Auscap
Asset Management

Auscap Long Short Australian Equities Fund Newsletter – March 2013

Welcome

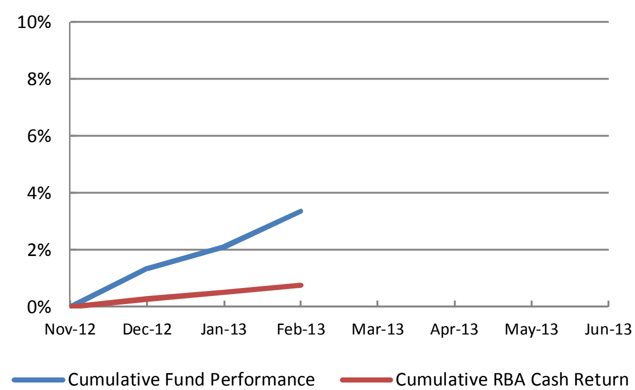
Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund ("Fund") to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we look at the business cycle, where Australia is at the moment and what it means for stock selection. Cycles often repeat themselves, and we have found that an analysis of our current position in the business cycle helps to identify stocks that will outperform.

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 1.23% net of fees during February 2013. This compares with the benchmark return of 0.25%. Average gross capital employed by the Fund was 133.2% long and 72.2% short. Average net exposure over the month was +61.0%. At the end of the month the Fund had 25 long positions and 4 short positions. The Fund's biggest exposures at month end were in the financials, consumer discretionary and industrials sectors.

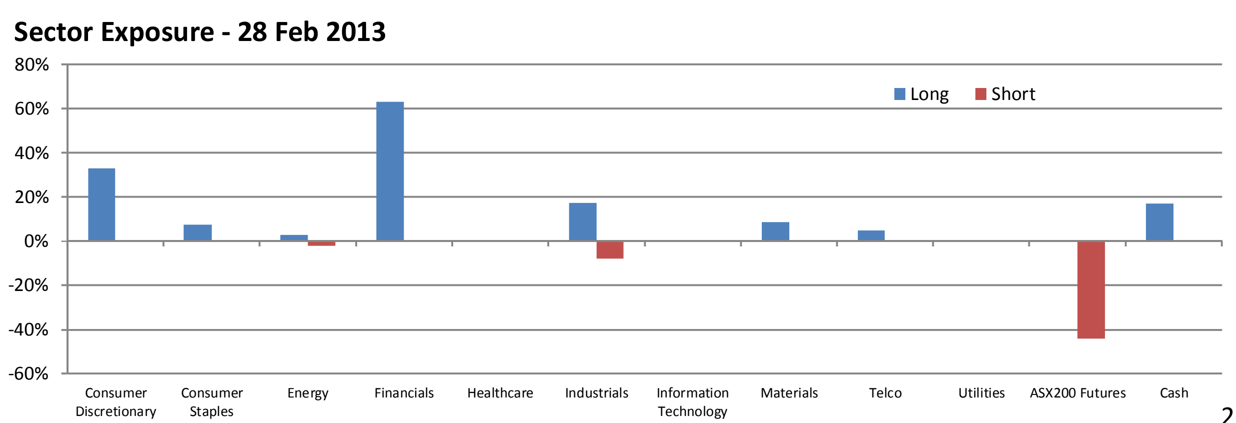


Fund Returns

Period	Auscap	Benchmark
February 2013	1.23%	0.25%
Financial Year to date	3.36%	0.76%
Since inception	3.36%	0.76%
Unit Price	1.0336	1.0076

Fund Exposure

February 2013 Average	% NAV	Positions
Gross Long	133.2%	27
Gross Short	72.2%	8
Gross Total	205.4%	35
Net	61.0%	

