

October 3, 2013

Dear Partner,

As of calendar quarter close, September 30, 2013, the net asset value for initial Founding Partners grew by 9.76% since Fund inception on May 1, 2013. This compares to the 6.26% gain of the S&P 500 total return over the same period. For the quarter, the Fund was up 11.16% as compared to 5.25% for the S&P. Thus, our relative outperformance to the S&P 500 year-to-date<sup>1</sup> is +55.9%, while during the quarter Stedman more than doubled the S&P's performance.

<b>Stedman Capital Fund Outperformance</b>				
	<b>Stedman</b>	<b>S&amp;P 500</b>	<b>Difference</b>	<b>% Difference</b>
Year to date <sup>o</sup>	9.76%	6.26%	3.50%	55.9%
Latest quarter	11.16%	5.25%	5.91%	112.6%

<sup>o</sup>As from Fund inception on May 1, 2013

Our results in the quarter were significantly better than our market benchmark. However, this is a short-term result, and over the longer term even modest outperformance can generate significant gains. To help illustrate this important fact, the table below shows the divergent potential of a single, one-time investment of \$100,000 compounding at different rates. The single point of this quarterly investor letter is to highlight how even small differences can have dramatic impacts on wealth creation. As legend attributes to Albert Einstein: "The most powerful force in the universe is compounding interest."

<b>Illustration of Compound Interest</b>				
<i>If \$100,000 is initially invested with the following annual compounding rates of return,</i>				
	<b>2%</b>	<b>4%</b>	<b>10%</b>	<b>12%</b>
After 3 years	\$106,121	\$112,486	\$133,100	\$140,493
After 5 years	\$110,408	\$121,665	\$161,051	\$176,234
After 10 years	\$121,899	\$148,024	\$259,374	\$310,585

It is obvious to see that total nominal gains dramatically diverge between lower and higher rates of return. For example, after 10 years, a 2% compounding return would deliver a 21.9% nominal gain on the original investment, while a 12% compounding return would have delivered a 210.6% total nominal gain! Outsized returns deliver outsized gains.

More interestingly, perhaps, is to consider the divergence where the absolute difference in rates of return between two scenarios is more modest. The first two columns share a 2% absolute difference in their rates of return (4% - 2% = 2%). The last two columns do too (12% - 10% = 2%). Comparing the returns *within* these sets show the effects of compounding where 'outperformance' by only 2% in absolute terms applies.

If we pretend that Stedman is the outperformer to the market in these scenarios, then this apparently modest 2% difference provides significantly greater wealth creation. At the lower set, Stedman would have delivered a 48% nominal

<sup>1</sup> Year-to-date in this case means from Fund inception on May 1, 2013.

return over 10 years compared to the market 21.9%. In other words, Stedman would have more than doubled the \$21,899 in wealth created by merely matching the market. This level of ultimate differentiation is not so surprising, however, given that 4% is 100% greater than 2%. Still, it is powerful to note that such a large amount of relative nominal wealth can occur at low rates of return and when only 2% is the absolute difference.

The second set is even more compelling. Here 2% again separates Stedman's hypothetical 12% from the market's 10%. Unlike the previous example, however, this is not a 100% outperformance, 'merely' a 20% one. Nevertheless, the higher absolute rate compounds to build wealth faster. By the end of 10 years Stedman would have built an additional \$210,585 on top of the original \$100,000. Impressively, while only 2% more annually than the market's 10% return, the net amount of *additional* wealth as compared to matching the market would be just over \$50,000 more - i.e., over 50% of the original capital investment. This is the power of compounding. It is why outperforming our market benchmark - even by a little - remains important for Stedman as a long-term objective.

Stedman seeks to maximize compounding benefits to our partners in many ways. We endeavor to minimize transaction costs and to leave holdings alone to grow. We keep dividends and gains in the Fund to reinvest. We only calculate performance fees on retained capital annually versus monthly, quarterly or semi-annually as some funds do. When performance fees are earned, they are computed only against inflation-adjusted or real returns. These are several important ways that compounding redounds to the benefit of our investors over time.

### *Take the Long View*

We are gratified that Stedman Capital Fund's returns are favorable to date. However, investors should guard against short-termism. Stedman is focused on outperformance over the long term. The current investing environment remains challenging - featuring unprecedented monetary policy globally, relatively richly valued markets thru September and highly polarized politics impacting fiscal policy in the United States.

Wealth is a relative phenomenon. It is a mathematical certainty that *if the amount one invests is relatively more than average, and the rate of return on that capital is relatively higher than average, then one will become (or will remain) wealthy.* By investing in Stedman all partners provide at least a minimum capital requirement larger than the average liquid savings of most Americans. With this capital, Stedman endeavors to achieve above average market returns at conservative market risk levels. When we do so, the result - compounding over time - will be significant wealth creation for our investing partners.

Until next time, wishing you a joyful autumn holiday season and many compounding returns.

Yours very truly,



Gilbert Shaw  
Stedman Capital Management