Auscap Long Short Australian Equities Fund Newsletter – April 2013

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Welcome

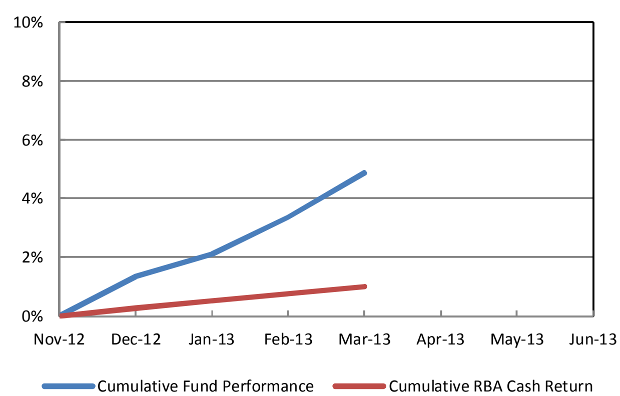
Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund ("Fund") to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we look at the housing cycle in the context of a potential east coast economic recovery, and what sector based indicators we look at in relation to the building, construction and property industries.

Overview

The Fund was launched in December 2012 and targets strong absolute returns in excess of the RBA Cash Rate. The Fund focuses predominantly on fundamental long and short investments while utilising a multi-strategy approach to take advantage of shorter term market opportunities to increase returns, hedge the portfolio, protect capital and minimise volatility where prudent. The Fund will typically have 25-45 positions primarily in liquid stocks in the ASX200. Further information, including access for sophisticated investors to the Fund's Information Memorandum, is available at our website www.auscapam.com. Enquiries can be directed to info@auscapam.com.

Fund Performance

The Fund returned 1.46% net of fees during March 2013. This compares with the benchmark return of 0.25%. Average gross capital employed by the Fund was 161.7% long and 45.2% short. Average net exposure over the month was +116.5%. At the end of the month the Fund had 29 long positions and 11 short positions. The Fund's biggest exposures at month end were spread across the consumer discretionary, industrials, property trust (financials subset), healthcare & materials sectors.

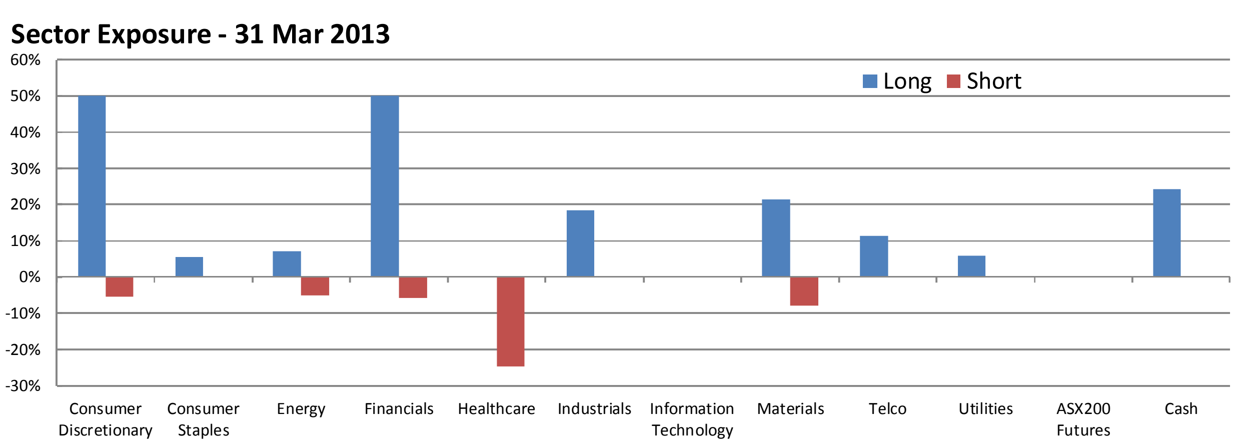


Fund Returns

Period	Auscap	Benchmark
March 2013	1.46%	0.25%
Financial Year to date	4.87%	1.01%
Since inception	4.87%	1.01%
Unit Price	1.0487	1.0101

Fund Exposure

March 2013 Average	% NAV	Positions
Gross Long	161.7%	28
Gross Short	45.2%	8
Gross Total	206.9%	36
Net	116.5%	

