Dear Unitholders,

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

To 30 June 2019	STAR	All Ords	MSCI ($A)
1 year	10.7%	11.0%	9.8%
3 years (%p.a.)	20.7%	12.6%	13.4%
5 years (%p.a.)	25.8%	9.0%	12.3%
7 years (%p.a.)	25.5%	11.8%	15.8%
10 years (%p.a.)	25.3%	10.0%	11.8%
Since inception on 1 Nov 2003 (%p.a.)	15.9%	9.2%	7.7%

The Fund's 10.7% return narrowly beat our 10% target, but underperformed the Australian market. Our biggest loser was technology start-up, OneMarket, which fell 41%.

We lost a total of $2.8m, or about 2.2% of the Fund, on options trades. For the reasons discussed in last year's annual letter, we like buying cheap options, despite the fact that sometimes we lose money from that activity.

Our performance suffered from having over 20% in Kangaroo Island Plantation Timbers, which rose 4% during the year, and having an average of 14% in cash, whose yield shrivelled to about 1%. We still like both of these assets.

It was not all bad. Our biggest winners were Spicers (up 89%), Carnarvon Petroleum (up 300%) and Dubber Corporation (up 219%).

During the year, we bought 82% of Yellow Holdings, publisher of the New Zealand Yellow Pages. Like other yellow pages businesses around the world, Yellow's revenues and profits are falling fast, but we believe that the price we paid more than compensates for the poor outlook. Some of our unitholders have asked if the Yellow purchase indicates that we are changing into a private-equity firm, buying control of operating businesses. Our answer is that our strong preference is to continue investing in passive, preferably listed equities and debt securities. We are open to buying control of operating businesses, but only if the deal makes sense financially and we have the right people to oversee the business. We are confident that Yellow satisfies those tests and expect satisfactory results from it.

Conversion to a stapled trust

The Fund had its first formal unitholders' meeting on 24th June 2019. 41% of unitholders were present or represented at the meeting, which voted unanimously to convert the Fund into a stapled trust, comprising the original Samuel Terry Absolute Return Fund, and the new Samuel Terry Absolute Return Active Fund. The Fund's accounts cover both of the stapled trusts, treating them as if they were one entity.

The reason for the conversion to a stapled trust was to remove the tax issues created by the Fund's acquisition of a majority stake in Yellow Holdings, an operating business. It also allows us to buy control of other operating businesses in the future.

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[1] Please note that the returns for A Class Units and the Founder units may be different as the Founder units in STAR have a different hurdle rate than the A Class Units.

Macroeconomic views

We remain cautious about global markets and economies. Low interest rates and easy monetary conditions in many countries have caused the prices of many assets, especially fixed income, to trade at levels which we do not regard as sustainable in the long term.

Globally, there is over $US 12 trillion of negative yielding debt, meaning that you are guaranteed to lose money if you buy those bonds and hold them to maturity. Even Greece has been able to issue debt at a negative yield, a few years after it defaulted on its debts!

Low interest rates are affecting equity and property markets in many countries. Speculative technology companies in the USA and Australia often trade at prices which make no sense to old fashioned value investors like us. The highest profile example of this was the recent attempted IPO of WeWork at a valuation of $US 45bn, despite WeWork's poor corporate governance, enormous losses and lack of any obvious path to profitability.

In addition to high asset prices, we worry about vulnerabilities in market structures that could cause large falls in market prices triggering a feedback loop of further selling in a vicious circle. These include:

- High levels of margin lending, not just to buy shares, but also property and debt securities. Lower prices cause lenders to force some borrowers to sell.
- Exchange traded funds (ETFs) which invest in illiquid asset classes like junk bonds and bank loans that promise instant liquidity, but where the underlying assets can be very difficult to sell in a bad market. Once investors see that the apparent liquidity was a mirage, and that they have lost a lot of money in what was purported to be a safe asset, many will sell quickly. We suspect that some folk have borrowed money to buy such ETF's, and might be forced to join the rush of sellers.
- Falling prices of junk bonds and bank loans mean higher interest rates for lower quality corporate borrowers, some of whom might find it impossible to fund themselves. Corporate bankruptcies will worsen sentiment further.
- Large institutional investors have been increasingly investing in volatility targeting and "risk parity" investment strategies. These strategies necessarily increase leverage when volatility is low and times are rosy; and become forced sellers as volatility rises. While these investment strategies make sense in theory, there is so much capital invested that their inevitable periods of deleveraging could move asset prices, spurring more volatility and more deleveraging.
- Some banks, especially in Europe, have weak balance sheets. In a bad environment, they will require assistance from their home government, but several European states (eg Italy) already have unsustainably large debts and deficits and may struggle to help their banking system. To add to the problem, those troubled banks often hold large amounts of their own government's debt, which they might be forced to sell at the same time as their government needs to raise urgent funds to support their banks.
- The United States is running a very large federal government deficit ($US 984bn in the year to 30 September 2019) despite strong economic growth and low interest rates. Unless the US takes action during the good times to reduce its deficit, then the next US recession could push the deficit to record levels. If deficits are left unchecked, and there is little political will at present to reduce them, eventually the United States will enter a spiral of rising interest rates and deficits. We don't think this is imminent, but it is a plausible scenario within a decade.

We are not predicting a crash anytime soon, but the above risks are real. We are aiming to position ourselves for difficult times ahead, believing that the best time to panic is when the outlook is bright. Hence, we are comfortable with the 40% (approx.) cash weighing the fund will have following the current capital raise.

Part of the appeal of a high cash weighting is its unpopularity. A newspaper headline summed up what we suspect many people believe:

"Even the best financial advisers no longer recommend holding cash as an investment. With official cash rates below 1%, cash in the bank as an investment choice is dead."[2]

As well as increasing our cash, we continue our policy of having the majority of our equity portfolio in companies which themselves have either net cash or strong balance sheets.

We remain keen to own a variety of options, provided we can buy them at attractive prices. We are looking at ways of investing part of our cash in gold.

Ethical constraints

During the year, we formalised a previously informal policy of not investing in businesses primarily engaged in the following activities:

- Thermal coal (i.e. coal for electricity production – coal for steel is not excluded)
- Tobacco
- Gambling
- Lending to poor people at very high interest rates

We recognise that this policy will not please everyone. Some say that it is not our job as fund managers to make moral judgements with your money. Others say that we should exclude other sectors such as oil production. However, this is the basis upon which we have been investing for some time, so we believe it is time to articulate our policy.

Outlook

Despite generally high asset prices, we are still finding new attractive investments. We recently invested 5% of the fund in AMP and are looking at various opportunities, including another large well-known company.

While we don't expect the next few years will be as kind to our unitholders as the last decade, we remain optimistic about our continued ability to generate attractive returns.

We thank you for your continuing support.

Fred Woollard, Nigel Burgess and Mitch Taylor

31 October 2019

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[2] This was on the front page of "The Australian", a newspaper popular with old, wealthy Australians, on 2nd October 2019.