Firetrail Absolute Return Fund

MARCH 2019

ABOUT FIRETRAIL

Firetrail is an investment management boutique which is majority owned by the Firetrail investment team. Additionally, the investment team is invested alongside clients in the investment strategies.

ABSOLUTE RETURN FUND

The Absolute Return Fund ("Fund") is a market neutral strategy with minimal correlation to equity market direction. It aims to generate positive returns in all market environments. The strategy is built on fundamental, deep dive research guided by the philosophy that 'every company has a price'.

INVESTMENT OBJECTIVE

The Fund aims to outperform the RBA cash rate over the medium to long term.

FUND PERFORMANCE TO 31 MARCH 2019

	Net Fund	Benchmark	Net Excess
1 Month (%)	(0.02)	0.13	(0.15)
3 Months (%)	0.42	0.37	0.05
1 Year (%)	(3.47)	1.50	(4.97)
Inception (% p.a.)	(2.74)	1.50	(4.24)

Net Fund returns are in AUD terms. Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. Past performance is for illustrative purposes only and is not indicative of future performance.

FUND DETAILS

Unit prices	29 March 2019
Application price	$0.9754
Redemption price	$0.9657
NAV price	$0.9705

Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	$210m
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance

*Please read the Product Disclosure Statement for more details

PORTFOLIO POSITIONING 31 MARCH 2019

Top 3 Overweight Holdings (Alphabetical)
Amcor Ltd
Woolworths Group Ltd
WorleyParsons Ltd

FUND EXPOSURE 31 MARCH 2019

	Portfolio Exposure
Long Equity	151%
Short Equity	151%
Net Equity Exposure	0%

PORTFOLIO COMMENTARY

The Fund returned (0.02%) for the month ending 31 March 2019, underperforming the RBA cash rate by 0.15%. Over the quarter, the Fund returned 0.42%, outperforming the RBA cash rate by 0.05%.

Positive contributors during the month were the fundamental short positions and small company long positions. Mid to large cap long positions were a negative contributor.

We continued to see aggregate earnings forecasts for Australian companies decline over March, which are continuing to create significant opportunities for fundamental shorts. However, the equity market itself continues to rise, with the ASX200 Accumulation Index up 0.7% during March, solidifying the 10.9% rise in this index so far this calendar year.

Global equity markets have been continuing to rise as interest rate expectations fall. Intuitively this is due to two reasons:

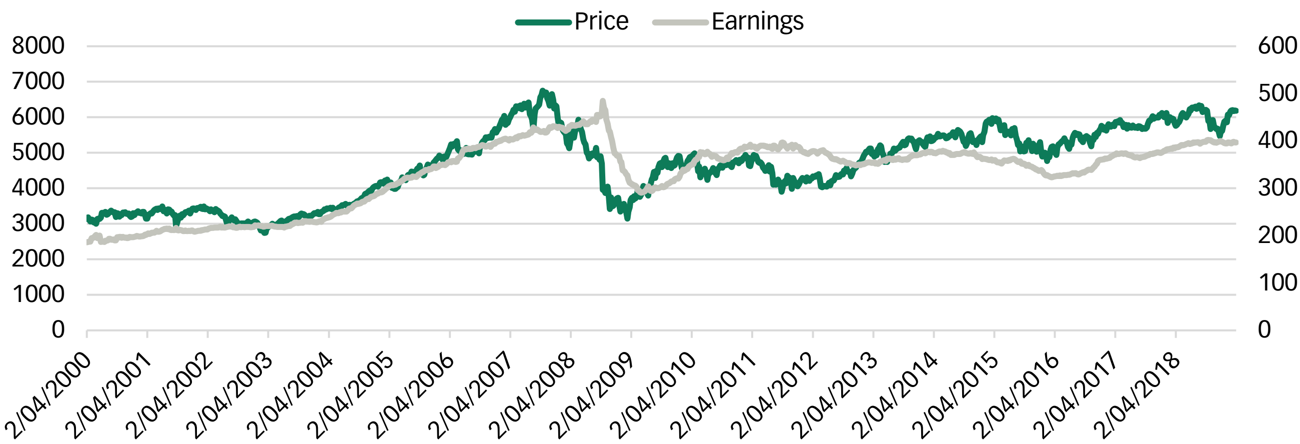
1) the first order impact of being able to put through lower discount rates in stock valuations; and

2) investors hunting for income moving away from lower yields in the bond market to dividends in the equity market.

