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December Quarterly Report

MACRO CAPITAL LIMITED
ABN 14 145 321 928 | AFSL: 392401

GANES INVESTMENT MANAGEMENT PTY LTD
ABN 86 113 032 741 | AFSL 287598

Markets

A rally late in the month saw December produce another positive month rounding out another year of strong returns. The local market was up 19.66% for the year and 3.42% for the December quarter. Overseas markets also reported very strong returns with the S&P500 in the USA up 29.6% for the year and the Nikkei index in Japan up 56% for the year.

During December, the Australian dollar fell 2.1% against the US dollar following public statements by the Reserve Bank Governor that he would like to see a lower dollar. Overall, the Australian dollar fell 14% against the US dollar during 2013, and similar amounts against most other major currencies except the Euro. This has greatly assisted local investors with unhedged overseas holdings, highlighted by the growth in international managed equity funds and their strong returns for the year.

Portfolio performance

The Fund reported a return of 0.65% for the month and a 1 year return of 17.28%. Low interest rates, and rising equity markets, means our large cash weighting continues to detract from fund performance on a relative basis in the short term. In hindsight, our decision to reduce or sell some of our positions due to valuation concerns now appears somewhat premature and conservative. However, this has served us well in the past and we believe this is the most appropriate approach when acting as custodians of other people's money and their future (or current) retirement funds.

While much commentary appears to be now focused on further strong markets, we remain cautious as we are not seeing justification for these expectations in future earnings against current share prices. In short, many companies are currently priced for perfection, something we regard as unlikely in most cases.

Performance 31-Dec-13	Ganes	All Ord Index
1 Month	0.65%	0.92%
3 Month	1.67%	3.42%
6 Month	6.02%	14.57%
1 Year	17.28%	19.66%
2 Year (p.a.)	18.60%	19.25%
3 Year (p.a.)	11.12%	7.99%
5 Year (p.a.)	16.68%	12.67%
Since Inception (p.a.)*	7.95%	6.34%
NAV Unit Price ($)	1.4553	
Fund Assets ($ million)	46.37	

* Inception date of Fund 18/11/2005

Flight Centre

The largest holding in the Fund, Flight Centre, was down 2.4% for the month and flat for the quarter following news the company has lost a test case in the Federal Court brought by the ACCC for alleged price fixing. The company announced it intends to appeal the decision and a hearing for the penalty has been adjourned until February 2014. This news notwithstanding, Flight Centre has been the standout performer in the Fund for 2013 producing a return of 81% for the calendar year.

Top 10 Portfolio Holdings	%
Cash	40.02%
Flight Centre	9.09%
Austbrokers Holdings Limited	7.22%
Woolworths	5.97%
Treasury Group Limited	3.47%
Spark Infrastructure Group	3.33%
Computershare Limited	2.78%
ARB Corporation Limited	2.75%
Magellan Flagship Fund	2.70%
Sonic Healthcare Limited	2.51%
Other Holdings	20.16%
Total	100.00%

Austbrokers

Austbrokers is the second largest holding in the Fund, and one of the Fund's quiet achievers rarely receiving much business coverage, or even commentary from us. However it has delivered impressive results for shareholders over the past few years and 2013 was no exception. The share price was up 3.1% in December, but more importantly it has provided a return of more than 40% for 2013 and 31% per annum for the past 3 years for shareholders.

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Austbrokers is an insurance broker to businesses receiving commissions on the insurance policies it places with underwriters. For 2013 the company reported an increase of 8% in revenues to $273m and a 17% increase in profits to $32m. The company has a track record of under-promising and over-delivering on profit expectations with profits growing at a compound rate of 15% per annum for the past five years. Management adopts a low-key approach and the company conducts its business with minimal fanfare. All the characteristics we seek in a business, along with its strong Balance Sheet.

Like almost all our preferred investments the share price is not as attractive today as it has been but Austbrokers is typical of the type of high quality, conservatively run business we continually seek for the portfolio. With a market share of 10% of the insurance brokerage industry, the company still has significant opportunities to grow and provide further returns for patient shareholders.

