PetersMacGregor GLOBAL FUND

September 2016

Fund Facts

Portfolio Managers	Wayne Peters Michael Haddad
Structure	Global Equity Fund $AUD unhedged
Inception Date	10 September 2004
Fund Size	A$93.5 million
Recommended Investment Timeframe	5 years plus
Distributions	Annual, 30 June
Management Fee[1]	1.35% p.a.
Performance Fee	Nil
Buy / Sell Spread	0.10%/0.10%
Benchmark	Unaware

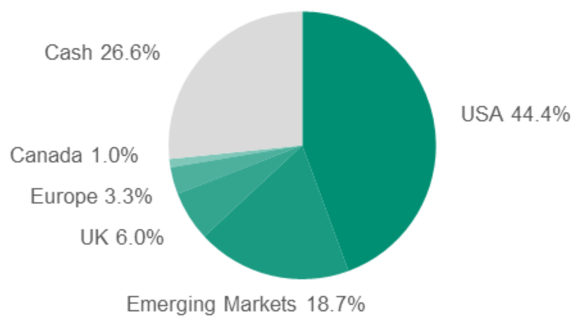
Top Holdings

Stock	Sectors
Amerco	Transportation
American International Group, Inc.	Multi-line Insurance
Berkshire Hathaway B	Multi-sector Holdings
Fairfax Financial Holdings	Multi-line Insurance
Liberty Broadband Corporation	Cable
Liberty LiLAC Group	Cable
Liberty Media Corporation Sirius XM	Satellite
Liberty Ventures	Internet Retail
PayPal Holdings	Information Technology
Wells Fargo & Company	Diversified Banks

Fund Features

Investment Style	Value
Portfolio Composition	15-30 stocks, up to 30% cash

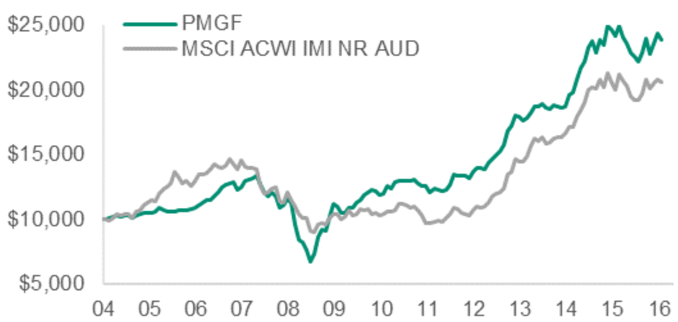
Geographical Exposure by Revenue[2]



Fund Performance[3]

	Fund %	Index %[4]	Excess %
1 month	-2.09	-1.07	-1.02
3 months	4.94	2.72	2.22
1 year	-1.19	3.01	-4.20
3 years (p.a.)	10.66	12.51	-1.85
5 years (p.a.)	14.57	16.29	-1.72
7 years (p.a.)	11.66	10.28	1.38
10 years (p.a.)	7.97	4.36	3.61
Since inception (p.a.)	7.48	6.18	1.30
Total return since inception	138.67	106.16	32.51

Growth of $10,000 Since Inception



[1] *All fees are inclusive of the net effect of GST*

[2] *Peters MacGregor may on occasion, hedge against movements in the Australian dollar and other currency exchange rates, but the default position is to remain unhedged. As part of this policy it considers the intrinsic currency exposures of investee companies. The graph summarises the principal net currency exposures based on generally accepted accounting standards. GAAP measures currency exposure based on the country of stock exchange listing in which the investee company security is held, which is not necessarily reflective of the intrinsic currency exposures of the investee companies. Regional Revenue breakdowns are approximations.*

[3] *Performance figures are calculated using exit unit price to exit unit price for the given period. Intra year performance figures are unaudited; the returns are after all applicable fees and taxes. They do not include franking credits.*

[4] *MSCI ACWI IMI NR AUD*

Monthly Performance (%)

