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H1 Financial Year 2015:

The general market:-

The ***Standard and Poors ASX200 Total Return Index*** (hereafter referred to as '**the benchmark**') commenced financial year 2015 (FY2015) at 45991.23 points. Including reinvestment of dividends, the benchmark finished the first half of FY2015 (July 1st 2014 – December 31st 2014) at 47139.24 points.

The investment experience of the Australian investing public in the stock market generally in H1FY2015 was a gain of 2.50%.

The 2.50% figure quoted above of course excludes management fees and costs which on average would trim between 1.5 to 2 percentage points off such a result (annually) for persons having their money professionally managed – in years when the returns are high, people will happily pay such fees, but in a year of substantial decline, it is particularly galling to most investors to pay these fees. This is why the EGP structure requires both a positive return and a market beating performance in order to earn a fee.

The chosen benchmark over a period of years will approximate the results of leading investment companies before fees & charges. Such investment companies are the most probable alternative investments for the majority of fellow EGP investors.

Our benchmark was selected in advance and represents the most logical choice in my view. It covers nearly $1.5 trillion in market capitalisation and over 80% of Australian listed stocks (by value). The chosen benchmark presents no pushover and I estimate that after fees, at least 80% of equities focused investment funds will fail to exceed the benchmark over the medium-term.

Our experience:-

EGP Fund No. 1 Pty Ltd (hereafter referred to as '**the fund**') commenced FY2015 at $1.56145. The fund finished H1FY2015 at $1.56166, for a gain of 0.01% after allowing for all fees and expenses (no fees were allowed for due to the below market return and expenses, as always were contained to around 0.1% of assets annually).

Results should really be considered over the longer term, preferably 3 – 5 years. In the 3 years and 9 months the fund has operated, our 15.29% annualised return to our holders exceeds the 7.76% annualised performance of our benchmark by 7.53%.

Despite the market seemingly residing (as it does most of the time) in the fairly valued range, we continue to find good opportunities that look likely to provide well above-average returns over the medium term. The recent decline in Australian equity markets means many of the positions we will acquire in early 2015 will generate better long term results for us. I have outlined my thoughts on a few of these investments in the weekly updates on the website. Further falls will naturally make this easier still.

Recently periods of flat or even negative returns will make this seem more real than the last couple of years, but it is important that my fellow investors in the fund remember this:

Any year when the benchmark declined by 35% and the fund declined by 20% would be viewed as a substantially superior year to one in which both advanced by 15%. Calendar 2014 was not a great one in terms of returns, but a quick look at the tables below will reinforce why stock market investing requires the ability to look through a longer-term lens.

If the concept of holding an investment capable of substantial decline in the short-term makes you uncomfortable, you would be well-advised to have the majority of your wealth and investments outside of the stock-market, for it is precisely the type of out-performance described above that we will be chasing. The expectation that over a reasonable period, outperformance of the benchmark will lead to very satisfactory results has borne out so far. You should also expect approximately one in six periods to result in a negative return for the market and that the fund is unlikely to be completely immune should this happen.

Performance Tables, instructive for comparison:

Year by Year Performance			
Australian Financial Year	The benchmark	EGP Fund No 1 Pty Ltd (A-Shares after performance fees)	EGP Fund No. 1 Pty Ltd (gross results)
2012*	-10.46%	2.99%	2.99%
2013	22.75%	32.58%#1	35.07%#1
2014	17.43%	24.71%#1	26.83%#1
H1FY2015	2.50%	0.01%	0.01%

* 2012 is the 15 month period from 1 April 2011 (fund inception) to 30 June 2012 (first full financial year)
#1 Assumes reinvestment of dividends

We include below a cumulative table, which we hope will demonstrate over time what Albert Einstein called “the most powerful force in the universe” – compound interest. My hope is that over time, small advantages over the benchmark will accumulate to a substantially superior overall performance:

Cumulative (compounded) Performance			
Australian Financial Year	The benchmark	EGP Fund No 1 Pty Ltd (A-Shares after performance fees)	EGP Fund No. 1 Pty Ltd (gross results)
2012*	-10.46%	2.99%	2.99%
2013	22.75%	32.58%#1	35.07%#1
2014	17.43%	24.71%#1	26.83%#1
H1FY2015	2.50%	0.01%	0.01%
Cumulative	32.29%	70.39%#1	76.45%#1
Annualised	**7.76%**	**15.29%#1**	**16.37%#1**

* 2012 is the 15 month period from 1 April 2011 (fund inception) to 30 June 2012 (first full financial year)
#1 Assumes reinvestment of dividends

