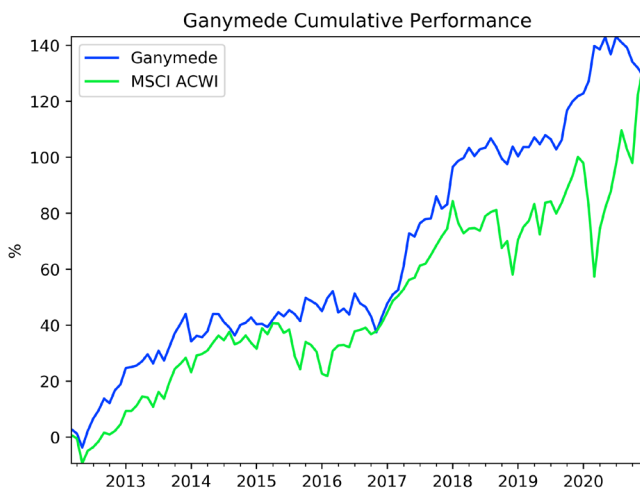


The Bronte Ganymede Fund is a global long/short fund targeting double digit returns over the long term, advised by a performance orientated firm with a process and portfolio that we feel is genuinely different. Objectives include lowering the risk of permanent loss of capital and providing global diversification without the market/drawdown risks typical of long-only funds. We believe a highly diversified short book substantially reduces risk and enables profits to be made in tough markets.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2012			2.8%	-1.5%	-5.0%	6.1%	4.3%	2.8%	3.8%	-1.4%	4.1%	1.7%	18.8%
2013	5.0%	0.3%	0.5%	1.2%	1.9%	-2.5%	3.6%	-2.7%	3.8%	3.7%	2.3%	2.6%	21.3%
2014	-6.8%	1.5%	-0.4%	1.6%	4.5%	0.0%	-2.0%	-1.4%	-2.1%	2.7%	0.6%	1.3%	-0.9%
2015	-1.7%	0.1%	-0.8%	1.9%	1.8%	-1.0%	1.5%	-0.9%	-1.7%	5.4%	-0.6%	-0.7%	3.1%
2016	-1.7%	3.1%	1.4%	-4.6%	0.9%	-1.4%	4.9%	-2.1%	-0.8%	-2.3%	-4.0%	4.0%	-3.1%
2017	3.3%	2.2%	1.1%	5.6%	7.2%	-0.7%	2.8%	0.8%	0.1%	4.4%	-2.2%	0.86%	28.1%
2018	7.2%	1.1%	0.5%	1.8%	-1.4%	1.2%	0.2%	1.7%	-1.5%	-2.0%	-1.0%	3.2%	11.3%
2019	-1.7%	1.7%	0.0%	1.7%	-1.2%	1.6%	-0.70%	-1.8%	1.6%	5.2%	1.5%	0.9%	8.9%
2020	0.4%	2.0%	5.4%	-0.5%	1.8%	-2.5%	2.6%	-0.8%	-0.8%	-2.1%	-0.9%	-1.3%	3.2%



The fund was down by 1.26% whereas the globally diversified MSCI ACWI index gained 4.64%. Our results this quarter are poor. Our long-held strategy of shorting garbage stocks has hurt us and hurt us some more. Our long book has been adequate – but not great. Across a tempestuous year the fund has generated a positive return with much reduced volatility however the strong outperformance of earlier months gave way to significant recent underperformance. This letter focuses on these last few months, as they have not been fun. (see over).

Fund Features		Portfolio Analytics		
		Metric	Ganymede	ACWI
Investment Objective	Maximise risk-adjusted returns with high double-digit returns over 3 year periods.	Sharpe Ratio ¹	1.00	0.73
Min. initial investment	\$500,000 (for qualifying investors)	Sortino Ratio	1.88	1.12
Min additional investment	\$50,000	Annualised Standard Deviation	9.23%	13.52%
Applications/redemptions	Monthly	Largest Monthly Loss	-6.83%	-13.50%
Management fee	1.5%	Largest Drawdown	-9.64%	-21.37%
Performance allocation	20%	Winning Month Ratio	0.59	0.67
Administrator	Citco Fund services	Cumulative return ²	128.99%	132.64%
Auditor	Ernst & Young	1 year annualised return	3.22%	16.25%
Custodian/PB	Fidelity Prime Services, Morgan Stanley, JP Morgan	3 year annualised return	7.72%	10.06%
		5 year annualised return	9.20%	12.26%
		Annual return since inception	9.83%	9.56%

¹ Sharpe and Sortino ratios assume US 3 month T-Bill rate

² Returns are net of all fees

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In these months some fund managers we admire have had solid double-digit returns. Also, some fund managers we think are gunslingers destined to drop 80 percent or more have had double digit returns (with triple-digit returns a possibility). This –despite what the averages say – is an aggressive melt-up market.

