

Performance as at 30th June 2021

	1 Month	3 Months	1 Year	2 Years [#]	Inception [#]
Fund[^]	1.5%	9.2%	45.0%	25.7%	25.0%
Benchmark[*]	2.3%	8.0%	66.5%	26.4%	22.9%
Value added	-0.7%	1.2%	-21.5%	-0.7%	2.1%

[^] Spheria Global Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes. All p.a. returns are annualised.

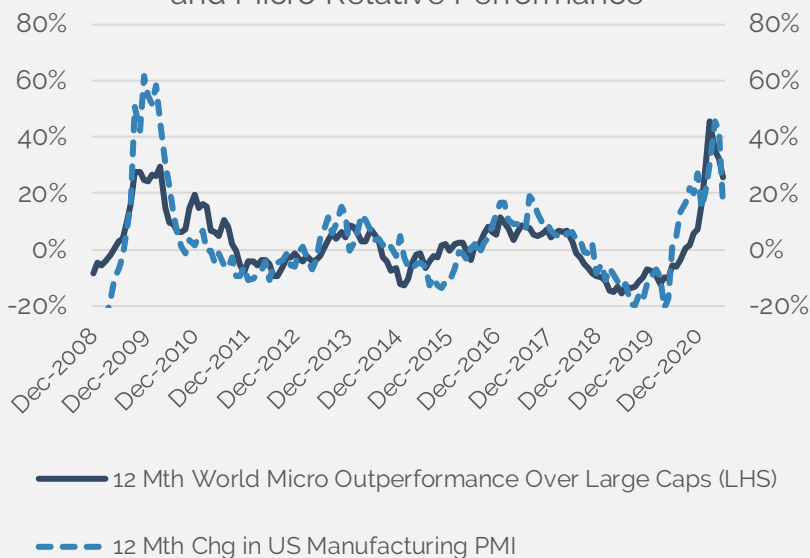
^{*} Benchmark is the MSCI World Microcap Index in AUD (Net) from 1 July 2021 and prior to that MSCI Kokusai (World Ex-Japan) Microcap Index in AUD.

[#] Inception date is 1 March 2019. Returns are per annum.

Past performance is not a reliable indicator of future performance.

The Spheria Global Microcap Fund returned 1.5% after fees, lagging the MSCI Kokusai Microcap Index (World Ex-Japan) by 0.7%. Microcaps underperformed their larger peers in June. As we have noted in recent months, the best days of microcap outperformance are behind us. The below chart we developed remains a reliable timer of relative performance.

US Manufacturing PMI and Micro Relative Performance



Source: MSCI, Bloomberg, Spheria

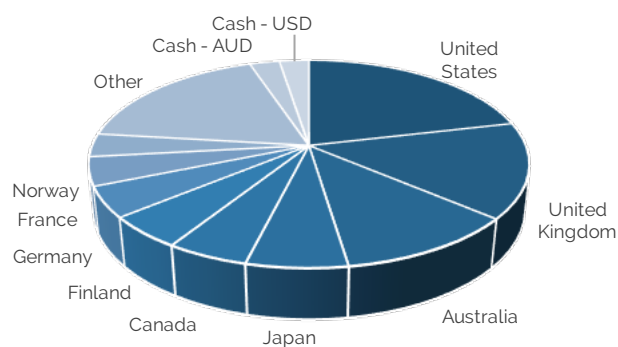
Indeed, it is likely that the best days for equity markets more broadly are now behind us after such a protracted cycle. This setup only makes a fund manager's ability to generate alpha all the more critical in the context of total returns. As the chart on the next page shows, Spheria does most of the heavy lifting when market returns are modest. Periods of market performance such as the second half of 2020 and first half of 2021 are rare, and are unlikely to persist for long.