Magellan Flagship Fund

Magellan Flagship Fund provided the strongest return for the month with the share price up 12% in December and a 1 year return of more than 50%. Magellan Flagship Fund is an international investment fund with a focus on global companies and as we noted in the introduction, international funds have benefitted from strong overseas markets and a falling Australian dollar. During 2013 the investment return of the Fund aligned with the share price increase as the NTA of the Fund rose an impressive 54% to $1.519.

The Fund's portfolio has a focus on major financial services businesses with its largest three holdings of Wells Fargo Bank, Visa and Bank of America comprising nearly 30% of the portfolio. Other significant holdings include Apple, Walmart and Home Depot, all high quality businesses we also admire.

However, even with a wider international investment universe to work in Magellan has also stated their concerns in their latest update from December: "We continue to be cautious about valuation risks as markets continue to rise."

The Magellan investment has served us well and one of the few times everything went as we had hoped and predicted but we are under no illusion that Magellan will produce another 50% return for 2014.

Computershare

Computershare also enjoyed a strong month with the share price rising 4.5% during the month. There was no specific company news that can be attributed to the rise but Computershare should benefit from a lower Australian dollar, positive equity markets, and any increase in interest rates.

With increased IPO activity and the 14% fall in the Australian dollar (Computershare reports in US dollars so this will be a tailwind for the company), the market is finally starting to feel some better times could be ahead for the company after the tough conditions following the GFC.

Platinum Asset Management

Platinum is one of our smaller holdings but with an 11% increase in share price for December and 1 year return of more than 40% it has punched above its weight in the portfolio. Similarly to Magellan, Platinum has benefitted from strong international markets and funds under management have risen nearly 12% over the past 3 months to reach $23.2bn.

Profits for fund managers are directly tied to funds under management and so it is reasonable to expect that after a few quiet years Platinum should grow profits this year and this has been reflected in the strong rise in the share price during 2013.

ARB Corporation

By contrast, ARB was down 5% for December on essentially no news but has probably been swept up in the general malaise effecting mining service stocks. ARB is a manufacturer of 4WD parts and components, and while not directly involved in mining services, it is one of the businesses that has benefited from the mining boom with sales to the sector.

The company advised at its AGM that sales are flat as sales to vehicle manufacturers (the OEM market) are down 50%. While the OEM market is relatively low margin work it is profitable nonetheless, and as such profits are down 10% for the first quarter against last year. This is something shareholders have not heard from the company for over a decade. Naturally enough, given the expected growth that had been factored into the share price, the shares were sold off.

Anecdotal evidence that many of the mining towns now have car yards full of 4WD vehicles not being used as mining projects slow down is probably affecting local sales. On the positive side, a lower Australian dollar will help with exports which constitutes 20% of sales.

ARB was the Fund's largest holding for a number of years but recognizing the risk associated with the resources boom slowing down, and the shares selling at record multiples, we have steadily reduced our holding by 75% over the past 12 months.

ARB is a wonderful business with an outstanding track record of delivering returns to shareholders and has all the qualities we seek in an investment. Should the share price fall sufficiently to provide what we believe will be attractive returns again, we would look to increase the holding.

Portfolio News

In other portfolio news, Reece Australia announced the acquisition of Actrol Parts for $280m cash just prior to Christmas. There was little elaboration of details surrounding the purchase, but we can glean that Actrol provides components, units, systems and gases to the heating, ventilation, air conditioning and refrigeration industry and provides the company with access to these industries as a complement to their plumbing activities.

Outlook

Not much has changed since our last quarter update and we reiterate we are having difficulty finding value in the current market and we remain cautious on current valuations being applied to even the best companies – the ones we would like to own. However, we continue to scour the markets using various search tools and several small opportunities have presented themselves as worthy of further analysis. We have added a number of smaller positions to the portfolio in recent months and added to our larger position in Trade Me during December.

The Fund is still small enough that we can take advantage of most investment opportunities that we find and we are prepared to take meaningful positions so we would only require a handful of good ideas to be fully invested again.

Distribution

The Fund will pay a distribution of 1.1878c for the quarter. We are conscious of providing income for investors and continue to seek companies that pay dividends (usually fully franked) as well as the ability to increase their dividend over time as profits grow.

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