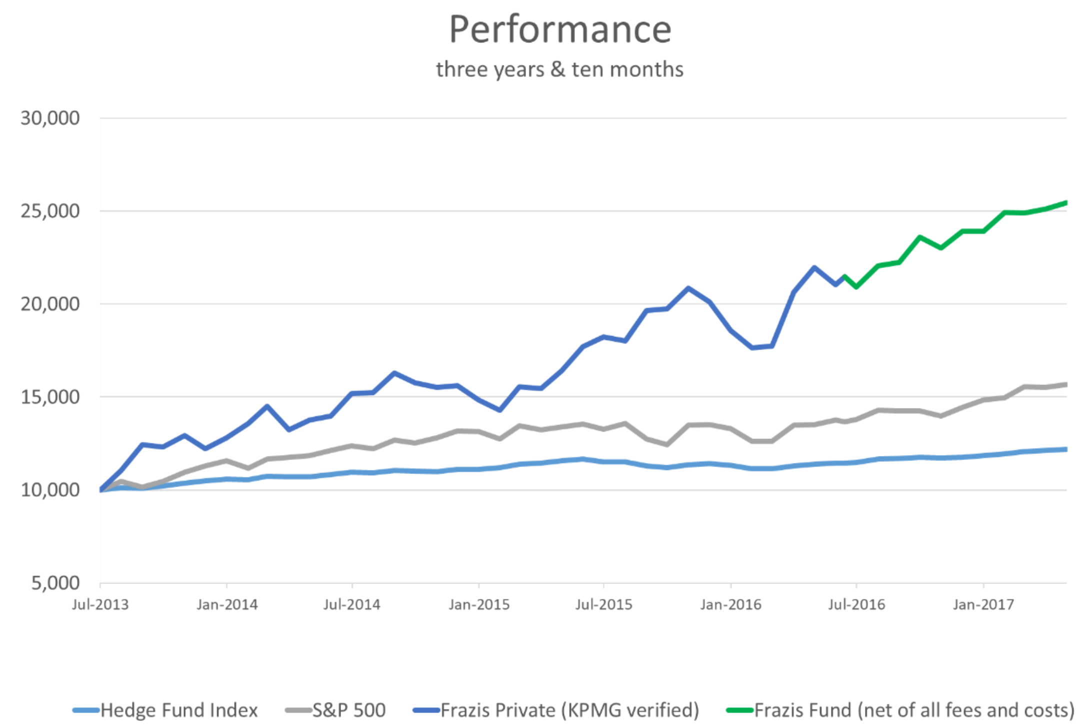
April 2017

Dear investors

We had a solid month, up +1.3%, ahead of the S&P500 at +0.9%. This brought our net performance since inception to +19%. Our IRR over the past three years and ten months stands at 28%.



It appears our performance can be credited to the 15% rally in US stocks, but we've actually lost about 6% on a portfolio basis betting against the market. Our index hedges and long volatility positions were costly, but our stock selection and handy contributions from credit, foreign exchange and commodities outweighed those losses.

Major gross contributions to the portfolio for the month were approximately:

Contributors	
Foreign Exchange	0.9%
Persimmon	0.7%
US Oil short	0.5%
Crest Nicholson	0.5%
Sears short	0.4%

Detractors	
Hedging	-1.1%
Zillow short	-0.4%
Beach Petroleum	-0.3%
Bluebird bio	-0.3%
Burberry	-0.2%

Hedging

This month our largest detractors on performance were our short position in the S&P500, and our long volatility positions. On reflection it has been something of an error to conduct all our hedging in the US, which involves bets against some of the best companies in the world.

The five largest contributors to the performance of the S&P500 will come as no surprise: Apple, Google, Facebook, Microsoft and Amazon.