The real economy is awful at the moment (COVID), but the financial economy is setting bullish records.

The averages do not tell the story. Old-time value stocks are not nose-bleed expensive and, relative to bond yields, look outright cheap. We have been buying a few.

By contrast many quality growth stocks are now very expensive, often requiring a decade of uninterrupted growth to “earn their way” into the current valuation. And garbage stocks and new issues are at levels that even a few years ago we would have considered vanishingly unlikely.

The rise in garbage stocks has been very difficult for us. We short garbage stocks. On the plus side we look at shorting opportunities now and see a “target rich environment”. Alas, recent experience tells us that the targets can shoot back.

The rise of retail

Rampant speculation in growth-oriented and garbage stocks has had many drivers – but the one that matters most to us is the massive increase in the number, value and confidence of retail investors, particularly online retail investors, often young and with no investing experience or historical perspective.

It is not uncommon to have 20-year-old “investors” ask you about call options. The widespread retail interest in short-dated, highly levered positions is reflected in massive call option volume in the most speculative retail stocks. Tesla has literally billions of dollars in one-week call options every week, even in the low-volume Christmas week.

This sort of levered speculation in controversial names sharply contrasts with dull markets in the sort of long-haul, established companies in which we like to invest.

How this has hurt us

Historically the biggest driver of our short book – and the driver that has worked best for us – is shorting stocks aggressively promoted to retail investors. We seek to find the most cynical and self-serving promoters who promote fads, frauds and failures to retail investors. But “sold to naïve investors” is a basic tell.

This tell has not worked in 2020. Indeed, it is a way to lose considerable money as a shortseller. When you think the retail investors being promoted this new shiny fraud (that they cannot possibly know anything about) are hitting exhaustion, a new wave of newbies – with their Robinhood accounts – comes to bid your short up double or triple.

The biggest retail stock of them all – Tesla – is a stock we have no position in (anymore). But the eight-fold increase in stock price this year has convinced many newer investors that they can do no wrong.

If your main schtick is finding the dumbest retail investors and shorting whatever has been sold to them then you have done poorly. This sort of bullish investor may have the intelligence of their bovine counterparts, but a herd of them can gore you.

A tidbit from a fellow traveler

We are not the only ones watching tip-sheets and other stock-promotion newsletters. A keen observer noted that 2020 is the first year in their decade-plus history that a majority of tipped stocks beat the market. Ordinarily, a handful of such stocks double, two-thirds trail the index, and a fair few lose almost all of their value.

Promoted stocks with a good story are, in part, the raw material from which Bronte's short returns are typically made.

Outline

This letter discusses

- I. where we are,
- II. historical precedents and
- III. how we are managing in this environment

1. Where we are:

There is a famous Scott McNealy quote, originally given to *BusinessWeek*, but now [stored at Bloomberg](#) since Bloomberg acquired it.

McNealy, as older and market-attuned readers will remember, was the founder-CEO of Sun Microsystems, a darling of the 1999-2000 tech bubble. Their slogan: “We are the dot in dot-com”. Their [TV adverts](#) now look like dot-com kitsch but they captured the zeitgeist.

In March 2002, just under two years after the bubble burst and by which time Sun had lost about 90 percent of its market capitalization, McNealy said this:

... two years ago we were selling at 10 times revenues when we were at \$64. At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at \$64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?

McNealy is right when it comes to paying 10 times sales for a hardware business. Cost of goods sold is always going to matter, and even the fattest-margin hardware company struggles to earn over 25 percent operating margins. Apple – a company with eye-watering profitability – only earns 25-27 percent margins.