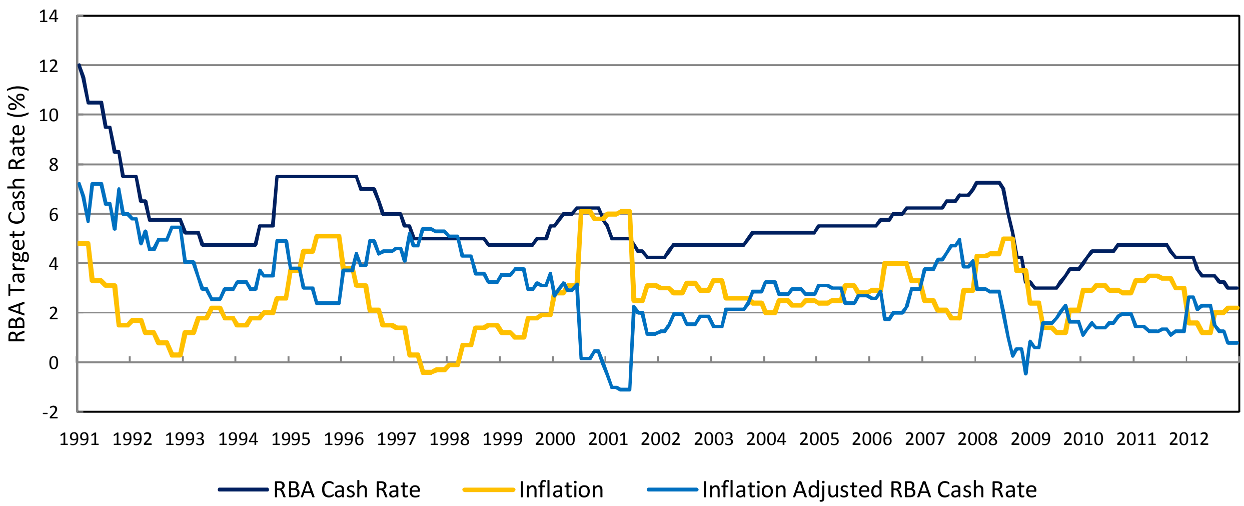


Where is Australia in the business cycle?

History suggests that where an economy is in the business cycle affects what sectors will perform most strongly over the medium term and what sectors are likely to underperform the market as a whole. To determine where the Australian economy is in the business cycle we analyse interest rates, inflation, the yield curve, industrial production and consumer expectations. Let us have a look at each of these indicators in turn.

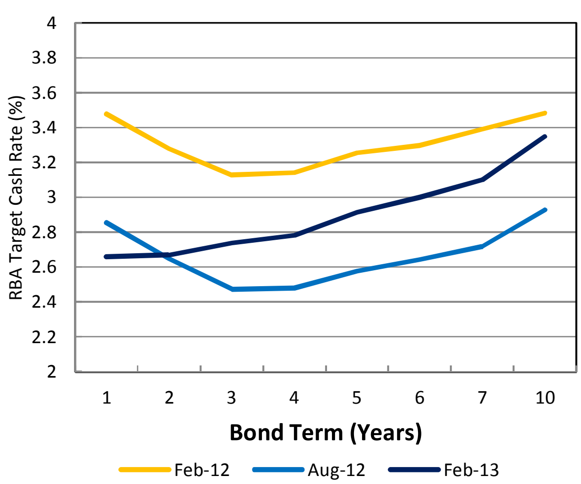
Interest Rates and Inflation: Interest rates have been falling, but evidence suggests this cycle is coming to an end. In our opinion, notwithstanding a major economic shock or slowdown in China, we consider this to be the bottom of the interest rate cycle in Australia. Inflation is benign and currently within the RBA target band.

Historical RBA Cash Rate

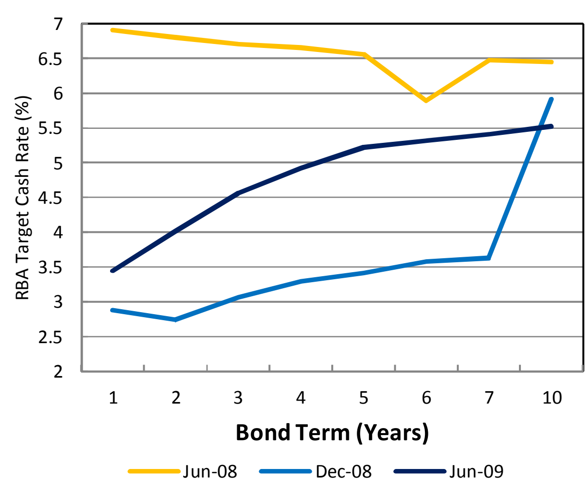


The Yield Curve: The Australian Government Bond yield curve has normalised and steepened in the last 6 months. An inverted yield curve, where the yield on bonds with longer duration is less than those with shorter duration, indicates the likelihood of a negative growth or recessionary environment. A normalisation and steepening of the yield curve suggests a recovery in growth. A comparison with various points in time in 2008-09 is provided.

