

9 July 2009

Client Letter for Quarter Ending 30 June 2009

Dear fellow investors in Bronte Capital funds

Welcome to our first client quarterly letter. We have been operating less than a month and will be brief. There is currently no individual fund. Instead we are running separate client accounts based off two model portfolios. [These portfolios are for clients denominated in US Dollars and Australian Dollars.]

We plan to open a central fund at some stage in the future – depending on investor demand. We will open separate accounts for any client with substantial funds to invest in us – though until we have finalised our US License we are not allowed to seek clients in the US.

The Portfolio

We would love to say that there is a theme to our portfolio – some unifying world view that explains why our positions are sensible. Alas there is not – and besides we think that such themes are inherently dangerous. *Nobody knows how the world will end up – and a single unified theme can leave your portfolio in pieces on some intermediate point – even if you are ultimately right.* At my old firm we started shorting housing cycle stocks two years too early. The theme was right – the execution left a lot to be desired. Our portfolio should have enough diverse ideas that we are not – in aggregate – likely to be victims of that sort of execution error.

In that light we give you our portfolio with a brief explanation of most of the major positions. For this quarter only we give a full list of all Bronte positions. In future we intend to list only substantial and new positions.

Code	Domicile	Name	% of Equity		Description
			Australian Reference Acc.	USA Reference Acc.	
Oil and gas related					
AJL	Australia	AJ Lucas	3.7%	3.2%	An coal seam methane drilling company also in water, construction and infrastructure
COP	USA	Conoco Phillips	9.1%	9.1%	Oil-and-gas near major. This company has the most developed-country portfolio of any major and hence has the lowest political risk. We believe the political risk in oil and gas is considerable. The disadvantages are a large exposure to US Natural Gas (which does not look very good) and a large part of the value is huge-but-expensive-to-develop steam assisted gravity drainage oil sands. Also they are very exposed to downstream refinery businesses where margins are poor.
JEC	USA	Jacobs Engineering	4.8%	4.8%	Arguably the most competent oil and gas engineering firm globally. This is a play on increasing capital expenditure by majors and by the Middle Eastern government majors.
Total oil and gas longs			17.7%	17.1%	

Code	Domicile	Name	% of Equity		Description
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Banking and finance longs					
BAC	USA	Bank of America	14.3%	14.2%	Our biggest position. We believe that Bank of America operating income will vastly exceed pre-crisis peak due to reduction of competition. The largest US deposit franchise will give this bank a huge advantage in a post-wholesale finance banking economy. Against this Merrill Lynch will retreat into being an inferior high net worth client business and traditional investment banking will never again be the business it was.
XCA	France	Credit Agricole	2.3%	2.2%	This continues our theme of being long deposit rich financial institutions. However it is best to be long deposits in economies where deposits are short (ie not Japan). So we like Bank of America and French regional banking groups. The ticker for Caisse Regionale Alpes Provence is CRAP. So we can say we are filling your portfolio with ...
CRAP	France	CRCAM Alpes Provence	4.7%	4.5%	
CRSU	France	CRCAM Sud Rhone Alpes	1.7%	1.7%	
Total banking and finance longs			23.1%	22.7%	
Media companies					
NWSA	USA	Newscorp	9.4%	9.0%	Media companies are almost as unpopular as financial stocks. Most of them have terrible balance sheets and the unpopularity is deserved. The global media behemoth. A very strong balance sheet means that the company will remain highly profitable and solvent throughout this cycle. Unpopular because of its exposure to newspapers - but is benefited by large and fast growing subscription businesses.
PRE	Germany	Premierre AG	3.9%	3.8%	A highly speculative pay-TV business in Germany. This company has never failed to disappoint - and needed financial rescue by News Corporation. Since then new management (which we know to be competent) have been installed and they have obtained a football (soccer) monopoly over the Bundesliga. We will either lose entirely or make five times our money on this.
Total media			13.3%	12.8%	
Assorted other long positions					
BTA	Australia	Biota	5.4%	5.5%	Biota have a royalty on one of two influenza drugs. (They own a percentage of Relenza versus the competitor Tamiflu.) There has been a substantial increase in sales due to swine flu and problems with Tamiflu.
HBH3	Germany	Hornbach	3.3%	3.3%	Home Depot for Germany. Essentially a play on a never-to-come-about German housing boom - but with high underlying asset support whilst we wait.
HEN3	Germany	Henkel	3.2%	3.6%	Consumer goods company with attached specialist glue company. The specialist glue company is mostly automotive and doing very well in a very poor business environment.
PER	France	Pernod Ricard	3.8%	3.7%	Hard liquor giant - struggling because it paid too much for Vin & Sprit (Absolut Vodka) at the peak of the cycle - but cheap as a result. Liquor should be stable in bad times.
EXC	USA	Excelon	3.4%	3.4%	A nuclear utility in the US which will benefit if (a) natural gas prices go up or (b) greenhouse gas rules apply in the US. We do not like the increased exposure to US natural gas.
Total other longs			19.1%	19.4%	
Total base long positions (not including risk arbitrage and super-speculative preference shares)			73.2%	72.1%	

