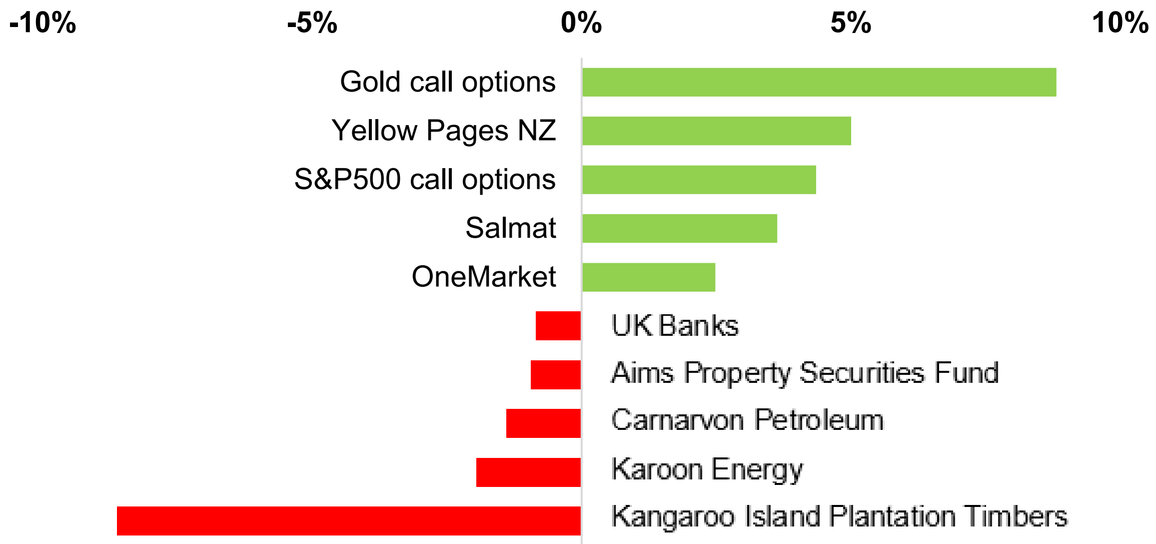
Dear Unitholders,

The Fund's results during the year are shown in the following table, which compares the Fund's return (pre-tax, net of fees[1]) to the Australian All Ords Index and the MSCI World Index:

To 30 June 2020	STAR F-units	All Ords	MSCI ($A)	STAR A-units
1 year	15.5%	-7.2%	2.9%	14.6%
3 years (%p.a.)	20.1%	5.4%	9.2%	18.6%
5 years (%p.a.)	22.4%	6.2%	8.3%	
7 years (%p.a.)	25.0%	7.7%	11.9%	
10 years (%p.a.)	24.6%	7.8%	11.3%	
Since inception on 1 Nov 2003 (%p.a.)	15.8%	8.1%	7.4%	

The Fund generated satisfactory returns, both in absolute terms and relative to world markets.

Top contributors to 2020 return[2]



2020's biggest wins were from call options over gold and the S&P500 Index which contributed approximately 9% and 4% respectively to returns. We explained our rationale for valuing and buying options in our 2018 letter (click here to view). Conveniently, our largest wins were in January, which meant we entered the COVID bear market in February and March with 33% of the Fund in cash. Since the COVID collapse, option prices have generally remained expensive; as a result we have owned almost no options since March.

Yellow Pages NZ generated cash flow in excess of our initial expectations and contributed 5% to returns. We purchased our interest in Yellow NZ in FY19 at advantageous prices from

[1] Please note that the returns for A Class Units and the Founder units are different as the Founder units in STAR have a different hurdle rate than the A Class Units.
[2] STAM Internal estimate of contribution to NAV return before fees.

motivated sellers. After acquiring control, we restructured the Board, management incentives and accountability. The company has already returned cash distributions significantly in excess of our investment. Yellow should continue to generate cash at a declining rate.

Profits from “wind-ups”, Salmat and OneMarket, also contributed meaningfully. In both cases our thesis that smart, aligned boards would allocate capital rationally and act in our interest was rewarded.

Our biggest loser was Kangaroo Island Plantation Timbers (KIPT) which cost almost 9% of the Fund. In January, bushfires damaged (to varying degrees) 95% of the trees owned by KIPT, which caused its share price to more than halve. As KIPT was close to entering production, the Fund lost the large upside from commencing production, meaning the actual loss from the fires was much greater than the reported 9%. KIPT’s outlook is uncertain, but it retains substantial asset value in land and cash. At year end KIPT was 4.6% of the Fund.

For several weeks during the COVID bear market much of the world’s assets were “on sale”. We took advantage and aggressively invested almost all of our cash in that period buying shares and distressed debt at prices much reduced from a few months earlier.

