Past performance is not a reliable indicator of future performance.

1. Firetrail Absolute Return Fund (‘Fund’). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. 2. Fund inception is 14 March 2018. 3. The Fund has been operating since 14 March 2018. To give a longer-term view of our performance for this asset class, we have also shown returns for the Firetrail Absolute Return Strategy Composite (‘Strategy’) which has been operating since 30 June 2015. Strategy performance has been calculated using the monthly returns (after fees) of the Fund from 14 March 2018 to current date, as well as the monthly returns of the Macquarie Pure Alpha Fund (after fees) between 30 June 2015 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie Pure Alpha Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie Pure Alpha Fund. The composite returns for the Strategy and the RBA Cash Rate (Benchmark) exclude returns between 24 November 2017 and 13 March 2018. During this period the investment team did not manage the Strategy. As such, the annualised performance periods stated are inclusive of the combined composite monthly returns, and do not include the period when the team were not managing the Strategy. For example, the annualised return over 3 years for the Strategy and benchmark are inclusive of 36 monthly performance periods available in the composite return period, excluding the period between 23 November 2017 and 13 March 2018. For additional information regarding the performance please contact us through the link on our website. 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. 4. Strategy inception 30 June 2015.
PERFORMANCE COMMENTARY

The Fund returned 12.64% during April, outperforming the RBA Cash Rate benchmark by 12.62%. The outperformance was driven by all segments of the fund – large cap longs, mid and small cap longs, as well as the fundamental shorts. The largest contributors to performance this month were the large cap long positions.

WHAT HAPPENED IN MARKETS?

After the negative performance of March, April proved to be largely positive across most asset classes globally, as shown in the chart below. Despite the rally across asset classes, the ASX200 still remains down 17.4% for the calendar year to date. The outlier to performance was WTI oil – which briefly traded negative as suppliers had to pay customers to take the oil off their hands.

Volatility is heightened, but so are the opportunities…

Whilst volatility still remains higher than usual, markets have calmed somewhat since mid-March, as can be seen in the chart on the LHS below. At Firetrail, we have typically found that our strongest periods of performance are in the periods following these high periods of volatility. As an active, fundamental stockpicker, we are able to take advantage of “panic selling” when it occurs in companies that we know well. This occurred in the GFC, after the stress of debt crises in 2012-2013 and now during the COVID crisis. On our view, current conditions have created exceptional opportunities for active stock pickers like Firetrail.
Within the Australian market, we have been closely monitoring the extent to which analysts have updated their earnings forecasts. Currently market consensus earnings growth for the year to June 2020 is at **negative 10%** for the overall market. This has been downgraded significantly from the **10% growth** that was forecast for this financial year as of June last year. We still believe that there are significant earnings downgrades to come through as analysts update their forecasts. However, in some senses, the level of earnings this year is almost a moot point looking backwards – what matters now is the balance sheet, cash flow, industry positioning and how this affects our future earnings predictions for the companies we own and potential investments in the portfolio.

The capital raising opportunity…..

Capital raisings across the ASX were almost a daily occurrence in April. Over $18.5bn of COVID-19 related equity raisings have occurred so far. The best performers have tended to be those companies where the share price had been significantly challenged ahead of the equity raisings – think Flight Centre, Kathmandu or Webjet. For these companies, raising capital was an absolute necessity to survive – and once survival has been taken off the table the share prices enjoyed a rebound (although still well below pre-COVID levels).

PORTFOLIO POSITIONING

There is much debate as to whether the bounce in equity markets in April is sustainable, or whether it is simply a short-term rally that occurs within an extended market decline. We do not try and pick the direction of markets – **the fund stays strictly market neutral on a dollar basis (i.e. dollars long = dollars short) each day.** However, we do need to model the trajectories for the inputs to our company forecasting. Under our base case scenario, we are not anticipating a “V” shaped recovery in economies and activity, and when there is a recovery, we are not anticipating activity levels to get back to pre-COVID levels for some time. Importantly, for the companies we own in the long portfolio, we have conducted detailed analysis on the balance sheet, cash flow, liquidity and future industry structures and are comfortable that the portfolio in companies that can withstand an extended period of lockdowns, whilst ensuring we have appropriate exposure to companies that we believe are well positioned to capitalise on the other side of COVID-19.

