Dear Unitholders,

The Fund generated a satisfactory return during the year as you can see in the following table, which compares the Fund's return (net of fees) to the Australian All Ords Index and the MSCI World Index.

To 30 June 2016	**STAR**	**All Ords**	**MSCI ($A)**
1 year	35.1%	2.0%	-0.6%
3 years (%p.a.)	32.8%	8.2%	13.5%
5 years (%p.a.)	26.0%	7.3%	13.4%
Since inception on 1 Nov 2003 (%p.a.)	14.7%	8.4%	6.4%

The Fund had several big winners. These included:

- Infigen Energy - up 215%
- Kangaroo Island Plantation Timbers - up 116%
- Saracen Minerals – up 70% (until we sold it. Saracen more than doubled after we sold it. Sigh…)
- Macquarie Atlas Roads - up 69%
- Sberbank - up 67%
- Astro Japan Property – up 46%
- South32 – up 33%

Our biggest losers were Co-Operative Bank which fell 86% and call options on the S&P 500 Index which expired worthless. Each of these reduced the Fund's performance for the year by about 2%.

Kangaroo Island Plantation Timbers Ltd (KPT)

The Fund has been an investor in KPT for over ten years. Until 2013, it was a cause of much angst and substantial losses. After we pushed through a recapitalisation in 2013 (that narrowly averted bankruptcy), and a change of management, KPT has made wonderful progress.

We were delighted when KPT agreed to purchase New Forests' Kangaroo Island timber plantations for $55m on 21st October 2016. This transaction, which the Fund supported with a short-term loan, makes it virtually certain that KPT will be able to turn its substantial land and timber assets into a source of sustainable revenue and profits. Quite rightly, this transaction caused KPT's share price to rise rapidly. Since early 2013, KPT's share price has risen from $1.50 to $28.

This has created a problem of sorts for the Fund, in that our weighting in KPT was 34% on 30 June 2016 and is now 36%. These numbers are well above our preferred maximum weighting in any company of 10%.

We are acutely aware of this problem, but as the Fund owns 41% of KPT, it is not possible to easily sell enough shares on the share market to reduce our weighting to less than 10%. In addition, as we have a high regard for KPT's board and management and are optimistic about the company's prospects, we feel no urgency to reduce the Fund's holding.

This is a matter that we have discussed at length many times internally and are continuing to monitor.

Macroeconomic views

We have generally been cautious in recent years, believing that most major world markets are in the second half of a major bull market that started in early 2009.

We are particularly worried that the 35 year global bull market in US government bonds is close to its end. [1] Interest rates have been forced to ridiculously low levels by central banks, which has caused prices of most equities, property and government bonds to rise to unusually high levels. Unfortunately, the policies of "quantitative easing" and low or negative interest rates have not caused the desired boost to business capital spending and increased employment, especially in Europe. What they have caused is financial problems for many investors, not just individuals, but also banks, pension funds and insurance companies. These problems have, to some extent, offset the expected benefits from low interest rates and monetary easing.

Bond yields, especially the $10 trillion of bonds with negative yields, are unsustainable and will eventually rise, possibly sharply. *When* this occurs, we expect to see some turmoil in markets, and opportunities for the Fund to invest on attractive terms. Rising global interest rates would be particularly damaging for Australia's economy and property markets.

This is one reason we hold so much cash. About 35% of the Fund is now in cash[2]. We perceive cash in the current environment as a low risk, but potentially high-return asset. In difficult market conditions, it gives us the opportunities to earn high returns, while exposing us to now downside risk.

Our attitude to risk is summarised in the following paragraph, which has appeared in previous annual letters.

Because we do not have the ability to accurately predict economic and market conditions, we aim to diversify in a way that can be expected to do reasonably well across the widest possible number of potential scenarios. This requires that our strategy is able to overcome not only occasional bear markets and dislocations, but all of the other hurdles that are endemic to active investment management. The list includes bad luck, bad timing, and occasional mistakes in judgment. Most importantly, any truly robust long-term investing strategy must be built to survive the worst possible scenarios the market can throw at us and allow us to live to play another day. If we do this, we are unlikely to be the best performers in any given year, but we do have a good chance of continuing to generate satisfactory overall returns.

The Fund's robustness is assisted by our longstanding policy of having the majority of the Fund in cash, or in securities which themselves have net cash on the issuer's balance sheet. During the year, an average of 17% of the Fund was in cash and at year-end, 25% of the Fund was in cash. In addition, at year-end, 61% of the Fund was in companies which had net cash. As we both have large personal stakes in the Fund, this policy helps us to sleep soundly.

Outlook for the Fund

The current financial year has started well, with the Fund up about 20%. While we remain optimistic about the Fund's longer term outlook, we warn you to expect lower returns from us, and many of our competitors, in the future than in the past. This is because we are finding it harder to find new attractive investments as well as our pessimistic outlook for most asset classes.

Finally, if you know of someone whom you think would benefit from investing in the Fund, please don't hesitate to give them our contact details.

Yours sincerely,

Fred Woollard and Nigel Burgess (31 October 2016)

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[1] Our non-financial readers may want this sentence translated. Global interest rates have, in general, been declining for the last 35 years. We fear that this trend may have already ended, or will soon end.

[2] This includes our holdings in Asset Resolution and Hamilton Securities, both of which invest mostly in cash.