4 June 2010

Client Letter for Month Ending 31 May 2010

Both our USA and Australian reference accounts were fully funded and commenced trading securities on 1 June 2009, and so, with the month of May behind us, Bronte has been managing money for a full year. Over this time our USA and Australian reference accounts have increased by 36.8% and 35.6% respectively compared to our benchmark increasing by only 11.7% and 5.9% respectively. (We are global equity investors and when we measure ourselves it is against global equities.)

The outperformance of 25.1% and 29.7% respectively has not resulted from excessive leverage. Our net long position has never exceeded 100% and for the most part has been close to where it is today ~ 70%. In the last month the US accounts were down about 6.6 percent and the Australian accounts up almost 1.2 percent. These returns are 2-3 percent ahead of index, and the profit on the Australian account is an artifact of the fall in the Australian dollar.

Obviously we are happy with the annual numbers – though with some reservations. Firstly the performance was clearly better in the first part of the year than the second. This was random chance – but not all of our clients received the benefit of our performance and we have had a few down months including – at least for our US dollar clients – the last month.

Any fool can outperform a rising market by taking more risk – and this was a rising market. The question is: "was Bronte outperforming by taking more risk"? We would like to think we were not – and in the current market – especially the last month – we have a down market to test that proposition. We outperformed in the down market too – but by less than 3 percent. We think we are taking less risk than the market to get better performance – and the numbers would seem to suggest that – but it is not a lot less risk than the market and we are not thrilled about how our portfolio performed when the going got tougher.

Moreover we have had some errors of analysis which have not cost serious money – so luck has played a part as well. Still we like the portfolio and we think we will continue to earn reasonable returns at lower-than-market risk even if we don't duplicate the first year's results.

When do we go to Europe?

Investment wise the big question is "when do we go to Europe"? Europe's problems are macroeconomic. Anyone who has read (and understood) Paul Krugman's seminal book Currency and Crises will recognize the patterns.[1] In Europe are several businesses that are intrinsically attractive and will benefit from a weak Euro. For instance French companies export consumer goods at fat margins to Asia. Louis Vuitton for instance makes most of its profits from selling to Asians – and is probably as good a play on rising Asian affluence as anything listed in Asia. We do not own it –

[1] Warning: Paul Krugman's early career (on which his academic record is based) contains many technical papers on trade theory and currency crises. This thought was assembled in two books which are – to put it mildly – technical reading. The currency book presents models however which remain the best way to think about currency crises. They are not light reading and bear only modest resemblance to Krugman's popular writing.

Bronte Capital Management Pty Ltd (AFS License: 334325)
Suite 2101B Tower 1, 520 Oxford Street, Bondi Junction, Australia.
Phone: +61 2 9389 3293 • Email: simon@brontecapital.com

but France – a company perennially unpopular from a North American investor's perspective – has parlayed itself into a very nice position. It is the arbiter of good taste for many nouveau-rich Chinese. We don't own Louis Vuitton – and we hope we can pick even better stocks – but we know as Europe gets cheaper we should be investing more there.

We are however – at least with respect to big portfolio changes – gradualists. When we sell stocks it will mostly be in North America and when we buy stocks it will mostly be in Europe – but portfolio turnover is low and this change will be gradual.

At some stage – and this is dependent on getting more funds under management – we are likely to do a tour of Mediterranean ruins. This will include the tourist jaunts (the Parthenon, the Forum) but we are far more interested in the "modern ruins" such as the National Bank of Greece and Hellenic Telecom. We are happy taking well-placed small speculative bets on recovery from disaster. We have a couple of such bets in American finance and the ones that have worked, have worked very well and the ones that haven't have not really hurt performance. Still – taking these bets we expect to take some hits.

We have spent a lot of time looking at National Bank of Greece for instance. We have a position (which is short the preferred stock listed on the NYSE) – however we note that NBG is in fact quite well run – a nice little bank. Its' only problem (which is a doozy) is that it is Greece. When and if Greece recovers, NBG will be a fine investment.

Portfolio Management

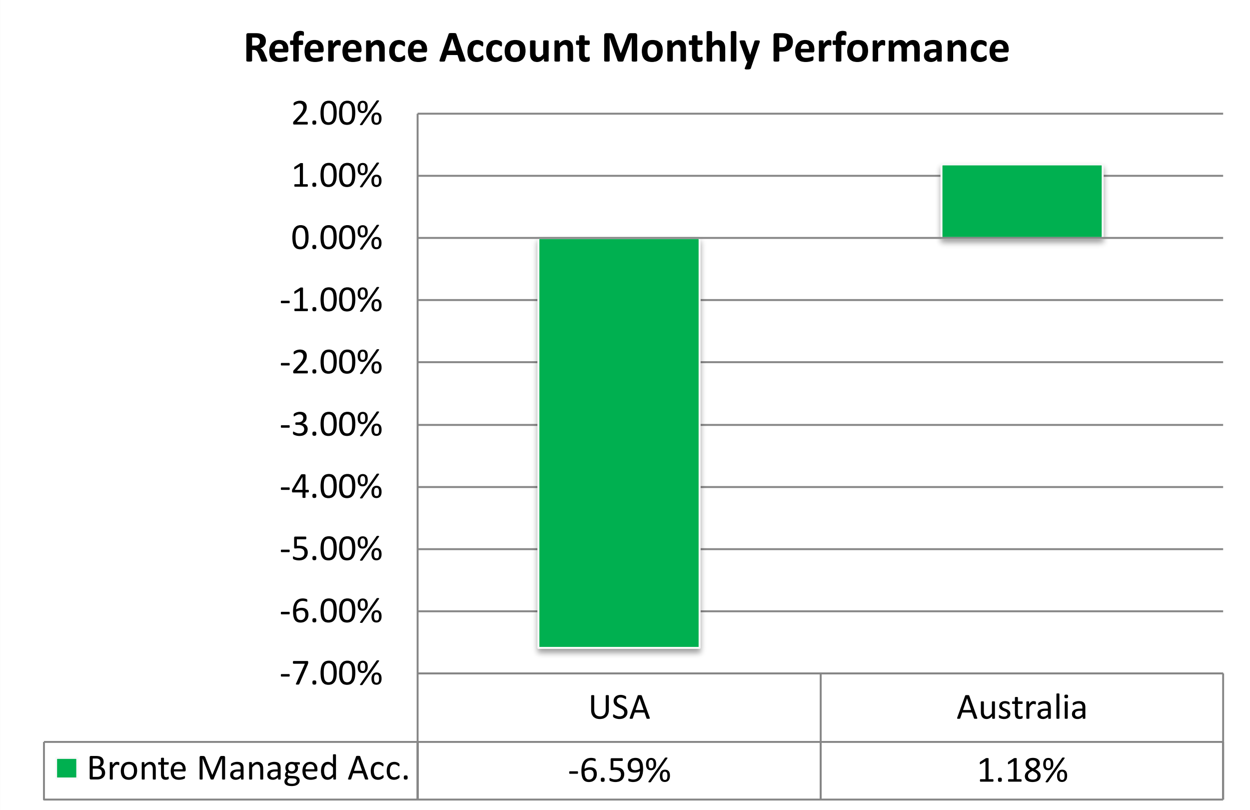
	Long	Short	Net Long
USA Reference Account	113.3%	42.9%	70.4%
Australian Reference Account	112.8%	44.5%	68.3%