That said, ten times revenue can be inexpensive for a business with nearly 100 percent profitability. (Property trades at well over ten times rent.) It can also be inexpensive for a company with high incremental margins and growth. Buying fast-growing software companies with difficult-to-replicate positions at ten times sales has tended to work out. But outside that context, buying things at ten times sales tends to work out very poorly indeed.

Ten times sales is a high price to pay for any business; perhaps justifiable in fat margins and high growth cases, but just as often an indicator of market insanity.

Try twenty times sales

Alas twenty times sales is the new ten times sales.

Here are a small sample of companies trading at twenty or more times trailing revenue (as of writing in January 2020). There are many more. We have a position in only one.

Tesla

Market capitalization – \$696 billion

25x revenue



NIO Limited (Chinese Tesla)
Market capitalization \$83 billion
43x revenue



NVIDIA Corporation – the dominant maker of graphics processors which are used in AI (but which is ultimately a hardware company)
Market capitalization 332 billion
22x revenue



The Trade Desk -a small but successful software as a service provider to help people manage data for advertising campaigns and similar.
Market capitalization – 37 billion
50x revenue (but having declined from well over 60x revenue)



Twilio – a successful provider of software for cloud-based customer engagement
52 billion market cap
32x revenue



Shopify – a successful provider of software for independent online retail
Market capitalization – 137 billion
54x revenue (but recently also 60x revenue).



Pinduoduo
33x revenue



The last one was founded only in 2015 and has over USD216 billion in market cap and is a fast-growing multi-level marketing scheme. We are familiar with multi-level-marketing schemes (we own a big position in Herbalife) and we are aware of the problems they face in China.

Pinduoduo has none of the features that we associate with sustainable multi-level marketing schemes (and we think we have some expertise). Moreover, large hierarchical organizations in China (including such schemes) either wind up being heavily answerable to the Communist Party or dismantled as a threat to the Party.

The accounts at Pinduoduo are “interesting” in the same sense as the purported Chinese proverb. And Pinduoduo has never generated cash, whereas MLMs normally have negative working capital and are highly cash generative in the growth phase.

But, whatever, Pinduoduo is fast growing and it is in China.

Oh, and no we have no position long or short in Pinduoduo. We would love to short it – but in this market we would just get thumped.

The growth end of the market is euphoric.

Of particular note is the euphoria for stocks with so much as a whiff of “ESG,” a Wall-Street-ism for a desirable “environmental, social, and governance” story, with electric cars and their battery supply chain being the foremost example. Further enthusiasm is noted in anything China-related with a gloss of technology, speculative gold mines (although that mania may be quieting as Bitcoin supplants gold as the speculative asset-du-jour), as well as certain areas of biotech. In extrema, someone rolling out electric car charging stations, a business that should ultimately be highly competitive and hence low margin, might trade at a hundred times sales.

With the exception of Tesla’s notable addition to the S&P500, these areas of great enthusiasm are not reflective of the broader market indices. Established technology stocks are expensive, but their valuations are less hard to justify. Traditional value stocks have performed relatively badly for years and particularly badly for most of 2020, and they do not seem expensive at all. We have bought a few such value stocks and that has – if anything – exacerbated our underperformance.

Europe, outside those trendy sectors, has not produced glamorous returns at all. (Near-zero interest rates, a commonly-heard explanation for buoyant US equity valuations, have not had the same salutary effect on European shares.) But there are still some fundamentally decent businesses there.

Quality growth has appreciated beyond what we think is rational. Fraudulent growth companies (of which there are many) have been even stronger. Companies with dodgy COVID-19 treatments abound. At the dodgier end of the market, old-fashioned disinfectants reborn as COVID treatments (yes, they kill the virus on contact, but then so does soap) were

rewarded with big market caps. Further up the chain we find people with a history of dodgy stock promotion piggybacking on the new hot— but real—thing, namely RNA vaccines. And there is money for it: both from shareholders and from governments that have been spraying around money on anything COVID-related.

Our normal practice of shorting the low-quality end of the market has, lately, been a losing game. And the normal counterweight of being long quality stocks has – with the exception of a few growthy-positions in our portfolio – been a poor offset.

Special Purpose Acquisition Companies (SPACs)

A feature of the late stage of most (maybe even all) stock market manias is a garbage new-issue market. There is a stage in the market cycle when masses of people trip over themselves to buy newly created shares at prices disconnected from reality. The market's machinery will happily satisfy that demand.

