EGP Fund No. 1 Pty Ltd
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Erik A. (Tony) Hansen – Investment Manager 3 October 2014

Q1 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 quarter of FY2015 (July 1st 2014 – September 30th 2014) at 45716.65 points.

The investment experience of the Australian investing public in the stock market generally in Q1FY2015 was a loss of 0.60%.

The (-0.60%) 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 Q1FY2015 at $1.56804, for a gain of 0.42% after allowing for all fees and expenses.

Results should really be considered over the longer term, preferably 3 – 5 years. In the 3 years and 6 months the fund has operated, our 16.62% annualised return to our holders exceeds the 7.39% annualised performance of our benchmark by 9.23% over the same period.

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. That said, a substantial decline in the markets would always be helpful in our quest for investment bargains and outperformance. Holders need to 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%. The more years that go by without a substantial decline, inevitably the closer we are to a year when such an event will occur.

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 this type of out-performance 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
Q1FY2015	-0.60%	0.42%	0.68%

* 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
Q1FY2015	-0.60%	0.42%	0.68%
Cumulative	28.30%	71.12%#1	77.62%#1
Annualised	**7.39%**	**16.62%#1**	**17.87%#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

We have added two stocks in the quarter, bringing the total number of our holdings to 26. Our 3 largest (and best) holdings currently comprise 47.8% of our stock portfolio (i.e. excluding cash holdings). Our smallest comprises 0.43%. With our investor intake on 30 September 2014, we hold just over 18% cash. We stated our intention in the most recent quarterly letter to trim the number of our holdings, so you may not have expected the increase. We began selling one stock, before the recent retreat in the market took the prevailing price below prices at which we are willing sellers, for this reason, we stopped selling. With luck, prices will return to a level we are again satisfied to sell at. We will hopefully eliminate the remainder of this stock and at least a couple of other stocks over the period between now and December 31st. I will discuss these stocks in the weekly blog once the selling is done.

I state in the 'Investment Principles' document 'we do not expect to hold any more than 25 individual issues'. This number would ideally be closer to 20 or below, but as with buying, discipline in selling is very important. The stocks we have sold or will soon be selling we do not view as overvalued, just the most <u>fully</u> valued of our holdings. We feel that we will maximise our long-term returns by replacing them with businesses whose current price suggests superior long-term risk-adjusted results.

Dividends:-

We distributed a 10c (7c dividend plus 3c FC) dividend 31 May 2014. We expect to maintain (and hopefully grow) the dividend in future financial years, subject to the level of Franking Credits held (we will only pay dividends to the extent we can fully frank them). At the time of writing, more than 3 cents per share in Franking Credits have accrued so far, the FY2015 dividend will therefore at least match FY2014 unless we have substantial new capital inflows in the December 2014 and March 2015 intakes.

Risk:-

Investing carries risk. There is no way to skirt around this fact. If a riskless way to make a satisfactory return were found, it would be chased by investors until the return was no longer satisfactory. The definition of risk is different for different people and depends on many factors, mostly maturity date (when you want to start drawing down on the investment). One under-considered risk is the emotional risk of investing. If you are likely to find the daily gyrations of stock ownership emotionally taxing, then even if you are confident of a good outcome over time, holding one of the more volatile asset classes, such as equities may be a mistake for you. The psychic pain experienced by some in observing daily volatility may well be insufficient compensation for the expected additional return. Remember though, some so-called 'risk-free' assets are pretty risky at present in terms of how well compensated you are for the risk you carry. This is sometimes waggishly referred to as 'return free risk'. Holders of these assets won't be laughing at some point.

Standard investment thinking is that (safely stored) cash is virtually riskless. You occasionally hear of persons with substantial sums of cash stored in a roof cavity, or some such space, I often wonder how frequently cash disappears when a house burns down or something similarly destructive happens. The primary risk with cash however, is the loss of purchasing power through inflation.

Next are short-term loans to Government bodies. You can make your own mind up whether the current 2.59% return on 2-year Australian bonds is satisfactory compensation for risk. I can save you the thinking on 1-year US treasuries; the 0.09% yield is insufficient for the risk you bear.

Long term Government bonds are next on the risk/return spectrum. The Spanish Government recently issued 40 year bonds at a 4% yield. 30 year US treasuries yield only 3.15%. These yields are manifestly inadequate for the durations involved. Far too much uncertainty exists in the world to accept such low yields over such long periods. 30 year TIPS (the inflation protected version of the 30 year US treasury) trade at 1.03%. This effectively implies an expected inflation rate over 30 years of 2.12%. That could very well prove to be the case, but given the unusual level of monetary intervention in recent years, it would not be unreasonable to expect that at some stage during that 30 year period, a bout of inflation causing the long term inflation rate between 2014 and 2044 to exceed 2.12% is possible, or even likely.

Short and mid-term bonds for 'blue-chip companies' usually place next on the risk spectrum. These are usually followed by property. I view property as no less risky than good businesses (i.e. equities), but people feel the risk less because of the fact you aren't quoted hour by hour prices with property.

Equity is where your investment in the fund is put to work. Equities land further along the spectrum of risk for one primary reason. Volatility. The last 12 months have been an unusually stable period in equities; volatility measures have recently set new record lows. Despite this historically stable period, the price range (12 months high to low) for the 20 largest stocks in the Australian indices averages 24.5%, with a high of 60% (QBE) and a low of 14.5% (BHP). I encourage investors to work very hard to remember that the businesses sitting behind the ticker symbols you look at every day mostly do not really change their valuation all that remarkably from year to year. Properly exploited, volatility actually creates opportunities for lowering risk in pursuit of returns.

There are a number of asset classes that follow equities on the risk spectrum - options, swaps or futures for example, or other derivatives. The average investor need not spend a lot of time thinking about these assets. Most professional investors would be well advised not to think about, or participate in these classes if the truth be told, but something in professional investors psyche seems to demand that they be doing something complicated. At EGP, we like to keep it as simple as possible, I think over time the results will be perfectly good and our efforts are better focused on business fundamentals than complicated financial engineering.

Member Audit:-

The first member audit was completed on 27 August 2014, Ray and Jane (the inaugural member auditors) sent me these words to use to describe their member audit:

We, as shareholders of EGP Fund No. 1 Pty Ltd have reviewed the FY2014 full accounts and the fund structure as part of our member audit.

We have received copies of the bank statements, viewed brokerage statements and the ASIC share register.

During our audit we liaised with the fund manager and were given full co-operation with all of our questions being fully and openly answered.

We are not qualified auditors, however, we hold a substantial interest in stock of the fund and because of this have reviewed all the information carefully and with a very critical eye.

We are satisfied that the per-share asset values referred to in the FY2014 performance letter reflects a correct view of the fund's asset on a per-share basis.

We are satisfied that the fund's structure in its current form is fair and equitable to the A class shareholders and that the A class fee paying shares rank equally with the B class non-fee paying shares.

I have had volunteers for the December 31 2014 and the June 30 2015 audits. If you would like to conduct the audit for December 31 2015 or beyond, 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.

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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