? We suggest not. There will be many commentators espousing a view as to why Macquarie Group fell so significantly. The simple fact is that more people wanted to sell the stock than buy the stock at a particular point in time so the price declined. What matters to us is what happens to earnings over time. And for very good reason. Ultimately the market will weigh the earnings of the company, which will be reflected in the share price. The evidence is clear in the fifteen year chart below. Eventually the share price will follow the earnings of every listed company. That is why we focus on finding good businesses with growing earnings trading at attractive prices.

**Macquarie Group Earnings and Share Price**



Similarly the Auscap Fund’s “share price”, the monthly unit price we provide to our investors, will often move around in the short term, reflecting the short term gyrations in the share prices of the companies we own. This is not something that we can or try to control. In the long run it will be the earnings of the companies that we own that will determine investment performance. Our job as an investment manager is to find high quality businesses with growing earnings that we can buy at attractive prices and hold for a long time.

**If you do not currently receive the Auscap Newsletter automatically, we invite you to register.** To register please go to the website [www.auscapam.com](http://www.auscapam.com) and follow the registration link on the home page. Interested investors can download a copy of the PDS at [www.auscapam.com/auscap-fund/pds](http://www.auscapam.com/auscap-fund/pds). We welcome any feedback, comments or enquiries. Please direct them to [info@auscapam.com](mailto:info@auscapam.com).

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