Code	Domicile	Name	% of Equity		Description
			Australian Reference Acc.	USA Reference Acc.	
Highly speculative defaulted debt positions					We have a few positions in highly speculative defaulted debt. These positions can make us 800-2500 percent - but statistically they are likely to be worthless. These positions are very well researched.
DF1	USA	Defaulted Pref1	4.6%	4.5%	These are defaulted preference shares in a major American financial institution. We believe that they will eventually pay something approaching par but they were purchased at approximately 2c in the dollar. The positions were originally approximately 3% in each of these - and the larger positions are as a result of gains. It is these gains that make us believe that our quarterly performance is "low quality".
DF2	USA	Defaulted Pref2	6.1%	5.9%	
DF3	USA	Defaulted Pref3	5.7%	4.9%	
Total highly speculative longs			16.4%	15.3%	This is a suspended preference share in a large real estate REIT. We expect the company one day to tender for the outstandings - but at the moment the price is about 8c in the dollar - and the small profit we show on them is also "low quality".

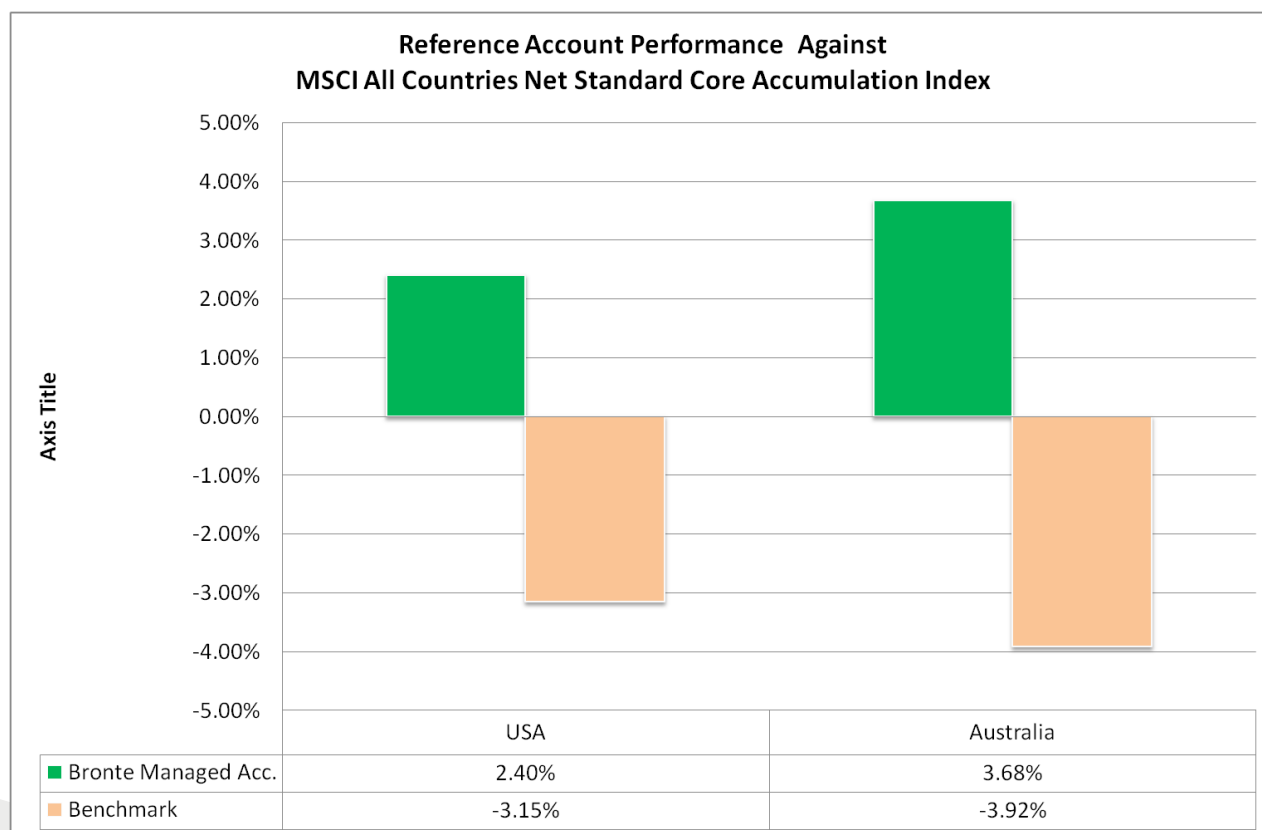
Short sales					
FS1		Fraud Short 1	-4.2%	-4.2%	Fraudulent oil company. As we are alleging fraud we would prefer not reveal the identity of the company.
FS1 puts		Fraud Short 1 puts	-2.6%	-2.5%	Out of the money puts on the same company.
AOD	USA	Alpine Total Dynamic Dividend Fund	-3.0%	-2.7%	A fairly ordinary closed end fund trading at a strong premium to market. Essentially a market short.
BBBY	USA	Bed, bath and Beyond	-4.2%	-3.6%	A valuation short. A homewares company with over 900 big-box stores - and hence covering the entire US population. This makes it ex-growth - however it trades at 20 times earnings.
CCL	USA	Carnival Cruise Lines	-1.4%	-1.3%	A cruise line company with very large orders for new boats and quite a lot of debt. This will be problematic if capital markets tighten again and/or if Western consumers retrench further. However to date we have not been right - with consumers responding to discounting with sharply increased volume.
FCNC	USA	First Citizens Bancshares	-3.2%	-3.3%	A well run regional bank in Charlotte, but with some commercial property exposure. Charlotte is probably the city that has fared best in this downturn with residential property off only about 5 percent. This position will work if the US economy takes another leg down - but otherwise will be fairly neutral. Partial hedge of Bank of America position.
FS2		Fraud short 2	-2.0%	-1.9%	A long time fraudulent insurance company. We wish to obscure its identity as we allege fraud.
FNF	USA	Fidelity National Financial	-1.0%	-0.8%	A title insurer based in California. It does not like decreasing volume in mortgages. More importantly it has a third of its capital in Ceridian - an LBO of a payroll company done near the peak of the market. There is a reasonable chance that the LBO fails - in which case Fidelity is itself in some trouble.
GE	USA	General Electric	-1.7%	-1.6%	Large finance company without a deposit base and with a large commercial property exposure. Unfortunately as a short there is attached an enormous and high quality industrial concern.
HCBK	USA	Hudson City Bank Corp	-3.2%	-3.2%	A specialist bank in Jumbo mortgages. We think they will have some credit trouble. Partial hedge of Bank of America position.
ZN	USA	Zion Oil	-4.4%	-3.7%	An oil and gas company which drills in unprospective ground in Israel. The stock is promoted by proselytizing televangelists in the USA. We believe it is an affinity fraud.
STD	Spain	Santander	-1.2%	-1.1%	Large Spanish bank. Not well run (as evidenced by their large Madoff exposure). However with a huge oligopoly on their home market allowing them high levels of profitability that they mistake for genius. A play on the macroeconomic disaster unfolding in Spain.
FS3		Fraud Short 3	-2.4%	-2.3%	A fraudulent telecommunications/GPS company.
Total shorts not including risk ar			-34.5%	-32.3%	