New stocks are thus issued *en masse*. A few are high quality businesses, but many are over-inflated mediocre businesses. And more than a few are outright frauds.

A “junk” market may even be a necessary phase of the end-game of any mania. After all, someone must mop up all of that speculative demand and teach new investors and the deluded a lesson. If the market is being driven by fools then the sharp will separate the fools from their money.

This time round the mania is in SPACs or Special Purpose Acquisition Companies.

“Blank Check Companies,” so named because investors part with their cash before knowing what they have bought, have a long and often dishonorable tradition on Wall Street dating back to the South Sea Bubble and the [possibly apocryphal](#) “Company for Carrying out an Undertaking of Great Advantage, but Nobody to Know What It Is”. At the late stage of bull markets new stocks are more attractive than old stocks and Wall Street happily provides them.

According to a recent academic paper, SPACs raised as much cash in their IPOs from January through late October 2020 as they had over the entire preceding decade—and the pace seems to have accelerated in November and December.

This time round there are a few extra protections. The typical SPAC is listed at \$10 with “free” warrants granted at \$12.50. The promoter receives as much as twenty percent of the issue for, well, being the promoter.

The \$10 sits in a trust account (earning roughly zero) until a deal is done whereupon shareholders get to vote on the deal. If they vote “yes” the deal is consummated. If they vote “no” then their \$10 is returned. Initial backers of the SPAC thus get a “free option”: they will vote “yes” if the SPAC is trading above \$10 and “no” otherwise. Reputable funds are regular buyers of the SPAC as what hedge fund does not want a “free” option.

The promoter's carry can be large. If a SPAC raises half a billion dollars (well within the range these days) the promoter's carry can be worth a cool hundred million dollars. Often, they get to cash a fair bit of it.

Unsurprisingly SPACs are being assembled by the full pantheon of Wall Street characters from the highest quality executives and fund managers to people we think are organised-crime adjacent. The latter of course will use the cash raised to buy rubbery assets from undisclosed related parties. In the old days of China stock fraud for instance, management had to convince gullible investors to buy their stock. Now they just "convince" the SPAC they already control to buy the rubbery business.

It may be even worse when a highly reputable fund manager controls the SPAC. The payoffs are enormous – especially for a merger with a company in a hot sector. An "idea" on how the company might develop an electric car for instance commands billions of dollars in a SPAC merger, tends to drive the SPAC shares up and the promoter gets rich beyond avarice. Even the fund managers with the best records (and reputations for integrity) seem to like that. A few are cashing in their reputations.

This will end badly. Maybe not for every SPAC – but badly overall, and badly on average. We would like to think (and will return to this later) that the SPAC boom is the last stage of the long bull market since 2009. But there are no guarantees. And we debate it internally. The IPOs at the late stage of boom are normally all terrible. The companies that IPO'd in the year 2000 are as pustulant a list of failures as have ever been foisted on Wall Street. Per a 2002 copy of the *Morgan Stanley Technology IPO Yearbook*, of the 204 technology companies that went public in 2000, by 31 December 2001 only 30 had appreciated from their IPO price and many had collapsed by more than 80%. This time round there are plenty of festering pustules to be found – but interspersed are some quality companies (such as AirBnB) at prices that reflect their quality³. Whether that says there is more bubble to be had is yet to be seen.

[An extreme example of where we are](#)

We can't let this pass without an extreme example – taken from a tweet – as to the state of the market. This is a direct quote from a famous venture capitalist, whose record is extremely good. He later turned SPAC promoter and has pocketed literally hundreds of millions of dollars. And it says everything about this market.

Eventually, stocks can trend back to 10-20x sales, but when you're trading 30-80x, it's an incredible opportunity to aggressively expand/consolidate a market. These capital allocation decisions tend to be the hallmark characteristic that separates great CEOs from everyone else.

To an investor from another era – even someone who like Scott McNealy who was tartly realistic about the nature of bubbles – this quote is otherworldly.

³ AirBnB trades at just under 20 times its 2019 (pre-COVID) revenue. In this market that seems positively cheap.

2. Historical Precedents

There are plenty of precedents for this sort of market. But history only rhymes; it does not repeat.

We could write a book about the speculative morass of past cycles. But we do not need to. Our bookshelves are full of them.

