

## Performance as at 29<sup>th</sup> February 2020

	1m	3m	6m	Inception <sup>#</sup>
<b>Fund<sup>^</sup></b>	-6.4%	0.0%	9.6%	14.0%
<i>Benchmark*</i>	-6.0%	-1.5%	4.0%	3.8%
<b>Value added</b>	-0.4%	1.5%	5.6%	10.2%

<sup>^</sup> Spheria Global Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes

\* Benchmark is the MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net).

<sup>#</sup> Inception date is 1 March 2019.

Past performance is not a reliable indicator of future performance.

The Spheria Global Microcap Fund declined 6.4%, marginally more than the Global Microcap Index (Kokusai) which fell 6.0%. However, during the sell-off from the 20th of February to the end of February, the Fund's net return outperformed the index by 1.4%, confirming our expectation that the Fund is well positioned for a more difficult macro environment. Since inception the Fund has returned 14.0% after fees while the Index has returned 3.8%.

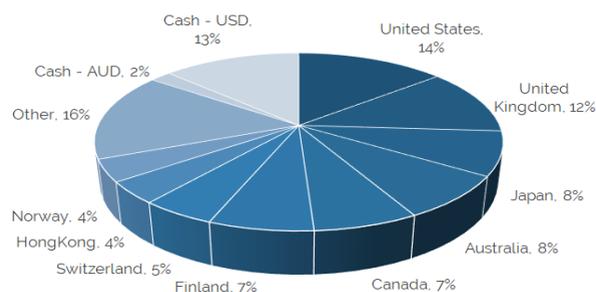
### Markets

The coronavirus dominated the market's attention in February. Early in the month concern was confined to the supply disruption to China, and as one of the world's largest users, the impact on raw materials and energy markets. Energy was again the worst performing microcap sector in February (-15.9%) followed by Materials (-9.5%). Despite record low US bond yields, investors still see safety in long duration assets such as Utilities (-0.7%) and Real Estate (-2.8%). However, these two sectors almost ubiquitously rely on leverage to deliver investors a decent return on equity. Lower Government bond yields are a tailwind to valuation, but at some point if credit markets price in a recession (the same one Government bond yields are signalling), widening credit spreads could prove these sectors' undoing. There is no all-weather sector in equity markets.

Hong Kong was the best performing microcap market in February. Riots gave way to coronavirus concerns, but there was already so much bad news priced into the Hong Kong market, and it seemingly received a lift from the outperformance of mainland China A-shares. Australia was the worst performing country in the benchmark, not helped by its sector exposure to Energy and Materials. Likewise, Norway was impacted by its economy's exposure to Energy. The US market outperformed again. The Fund retains a large underweight position to the US as our bottom up stock picking has been less fruitful in that country due to stretched valuations. We also have concerns that companies in the US have benefited from a much stronger economy than peers in Europe and Japan and that high earnings multiples on an elevated earnings is unlikely to be a good place for investors.

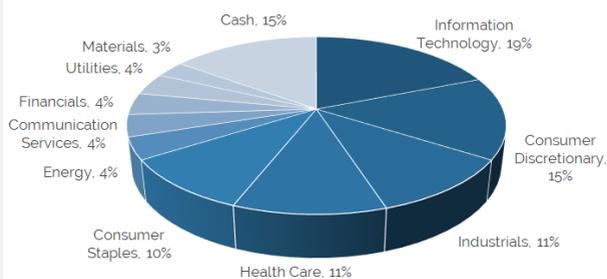
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### Regional Exposure