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Risk arbitrage					
WYE	USA	Wyeth	8.7%	10.1%	Pfizer is bidding cash and shares for Wyeth. This position should close automatically when the deal closes.
PFE	USA	Pfizer	-2.8%	-3.3%	
ENE	Australia	Energy Developments	3.9%	4.0%	An electricity company dependent mostly on garbage dump methane - which has not failed to disappoint over the past few years (for example with maintenance problems). Subject to takeover and with disappointed shareholders which make such a takeover likely.
Total risk arb longs			12.6%	14.1%	
Total risk arb shorts			-2.8%	-3.3%	
Total longs			102.2%	101.5%	
Total shorts			-37.3%	-35.6%	
Net long			64.8%	65.9%	

These positions are given for the model portfolios which in fact are real portfolios held by foundation clients. Some later clients have portfolios that differ slightly from the model portfolio. Substantial differences (of which there are few) will be explained individually to those clients.

There are a few positions (Defaulted Prefs 1, 2 and 3) which we have obscured in the client newsletter. Larger clients may – at request – get a full identification and explanation for all these however we would prefer that our less-liquid positions are not circulated in the public domain. We will reveal these positions in later letters as we admit failures or hopefully bask in some success.

Performance



The one month performance is – as you will note – satisfactory. Returns were low single digit positive against a market that was low single digits negative. For our USA reference account returns were almost 6 percentage points ahead of our index (the MSCI global all countries net standard core accumulation index in USD) and approached 8% for our Australian reference account that uses the same index converted translated to AUD¹. We would be thrilled to have continual annual returns 7 percentage points higher than index – and getting this return in one month is pleasing.

However we recognise that our relative performance is of *very low quality*. In particular our biggest gain has happened in what – by far – is the most speculative position in the portfolios. We purchased some defaulted preference shares at sub 2c in the dollar and they traded up. The statistical likelihood is that these speculative securities remain worth zero and all the gains are reversed. We however believe that the speculative securities involved are worth at least 15 times their current price – and that our being wrong is a risk that we are prepared to take.

The low quality but satisfactory returns against market have continued into the first few days of the new quarter.

Finally we confess to a trading error in the first month which cost our clients about 70bps of return. This is not substantial in the scheme of things – but does point to some system problems at Bronte which we are working to remedy.

Thanks again for the trust you have shown in us.

John Hempton
Simon Maher
Bronte Capital Management.

¹ We convert the USD MSCI index to an Australian MSCI index using the 4PM exchange rate database maintained by the Reserve bank of Australia at:
<http://rba.gov.au/Statistics/HistoricalExchangeRates/index.html>