From a fundamental perspective, rate expectations have been lowered due to economic conditions deteriorating, impacting the operating conditions of many of the companies we invest in. However, in the short-term markets have risen significantly largely due to lower rates. However, investors should note that over the long-term the most considerable driver of capital appreciation (or depreciation!) in equity markets is changes in earnings (positive or negative), as opposed to changes in valuation ratios.

To illustrate this, the chart below shows the ASX200 over the past 20 years, plotted beside the one-year forward earnings estimates for the market. Earnings have nearly doubled, and so has the market – a nice correlation. Throughout market cycles valuation ratios will move up and down, but it is the earnings that will be the big differentiator over the long term. Over time the best winners for our portfolio, on both the long and the short side, have been where we have predicted a significant change in earnings for a company. In our view, is the best way to predict these changes in earnings is through deep fundamental research.

ASX200
Index level (LHS) and Earnings Estimates (RHS)



Top contributors for the month

Rio Tinto was a key contributor in the mid to large cap long positions for the month. Rio continued to march up on the back of increases in the iron ore price. Iron ore remains in a sweet spot from both a supply and demand perspective. Supply appears to remain constrained for some time as Vale's output remains constrained following the unfortunate tailings dam collapse. Demand also appears resilient, with Chinese steel demand picking up as we continue through the year. The company also paid a special dividend of US$4b during the month, bringing total cash returns for shareholders to $13.5b from the 2018 year.

ERM Power was a key contributor in the small cap long portfolio. ERM Power is a supplier of electricity to businesses throughout Australia and also owns gas powered electricity generation assets. At the February results ERM lifted its dividend, as well as continued its buyback, signalling the strength in the cash generation of the business. Operationally, ERM continues to improve gross margin and gain market share from larger peers.

Key fundamental short contributors included stocks in the building materials and technology sectors.

Firetrail INVESTMENTS

Top detractors for the month

A long position in Reliance Worldwide underperformed after the market digested the share sale from the former private shareholder, Jonathan Munz. Munz sold his remaining 10% stake in the company at the end of February. Reliance remains a key long position in the portfolio. Our research continues to suggest market share gains for the key plumbing product lines in both the US and the UK. Whilst growth rates may be impacted from the lack of a major freeze event this year (like the one that benefited sales growth in 2H18), our calculations suggest that underlying growth remains solid.

Nufarm also detracted after reporting their interim FY19 result. In the short-term earnings have been under pressure from the Australian drought and supply issues in Europe. Whilst net debt was high at the half, this will come down significantly during the year as receivables are collected. In our view, significant upside remains in Nufarm long position from the normalisation of climatic conditions, as well as the significant opportunity from their proprietary canola-based omega 3 production.

ONE INTERESTING THING THAT HAPPENED THIS MONTH….

Was an apparent improvement in the percentage that online bookmakers are taking from punters betting in Australia. As we wrote in January, the introduction of a Point of Consumption Tax (POCT) has created a significant cost headwind for online bookmakers – estimated at ~$200m per annum. Prior to January 1, online bookmakers registered themselves in the Northern Territory and paid only a small tax rate. Both Victoria and NSW introduced the further POCT from January 1, creating the additional impost for these bookies.

Logic appears to have prevailed, and online bookies are now trying to offset this cost through offering the punter slightly lower odds. This is rather than bookmakers trying to offset the additional cost by gaining scale (i.e. a price and market share war), which was always a risk.

We see this a positive development for our long investment in Tabcorp, which as the incumbent bookmaker is largely carved out of the additional POCT. It thus should keep most of the improved revenue. The question remains whether the additional revenue is reinvested in marketing or drops through to the bottom line. Right now we believe a good option would be for Tabcorp to use any additional revenue to cement its position, and maintain market share. This will set the business up well for the future.

MORE INFORMATION

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