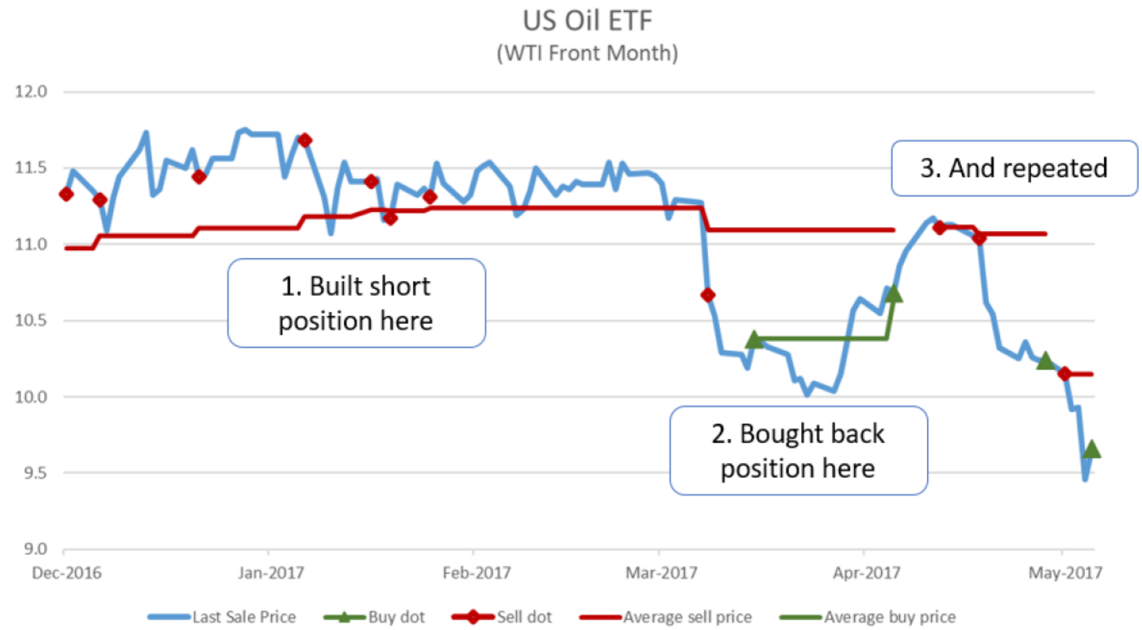
These alone added 40% of the index return. Not a single European or Australia company comes close to this level of value creation. The persistent bid on these leaders may be one of the reasons that volatility has been so low. Since April month end, a short sell-off in May released some cash, which we used to purchase a Nasdaq 100 ETF. Along with our existing positions in Apple, Alibaba and Baidu, this should alleviate the underperformance caused by the US tech giants, who seem as likely to dominate the next few years as they have the past. The Nasdaq has the added benefit of including the winner in each major tech sector, without requiring us to pick it.

There are two main reasons we are so comprehensively hedged in April: price signals in commodities and the approach of tightening cycles in the US and China.

There have been sharp sell-offs and air pockets in the bellwethers iron ore and oil. Price is the best indicator, and weaknesses in these commodities seem to indicate a slowing of demand, especially in iron ore, which has been resilient for some time.

Most sell-offs since the financial crisis have been precipitated by sudden moves in energy and industrial metals, and we had some success shorting oil directly, for reasons discussed in previous letters.

The core thesis was that price was responding negatively to positive news (OPEC cuts), which suggested there was real pressure on the commodity. The US rig count continued to rise, and we still expect US shale drillers and rising fuel efficiencies to comfortably negate any OPEC cuts.