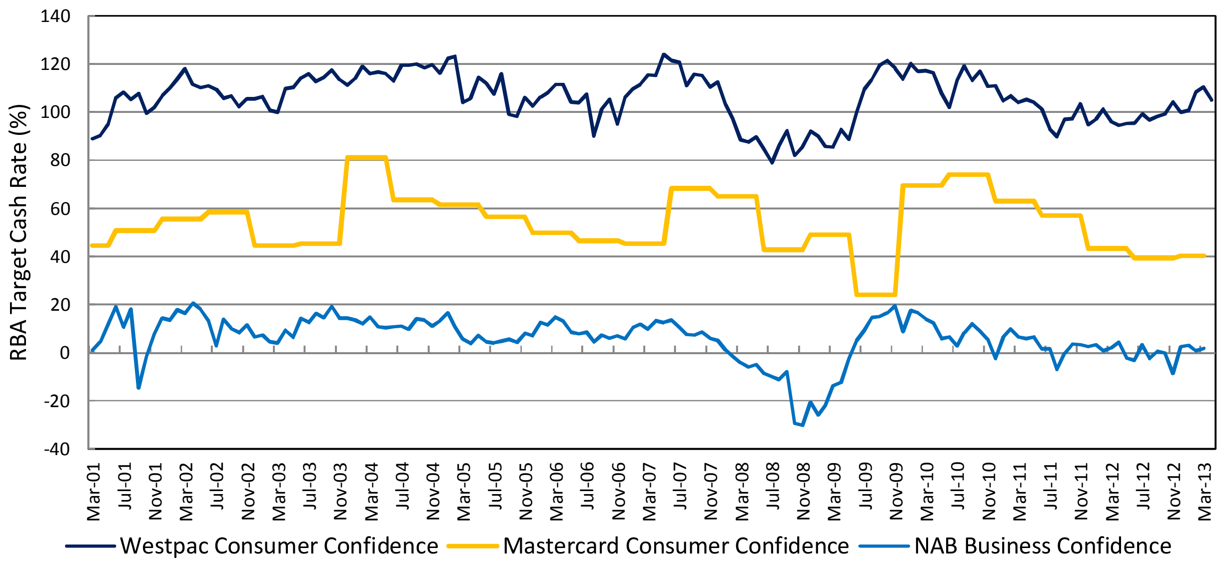


A Top-Down Approach to Investing – Housing & Construction

In the March newsletter we looked at where we thought Australia might be in the economic cycle. If the assumption that: improving consumer confidence; rising business confidence; low interest rates; a steepening yield curve; and low inflation are likely to lead to an east coast led economic recovery, then the next question to be asked is what is the best way to gain exposure to that potential recovery. Before we dig deeper, it might worth revisiting and updating a few of those charts.

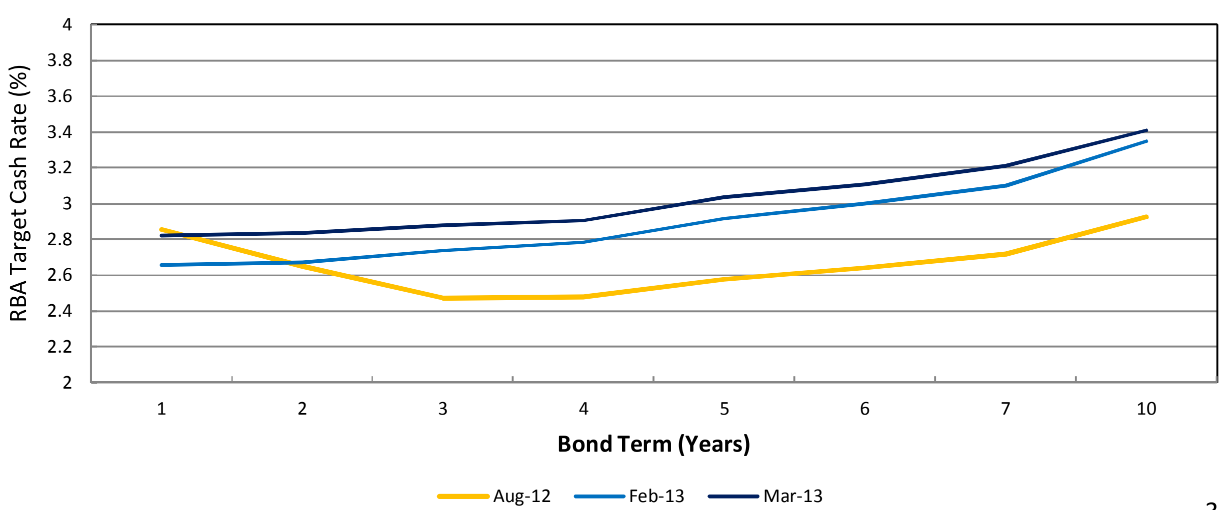
Consumer confidence fell in March, but remains above where it was through most of 2011 and all of 2012. Business confidence picked up slightly. Any economic recovery that is underway is progressing slowly.