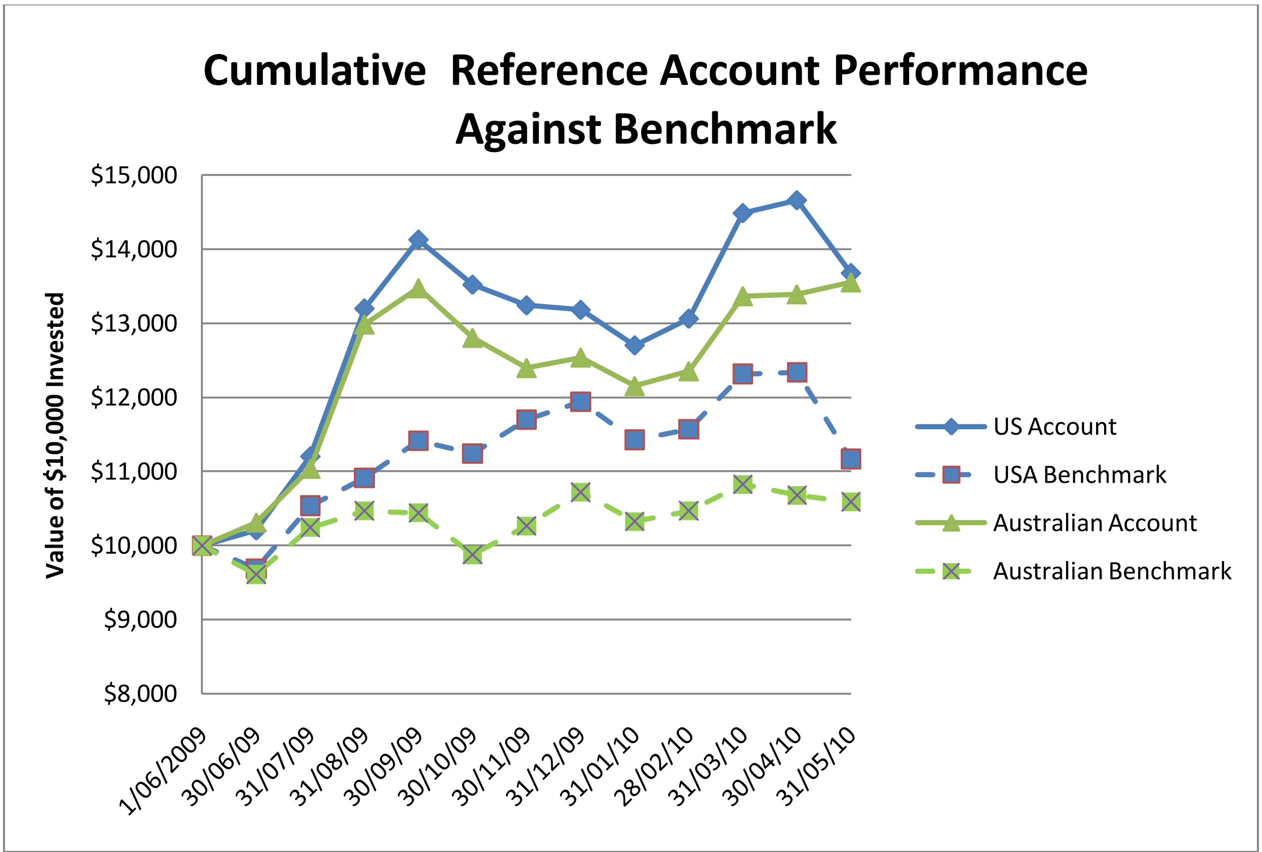
We noted last month that this portfolio was longer than it looked as some of the shorts were debt instruments (and unlikely to decline in a falling market). Alas – we had a falling market – and the portfolios were longer than we would have (in retrospect) liked. It is still that way – and the funds will continue to decline in a falling market. We do however hope to continue to outperform falling markets and keep up with rising markets and we think the portfolio is well positioned for that.

Thank you for placing your trust in us.

John
Simon

Performance Data [2]





[2] All performance data is adjusted to allow for an accrual of the annual performance fee.