Cash and gold

We are often asked why we hold so much cash and gold. The main reason we hold a large cash position is we want to be prepared to “go shopping” when markets are next “on sale”. As interest rates on cash are close to zero, this means that our short-term returns may suffer by holding lots of cash. We regard this as a price worth paying to have the ability to “go shopping” when no one else is willing or able to do so. Cash has no downside risk, but large upside potential when tough times return.

But why gold? The main reason that many bond, share and property markets are expensive is that central banks around the world, including Australia, are printing enormous amounts of money, both to fund government deficits and to enable banks to lend money to support asset prices. So far, this has ameliorated the economic effects of the COVID virus, but we suspect it will eventually lead to inflation, higher interest rates and increased corporate bankruptcy.

Gold is the only money that central banks cannot print. If we are correct that inflation is coming, then the gold price could go higher, possibly a lot higher. Conversely, if we see a wave of corporate bankruptcies, which we regard as very possible, then gold could also go higher as it could be desired as a monetary asset which is not someone else’s liability.

Confessions of a “value” fund manager

The commercialisation of the internet over the last decade has spurred an industrial and technological revolution comparable to the roll-out of the steam engine. A resulting productivity boom has directed large future profits to innovators leading the commercialisation. Stock market participants have noted this shift and pre-empted future profits, resulting in amazing gains in the share prices of some technology companies.

We aren’t technologists, and don’t pretend to be capable of successfully investing your money in such ventures. We focus on investments we understand; those that offer downside protection with potential upside, or irrationally priced payoffs. As a result, our relative performance has suffered in recent years from not owning the most successful companies like Tesla, Amazon or Afterpay.

“Growth” (i.e. fast growing, but not statistically cheap) shares have substantially outperformed “value” (i.e. statistically cheap, but often slow growing) shares for most of the last ten years.

Momentum in stock markets is often self-reinforcing, until it is not. The rise of passive investing has been accompanied by a wave of indiscriminate buyers who have exaggerated this momentum. As a result, many “growth” companies now trade at very high prices which imply aggressive growth and profit into perpetuity.

Momentum self-reinforcement tends to work both ways in stock markets. As a result of underperformance for a decade, many “value” fund managers are losing clients, and some of those firms are closing down. These actions have forced those managers to sell some or all of their holdings, reinforcing their underperformance.

The gap in valuation between the two classes has widened to record levels. To put that another way, the premium you pay for a high-quality fast-growing company, rather than a laggard is now as high as it has ever been, even more than at the height of the dot-com boom at the turn of the century. The collapse of that boom led to several years of great performance by “value” fund managers at the beginning of this century.

We are hearing many stories of investors, both professional and amateur, making large, easy profits in technology and other speculative shares. We are reminded of earlier booms like 1987 and 1999, neither of which ended well.

We believe that “value” shares are likely to have a brighter future than their recent past and expect to benefit from this change when it eventually occurs.

Re-opening and optimal size of the fund

In October 2019, we re-opened the Fund to new investors before closing the Fund again in December. During the COVID bear market we decided to re-open the Fund as there were opportunities to invest money at attractive prices.

Our Fund now has almost A$300m of assets. That size precludes us from viably trading in some of the small, illiquid positions in which we have previously made money. On the other hand, our larger size opens new opportunities that were not previously accessible to us. These include:

- Buying distressed bank debt
- Taking control of companies, as we did with the NZ Yellow Pages
- Buying over-the-counter options and other similar instruments

We have a track record of making money in large companies as well as small ones. Furthermore, the increased size of our team enables us to manage more money than we did a few years ago.

How we see our role

We want unitholders to understand how we manage your capital. When thinking about the assets we hold in the Fund, we do not think of ourselves as running a traditional fund, but as running a family office with a long-term investment horizon.

We think of our employer as highly averse to any risk that could severely reduce their net worth. They are rational risk takers, smart enough to accept moderate losses on individual bets, provided the odds on the bet are highly advantageous. Our employer is also willing to have a large proportion of their net worth in one security, provided the downside is tiny and the upside large. They will accept a bumpier ride, provided that overall, it is likely to make them a lot richer.

We do not see ourselves as takeover raiders, but if the opportunity arises to buy control of a company on incredibly attractive terms, we are open to having a large proportion of the Fund in such an asset.

Our views on these matters are significantly influenced by the fact that we all continue to have a high proportion of our own net worth invested in the Fund. Unlike many fund managers, our interests are aligned with our unitholders.

Outlook

The COVID crash enabled us to buy new positions at cheap prices. Although we are still finding attractive investments, we are happy and willing to hold cash in anticipation of opportunities some time in the future. This “cash drag” may cause us to underperform if stock markets continue to rise.

We are comfortable with the current portfolio and optimistic about our continued ability to generate attractive returns.

We thank you for your continuing support.

Fred Woollard, Nigel Burgess and Mitch Taylor.

30 October 2020