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Erik A. (Tony) Hansen – Investment Manager 30 June 2013

Full Financial Year 2013:

The general market:-

The ***Standard and Poors ASX200 Total Return Index*** (hereafter referred to as '**the benchmark**') commenced financial year 2013 (FY2013) at 31,904.52 points. Including reinvestment of dividends, the benchmark finished FY2013 (July 1st 2012 – June 30th 2013) at 39163.27 points.

This means that the investment experience of the Australian investing public in the stock market generally in FY2013 was a gain of 22.75%. When I drafted this update in early May, the market was more than 30% in the first 10 months; I intended to pose the question "are the underlying businesses of the ASX200 really over 30% more valuable now than they were July 1st 2012?" Now the question could be followed with "And are they worth about 10% less than they were just 2 months ago?"
I am quite confident we can answer both questions in the negative – individual businesses can certainly grow and shrink value that quickly, whole markets almost assuredly cannot. Times like this we must invoke Benjamin Graham's advice that "the market is there to serve you, not to guide you". My sense is that the market as a whole is neither substantially under or overvalued – this does not mean meaningful movements in either direction are not possible, the market is irrational and major swings are always a possibility. As with (virtually) always however, there are ample individual stocks available at bargain prices.

My expectation is that the underlying value of the ASX200 with reinvested dividends will increase by about 7 – 10% per annum over the very long term; though it will swing wildly, the 22.75% gain we saw in FY2013 could be met at any time with a decline as sharp as the 38.44% loss experienced in calendar year 2008 (or sharper!). The 22.75% 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 so high, people happily pay such fees, but in a year of substantial decline, it is particularly galling to most investors to pay a fee, which is why our structure requires both a positive return and a market beating performance in order to earn a fee.

As I have said previously, I believe this 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 about $1.35 trillion in market capitalisation and about 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.

<u>Our experience:-</u>

EGP Fund No. 1 Pty Ltd (hereafter referred to as '**the fund**') commenced FY2013 at $1.02993. The fund finished FY2013 at $1.33220, for a gain of 32.58% after all fees and expenses (the 3.333 cent dividend - including Franking Credits - is added back in to arrive at this annual return).

The 6-month performance of the fund in the period just completed looks especially impressive when viewed in isolation (please remember – you should always look at results over the longer-term, I prefer 3 to 5 years). While the fund generated 12.18% after fees, the benchmark only managed 5.46% after sharp falls in May and June, giving us a handsome advantage of 6.72% in the period.

Desiderius Erasmus is credited with the saying "In the land of the blind, the one-eyed man is king". Despite what is on the surface an outstanding gain in FY2013, I don't feel like FY2013 was an especially exceptional one for the fund. This is not false modesty; I would take a return that matched this year's 10 times out of 10 if it was offered to me in advance. I guess what I'm saying is that it could have been a lot better but for some 'unforced errors'.

The 'blind' element of the market was that it should have been very apparent that certain sectors relating to the mining industry were very likely to have a tough time over FY2013. This is where I had 'one-eye', for although we have some exposure to one mining company and a couple that service the mining industry, their performance was much better than their peer group. However, in hindsight, I should have had no exposure there and it has cost us a few percentage points of return.

After the first 2 financial years of operation, we have managed to generate results that have exceeded my expectations. After performance fees we have delivered a 14.85% annualised return to our holders, which amounts to 10.56% outperformance annually of the benchmark (4.29% annualised to date). This is meaningfully better than the 3 – 5% outperformance we state as our target in the 'Investment Principles and Shareholder Guidelines' documentation. I am quite hopeful of providing continued above average results long into the future, though it is reasonable to expect the outperformance to be below 10.56% annually in future years.

I have made this comparison before and expect to do so in every report so it will not go unheeded, but a year when the benchmark declined by 35% and the fund declined by 20% would be viewed by myself as substantially superior year than one in which both advanced by 15%. If this concept 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 this type of out-performance we will be chasing.

Performance Tables, instructive for comparison:

Year by Year Performance			
Australian Financial Year	S&PASX200(TR)	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

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

I will also include a cumulative table, which I hope will demonstrate over time the force 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	S&PASX200(TR)	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%	35.07%
Cumulative	9.91%	36.55%	39.11%
Annualised	**4.29%**	**14.85%#1**	**15.80%#1**

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

I have consistently emphasised the importance of relative results. Beating the market in sharply advancing years as we have this year, should be considered unusual. As I have stated in previous communications, my expectation that we are far more likely to outperform the benchmark in sharply declining years than in sharply advancing ones. This has been my experience in investing prior to starting the fund and I expect it will continue to be so in future years, as my methods remain basically the same. The reason for this is what I like to think is a conservative investment philosophy. In my view, our holdings are as a group extremely conservatively managed, carry substantially higher cash and asset holdings (and consequently lower debt ratios), and are generally less exposed to economic downside risk because of reasonable valuations. I expect they will therefore likely suffer smaller falls in a declining market. The downside of this fact is that our holdings, which are generally in less exciting industries than many businesses are less likely to be carried along in a market which develops a substantial speculative component.

Our holdings are presently more diversified than they have been in the first 2 years of the funds existence; we now hold more stocks (17) than we ever have before, although our largest (and best) 3 holdings still comprise about 50% of our stock portfolio (i.e. excluding cash holdings). We watch these 3 like a hawk.

<u>Dividends:-</u>

Our inaugural dividend was distributed, with the option of cash or new shares (depending on investor election) on 31 May this year. We were extremely pleased that every investor chose the reinvestment; it demonstrates a humbling faith in the fund.

It remains our intention to distribute substantially all of the earned Franking Credits out of the fund and into the hands of the fund-holders at the earliest opportunity. This being the case, our dividend is expected to at least double in FY2014 and then rise again by at least 50% in FY2015 as we generate evermore Franking Credits. Thereafter, we expect the dividend will grow at least in keeping with any capital growth obtained within the fund.

Let me hear from you regarding any questions you may have on any aspects of this letter, or anything else regarding our fund that may puzzle you.

Best Regards,

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