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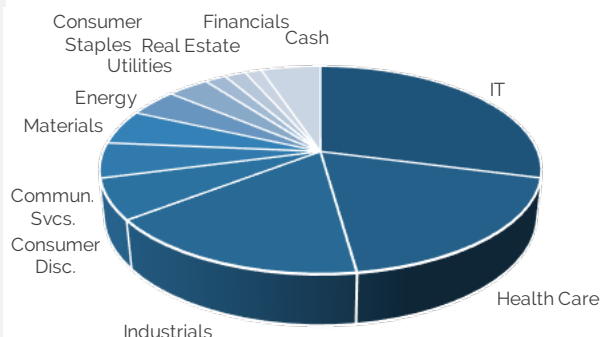
Top 5 Holdings

Company Name	% Portfolio
Steelcase (USA)	3.7%
Fjordkraft (Norway)	3.6%
Inogen (USA)	3.6%
Poletowin Pitcrew (Japan)	3.2%
MCJ (Japan)	3.1%
Top 5	17.2%

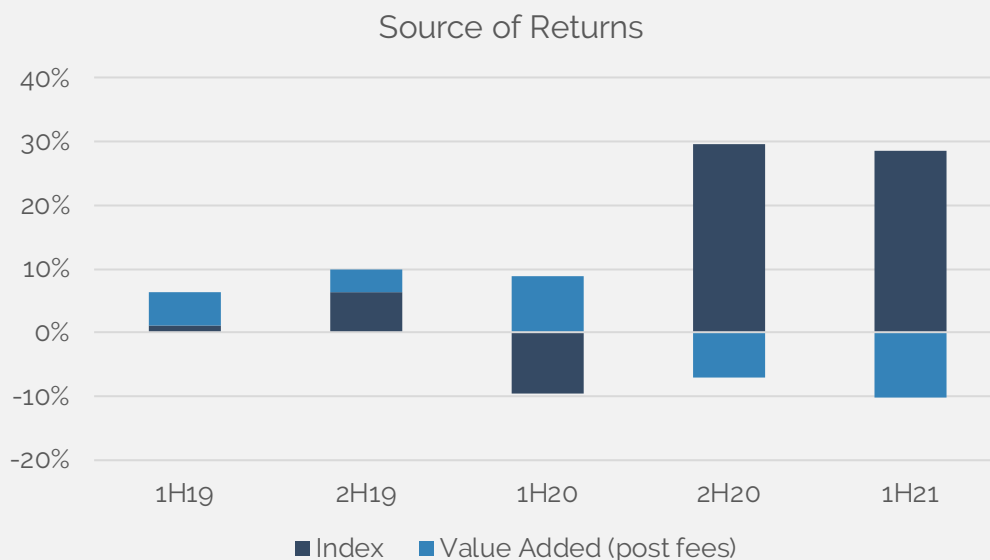
Regional Exposure



Sector Exposure



Source: Spheria Asset Management



Source: MSCI, Spheria

With global microcaps vast universe, low analyst coverage and our fundamental process, we like our odds of adding relative value for investors when market returns moderate.

Since its inception, the Spheria Global Microcap Fund has returned 25.0% after fees compared with the benchmark return of 22.9%. The large-cap MSCI World Index has delivered 16.1% p/a over the same time frame.

Markets

Commodities occupied both ends of the spectrum in June. Energy was the best performing sector in microcaps, up 11.1% in AUD. However, Materials lagged, down 2.4%.

Of the Fund's energy exposed holdings, its Canadian investment has lagged the broader move in Energy names and remains compelling at these prices. Our only hesitation with the company is that it asked a lot from its staff when energy prices were at their lows (salary cuts), and so margins are likely to be capped in the short-term as workers are made whole.

In Materials, metals and mining; Copper, Silver and Gold miners in particular were the most unloved. Each industry fell over 9%. Central Bank tapering and the prospect of higher real yields are precious metals' Achilles heel, while the roll-over in copper mirrors the pull-back in the underlying metal from lofty levels.

By country, the USA again led microcap markets higher. How adept these current markets are at making one feel clever. Continuing to do what has worked best seldom skips a beat. However, as General George S Patton said, "If everyone is thinking alike, then somebody isn't thinking".