In terms of fund positioning, the market dislocation in March was an opportunity to incrementally increase our exposure to oil stocks. The demand destruction from COVID of ~25 million barrels per day in a 90-million-barrel market has finally started to elicit a supply response from producers. As such, whilst the short term remains significantly challenged – in our view the medium-term outlook for the oil price has improved, as some of this capacity may not return.

The fund participated in multiple capital raisings during April, and this was a positive contributor to performance during the month. We analyse each raising on its own merits, just as we would for a company we invest in on the secondary market. This precludes us from investing in raisings that we believe to be low quality or where the valuation does not stack up on a medium-term view. However, we will participate heavily where we believe it will add value for our investors and did so during April. Over the next few months, retail shareholders should also be able to benefit from the large number of Shareholder Purchase Plans (SPPs) at significant discounts – many of which are being upsized.
A long position in engineering consultancy **Worley** was one of the largest contributors in April, after being one of the largest detractors in March. As a consulting engineer, we closely analyse the utilisation of its staff, which has been improving ever since the acquisition of Jacobs ECR in mid-2019; an impressive feat considering it doubled its headcount in the acquisition. In a market update during April, Worley noted that their March billable hours were down ~2%. Going forward we are closely watching two things – firstly the actions of its major customers on capex programs and spending, and secondly the speed at which Worley responds to slowing conditions. We have little doubt that having lived through the consequences of the oil fall of 2015, the company is in a position to move quickly on costs to protect its earnings should conditions deteriorate further.

Gold Miners **Newcrest Mining** and **Evolution Mining** continued their run of performance in the month as the gold price continued to rise. At the end of the month, Newcrest raised $1.1b to primarily fund the acquisition of a gold stream from Fruta Del Norte, an Ecuadorian mine in which it already had a 31% stake. The acquisition not only gives Newcrest a further say in the operations of the mine, but also is at an attractive IRR of 11% at spot gold prices.

**Afterpay** rounded off the top contributors after a wild ride throughout February, March, and April. After peaking above $40 in February, and falling to a low of $9 in March, Afterpay finished April above $30 again. The market’s primary concern appears to be the bad debt risk associated with buying now and paying later. We have significant confidence not only in Afterpay’s risk model and the tightening of availability of funds, but also the proactiveness of the company in reducing customers payment terms from 8 weeks to 6 weeks. Afterpay differs from a credit card model. For example, in a crisis, customers can utilise their entire credit card balance, which may then turn into a large bad debt. Whereas Afterpay is on a purchase by purchase basis – and approvals are based upon a multitude of factors including your previous spending history. We still believe there is significant global expansion opportunities available for Afterpay to increase its customer base.

Fundamental shorts in companies within the financial and healthcare sectors also contributed positively to performance for the month.

**TOP DETRACTORS FROM PERFORMANCE**

The top detractors from performance in April were all long positions that could be classed as “defensive” stocks.

In a strongly rising market, a long position in NZ fibre infrastructure owner **Chorus** lagged after a strong March. Whilst the market in the short term is clearly viewing Chorus as a defensive asset, we are on the contrary excited about the strong growth in cashflow yet to come from Chorus. Currently, Chorus is spending ~$640m NZD each year laying fibre in the ground as it finishes the build of NZ’s ultra-fast broadband network. Over the next four years, we anticipate this capex bill will reduce to about ~$150m pa, yet the operating cashflows (i.e. core earnings) of the business will be little changed. Thus, the company will be producing a significant amount of free cash flow, the majority of which can be paid to shareholders. Chorus is our preferred stock in the yield/income bucket.

