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

From: **Peter Phan**

Date: **31 August 2018**

Re: **Monthly Update**

	Castlereagh Equity	ASX All Ordinaries	Relative Performance	CE Net Asset Value
1 November 2013 to 31 August 2018	65.2%	18.6%	46.6%	140.2 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 January 2017	19.7%	12.5%	7.2%	151.8 cents
1 February 2017 to 31 Jan 2018	9%	8.3%	0.7%	146 cents
1 February 2018 to 31 August 2018	0.8%	4.6%	-3.8%	140.2 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 reporting period (12 months period from 1 February 2016 to 31 January 2017).
6. The fifth row of the table provides a summary of CE's performance for its fourth and current reporting period (period commencing 1 February 2017 to the date of this memorandum).
7. *CE NAV is after payment of dividend and director fees in Feb 2017 and Feb 2018. These payments "reset" the NAV from 1.52 to 1.34 in Feb 2017 and from 1.46 to 1.39 in Feb 2018.

The XAO started at 5420 on 1 November 2013 and ended at 6428 on 31 August 2018. In percentage terms, the XAO gained 18.6% for the 57 months period since the start of the CE fund. CE's performance over the same 57 months period is 65.2%.

For the month of August 2018, the XAO was up by 1%. The CE portfolio was up by 2.2% for the month.

The cash component of the CE fund is just under 20%.

The reporting season has passed relatively uneventfully as far as the CE portfolio is concerned. Overall, a significant portion of our holdings reported results within guidance and are more or less already factored in by the market. Within the sector of the market where we are invested in, trading and price movements can more aptly be described as trench warfare. Gains grudgingly eked out, then taken away via continuous selling pressure. This is a direct consequence of market sentiment and flow of money getting out of value plays and ploughing into growth stories, regardless of price. From a portfolio construction perspective, given the defensive nature of CE's strategy, the portfolio is actually behaving exactly as expected. We are not making any significant paper gains, but we are also not giving away anything easily, if at all.

This continuing market trend towards growth has resulted CE holding a significant number of businesses trading at between 4x to 5x free cashflow to enterprise value. On the other end of the market, names such as Wisetech and Afterpay are trading at over 100x multiples. The mathematics involved is simple. Given the same price, a growth stock trading at 100x cashflow needs to grow its cashflow 25x to match the "non-growth stock" trading at 4x cashflow. In terms of compounding, the growth stock needs to double its cashflow every year for 5 years in succession to get ahead of the non-growth stock. Bear in mind that at the end of 5 years, the "non-growth stock" would have collected enough cash to cover the initial capital outlay to purchase it.

Nevertheless, there are still eager and avid buyers for growth stocks trading at 100x multiples. This is what happens in a market when participants do not make a distinction between price and value.

I also pose a further question: when is it appropriate to sell a growth stock? At 20x, 50x, 75x, 100x or never? One possible answer is to sell when the growth stops. However, collectively as a group, it is not possible for the whole shareholder base to escape at the same price when the music stops. So it must be that each individual shareholder is confident that he/she could get out faster than the others before the music stops. Holding and speculating in growth stocks then becomes a game of chicken. This is the paradox of crowd psychology in growth stocks- a perfectly rationale action at an individual level, a wholly illogical and irrational action collectively as a group.

As a steward of your precious capital, I have a responsibility and duty to keep sane when everyone is losing their minds. This is precisely one of those periods when our style of investing does not appear to be working. I suspect that going forward, a copious amount of patience will be required, both from me and from you.

Thank you for your trust and confidence in us.

Regards
Peter Phan
Director, Castlereagh Equity Pty Ltd