Australian Government Bond Yield Curve: 2012-2013

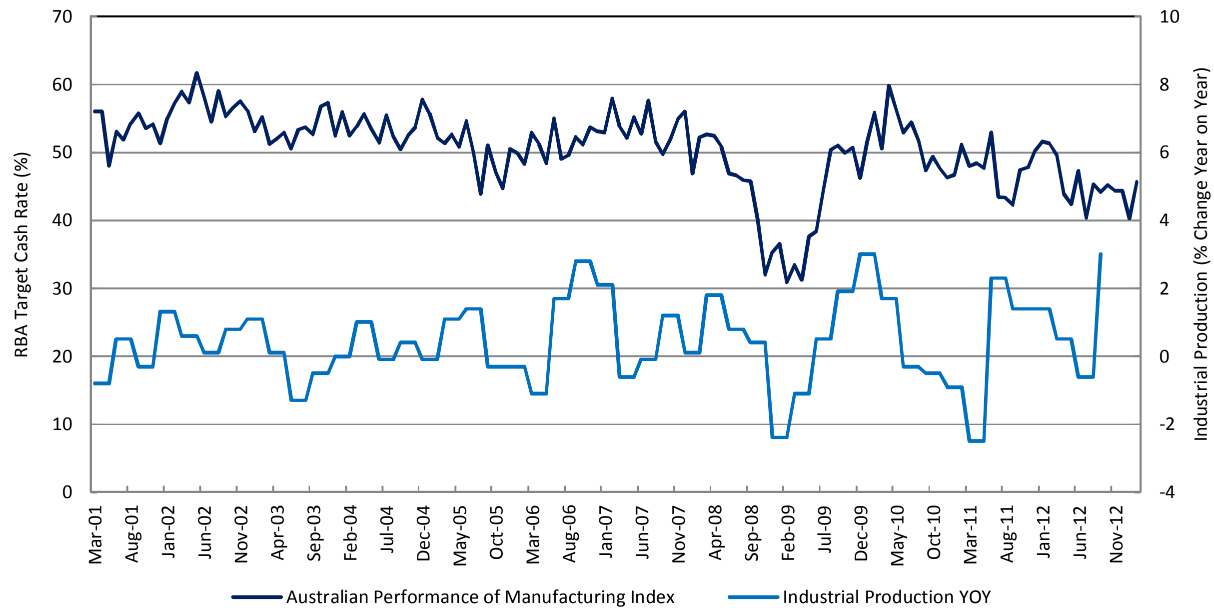


Australian Government Bond Yield Curve: 2008-2009



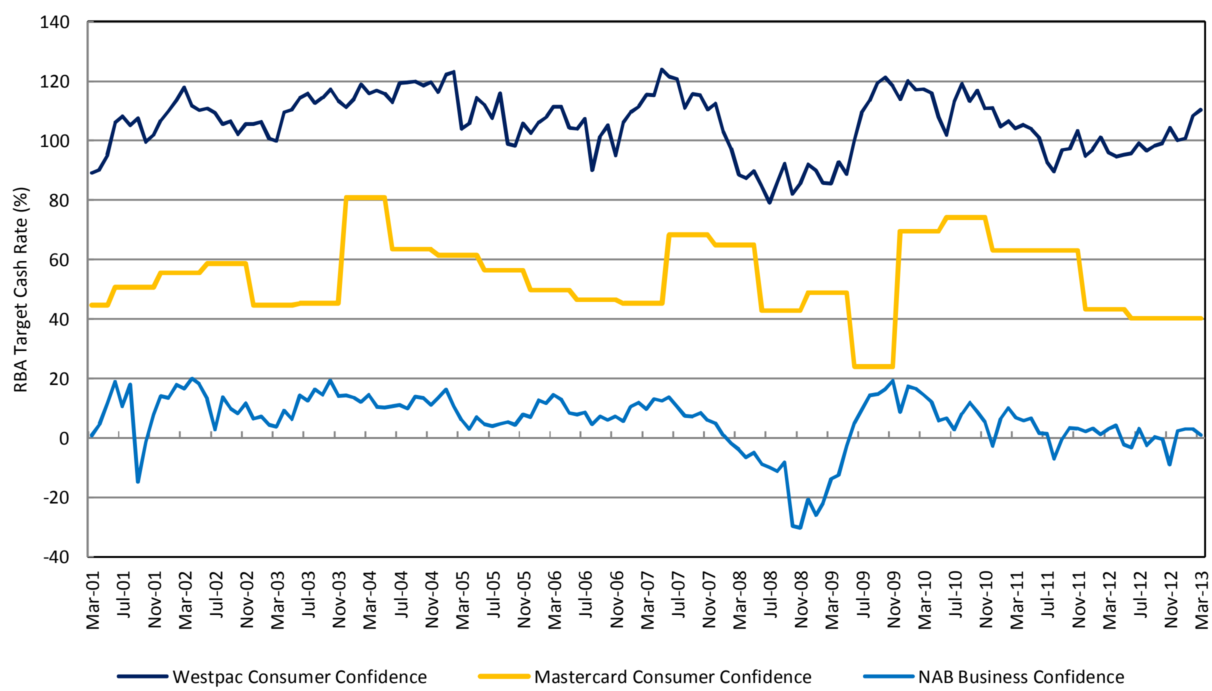
Industrial Production: Australian Industrial Production looks to have stabilised in late 2012. The Australian PMI remains in negative territory, as of its last reading of 45.6 in February 2013, but may have bottomed.