In a similar defensive vein, **Telstra** lagged the market. The biggest issue we see with Telstra is how the structure of the Australian mobile market plays out. Whilst Telstra is a premium service offering at a higher price point, TPG Telecom and Vodafone as a merged entity are entering, and their behaviour needs to be watched. Our working view is that rationality will prevail, especially as there is a significant debt pile that needs to be serviced by the new entity. This is what we are seeing in market surveys so far. Telstra is also (so far) maintaining a dividend – an increasing rarity in large cap "blue chip" companies.

Finally, a small cap long position in litigation funder **Omni Bridgeway** (formerly known as IMF) detracted from performance. Omni Bridgeway has evolved its business model from funding litigation cases on its own balance sheet, to being more of a manager of cases within fund structures. It is therefore more comparable now to a regular fund manager – with revenue driven by base and performance fees. The company has increased its litigation case funding by 17% y/y in its latest update, which we expect a dividend from in the future given their historical track record. The stock is trading on ~9x PE on FY22 earnings.

**SUMMARY**

As we enter May our research analysis is focused on the medium-term impacts on earnings and cashflow for the companies in the portfolio. The direct shock of COVID may be wearing off on markets with the rise in April, however the longer-term impacts are yet to be felt. Earnings downgrades continue across the market, producing opportunities for fundamental shorting, albeit in the context of share price moves. In our long portfolio, we are seeing material upside over the medium-term due to the COVID driven market dislocation. All in all, we are excited for the outlook for the portfolio on a medium-term view and believe we are well positioned to meet our investment objectives, irrespective of market movements.

As always - stay safe, take care of yourselves – and please be in touch with us if you have any questions or queries.
This document is prepared by Firetrail Investments Pty Limited ("Firetrail") ABN 98 622 377 913 AFSL 516821. The information is not intended for general distribution or publication and must be retained in a confidential manner. Information contained herein consists of confidential proprietary information constituting the sole property of Firetrail and its investment activities; its use is restricted accordingly. All such information should be maintained in a strictly confidential manner. The information is not intended as a securities recommendation or statement of opinion intended to influence a person or persons in making a decision in relation to investment. This communication is for general information only. It has been prepared without taking account of any person’s objectives, financial situation or needs. Any persons relying on this information should obtain professional advice before doing so. Past performance is for illustrative purposes only and is not indicative of future performance.

Pinnacle Fund Services Limited ABN 29 082 494 362 AFSL 238371 ("PFSL") is the product issuer of the Firetrail Absolute Return Fund ARSN 624 135 879 ("the Fund"). PFSL is a wholly-owned subsidiary of the Pinnacle Investment Management Group Limited ("Pinnacle") ABN 22 100 325 184. The Product Disclosure Statement ("PDS") of the Fund is available at [https://firetrail.com/products/firetrail-absolute-return-fund](https://firetrail.com/products/firetrail-absolute-return-fund). Any potential investor should consider the PDS before deciding whether to acquire, or continue to hold units in, the Fund.

Whilst Firetrail, PFSL and Pinnacle believe the information contained in this communication is reliable, no warranty is given as to its accuracy, reliability or completeness and persons relying on this information do so at their own risk. Subject to any liability which cannot be excluded under the relevant laws, Firetrail, PFSL and Pinnacle disclaim all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage), however caused, which may be suffered or arise directly or indirectly in respect of such information. This disclaimer extends to any entity that may distribute this communication.

Any opinions and forecasts reflect the judgment and assumptions of Firetrail and its representatives on the basis of information available as at the date of publication and may later change without notice. Any projections contained in this presentation are estimates only and may not be realised in the future. Unauthorised use, copying, distribution, replication, posting, transmitting, publication, display, or reproduction in whole or in part of the information contained in this communication is prohibited without obtaining prior written permission from Firetrail. Pinnacle and its associates may have interests in financial products and may receive fees from companies referred to during this communication.

This may contain the trade names or trademarks of various third parties, and if so, any such use is solely for illustrative purposes only. All product and company names are trademarks™ or registered® trademarks of their respective holders. Use of them does not imply any affiliation with, endorsement by, or association of any kind between them and Firetrail.

MORE INFORMATION

General enquiries 1300 010 311
Existing client enquiries 1300 360 306
[www.firetrail.com](http://www.firetrail.com)