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Fund Performance

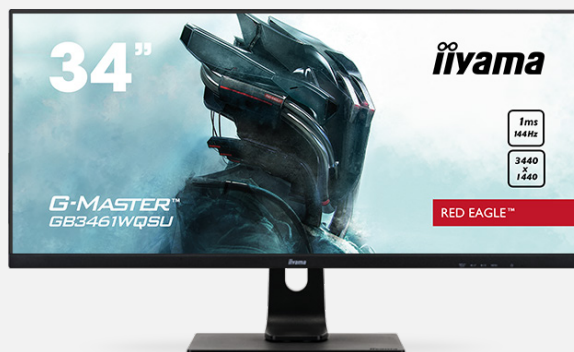
MCJ (6670.JP)

The Fund's top-performing position in June was MCJ.

MCJ is Japan's largest retailer of PC hardware and accessories. The company has a well developed omni-channel strategy with strong sales from its stores and online channel. MCJ has no doubt been a beneficiary of Covid as consumers have upgraded tired home office equipment. It also has increasingly targeted SME customers with its competitive pricing and high service levels.

While even a simple computer retailer can be made to look like a good business with the tailwind of Covid, this in itself does not justify a position in our Global Microcap Fund, where we have the world to choose from. MCJ earns its place in the portfolio from its high-end gaming laptops and desktops sold under the brands Mouse, G-Tune, and Tekwind. MCJ manufactures these high-end gaming machines and, with some clever sponsorship of professional gamers, has built a reputation for performance and reliability. The portfolio is supplemented by its high-end gaming monitors distributed in Europe called iiyama. To reach the upper echelons of the gaming community is no easy feat and one that is providing MCJ with strong growth and handsome margins.

The company has grown its revenue 14.5% p/a since 2015 without the help of acquisitions, and margins have continued to ratchet up steadily. However, despite this track record and competitive advantage in PC gaming, the company trades on a forward EV/EBIT multiple of 7.0x. Given our requirement that reported profit and loss translates into cold hard cash, this means its free cash flow yield is in the vicinity of 14%. Not bad if we consider that Japanese 10 years are yielding 0.03%.



Fjordkraft (FKRFT.NO)

Fjordkraft (FKRFT.NO) was the Fund's largest detractor in June.

Fjordkraft has been a painful experience for the Fund. The Fund first bought the stock in September 2019 at NOK49. Our average entry price is NOK60.3, compared to the end of June share price of NOK51.2. While any honest fund manager will tell you it's not the deepest scar they've endured, losing money is never an enjoyable experience (and a reminder that Spheria, Pinnacle and the Investment Team's personal wealth is also in the Fund).

However, a relatively small loss can take on far greater proportions when compared to the Index. Over the same time frame, the MSCI Kokusai Microcap Index (Ex-Japan) is up 59.1%. Highlighting this metric is both a swift uppercut to our own chin and a lesson in the idiosyncrasies of the funds management industry. Should we feel compelled to keep up with a benchmark racing ahead at breakneck speed and jettison our position in this company we continue to believe offers strong fundamental value? Fjordkraft has a dividend yield of 7% and our analysis concludes the market is implying margins more than halve over time..

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Or, should we be more concerned about the nine Norwegian Kroners we have wasted for investors? Should we reassess whether Fjordkraft offers an attractive medium-term return relative to all the other opportunities we have and relative to its risk? That is our approach, and our answer remains - absolutely.