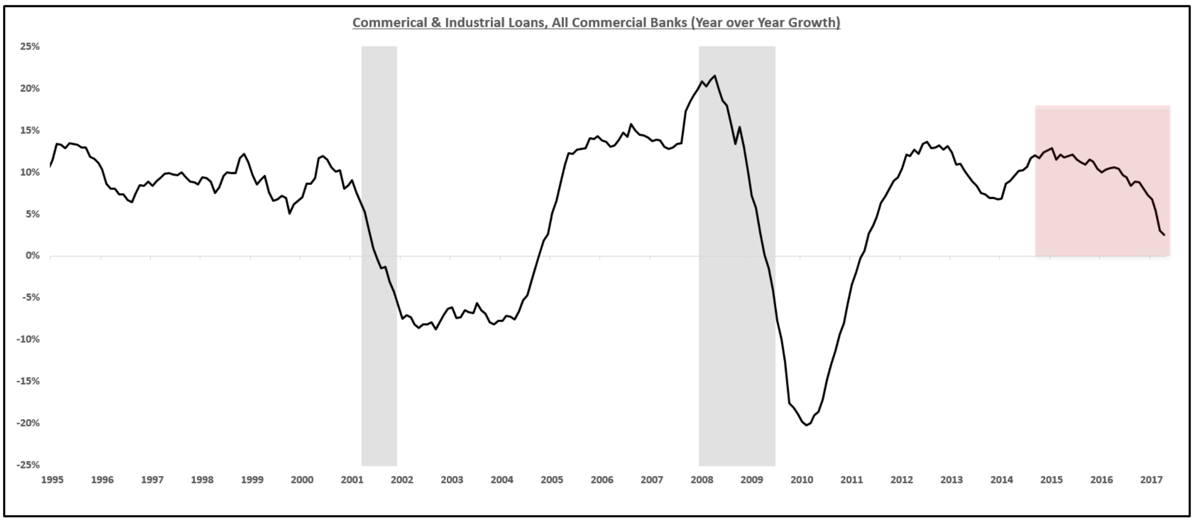


The second reason for concern has been the start of tightening cycles in China and the US. In the past it has paid well to ignore those who flippantly throw around phrases like 'China is a bubble'. 'Bubble' is about as over-worn and grating in financial commentary as Buffett quotes from the 80s. But as a rule of thumb tightening takes the gas out of stocks, commodities and real estate, and our best bet is that we are at the beginning of one, so we are approaching this market conservatively.

The Fed is expected to lift rates to 1% in June. Long term treasuries already yield over 3%, and US unemployment has hit a low of 4.4%. There should be considerable upwards pressure on wage and price inflation, which should give the Fed confidence to continue raising rates. The UK is also close to full employment, though wage inflation is not particularly apparent.

The risk we are watching is that the Fed is encouraged to lift rates into the teeth of a cyclical slowdown, which would have an outsize (if temporary) effect on equity market returns.

There have been negatives surprises in the past six weeks, such as the disappointing US GDP revision, and somewhat isolated data points, like declining lending growth. Charts like this have perhaps made us too bearish:



This may all be smoke, and the 'worry' that leads to the next 5-10% uplift in markets, but we will continue with a hedged strategy. Portfolio returns are driven by stocks that triple, quadruple or more. The more we can allocate to the best companies in the world, and the less we worry about short term cycles, the better. Our hedging program allows us to do this, and we are still working towards of generating positive returns on our hedges through the cycle.

Shorts: Retail and tech

We've discussed our shorts in Australian retail in the past. We finished the quarter with the following positions: Myer (1.5%), JB Hifi (1.5%) and Harvey Norman (2.5%). There are some telling statistics from the US on the effect of the internet on physical retail. Foot traffic in US malls dropped by 50% between 2010 and 2013 alone.

Sears equity is likely worthless. Note that the EBITDA loss in the next year alone is larger than the entire market cap of the company:

