To: **Investor Partners of Castlereagh Equity Pty Ltd**

From: **Peter Phan**

Date: **31 October 2016**

Re: **Monthly Update**

	Castlereagh Equity	ASX All Ordinaries	Relative Performance	CE Net Asset Value
1 November 2013 to 31 October 2016	55.9%	0.3%	56.2%	155.9 cents
1 November 2013 to 31 January 2015	6.2%	2.4%	3.8%	106.2 cents
1 February 2015 to 29 January 2016	19.4%	-9.2%	28.6%	126.8 cents
1 February 2016 to 31 October 2016	23.0%	7.2%	15.8%	155.9 cents

To aid in understanding the tables above:

1. CE commenced on 1 November 2013 with shares issued at $1 per share, backed by $1 of cash per share.
2. The first row of the table above provides a summary of CE's performance since its commencement on 1 November 2013 until the date of this memorandum. It also compares CE's performance with the benchmark All Ordinaries index over the same period.
3. The second row of the table provides a summary of CE's performance for its first reporting period (15 months period from 1 November 2013 to 31 January 2015).
4. The third row of the table provides a summary of CE's performance for its second reporting period (12 months period from 1 February 2015 to 29 January 2016).
5. The fourth row of the table provides a summary of CE's performance for its third and current reporting period (period commencing 1 February 2016 to the date of this memorandum).

The XAO started at 5420 on 1 November 2013 and ended at 5402 on 31 October 2016. In percentage terms, the XAO dropped 0.3% for the 36 months period since the start of the CE fund. For 3 long years, the market has basically returned nothing other than dividends. CE's performance over the same 36 months period is 55.9%.

For the month of October 2016, the XAO dropped 2.2%. The CE portfolio dropped by 0.2% for the month.

The cash component of the CE fund is roughly 9%.

Taking Out the Rubbish

Inverting is a very useful technique to solve difficult problems. After all, it is the fish that John West rejects that makes John West the best. There are 2200 securities on the ASX which comprise CE's current investable universe. If I remove all companies not making a profit, the remainder is 767 names- a more manageable number. If I then remove all companies achieving a return on equity less than 15%, I end up with 232. If I continue pruning all resources companies from this list, I will end up with less than 200 companies to investigate.

The basic principle is that once I removed most of the rubbish and the risky stuff, I should end up with a group of decent investment candidates.

The same principle can be extended to our investment process. I maintain a diary log of all investment decisions. Over an extended period of time, by constant re-examination of decisions, I aim to reduce errors to an absolute minimum. Since CE's inception, I have made 5 errors with the attendant consequences to NAV performance:

2014: -4%
2015: -3.5%
2016: -3%

These 5 errors caused a cumulative compounding loss of over 10% to the CE portfolio. If we factor in the opportunity costs where I could have directed the capital to our winners, the performance impact would be close to a range of 20% to 30%. This underlies the reasoning behind Buffett's Rule Number 1 and Rule Number 2. Don't lose money, and don't ever forget.

Hopefully, investor partners will now have a better idea of why I am so obsessively focused on risks and mistakes. They cost us heaps of money.

Annual Financial Report

Investor partners would have recently received CE's Annual Financial Report. From henceforth, all investor partners should expect to receive our Annual Financial Report in calendar months September to October of every year. I have been advised by our auditors that they require a period of roughly two to three months from the end of the financial year before finalising the reports, the reason being mainly due to waiting time for publication and issue of critical audit source documents from Etrade.

Thoughts on Franking and Tax Credits Within CE

In my last memorandum, I invited feedback from all investor partners concerning a proposed policy on the fair treatment of tax/franking credits in the event of redemption.

You can contact me by telephone, or you could write to me, whichever way you prefer. Please provide me with your feedback before 28 November 2016. If I decide to proceed with this policy (or otherwise), I will do so at the same time as we publish the November 2016 memorandum.

If any investor partner wishes to contact me to discuss this memorandum or any other matters related to CE, please do not hesitate to do so.

Thank you for your trust and confidence in us.

Regards
Peter Phan
Director, Castlereagh Equity Pty Ltd