Despite some additions and disposals throughout the quarter – with the disposals being outlined in the weekly blog updates, we have ended 2014 with our holdings numbering 26. Our 4 largest (and best) holdings currently comprise 57.7% of our stock portfolio (i.e. excluding cash holdings). Our smallest comprises 0.4%. With our investor intake on 31 December 2014, we hold just under 25% cash. Our last two quarterly updates have set out our intention to reduce the number of our holdings to something nearer to 20, but we will not dispose of a holding in order simply to meet some predetermined limit. Rather, we will wait until we feel we are getting a price for the holding we are satisfied represents reasonable value. We often sell our holdings for less than we feel they are worth, but usually only because there is an alternative application for the funds raised through sales that we feel offers superior longer term returns.

Dividends:-

We will distribute a 13.33333c per share (9.33333c dividend plus 4c FC) dividend at the end of May 2015. We are hopeful of the annual growth in the fully franked dividend continuing, but it remains subject to the level of Franking Credits held (we will only pay dividends to the extent we can fully frank them).

Benchmarking:-

EGP since inception has used the ASX200 Total Return index as the unit of comparison for the performance of the fund. I have explained before that this index was chosen because it is the premier Australian equities index. As the tables above show, in the 3 years 9 months the fund has operated, we have outperformed the index by about 44% before fees. Given we tend to be primarily an investor in small companies, we could quite logically have chosen an index like the 'Small Ordinaries', which include the members of the ASX300, excluding the ASX100. Since the April 2011 inception of EGP, this index, including dividends has fallen by around 20%, meaning had we selected that benchmark, we would be claiming an outperformance before fees of something exceeding 90%. The two indices were nearly 50% apart in terms of results over a period of less than 4 years. Benchmarks matter.

You will often hear people lament the price of houses they didn't own, or once owned but sold. When you hear such lamentations, it pays to mentally benchmark them. According to the Australian Bureau of Statistics, there are 9.405 million residential dwellings in Australia with a median value of $563,100 for a total residential housing stock of about $5.3 trillion (dwarfs the $1.5 trillion of the ASX200 doesn't it). Forty years ago the median Australian house price was something more like $25,000 (depending on where you source your data). This means average annual appreciation of around 8% for Australian homes over this 40 year period. There is a severe failing in using this figure as an 'investment' benchmark though. The size of Australian homes has increased by nearly 2% per annum over that period. The amenity of the home is much harder to measure, but would have increased by at least that amount annually I should imagine; consider the quality of the fitment of the average home over that period with the quality of kitchens and features such as ducted air-conditioning, automatic garage doors and the like. Finally, consider the value of neighbourhood amenity, it is for this reason the values of 'Capital City' home prices tend to outstrip regional areas (by about 1.5% annually).

So benchmarks matter and housing benchmarks can be quite misleading. Truth be told, most investors simply want to grow their wealth over time to ensure they can provide a satisfactory level of income in retirement. For you, if this is the case, the rate of inflation plus a couple of percent may be a satisfactory benchmark. Whatever benchmark you choose, it should be selected in advance and held constant.

A final word on benchmarking. Upon the death of Kerry Packer in late 2005, his reported wealth was something a little short of $7 billion dollars. It was reported in the AFR at the time that had Kerry invested his entire inheritance - thought to be worth circa $100m in 1974 – in the equivalent of the ASX200 index, his net worth upon his death would have been something more like $11 billion. To be sure, Kerry Packer was a legendary Australian, but properly benchmarked, his achievements seem more attainable. It's just that very few of us will start with such a large pool of capital.

Member Audit:-

We reported on our first member audit in the last quarterly letter. The audit for the period ended 31 December 2014 will commence shortly and I will likely report the member auditor findings in the March quarter letter.

There are volunteers for the June 30 2015 and December 31 2015 audits. If you would like to conduct an audit for periods beyond that, let me know and I will take your 'reservation'. You needn't feel any pressure in this regard, the books are still audited externally by regular accountants, but this process gives an important opportunity to critical eyes with a financial (rather than professional) interest in ensuring everything is in order.

For members who run a reasonable portfolio outside of their holding in the fund, it will likely be useful, particularly if you are prone to being an overactive trader to see how we generate good results with minimal turnover. The first half of FY2015 has been our most active selling period since inception and we have turned over only about 11 or 12% of the portfolio. Over time, except in the event of takeovers or corporate actions of substantial holdings, we would expect an annual turnover of no more than 10 or 15% annually.

Let me hear from you regarding any questions you may have on any aspects of this letter or anything else regarding our fund that you would like to know.

Best Regards,

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