Financial Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
2004-05			0.16	0.95	1.08	0.57	-0.36	0.51	0.06	-1.70	2.02	0.63	**3.94**
2005-06	1.02	-0.26	0.33	0.93	3.08	-1.76	-1.17	0.12	0.14	0.14	0.83	-0.32	**3.02**
2006-07	0.58	0.94	1.95	1.66	1.60	0.42	2.48	2.54	3.00	1.86	1.05	0.76	**20.52**
2007-08	-4.98	1.82	3.93	0.89	0.29	1.71	-5.42	-4.54	-2.49	2.70	-2.01	-8.03	**-15.66**
2008-09	1.55	5.28	-2.89	-14.76	-12.58	-2.26	-7.60	-11.11	8.79	17.70	6.27	-0.41	**-15.83**
2009-10	11.63	9.30	-1.28	-5.05	-0.18	4.37	-0.32	3.42	2.31	2.97	1.64	2.08	**34.26**
2010-11	-0.81	-2.86	0.87	5.45	-1.95	4.17	0.87	-0.25	0.33	-0.30	0.61	-1.88	**4.02**
2011-12	-1.50	-0.39	-3.66	2.59	-1.32	-0.83	1.11	3.07	6.64	-0.95	0.22	0.01	**4.67**
2012-13	-1.44	3.56	2.53	-0.09	-1.01	3.58	1.96	2.33	1.84	3.37	6.90	2.33	**28.83**
2013-14	4.41	-0.49	-1.71	1.38	2.26	2.74	0.02	0.86	-1.83	-0.05	1.27	-0.69	**8.28**
2014-15	-0.37	0.76	4.46	1.21	4.90	4.21	2.61	4.87	1.82	-3.59	4.52	-1.88	**25.70**
2015-16	6.53	-1.39	-2.03	3.38	-3.75	-1.70	-3.25	-1.29	-1.65	3.01	4.95	-5.20	**-3.09**
2016-17	3.69	3.37	-2.09										**4.94**

Introduction

The net increase in the Peters MacGregor Global Fund for the September quarter was 4.9%, outperforming the MSCI which increased 2.7%. This reversed a similar degree of underperformance during the June quarter.

Given our portfolio is currently short on glamour and popularity in a market that's enamoured with high flying growth stocks, businesses with defensive cashflows, such as consumer staples, and stocks paying high dividends, we're glad to record periodic wins, both in terms of strong absolute results and relative outperformance. We also note investors are slowly questioning valuations of the best performers, with some highly out of favour cyclical sectors of the market springing back to life.

Notwithstanding the strong recent performance, our medium term results remain slightly disappointing, lagging the index by 4% over the past year and 1-2% pa over 3-5 year periods. This underperformance is quite typical of value managers during the mature stage of a long bull market, and can be quickly and spectacularly reversed when market conditions change. Our medium term performance could easily match or exceed our longer-term annualised outperformance of 3+% over 10 years under certain market conditions, and we always welcome opportunities to add new names to the portfolio and increase our holdings in familiar ones.

General commentary

News flow over the past few months has been benign, and volatility has remained low as investors are taking on risk comforted by low interest rates and frustrated by a lack of attractive options. The impact of a looming Brexit and the saga around Deutsche Bank's solvency continues to weigh on British and European financials, with the British Pound drifting lower over the quarter ahead of a sudden 'flash crash' since quarter-end.

Two key themes continue to dominate markets. First, the rotation of funds from active to lower-cost passive strategies. The story sounds good: most active managers (ourselves included) have underperformed over the past few years, so exit these and invest in passive funds that simply give the market return at minimal cost.

In reality though, the self-reinforcing nature and lack of discrimination that increases the prices of an index's constituents without regard to their intrinsic value can lead to a top-heavy index set-up for a major market decline or persistently low returns. You saw this in the 1998-2000 technology bubble where certain segments of the market reached nose-bleed levels, lifting the broad market to its peak, before those same stocks collapsed and caused a major bear market through 2002.