Consumer & Business Confidence Measures



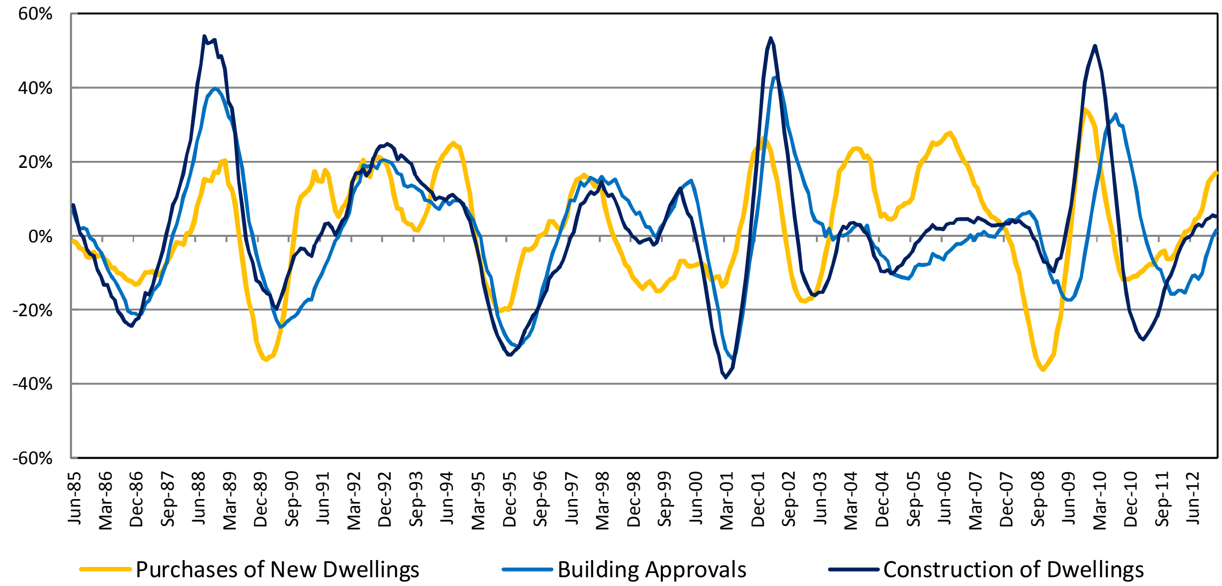
The RBA decided to leave interest rates unchanged in March, with the RBA Cash Rate remaining at 3%. We consider this to be an accommodative position. The Australian Government bond curve is normal and relatively steep, and inflation remains benign. This would typically indicate positive future economic growth.

Australian Government Bond Yield Curve



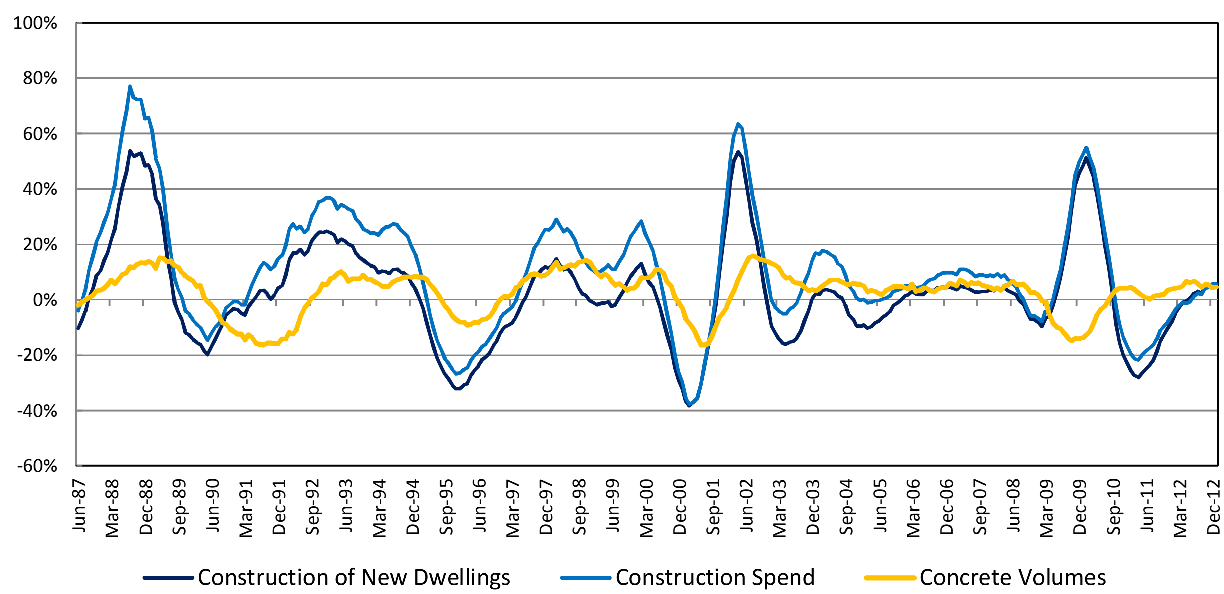
Increased consumer confidence and low interest rates would ordinarily lead to increases in new dwelling purchases which encourages further building activity. Higher building approvals and new dwelling construction activity follow suit. The anticipated correlation is shown below. The graph shows rolling year on year data sourced from the Australian Bureau of Statistics.