Moreover, we suspect for the most relevant rhyming history, we must go back a few market cycles. We are not about to repeat the mortgage bubble and denouement of 2008. It is too recent in memory. We recall instead the great “blank check company” craze of the 1970s as very few people remember that now. And so John found himself rereading *The Go-Go Years*, John Brooks’ excellent history of the 1960s on Wall Street.

John read it the first time in his twenties (fully a quarter of a century ago) and had alas forgotten some of the lessons.

Some of it was quaint. You had to add zeros to all the numbers. Numbers were between 1.5 and 3 orders of magnitude too small, with large changes in relative values. It was a true scandal with national significance for instance when someone was bankrupt to 15 million dollars. (A good Monet was repossessed with a value of \$75,000. You could easily add three zeros now. Telling us about relative values though Fragonard’s “Portrait of a Young Woman” was repossessed for considerably more than the Monet.)

Some of the hot stocks of the era actually earned their way to respectability. Motorola has gone now but was hot then and remained so well into the new millennium.

But most of the hottest names disappeared.

We should make a few further observations. The averages (usually in those days the Dow Jones) went down but they never collapsed. The mania was not in Dow stocks. It was in the hot sectors of the times: electronics companies, tech companies such as Polaroid, and financially engineered conglomerates. The mania stocks dropped well over 90 percent with the rubbery ones dropping 100 percent. They were held by retail either directly or through gun-slinger aggressive mutual funds sold to retail.

If you shorted those stocks on the way up, you were gored. But *if* the positions could be maintained, our strategy would have enjoyed a golden era as the market dropped maybe 30 percent while the hot sectors fell 90 percent or more.

There were several quotes that read utterly true. This from Chapter One for instance leaves us speechless:

Before the crash in 1929 the financial sages had insisted repeatedly that there couldn't be another panic like that of 1907 because of the protective role of the Federal Reserve System; before the crash of 1969-70 a later generation observed repeatedly that there couldn't be another panic like that of 1929 because of the

protective role of the Federal Reserve System and the Securities Exchange Commission. In each case a severe market break had taken place about eight years earlier (in 1921 and 1962, respectively), followed by a period of progressively more unfettered speculation.

This sounds familiar, and yet we cannot see what breaks the market's faith in the protective role of the Federal Reserve System—despite that belief having obviously failed to protect investors in prior bear markets.

While the explanations seem quaint, the book also (repeatedly) described the sort of scenario that is anathema for our strategy. For example:

By the end of May (in this case May 1962 but to be repeated in 1969) the blue chip averages were beginning to lose ground – evidently because people were digging up their old certificates out of bank boxes, selling them and putting the proceeds into the new issues market”.

This situation where stable companies are being sold to finance junk is a repeated late-stage market phenomenon – and one we have seen this year.

There is also a description of a company which sounds like a traditional Bronte short – but where the stock goes up:

Goaded by stock underwriters eager for commissions or a piece of the action, owners of family businesses from coast to coast – laundry chains, soap-dish manufacturers, anything – would sell stock in their enterprises to the public on the strength of little but bad news and big promises. In conformity with the law, the bad news would be spelled out in the prospectus: the company had never made any money and had no real prospects of making any; the President had a record of three business failures in succession; the competition had the market for the company's product all sewn up; and so on. But the effectiveness of warnings is limited by the preconceptions of those being warned, and the stock would be snapped up, leaving the underwriter with his easy commission and the owner of the company with more cash than he had ever seen before in his entire life. To top it all off, the heedless buyers of the stock would come out ahead to; they would ride it up..

To this we would add two further laments:

1. the firm's President not only had a record of three business failures in succession, at least one of them we would think on good reason had been a fraud.
2. not only would the heedless buyers of the stock come out ahead, riding it up, but the dopey short-sellers of the stock (us) would lose because we bothered to read a prospectus. (One of famed value investor Sam Zell's favorite aphorisms, he has said, is “We suffer from knowing the numbers.”)

It would work out all right for the shorts in the end *provided they could hold on.*

The final denouement of the book also has a quote for the ages, from Bernard J (Bunny) Lasker, the then-Chairman of the New York Stock Exchange. He describes the scene after a vast proportion of the exchange's member firms have gone bust, and in which he and Felix Rohatyn had managed to organize shotgun weddings for many of the failures.