Outlook

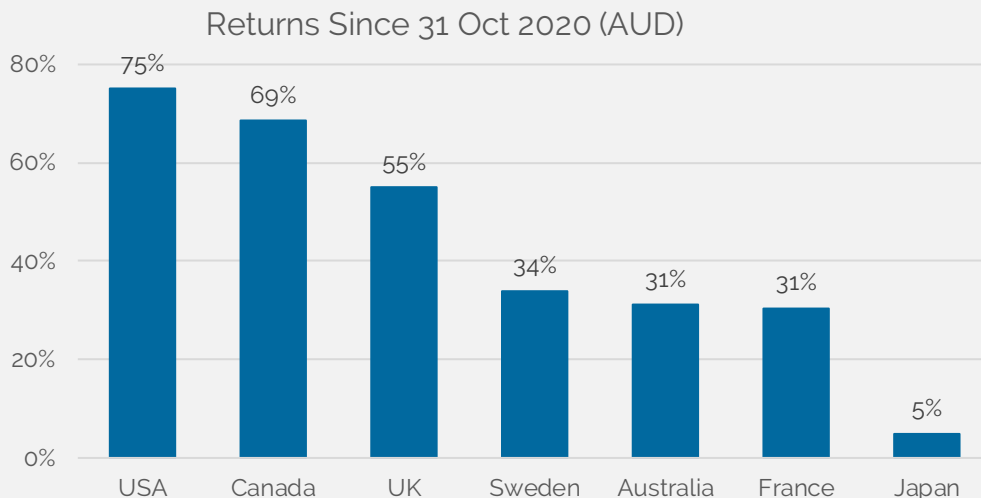
26 September 1983, Australia II crossed the finish line ahead of Liberty to win the America's Cup. Perhaps it was our slightly inebriated Prime Minister's antics or the delight we took in seeing the smug Dennis Connor taken down a peg, but that day remains one of the greatest in our nation's history. The architect behind the America's Cup challenge was Alan Bond. Sharemarket investors of the 80s will keenly remember Bond Corporation Holdings and Mr Bond's penchant for deal-making. Cheap debt, plenty of greed and poor corporate governance, mix with shady characters and serve before the '87 crash. What a cocktail for hi-jinx.

Despite it all, no story about the 80s entrepreneurs has been told more times, especially in financial circles, than the transaction between Alan Bond and Kerry Packer for the Nine Network. In 1987 Bond offered Kerry Packer the lofty sum of \$1.05 billion for the Nine Network, of which he controlled 100% (\$2.63 billion in today's terms). This transaction was not the first time Bond had displayed a lack of restraint. Throughout his career, when he wanted an asset, price was no obstacle.

By 1989 Bond had run into trouble and Packer was able to convert \$200 million of convertible preference shares that he received in the original transaction, into a 37% stake in Bond Media. Bond Media was heavily indebted, and Packer offered shareholders one of his Television Corporation Australia shares for every 10 Bond Media shares. This gave Packer control of the company. Bond was diluted down to 3% of Television Corporation Australia, which again became Nine Network Australia on 27 July 1990. Packer was able to buy back the company at about half the price (but note that this is not a like-for-like comparison as Bond had tacked on Nine Brisbane and Perth to the company's broadcast network during his ownership).

Despite this often-told parable, that price matters, investors refuse to heed this warning. It seems that, like the entrepreneurs of the 80s, cheap money is creating a legion of mini-Alan Bonds. They want an asset and price is no obstacle.

No market is this more apparent than in the US. The chart below shows that the US market, the largest in the Microcap Index, has left all others behind. Since 30 October 2020 the US microcap market has surged 75.0% in AUD, usurping all others by some way (for the record the Spheria Global Microcap Fund returned 39.5% net of fees during this same period).



Source: Bloomberg, MSCI World Microcap Index

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Owning stocks anywhere else has been a lesson in humility. And, the smaller and more speculative the exposure in the US, the better. At the height of this speculative mania in February, the Microcap Index's top stocks were almost exclusively loss-making.

Company	BBG Ticker	Index Weight	Market Value (\$USm)	Revenue (\$USm)	EBIT (Adj. \$USm)	Oct '20 to Feb '21 Total Return
Marathon Patent	MARA US	0.48%	2,831	1	-4	1,296%
Microvision	MVIS US	0.38%	2,214	9	-26	760%
Riot Blockchain	RIOT US	0.37%	2,954	7	-9	1,238%
Nano Dimension	NNDM US	0.36%	2,448	7	-15	224%
Gevo	GEVO US	0.33%	1,920	24	-26	911%
Cassava Sciences	SAVA US	0.29%	1,896	0	-5	492%
SM Energy	SM US	0.27%	1,590	1,127	137	761%
Ocugen Inc	OCGN US	0.25%	2,059	0	-11	3,802%
Bionano Genomics	BNGO US	0.24%	2,141	10	-26	1,879%
Silvergate Capital	SI US	0.23%	2,966	99	30	470%