Source: Spheria Asset Management

### Sector Exposure



Source: Spheria Asset Management

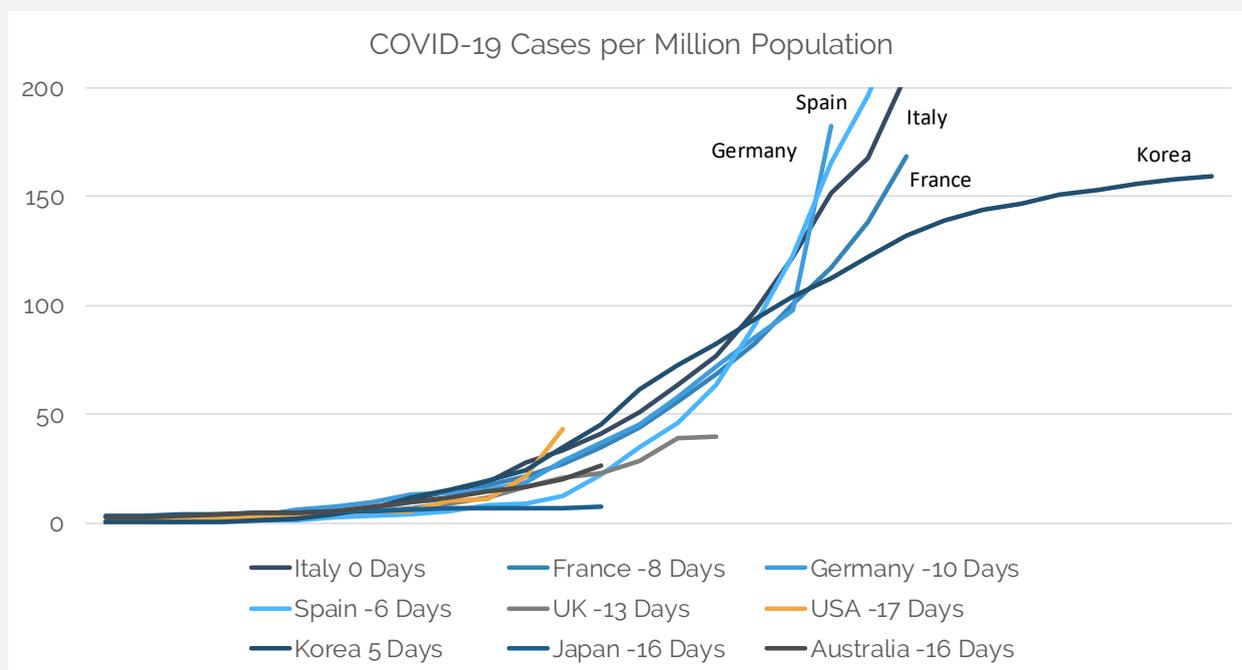
## Fund Performance

As expected, the Fund's holdings in Health Care, Utilities (not a traditional highly leveraged asset owner), and Consumer Staples outperformed the Index. All but one of our six healthcare holdings added relative value in February, with one holding proving to be a major beneficiary of COVID-19. The Fund's Utility stock is not an infrastructure owner and has a net cash balance sheet, but nevertheless benefits from the defensive nature of the company's product. Financials and IT detracted value, but the performance was stock specific as a few profit results fell short of expectations.

At a country level, our Australian holdings gave up some of their very strong earlier performance. The US market was also difficult for us. In our search for value we have taken on positions that are more discretionary in nature albeit they are all extremely well capitalised. As part of a balanced portfolio the volatility is dampened, but we are able to capitalise on the current market's extreme aversion to this form of risk. Scandinavian and Swiss holdings helped the Fund's performance.

## Outlook

Data about COVID-19 continues to accumulate. Albeit, many statistics are imperfect since they rely on the level of testing capacity and changes in the rate of testing as much as the underlying condition itself. What most experts agree on is that the virus spreads at least as rapidly as a pandemic influenza (1.8 people infected for every 1 person with the virus) and that mortality rates are higher than influenza.



Source: WHO, John Hopkins, Spheria Asset Management. As at 20 March 2020.

Even though the short-term economic impact will be severe, Governments have no option but to attempt to contain the virus' spread, for fear of overwhelming a healthcare system geared up to handle a bad flu season, but nothing of this scale. Not only do COVID-19 patients run the risk of not receiving treatment, but other acute conditions such as stroke and heart attack patients will not get the attention they normally would. While our focus is on the virus' impact on companies, we can't help but contemplate the human toll of this virus.

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Despite the obvious ramifications of this pandemic, as we write this note there are a few market observations we find puzzling:

- The market is pricing assets in Italy down more harshly than other developed economies. However, Italy's COVID-19 testing volumes have far surpassed that of the USA and the country has more hospital beds per capita. Despite these advantages the Italian healthcare system is being overwhelmed even as the Government attempts to lockdown affected regions. Asset markets appear to be in denial that a similar scenario could play out in the USA.

- Investors show unwavering faith in the Government's ability to save the day with stimulus measures and central bank interest rate cuts. It seems that ever since the launch of TARP (Troubled Asset Relief Program), which helped stem the GFC meltdown, investors have come to expect large Government action to come to their aid whenever there is trouble. However, US total public debt to GDP is 106%, up from 64% pre GFC. The Federal Reserve balance sheet has grown from \$870 billion in August 2007 to \$4.2 trillion currently. In our opinion investors' hopes for a rescue are too high.

The Fund remains well positioned to ride out a challenging market scenario. Our focus on cash flow generation, lowly geared balance sheets and decent valuations naturally provide a more defensive portfolio. This coupled with the fact that cash was sitting at close to 15% at the end of the month (predominately in US dollars) also puts the fund in a good position to preserve capital. We have coveted many high-quality companies since the Fund's inception however valuations have been unattractive in our view. A market pull back gives us the opportunity to reassess and add to our portfolio companies with exciting growth prospects that we intend to own for the long term.

# Spheria Global Microcap Fund

ARSN 627 330 287 APIR WHT6704AU



	Spheria Global Microcap Fund
Benchmark (universe)	MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net)
Investment objective	The Fund aims to outperform the MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net) over the long term.
Investing universe	Global listed microcap equities predominantly in developed markets with a market capitalisation of US\$1.0bn and below at time of purchase.
Distributions	Annually
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee.
Cash	Up to 20% cash
Expected turnover	20%-40%
Style	Long only
APIR	WHT6704AU
Minimum Initial Investment	\$25,000

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