As Lasker said in 1972. *"I can feel it coming, S.E.C. or not, a whole new round of disastrous speculation, with all the familiar stages in order – blue-chip boom, then a fad for secondary issues, then an over-the-counter play, then another garbage market in new issues and finally the inevitable crash. I don't know when it will come, and I can feel it coming, and, damn it, I don't know what to do about it."*

This really does feel familiar except that the over-the-counter play doesn't really apply anymore. And despite vigorous internal discussions, we are not really sure whether we are on the first or the second garbage market of this cycle.

But there is one further warning for us of *The Go-Go Years*: it is entitled *The Go-Go Years* and not *The Go-Go Six Months*.

These cycles alas are longer than our monthly cycle at which we report to you. And we might need to manage the mania for quite a long time yet without succumbing.

3. How we are managing through this

This environment, as described above, is actively hostile to our strategy.

It is not the first time that we have had a few months that are actively hostile to our strategy – but it is the most intense time in the history of the firm (since 2009) and is the most sustained period.

One of the main advantages of our portfolio is that it contains diversified long investments and diversified shorts. Wins on one side of the book tend to occur at the same time as losses on the other side of the book and big balance sheet swings are mitigated.

Alas in the last few months (and particularly in December) this natural hedge has not been working. We have found ourselves losing money on both the longs and the shorts or making money on both the longs and the shorts. (Alas more often losing money on both sides of the book.) Given that there are over 20 longs and over 200 shorts this is *statistically unlikely*, but it was happening with monotonous regularity. In the period between Christmas and New Year's there was not a single day where our book actually hedged itself as intended. We made money on some days, lost money on others, but on every single day prices for our shorts and longs moved in opposite directions.

As "the hedges are not working" our only defense has been to shrink the book. Mostly this has happened on the short side (as it the "sold-to-retail" obvious shorts that are hurting most intensely).

We should not hide the horror of this. In shorting frauds, this is the sort disaster that sometimes befalls you:

- a.) You short a stock at \$10 run by a promoter who you suspect is a liar. You are (as nearly as possible) certain that this stock is worthless. You hope to cover at \$1.
- b.) The promoter makes up a story that somehow retail seems to think is real and the stock trades at \$40.
- c.) You are forced to buy some back – because there is no conceptual reason why the stock can't trade at \$80. After all it is no sillier at \$40 or \$80 than it was at \$10 (it was worth 100 percent less at all times).
- d.) After you cover the stock normally goes to \$1 (as you expected all along) though it might go through \$100 on the way.

This is actually a fairly common event for us. We manage well over 200 shorts with the specific goal of blunting the impact of any such individual disaster. And the diversity *normally* works.

In this retail-driven market this defense is not working. Almost all of our “sold to retail” stocks are going up simultaneously because the market is driven by the least sophisticated gamblers we have seen in markets in our professional lifetimes. So rather than shrinking one-or-two stocks (as per normal risk management practice for us) we have been forced to cut large numbers of shares across many sectors.

This means that collectively we have spent over USD100 million buying back stock we think is worthless. We are appalled.

But it is also the right thing to do. The market is irrational, but we need to remember the aphorism often attributed to Keynes: “the market can stay irrational longer than you can stay solvent”. Our first-and-foremost duty is to stay solvent. And that is what we are doing.

Our results are poor but measured in USD (and remember this is mostly a USD book) they are not threatening.

Bronte's strategy has not changed. But we act with extra caution: keeping positions small, watching our hedges carefully, and increasing our willingness to “duck and cover” when danger lurks. Meanwhile we are honing our list of garbage SPACs and other dross sold to retail. It is a target rich environment. One day—when the targets are not shooting back with such vehemence—we will short more aggressively. Till then we just wish to keep the book under control.

You, dear clients, however have a choice to make – and we will understand if you make it. Our recent results are not good; but we believe our future will be better, for this period too will end. However, perhaps you possibly know a young manager who has earned well over 100 percent this year. You might want to take your money there. It pains us to say this – but given our results we will understand if you do.

And maybe it will work. But it comes with a warning. Of the tens of millions of people who have come to the market in the past year or so and are up big, some will be great – but most will be this cycle's go-go victims. For them 80-95 percent losses beckon.

Be careful out there. And stay rational.

We will be.

The Bronte Team