Source: MSCI, Bloomberg

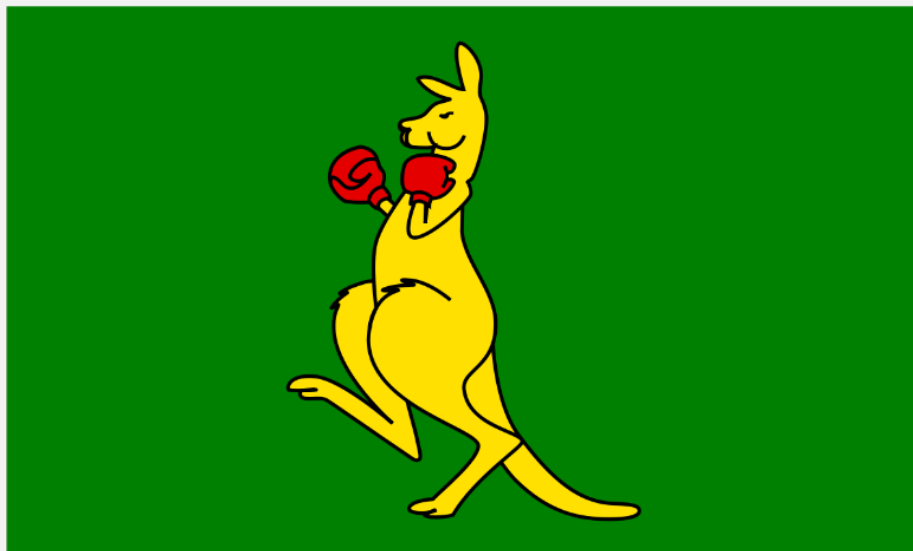
Maintaining our valuation discipline has been difficult, especially given the relentless rise of the expensive US sharemarket. As the chart below shows, the US & Sweden (which we are also underweight) are the most expensive major microcap markets in the world.

	USA	Japan	UK	Australia	Canada	Sweden	France
EV/EBIT	23.8	19	18.9	20.8	20.4	26.6	22.6
EV/Sales	7.6	2.5	3.5	5.8	4.1	7.2	6.6
Div Yield	0.8%	1.9%	1.1%	1.2%	1.2%	0.8%	1.1%
FCF Yield	-0.9%	4.7%	4.2%	-1.4%	7.4%	1.2%	1.8%
% Profitable	41%	61%	53%	36%	43%	4%	56%

Source: MSCI, Bloomberg, Spheria

Only 41% of the companies in the US microcap market are profitable, and the high EV/Sales metric implies that the US microcap market is rewarding high growth companies with negative free cash flow. However, our philosophy and process are proven to work through the cycle, not just when times are good.

Our experience tells us that chasing such go-go companies only makes sense so long as capital is cheap, and discount rates are low. That is why the Spheria process is designed to weed out these companies with a potential trap-door under them when easy conditions change. Some would say this process is our “winged-keel”.



Spheria Global Microcap Fund

ARSN 627 330 287 APIR WHT6704AU



Spheria Global Microcap Fund		Platform availability
Benchmark (universe)	MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net)	HUB24
Investment objective	The Fund aims to outperform the MSCI World Microcap Index in AUD (Net) over the long term.	Macquarie Wrap
Investing universe	Global listed microcap equities predominantly in developed markets with a market capitalisation of US\$1.0bn and below at time of purchase.	Netwealth*
Distributions	Annually	Praemium
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee.	* IDPS only
Cash	Up to 20% cash	
Expected turnover	20%-40%	
Style	Long only	
APIR	WHT6704AU	
Minimum Initial Investment	\$25,000	

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