Australian Industrial Production Measures



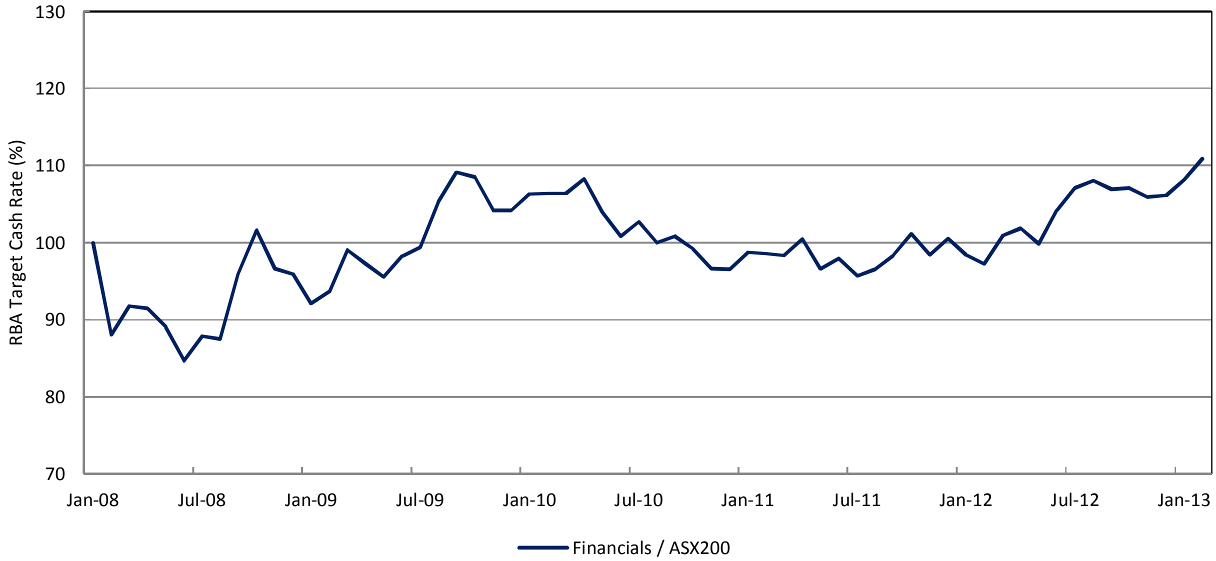
Consumer Expectations: Consumer confidence appears to be improving. This is positive for cyclically exposed industries. This improvement hasn't yet been reflected in the business confidence data.