Conversely, the reasonably priced securities that didn't participate in the boom largely side-stepped the subsequent carnage, with the majority of companies outperforming the 'average' from 2000-2002. Today's environment is similar, but less pronounced. So while many investors remain focused on passive investing, we're beginning to witness more dispersion among individual stock and industry returns. This creates opportunities for index-agnostic stock-pickers to add the value that's often lacking during a long bull market.

The second theme that will be less problematic from here is zero, pygmy and negative interest rates. There's a high chance rates will stay very low for an extended period of time, but given the mass re-pricing of risk assets in response to low interest rates, more normal patterns of market behaviour will eventually emerge as more investors realise you can't get blood from a stone. Valuations can only stretch so far before they have to reflect actual earnings growth, which is tepid in most sectors.

As has been the case for the past few years, emotional or behavioural factors such as patience and discipline are the key to respectable returns despite the market environment while avoiding the more obvious danger spots of the day.

Portfolio changes – an active and productive quarter

The big change this quarter has been the exit of a long-time and large holding, Michael Hill International. Having moved its primary listing from New Zealand to Australia in July, we maintained a large position as we expected the company to be re-rated.

Quarter-over-quarter the stock was up by around a third, but we took a balanced approach to our position, reducing initially into modest price strength in order to retain our full position, then progressively selling as the stock price kept increasing until it reached our estimate of fair value. The company has been a strong contributor to our long-term results, and was a major factor in this quarter's performance.

Though we still like their prospects, we also trimmed insurer American International Group, Berkshire Hathaway and US property developer Howard Hughes Corporation on valuation grounds or to balance the risks in the portfolio. The sales raised cash in excess of 20% of the value of the portfolio, with modest investments made in the Latin American cable and broadband operations of the Liberty empire, Liberty LiLAC Group, and US bank Wells Fargo & Co.

New positions included media giant Twenty-First Century Fox and European cable and broadband provider Liberty Global. Both stocks are down significantly from their highs from a couple of years ago, offering a margin of safety in addition to their dominant market positions. Both boast entrepreneurial managers with large amounts of their own money invested in their respective businesses.

Former holding, Amerco (owner of U-Haul moving trucks and trailers, which you're bound to have seen in a movie or two), was re-introduced to the portfolio following a 23% fall in its share price as investors reacted to falling margins in its moving division. Its storage business is first class, while the moving business remains the market leader by far.

Finally, we opened new positions in China's answer to Amazon and Google – JD.com and Baidu. Both have dominant market positions in the protected Chinese market, but more importantly their valuations are attractive having been weighed down by temporary factors. Regardless of the Chinese macro environment, we expect these companies to grow strongly over a long period of time. We have hedged our exposure to the Chinese Yuan, as we expect it may eventually be devalued as economic growth slows.

We have also published overviews on Amerco's CEO, Charter Communications, Expedia, JD.com, Liberty SiriusXM, and JD.com.

Insights – US & European research trip

September is a busy month with a multitude of industry conferences spread across the US and Europe. Our first was in California, where we heard from scores of US industrial businesses.

Some characteristics of these businesses include strong market shares in fragmented markets that can provide growth opportunities via acquisitions for decades. Often companies sell important electronic measurement devices like Ametek's, which must provide exact measurements under the harshest conditions. This would be a small, but vital cost for a miner, for example, giving Ametek pricing power. At the other end of the spectrum, the industrials group includes highly cyclical auto manufacturers, so as always you need to be picky as the industrial industry covers the full gamut of companies.

The constant theme we heard throughout was that there is essentially an industrial earnings recession in the US. Revenue and earnings in many cases have been falling, and growth rates have been anaemic elsewhere. Companies with more exposure to consumers than commercial customers are faring better.

Despite low interest rates, many companies are afraid to invest. Central bank policies have created a glut of almost everything, so the lower cost of capital doesn't encourage companies to invest in new production facilities, which will only put further pressure on prices as they increase supply. Many companies that should've went broke during the GFC were kept alive, so production capacity didn't contract like it might otherwise have done.