Australian Housing Data



As a consequence the new building activity leads to higher aggregate national construction spend and concrete volumes. Concrete volumes are distorted to some extent by the extensive use of concrete in infrastructure, commercial and mining projects.

Construction Spend and Concrete Volumes

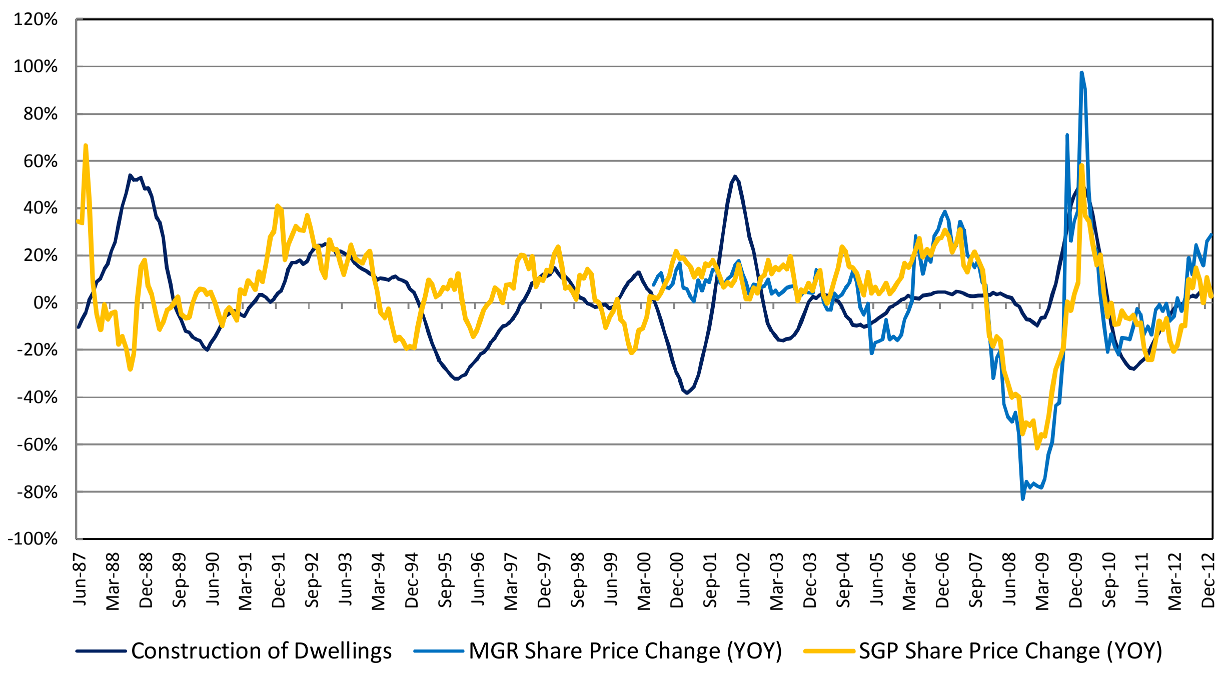


It may be that construction of new dwellings has run ahead of itself recently and the number of building approvals needs to continue to rise before we see a continued advance in new construction. Critically though, the increase in the purchases of new homes suggests that demand for new housing is improving. We would not be surprised to see a pull back over the short to medium term in the data, and correspondingly in sector activity, before continued growth in building approvals and construction.

The cyclical improvement in the building and construction data has a flow through effect on the level of activity for companies that operate in that industry. As their workflow and earnings outlook improves or deteriorates, the stock prices for these companies respond. The reason we pay attention to macroeconomic and sector specific cyclicality, such as the forces influencing the housing cycle, is so that we have an understanding of whether a company is likely to be facing headwinds or tailwinds in its quest to achieve revenue and earnings growth.