Key Financials[1]								
For the Fiscal Period Ending *Currency*	12 months Feb-02-2013A *USD*	12 months Feb-01-2014A *USD*	12 months Jan-31-2015A *USD*	12 months Jan-30-2016A *USD*	12 months Jan-28-2017A *USD*	12 months† Jan-31-2018E *USD*	12 months Jan-31-2019E *USD*	12 months Jan-31-2020E *USD*
Total Revenue	39,854.0	36,188.0	31,198.0	25,146.0	22,138.0	17,227.0	15,615.35	14,791.5
Growth Over Prior Year	(4.1%)	(9.2%)	(13.8%)	(19.4%)	(12.0%)	-	(9.36%)	(5.28%)
Gross Profit	10,549.0	8,811.0	7,218.0	5,987.0	5,109.0	-	-	-
Margin %	26.5%	24.3%	23.1%	23.8%	23.1%	21.32%	21.65%	22.00%
EBITDA	(28.0)	(571.0)	(858.0)	(949.0)	(1,039.0)	(944.0)	(796.55)	(530.2)
Margin %	(0.1%)	(1.6%)	(2.8%)	(3.8%)	(4.7%)	-	-	-
EBIT	(836.0)	(1,292.0)	(1,431.0)	(1,368.0)	(1,394.0)	(1,231.1)	(1,068.25)	(762.1)
Margin %	(2.1%)	(3.6%)	(4.6%)	(5.4%)	(6.3%)	-	-	-
Earnings from Cont. Ops.	(1,054.0)	(1,116.0)	(1,810.0)	(1,128.0)	(2,221.0)	-	-	-
Margin %	(2.6%)	(3.1%)	(5.8%)	(4.5%)	(10.0%)	-	-	-
Net Income	(930.0)	(1,365.0)	(1,682.0)	(1,129.0)	(2,221.0)	(1,096.45)	(1,236.05)	(1,077.1)
Margin %	(2.3%)	(3.8%)	(5.4%)	(4.5%)	(10.0%)	(6.36%)	(7.92%)	(7.28%)
Diluted EPS Excl. Extra Items[2]	(8.78)	(12.87)	(15.82)	(10.59)	(20.78)	(10.24)	(11.55)	(10.05)
Growth Over Prior Year	NM	NM	NM	NM	NM	-	-	-
Same Store Sales Growth %	(2.5%)	(3.8%)	(1.8%)	(9.2%)	(7.4%)	-	-	-

[1]All results are taken from the most recently filed statement for each period. When there has been more than one, earlier filings can be viewed on the individual statement pages.
[2]All forward period figures are consensus mean estimates provided by the brokers and may not be on a comparable basis as financials.
†Growth rates for forward periods are calculated against prior period estimates or actual pro forma results as disclosed on the Estimates Consensus page.

Latest Capitalization (Millions of USD)	
Currency	***USD***
Share Price	$7.84
Shares Out.	107.2
Market Capitalization	**840.1**
- Cash & Short Term Investments	286.0
+ Total Debt	4,398.0
+ Pref. Equity	-
+ Total Minority Interest	-
= Total Enterprise Value (TEV)	**4,952.1**
Book Value of Common Equity	(3,824.0)
+ Pref. Equity	-
+ Total Minority Interest	-
+ Total Debt	4,398.0
= Total Capital	**574.0**

While it's very likely Sears enters bankruptcy, I strongly advise against shorting companies like this. When stocks reach this level of distress (the bonds are trading at 40c) the equity trades very strangely. Stocks like this will double and half in days. The credit is a better indicator of the real value here, which would be roughly 40% of their $4.4 billion debt stack, or $1.76 billion of enterprise value… many billions lower than shown above.

The few people actually trading the stack are long term holders who are slowly selling at lower and lower prices, and short sellers, who sell the stock but are also compelled to buy the stock straight back after significant rises in price. The cost to borrow Sears stock went over 100%, which is 0.4% every business day. If you want to play in the game, you have to be fast.

Sears bottomed at around $5-$6 on the day of condemning news articles. We held fire, and watched the stock rise to $11 in short order. This was clearly absurd, as it equated to a market cap of well over one billion dollars - and there is little prospect of Sears ever making money at the EBITDA line, let alone offering a return to equity. So after the stock stalled at $11.5 we initiated a small short position.

Prepared for some short covering, we left plenty of room to increase our position, however, so when the stock moved up again we nearly tripled our short at $13.4, and the stock promptly collapsed. We captured a ~20% move while holding the stock for a very short period.