Consumer & Business Confidence Measures



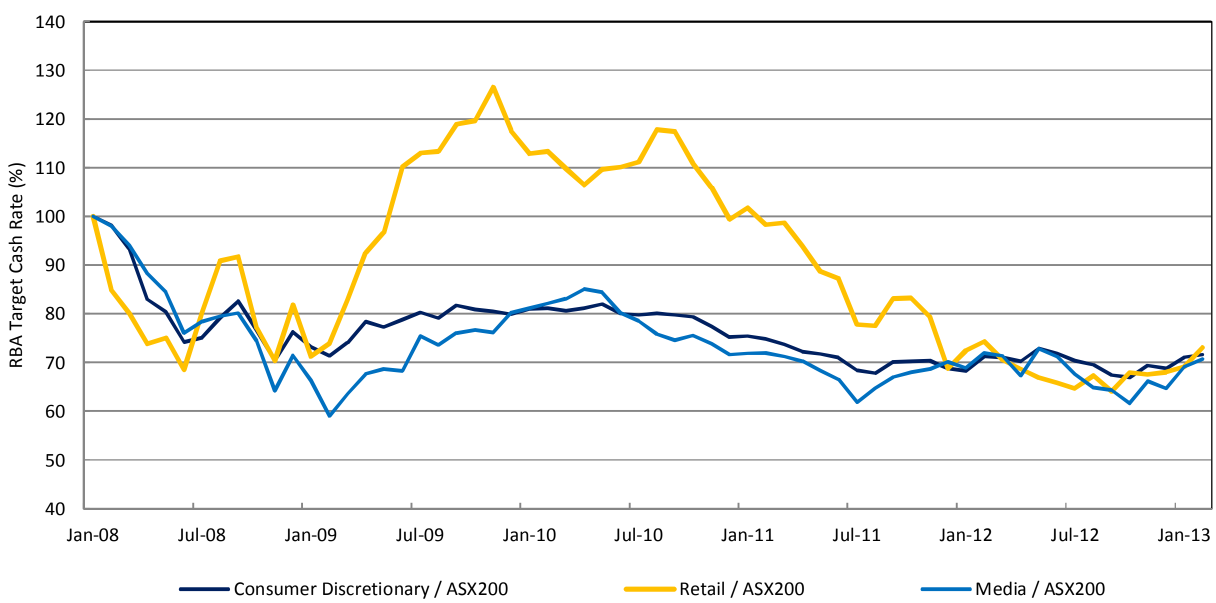
Our conclusion in relation to the business cycle is that we are most likely either in the very late stages of a cyclical slowdown or more likely the early stages of a domestic cyclical economic recovery. What does this mean for stock selection? As an economic contraction comes to an end the financial stocks typically react first. This trend has been evident recently in the Australian market, with the ASX200 Financials Index significantly outperforming the broader Australian market in recent months. The chart below represents the ASX200 Financials Index divided by the broader ASX200 Index.

Financials: Outperforming the broader ASX200



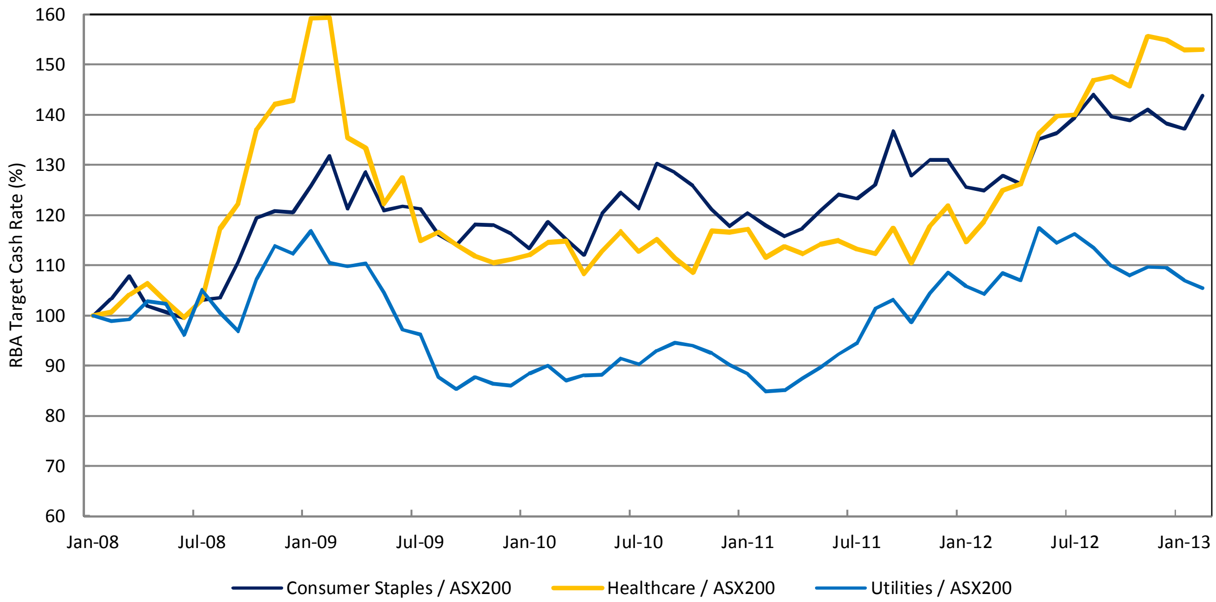
It is likely that as the economic recovery continues, stocks that are considered consumer cyclicals (including retail, media, automotive, entertainment, construction and building stocks) will outperform in the medium term. We have recently seen the first signs of evidence of the outperformance of cyclical stocks.