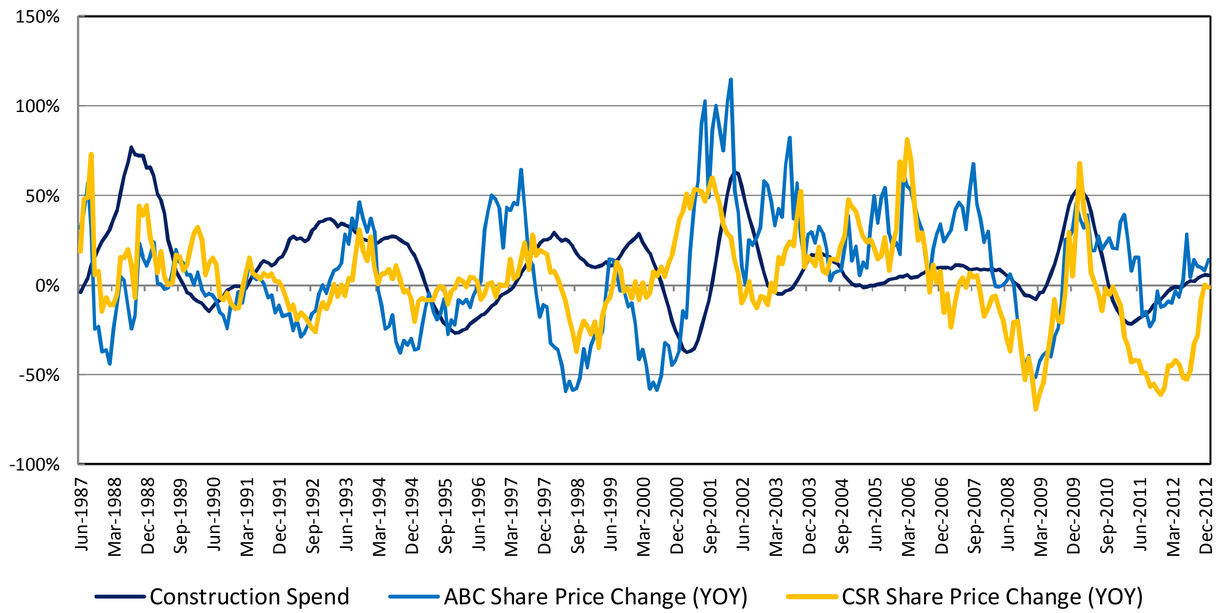
The two obvious sub-sectors exposed to housing and construction are the property developers and the building materials companies. The chart below demonstrates the high correlation between the housing cycle and a few select Australia-focused property developers. Stockland (SGP) is a large diversified property group that specialises in developing and managing residential communities, retirement living villages and retail centres. Mirvac (MGR) is a company that specialises in the investment management and development of residential and commercial property. Here we look at the year on year change in the share prices of SGP and MGR and compare them with the year on year change in the number of new dwellings constructed.

Construction of Dwellings vs MGR, SGP



Adelaide Brighton Cement (ABC) and CSR (CSR) are two of the bellwethers in the building and construction materials space. Adelaide Brighton Cement (ABC) is active in the manufacture and distribution of cement and cementitious products, lime, premixed concrete, aggregates, sand and concrete products. CSR (CSR) supplies building products including plasterboard, insulation, bricks and pavers, rooftiles, glass and aluminium products. Below we compare the share price movements of ABC and CSR with the year on year change in aggregate construction spend across Australia.

Construction Spend vs ABC, CSR



It is important to recognise that the macro environment is fluid and dynamic. The cycle can change and the data is not always predictable. Interest rates can move in a direction that either helps or hinders the building industry. A change of government can result in new policies that can be beneficial or detrimental to home buyers and industry. We adapt to changes we are seeing in the data, which to this point has been suggesting a mild recovery in the building industry.

To the extent that we decide to invest in any company, we would prefer to do so knowing that there is industry momentum. However, the road ahead is not always predictable. Having sensible criteria by which you judge individual companies helps to mitigate the impact of any unforseen headwinds or changes in the macroeconomic environment that are adverse to the industry as a whole. Stronger companies will typically navigate their way safely through the fluctuations of the economic cycle.

The qualitative and quantitative criteria we use to analyse a particular company prior to investment will be a discussion for another newsletter. Needless to say, while macroeconomic and industry factors are important, so too is the ability of a company to successfully invest capital in a way that generates strong returns on the both the company's assets and equity.

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Interested wholesale investors are encouraged to download a copy of the Information Memorandum from the website, www.auscapam.com/information-memorandum.

We welcome any feedback or comments you have. Please direct them to info@auscapam.com.