With the business cycle maturing after eight years since the GFC, as shown by the peak in auto sales, for example, that extra capacity is putting pressure on prices as companies struggle with high inventory.

Ordinarily this backdrop would call for low expectations, but instead these companies are regularly trading at 20x earnings or more offering no margin of safety against the next cyclical downturn. The good news is that we added several companies to our watchlist that will provide attractive buying opportunities through the next cycle.

Europe

In Germany we heard from 26 mostly mid-sized companies, amongst well over 100 companies in attendance. One of those was architectural and construction software company Nemetschek, which gives you an idea of how zero (or negative) interest rates has impacted continental investor attitudes.

Nemetschek was trading at around 18x earnings when I met with the company a couple of years ago. Virtually as I walked out the door, the company made an acquisition that has worked out very well and the stock has almost tripled. It's a top notch little business operating in a highly profitable but cyclical niche, so a price-to-earnings ratio of 40 seems optimistic. When your opportunity cost is zero, or worse, you have to pay the bank to look after your money, it's easy to see how anything offering a bit of growth or yield looks ok.

We've added some excellent German businesses to our watchlist that exhibit all the things we look for as long term investors, including strong market shares in niche industries, large insider-ownership, technical excellence in markets with large barriers to entry, growing earnings and pristine balance sheets. But as long as central banks continue with their deflationary policies, buying opportunities in these types of businesses seem a long way off. For more on our thoughts from Germany, you can download a 15-minute podcast here.

UK

Lastly, we heard from the major UK and European banks, as well as some insurers, which are all suffering from low interest rates. Bank share prices have fallen particularly hard since the UK voted to leave the European Union, as the central bank immediately lowered the official interest rate. The yield curve dropped in response, suggesting the UK will have lower interest rates for longer, putting pressure on profit margins.

The fears surrounding Deutsche Bank's solvency following news of a potential record fine from the US Department of Justice regarding mis-sold mortgage securities prior to the GFC, has also impacted the banking industry.

Our overall feeling was that the banks are being well managed. They're investing heavily in digital and closing bank branches rapidly. Customers now expect to be able to get approval for a home loan at any time of any day or night without needing to drop by a branch.

We expect many 'FinTech' companies will find it impossible to compete with the banks, despite providing valuable services. The working capital needs of serving millions of customers is overwhelming, and will likely see many upstart financial businesses fall into the arms of the incumbents.

For the most part balance sheets were in excellent condition with record levels of capital, though building even higher capital buffers seemed to be preferable to distributing excess cash to shareholders. Return on equity (ROE) figures mostly ranged from low single-digits to low double digits, but it's getting harder and harder for the best operators to increase ROE from current levels.

Costs have already been cut dramatically, technology investment is on-going, bad debts remain low and competition remains intense while credit growth is glacial. Tough regulation is also strangling the industry, and greatly hampering the ability of well-funded banks to return excess cash to investors. So far we've kept our small holdings in RBS and Lloyds Bank.

Summary

We're enthused about the prospects for our portfolio following a period of substantial refreshment and identification of exciting new holdings largely outside the US. Michael Hill was exited as its price reached full value, and new positions were established in Twenty-First Century Fox and Liberty Global. China's Baidu and JD.com were also added, and family owned and operated Amerco (U-Haul) was reintroduced to the portfolio. We're finding value in the less obvious nooks and crannies of the global equity market, and more volatility will eventually allow us to add more quality franchises at attractive prices.

Please enjoy the further reading, along with an analysis of Liberty Ventures, our stock in focus this quarter.

