JOHANNESBURG • LONDON • EMERGING MARKETS HEDGE FUNDS

CAPRICORN
FUND MANAGERS

REVIEW OF 2014

15 JANUARY 2015

Dear Investor

As we enter 2015, we review a past year of satisfying performance in a challenging environment for active money managers. The market presented a tale of two halves, with strong performance in the first half followed by weak and volatile moves in the second. This volatility was largely driven by ever changing expectations around interest rates and growth as well as massive movements in commodity prices, which we believe are set to continue. Given this dynamic, we have successfully navigated the markets in the past year and we are well positioned for the year ahead.

SATISFYING PERFORMANCE IN A DIFFICULT ENVIRONMENT:

THE HOLLARD STABLE STRATEGY (HSS)

Returned 8.5% in ZAR. HSS is now in its eleventh year of existence with positive returns for every calendar year since inception, while still returning in excess of 16% pa on average. With conservatism at its core, HSS has only recorded five negative months in the past 36 months.

THE CAPRICORN PERFORMER FUND (CPF)

Returned 11.9% in ZAR, marginally exceeding the return of the JSE All Share Index (on a total return basis) for the period. CPF looks to benefit from the same themes as HSS but with a more aggressive exposure strategy.

(for the 12 months ended 31 December 2014)

THE CAPRICORN GEM FUND (GEM)

Returned 9.2% in USD, significantly outperforming the MSCI Emerging Market Index for the year, which was down 3.9% on a total return basis. This performance is extremely pleasing given that the Fund was once again able to avoid the draw down in emerging markets.

THE CAPRICORN MARKET NEUTRAL FUND (CMN)

Returned 10.4% in ZAR for the year. After a stellar 2013 the CMN Fund consolidated well and yielded another double digit performance number. The Fund had a challenging first half of the year, but performed strongly in the second half. The Fund continues to provide its investors with strong returns at very low correlation to the general equity market.

Note:

The Hollard Stable Strategy comprises Silver Cluster Loan Stock Company (Pty) Ltd, The BlueInk Vesting Trust No 37, CFS Stable Trust and Novare Capricorn Hollard Stable Hedge Fund and these make up the strategy. Capricorn Performer Fund consists of the Capricorn Performer Partnership. The Capricorn GEM Fund comprises the Capricorn GEM Fund LP and Capricorn GEM Fund Inc. Capricorn Market Neutral Fund comprises Imalivest Quantitative Investments (Pty) Ltd and Ancilla Capital (Pty) Ltd.

MAIN DRIVERS

In our view, the primary drivers of the market in 2014 were:

i. **A slow but consistent recovery in the US Economy, the most obvious result being the significant strengthening of the US Dollar.**

ii. **The rapid decline in the price of almost all commodities, most notably iron ore and oil. For the first time in many years, the driver of these declines is a supply side reaction rather than a demand side issue.**

iii. **Non-existent growth in Europe with yet another Greek crisis.**

iv. **Geopolitical tensions continue to rise in many places around the world. This was most notable in Russia and Ukraine. The significant movements in commodities, currencies and interest rates added to these tensions.**

INVESTMENT STRATEGY AND MARKET ANALYSIS

Our strategy remains one of thematic investing by identifying transformative themes in everything from countries to companies. We look to single out companies that are in a bull market or have the potential to have explosive growth in their chosen space, whilst the opposite applies for shorts.

From the outset of 2014, we were moderately bullish given the increasing number of tailwinds in the global economy. The most notable being the continued recovery in the USA; the possible recovery in the Japanese markets led by a weaker yen; the stabilisation of the European countries albeit at a much lower rate and finally the somewhat soft landing in China driven by the motivation to shift its economy in the direction of being more domestically driven.

The key event at the forefront of investors' minds this year was the expected normalisation of interest rates in the USA, which we did not subscribe to due to the cautious nature of the Federal Reserve. Interest rates continue to be at historic lows and in our opinion these rates are likely to remain low for the medium term. This strategy is being led by the bigger economic blocks, being China, USA, Europe and Japan, which together make up over 80% of global GDP. There is a change in the trend of inflation and we believe normalisation will not take place in the manner it traditionally has.

Our top performing South African positions (Naspers, Steinhoff, Aspen and Brait) continued to play out their positive stories from 2013. In addition, performance was generated from several other positions that we have been building on more recently, including Reinet, Investec, Rockcastle and Netcare. Our long-book in South Africa continues to remain invested in best-of-breed operators that have been able to internationalise their businesses whilst reducing exposure to South Africa. On the short side of our book, returns were delivered from the resource and resource related stocks in our universe.