Consumer Cyclicals: Starting to walk out the door



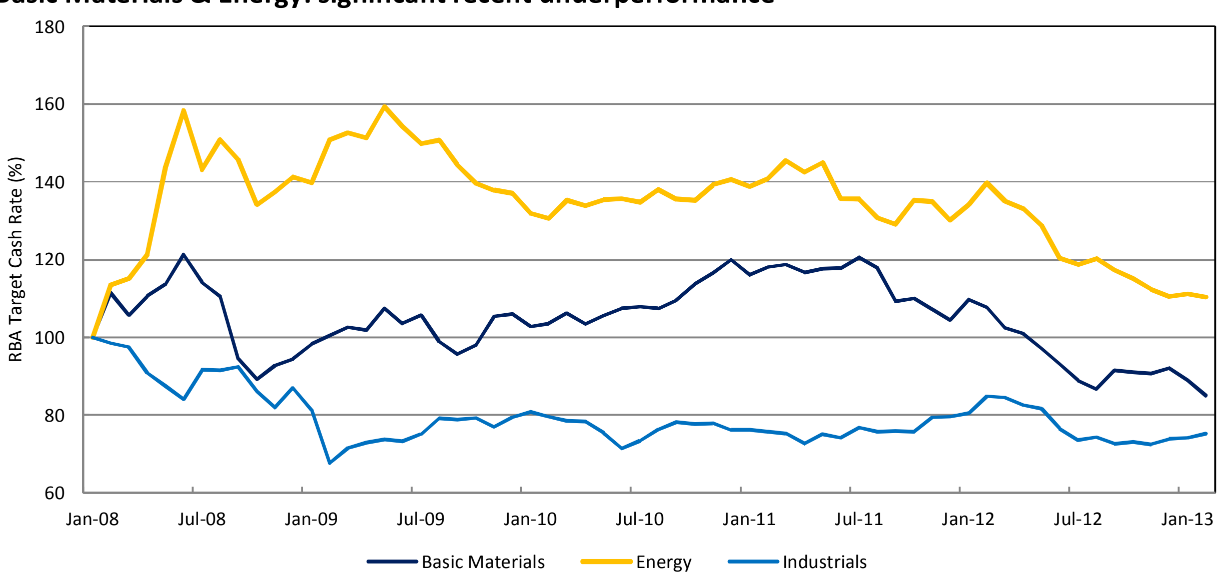
Defensive stocks typically outperform during an economic slowdown. The relative outperformance of stocks in the consumer staples, healthcare and utilities sectors between March 2010, when the market peaked previously and the last time the ASX200 was above 5000, and the middle of 2012, when the market flirted with the 4000 level, is quite apparent. If we are at the beginning of a cyclical recovery, this outperformance is unlikely to continue. In fact we would expect relative underperformance from these sectors going forward.

Defensives: Likely to underperform in an economic recovery



The commodity sectors, basic materials and energy, typically outperform late in the economic cycle when inflation becomes prevalent. While it may be too early for these sectors to outperform, we would expect their dramatic underperformance compared with the broader market to slow in the next few months unless Chinese growth and demand for Australia's bulk commodity exports stalls. The direction provided by China's new leadership team with respect to growth will be a significant factor affecting demand.

Basic Materials & Energy: significant recent underperformance



There are still obstacles to be navigated and macro risks, such as slowing mining capital expenditure, to be aware of in the near term. Indeed it is important to see if the new Chinese leadership implement any immediate reforms that are likely to impact on near term growth in demand for commodities. However the indicators are suggesting the start of a cyclical economic recovery in Australia. If this is the case it has obvious implications for the Australian stockmarket and potentially which sectors may prove the most fertile ground for delivering strong absolute returns for investors. It not only affects which sectors we are inclined to be long and/or short, but also the net exposure to the Australian market we provide for our investors.

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

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

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