Further reading

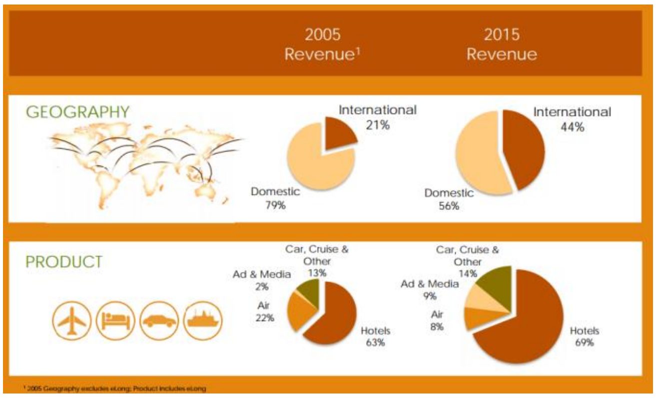
- Amerco CEO – Joe Shoen
  https://petersmacgregor.com/news-insights/joe-shoen-the-billionaire-youve-never-heard-of/
- Charter Communications and John Malone (video)
  https://petersmacgregor.com/news-insights/investment-insights/look-john-malone-cable-industry-charter-communications/
- Expedia
  https://petersmacgregor.com/news-insights/investment-insights/value-growth-attached-hip/
- JD.com (video)
  https://petersmacgregor.com/news-insights/videos/can-jd-com-deliver/
- Liberty Ventures (see below)
- Liberty SiriusXM
  https://petersmacgregor.com/news-insights/value-stocks-growth-potential/
- Investment podcast – Episode 1 (Europe research trip)
  https://petersmacgregor.com/news-insights/videos/investment-insights-podcast-episode-1/

Stock in focus: Liberty Ventures

Liberty Ventures is a holding company that owns a bunch of first class assets chiefly made up of a stake in listed companies **Liberty Broadband**, **Charter Communications** and rapidly growing online flight and hotel bookings company **Expedia** (the appendix in our June 2016 Quarterly Report explains the case for Charter and Liberty Broadband, so let's focus on Expedia).

Along with rival Priceline, Expedia is an online travel agent (OTA) that shares a virtual global duopoly for flight and hotel room bookings, with each having market shares over 30%. Expedia is dominant in the US processing 75% of bookings, versus 20% for Priceline, while Priceline is dominant in Europe. Still, Expedia has increased its non-US revenue from 21% in 2005 to 44% in 2015 as online bookings grow worldwide.

Expedia has also increased its share of higher-margin hotel bookings, from 63% to 69% over the same period. And despite more than quadrupling sales over the past 13 years, only 15% of bookings are currently made through online travel agents (OTAs), suggesting plenty of growth to come regardless of the economic environment.



Expedia's sources of revenue
Source: Expedia

Expedia has traditionally followed the Merchant Model, where it buys rooms from hotels in bulk at discounted or wholesale prices. This gives US hotel customers a reliable stream of business and an easy way to shift a lot of empty rooms, provided Expedia is willing to accept the risk that it can't sell them.

Expedia has also adopted the Agency Model, due to its popularity in countries like Europe, the Middle East and Africa. With the Agency Model, Expedia doesn't have to buy anything upfront as hotels simply pay a commission on reservations. This increases profit margins and Expedia's appeal to emerging market hotel brands.

Even if it's just for comparison purposes, hotels are forced to list their rooms on OTA websites. According to a Cornell University Study in 2011, nearly 62% of guests who booked directly on a hotel website visited Expedia prior to making the reservation.

Switch to mobile

With the growth of mobile, customers are making bookings across multiple devices (PC, Tablet, Smartphone). This creates problems for travel companies in tracking users unless they are signed in on the device, but the long term advantage is a migration to apps, which allows for a far stickier relationship for the OTAs.

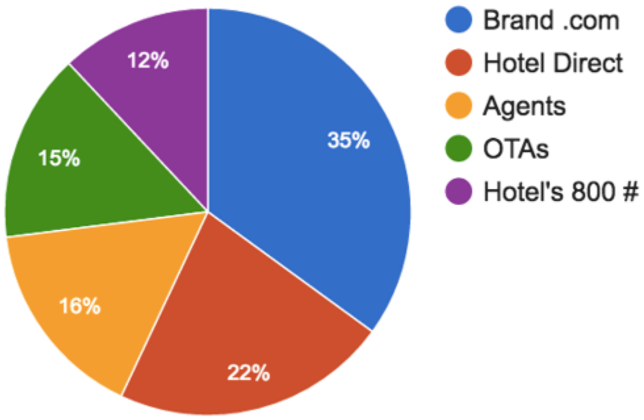
Deep Kalra, CEO of MakeMyTrip (an Indian OTA), said 'Apps are our favourite medium because of the obvious advantage of not having to re-acquire the customer. App customers convert higher.'