Our GEMS book shifted away from a natural long in the South African market to larger positions in markets outside South Africa. This transition was structural and bottom up in nature and will become more pronounced over time. We were satisfied that our investment methodology was able to capture the uptick in the MSCI EM universe given that emerging markets experienced another down year in 2014. Included in our top contributors are longs in Kalbe Farma (Indonesia), Turkcell (Turkey), DNL (Philippines), Raia Drogasil (Brazil) as well as various short positions in Russia and resource companies.

The defining feature for us in 2014 was the long held view that the commodity supercycle was going to challenge those dependent on commodity exports. We had built in very large shorts across this space with as many as ten Russian shorts at one point along with notable shorts in Brazil and South Africa.

OUTLOOK

In light of the stimulative efforts of almost every central bank, conditions are very good for risk assets to re-price upward with the potential of even over-heating in certain instances. However, we are confident that the areas standing to benefit will be even more nuanced than 2014 as "the tide fails to lift all ships". We are very bullish on Turkey, Indonesia and the Philippines with the latter, at the time of writing, having just issued 25 year government paper yielding below 4%. Many emerging markets will look to take advantage of these unprecedented low interest rates, which previously were not available to them. Even on a company specific level the notion of tapping international debt markets, and returning to home territories in order to achieve the higher returns on equity and returns on capital has the potential to be a global theme for 2015.

Key themes that are currently being expressed in our book include:

I. **The sharp decline in iron ore and oil has confirmed our long-held view that the supercycle is over. The counterbalance to this is that significant opportunities are being opened up because of these price declines, and many jurisdictions that we are traditionally active in should benefit. We will look to capitalise on this expectation.**
II. **We continue to favour emerging market consumer plays with strong franchises. The positive trend that this represents will be captured by these businesses and the growth potential in this space remains very exciting.**
III. **Domestically South Africa faces many structural challenges that the government needs to address. Whilst reform is much needed the dramatic fall in the oil price provides some respite for now.**
IV. **We continue to own and look for more exposure to scalable businesses in the emerging world, particularly those with a digital base. A key performer was once again Naspers and 2014 represented a year where the rest of the business ex-Tencent blossomed. Our single position in the Malaysian market was MYEG. This bears many resemblances to the other digital platform business models we are invested in. The risks were high and Malaysia itself is a nuanced jurisdiction due to higher than normal levels of investor scepticism. On a purely bottom up basis and having met with management many times we built up a sizeable position during 2014. This investment could prove to be one of the great Capricorn success stories over the next ten years.**
V. **The healthcare sector within emerging markets remains a key focus for us. We had several positions in this space, from South Africa to Brazil as well as Russia. We managed to capture significant upside in Brazil through Raia Drogasil which rallied over 60% in the year. Our multi-year holding in South Africa's Aspen delivered 40%. As wealth levels increase in emerging markets these services cannot be provided for by the state unlike in developed markets and this provides opportunities for the private sector to capitalise on.**
VI. **The world is awash with liquidity and whilst the US was tapering, this was more than offset by an expansion in easing from both the ECB and BOJ. We believe that the Federal Reserve will remain accommodative relative to the US Economy.**

South Africa is poised for an interesting year. Urgent reform is required to address the structural problems that it faces but the drop in oil has provided a lifeline. All things being equal, we expect the South African economy will be one of the biggest beneficiaries of a lower oil price and this should provide significant relief for the consumer. Owing to the drop in the oil price and the relatively stable Rand, inflation expectations have been significantly pared, with the effect of reducing the risk of interest rate hikes this year almost completely, further supporting the consumer. The critical issues of electricity generation and labour relations, specifically the public sector wage negotiations, will be key to how the year progresses. We expect much lower disruption in the private sector from labour this year and this should deliver better operating performances for many companies. Unfortunately, for the resource industry, prices have collapsed and as a result, earnings are unlikely to recover this year. In order to avoid a downgrade by ratings agencies the South African government will have to deliver in terms of long-awaited reforms. The most likely to

OUTLOOK 2015 CONTINUED

be relevant in 2015 will be the privatisation of state assets as well as rationalisation of portfolio assets, which includes numerous listed companies. We still favour companies that have offshore exposure or are less dependent on GDP growth to deliver earnings. As a consequence we have reduced our short exposure in the South African consumer space. The situation is very dynamic and fast moving and will require active management.

Our structural outlook on Indonesia remains very positive and is enhanced by the rapid series of reforms already passed in the intitial months of President Jokowi's presidency. The de facto removal of the fuel subsidy is one of the most significant moves, if not the most significant of the post Suharto era. This allows the budget for infrastructure to double from one year to the next as the new regime looks to boost growth rates from 5% to 7% through a series of structural reforms. We remain convinced that Indonesia will become one of the darlings of the emerging markets as President Jokowi continues to surprise on the upside with his determination to root out corruption and implement structural reform. Our recent trip to the country highlighted a number of new investment ideas and exciting companies to invest in and we have increased exposure as a result.