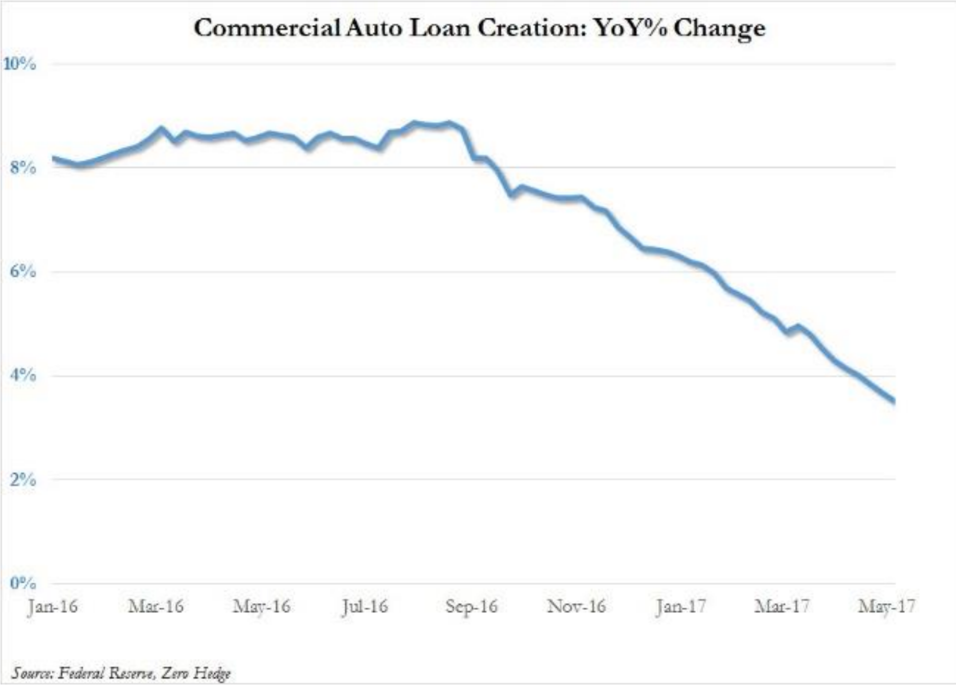
It may have been an error by taking off the position too soon, but the 100% cost to hold the position was quite testing, and it seemed prudent to pocket the gains rather than risk another cycle of short-covering followed by collapse that may have taken months to play out.

New position: Fiat

We've been watching global automakers closely as they are almost all trading on mid-single digit earnings multiples. We already own BMW, but added Fiat at just under 4% of the portfolio, finding the space by selling down Apple and Alibaba, both of which had strong runs. Fiat is trading very cheaply, at 3 times 2018 after-tax earnings multiple, and 1.2x 2019 EV/EBIDTA. Even for the auto sector, this is low. With a rapidly refreshing line-up the firm is likely to outperform.

The main concern is whether the world moves towards a post-car society. This is unlikely to happen in the next three years, by which time Fiat will have generated after tax earnings equivalent to its current market cap. Something to watch carefully, however. Auto loan growth in places like the US has been slowing, but given the low valuation the risk/reward seems strongly skewed to reward.

Auto loan has accompanied the decline in commercial lending. In this case there is slowing ***growth*** which has accompanied the incredibly low absolute valuation multiples on offer at Fiat and other major auto companies.



Fiat is in a highly cyclical industry, so fits well in our hedged portfolio, despite the chart above. We expect Fiat to outperform under normal conditions, and should a moderate downturn hit, we will have a long-awaited chance to realize returns in our hedging portfolio.

Best regards

Mike

Exposure

Country	%
USA	33%
Australia	24%
UK	19%
Europe	11%
China (US listed)	7%
India	5%
Total	**99%**

Investment Theme	%
Financials	19%
British Land Developers	15%
Autos	13%
Energy and Refining	11%
Tech	10%
Blue Chip Mining	8%
Biotech and Pharmaceuticals	9%

Luxury	3%
Shipping	5%
Mining Development	4%
Healthcare	2%
Total	**99%**

Short Positions	%
Short Tech	-6%
Short Retail	-6%
Short Healthcare	-2%
Total	**-14%**

Hedge book	%
Equity Index Hedge	-60%
Volatility Hedge	6%
Total Equity Exposure with VIX at 4x	**2%**

Credit and Macro	%
Corporate Credit Risk	5%
Long-dated US Treasuries	6%