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

From: **Peter Phan**

Date: **31 January 2019**

Re: **Monthly Update**

	Castlereagh Equity	ASX All Ordinaries	Relative Performance	CE Net Asset Value
1 November 2013 to 31 Jan 2019	62%	9.5%	52.5%	139 cents*
1 November 2013 to 31 Jan 2015	6.2%	2.4%	3.8%	106.2 cents
1 February 2015 to 29 Jan 2016	19.4%	-9.2%	28.6%	126.8 cents
1 February 2016 to 31 Jan 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 Jan 2019	0%	-3.4%	3.4%	139 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 5937 on 31 January 20198. In percentage terms, the XAO gained 9.5% for the 63 months period since the start of the CE fund. CE's performance over the same 63 months period is 64%.

For the month of January 2019, the XAO gained 4%. The CE portfolio gained 2% for the month.

The cash component of the CE fund is just over 15%.

The Year in Review

The portfolio ended flat after a topsy turvy year. CE's run of positive returns for the last 4 years (7 years if we include 3 years of incubation) finally came to an end in year 5. We continue to beat our benchmark XAO for a fifth year in a row since CE's inception, making a total of 8 years if we include the incubation period.

As I have repeatedly stated, such a continuous run of both positive returns and market beating returns are abnormal. The likelihood of a repeat performance of such nature is very low. Our expectation is that we will underperform once every 3 years. It goes to the fundamental nature of value investing. It works precisely because it does not work all the time.

From a longer term perspective, and having regard to the objectives of the CE portfolio, I regard the performance of the past 12 months (+3.4% against XAO) to be better than the performance of the preceding 12 months (0.7% against XAO). Over a long period of say 20 years, several percentage points of outperformance every year will add up to a very satisfactory end result.

Disappointingly, CE's performance over the last 12 months was marred by some rookie unforced errors. A brief description of mistakes made, in order of severity:

1. A failure to load up on a good investment idea with PME. This error of omission has cost us nearly 60%- and still counting. To put this into perspective, the loss from this error exceeds the total gains (in percentage terms) achieved by the CE portfolio over the last 5 years.

2. A failure to hold on to a good investment idea and selling too early with SSM. The price for this error is about 5%.

3. A failure to sell a major position early enough when the investment thesis was upended by management actions- GCS. This is balanced somewhat by a decision to sell another major position in Clydesdale Bank after the merger announcement. Nevertheless, in my view, the inconsistency of actions in both cases made the error even worse.

4. Multiple small holdings where I severely underestimated downside risks. The saving grace of these errors is the relatively small amount of capital allocated to each position. Even so, collectively they wiped out nearly 5% of gains. Dumb errors committed include underestimating the risks of operating a casino in Cambodia and Vietnam- Donaco, and underestimating the risks in litigation and antagonising a major stakeholder- Donaco and Adacel.

These errors are disappointing because they are all mistakes made in the investment process. The only consolation is that Mr Market has dished out timely punishment, so that I will take the lessons learned and avoid them in the future.

The CE portfolio holds exciting promise going forward. We have several positions that are working out nicely as time progresses. Some of the smaller positions are expected to conclude in the next 12 months, mostly through mergers and acquisitions. Our major positions have not yet concluded (and preferably, should never conclude). However, once they do eventually conclude, I look forward to discussing them in detail with you.

Portfolio characteristics for CE

For the last 12 months, CE's portfolio turnover (calculated as Total Value of Sells divided by Average of Portfolio Market Value) is a relatively high 17.5%, compared to the low 7% last year. 17.5% turnover still implies a holding period of over 5.7 years. This is consistent with our stated approach of investing in businesses for the long term.

Housekeeping

As per our IM principles, we will be declaring a fully franked dividend to an extent sufficient to "stream" all current franking and tax credits back to investor partners. The dividend will be automatically reinvested at the prevailing NAV on 1 February 2019.

Since I have failed to beat 6% hurdle return for this year, there will be no directors fees payable. This 6% shortfall is carried forward to next year. For existing investor partners, no director fees will be payable until 12% returns hurdle is reached for the next 12 months. For new investor partners joining us in February 2019, the hurdle for the next 12 months is 6%.

Thank you for your trust and confidence in us.

Regards
Peter Phan
Director, Castlereagh Equity Pty Ltd