The Philippines benefits greatly from the fall in the oil price in terms of the effect on GDP. We are the most bullish we have been on this country and have rotated our stock selection somewhat as well as increased our exposure to reflect this. The consumer space particularly is looking very attractive and we will continue to look for further Capricorn style companies that fit our views. President Aquino's term runs to 2016 and this year will be his last full year pre this handover. The political year will be punctuated by some jostling to see who succeeds him as president.

Turkey has seen a remarkable turnaround. Immediate political uncertainty has been somewhat alleviated by President Erdogan's purge of opponents and his victory in the 2014 Presidential election. However the general election in June 2015 is the next big landmark in Turkey. With the collapse in the oil price benefiting the economy greatly, it seems that Mr Erdogan and the AKP will have an excellent chance of maintaining power. However in Turkey, as history tells us, political complacency is dangerous and with the Kurdish peace process and a number of other variables as yet still unresolved, a lot can still happen. Economically as the oil price falls and inflation comes down off an already high base, it is the domestic space that looks attractive again and we have already adjusted our book to reflect this.

We believe that Russia will enter a deep recession in 2015. We remain of the view that until major changes are seen across the spectrum, Russia will remain a very difficult place to invest. The plunge in the oil price will affect no major market more than Russia and we expect further political manoeuvring from President Putin. That being said, 2015 is likely to bring major opportunities from a trading perspective following the enormous moves in stock prices seen last year. As always we will look to capitalize on these moves.

We remain negative on Brazil following the 2014 election. With the fall in commodities, Brazil is in a similar position to South Africa in that reform is desperately needed but the incumbent leaders are unlikely to rise to the task.

We are not in the camp of those who believe the collapse in the oil price will bring an end to the Mexican dream. Real progress has been made and despite some short term political volatility on the domestic front, we believe Mexico is beginning a multi-year period of higher economic growth, driven by structural reform and also the high level of interlinkage with the very strong US economy. We have two investments in the Mexican market, both high growth domestically levered companies – one in the airports space and one in the hotels and leisure category. These are newer investments and we are excited about their prospects.

THANK YOU

We would like to express our gratitude and appreciation to all our investors and stakeholders for all your support and trust over the past year. We believe our current suite of funds offer an optimal choice for capital preservation, capital appreciation and geographical diversification. We are committed to continue investing in our people, processes and systems and to maintain our top quartile performance.

SUMMARY OF CAPRICORN FUNDS:

EMERGING MARKETS EQUITY LONG/SHORT

CAPRICORN GEM FUND

US Dollar denominated (with USD, GBP and EUR share classes), moderate risk, equity long/short hedge fund, which aims to achieve superior risk-adjusted returns on an absolute basis by investing in Global Emerging Markets.

Launch date	Return 2014	CAGR since inception	Annual monthly volatility *(historic)*	AUM 31/12/14	AUM 31/12/13
MARCH 2008	9.2%	11.6%	7.5%	USD 157m	USD 132m

SOUTH AFRICAN EQUITY LONG/SHORT

HOLLARD STABLE STRATEGY

A Rand denominated South African long/short equity hedge fund. The fund has a strong focus on capital preservation, targeting an absolute return in excess of cash. The conservative, counter-cyclical nature of the fund could result in underperformance during equity bull markets, whilst outperforming in equity bear markets.

Launch date	Return 2014	CAGR since inception	Annual monthly volatility *(historic)*	AUM 31/12/14	AUM 31/12/13
JULY 2003	8.5%	16.0%	6.0%	R1,404m	R 1,245m

CAPRICORN PERFORMER PARTNERSHIP

A Rand denominated South African long/short equity hedge fund. The fund has a strong focus on long term capital appreciation, targeting an absolute return in excess of cash. The fund aims to provide returns with lower volatility and lower drawdowns than equities.

Launch date	Return 2014	CAGR since inception	Annual monthly volatility *(historic)*	AUM 31/12/14	AUM 31/12/13
AUGUST 2012	11.9%	30.3%	11.7%	R 329m	R 206m

SOUTH AFRICAN MARKET NEUTRAL

CAPRICORN MARKET NEUTRAL FUND

A Rand denominated, low risk, market neutral hedge fund that employs multiple investment methodologies to construct a portfolio. It aims to deliver superior risk adjusted returns that are uncorrelated to the general market over any 12 month period by investing in JSE listed equity instruments.

Launch date	Return 2014	CAGR since inception	Annual monthly volatility *(historic)*	AUM 31/12/14	AUM 31/12/13
APRIL 2006	10.4%	11.5%	6.4%	R 187m	R 150m

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