In 2013, Skift reported that consumers visit 38 sites before booking a vacation. This research process is fairly easy on a PC but it's dramatically more difficult on a mobile phone. Would you be prepared to thumb your way through 40 sites or download an app for American Airlines, Qantas, Hilton, Marriott, Best Western, Hertz, etc.? Or are you more likely to download one app that does it all like Expedia's? We believe the OTAs position as the industry shifts from desktop to mobile is underappreciated, as Expedia only currently processes 25% of its room bookings via mobile.

Expedia has also made many acquisitions to consolidate its market position, including Australian business Wotif in 2014. Expedia's collection of brands, such as Hotels.com, Orbitz and Trivago, provides an illusion of choice for customers. It's similar to Woolworths' successful liquor strategy, which consists of Dan Murphy's, BWS and Cellarmasters.

An illusion of choice – Expedia's brands

The regulators have endorsed the consolidation, as most hotels still aren't booked through OTAs. New competitors, such as TripAdvisor, have also started accepting direct bookings and may be a takeover target.



Hotel booking methods
Source: TravelClick

Hotels are fighting back with mergers of their own and offering rewards programs, but it's not a comparable service to quickly viewing a broad selection of travel options at the lowest prices, which tends to trump any loyalty to a hotel chain.

HomeAway

Airbnb is often considered the Uber of the online travel bookings industry, as it currently has over 2m listings. We disagree, as Airbnb is not currently a comparable service to staying at a hotel. But we're cognisant that it may eventually start listing hotels.

If that happens, Expedia can compete with its recent $3.9bn acquisition of HomeAway. HomeAway is similar to Airbnb but has historically focused on vacation properties. It currently has 1.2m listings and is the second largest alternative accommodation website behind Airbnb.

Over time we expect alternative private accommodation to expand the travel market rather than replace hotels and OTA's.

Why own Liberty Ventures?

Having made the case for owning Expedia, rather than buy the stock directly we bought Liberty Ventures instead. The reason was two-fold.

First, we were happy to increase our exposure in Charter Communications and Liberty Broadband, as both were undervalued and we were familiar with the businesses.

Second and more importantly, we were able to buy Liberty Ventures at a 21% discount to net asset value and a 28% discount to our estimate of the company's intrinsic value. We believe Liberty Ventures was trading at such a large discount due to its various unrelated holdings, liquidity and because some smaller private holdings are more difficult to value.

Our task was made much easier as we already owned Charter Communications and Liberty Broadband and were comfortable that management would find a way to close the valuation gap. If the market doesn't recognise the value, the discount should close as the various pieces are eventually spun off.

The Expedia component is expected to be spun off this year, which will reduce the complexity of Liberty Ventures and make the value of the remaining assets clearer. Expedia also remains in good hands, with Executive Chairman Barry Diller still owning a $600m stake.

We previously owned Diller's IAC/InterActiveCorp before the market recognised the value of its fast growing Tinder dating app. Diller, like cable industry legend John Malone, has a very long history of compounding share holder capital at a high rate of return. If you invested $1,000 in IAC/InterActiveCorp in August 1995, when Diller created the business, you'd have about $16,000 in 2015 versus $4,800 for the Nasdaq Index. As always, we're delighted to partner with managers with long track records of creating shareholder value, particularly when we're paying value prices for high growth businesses in highly profitable and sustainable industries.

Originally published 11 October 2016. Disclosure: Peters MacGregor Capital Management Limited holds a financial interest in Liberty Broadband and Liberty Ventures through various mandates where it acts as investment manager.