Spheria Global Microcap Fund

ARSN 627 330 287 APIR WHT6704AU

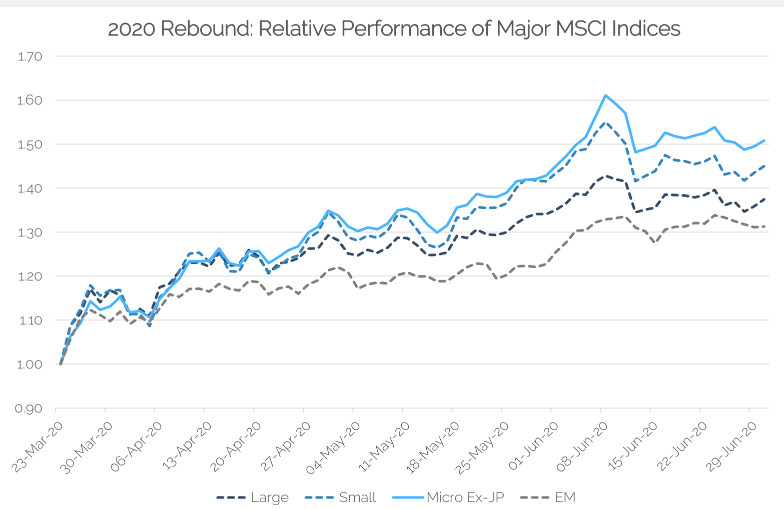
Performance as at 30th June 2020

	1 Month	3 Months	1 Year	Inception#
Fund^	-0.4%	13.7%	9.0%	11.8%
*Benchmark**	1.8%	16.3%	-4.0%	-2.1%
Value added	-2.2%	-2.5%	13.0%	13.9%

^ 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).
# Inception date is 1 March 2019. Returns are per annum.
Past performance is not a reliable indicator of future performance.

As we have highlighted many times in this monthly, Microcaps are the place to be during an equity market recovery. The Microcap Kokusai index flew early in June, and was up 12.9% in US dollar terms after only six trading sessions into the month. However, the Australian dollar rallied in conjunction, and the bounce early in the month faded. The Index ended up posting a more modest 1.8% return in Australian dollars for the month. Nevertheless, this was better than both the large-cap and small-cap MSCI indices. The Fund struggled to keep up with the fervour early in June and was never able to completely catch-up during the month, under-performing by 2.2% after fees.

Since inception the Fund has returned an absolute return of 11.8% per annum after fees, outperforming the benchmark by 13.9% per annum.



Markets

Canada was the best performing microcap market in June, up 6.7% in AUD terms, followed by New Zealand and Hong Kong. The US market continues to outperform, up 3.4% in AUD terms. It is difficult to reconcile why, with escalating COVID-19 cases and Joe Biden's rise in polling for the upcoming Presidential election. It seems that countries respective handling of the virus and geopolitical concerns are not at the forefront of investors' minds at present.

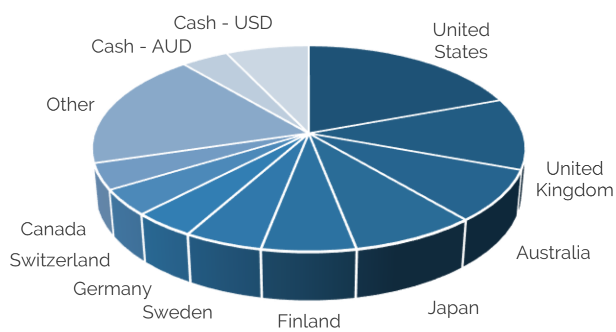
Continued on the next page…

Top 5 Holdings

Company Name	**% Portfolio**
Sonos (USA)	3.7%
Fjordkraft (Norway)	3.3%
Inogen (USA)	3.1%
Poletowin Pitcrew (Japan)	3.1%
Computer Modelling (Canada)	3.0%
Top 5	**16.2%**

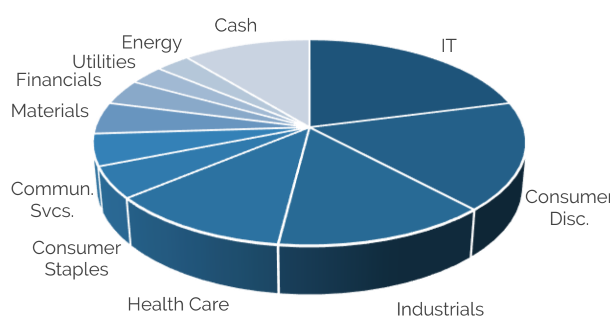
Source: Spheria Asset Management

Regional Exposure



Source: Spheria Asset Management

Sector Exposure



Source: Spheria Asset Management

Of these top performing markets, we are overweight only New Zealand which remains a favourite of ours. The country is home to two of our stocks which are high growth innovative software companies tackling a global market. One is well established, but with continued room to grow, the other embryonic, but with the support of major industry players.

Israel was the laggard in June. This country hosts an array of tech stocks and represents a meaningful 3.5% of the Microcap Kokusai index. At present the Fund does not have an Israeli holding. We did until recently own an insurance software company which, while listed in the US, was by all intents and purposes an Israeli company. The company had been one of our most successful investments. However, its valuation had become stretched in our view, and the market is extrapolating out what appears to be a purple patch for the company. The advantage of having such a vast universe is that we can part ways with stocks even when things seem to be going well, confident that we can find something just as good, but more attractively valued to replace it.

We expect Israel will be the source of many of these replacements going forward. Israel is home to the most engineers and scientists per capita and has the world's second highest R&D budget as a percentage of GDP, double that of the OECD average. Despite this, Israel represents only 0.7% of the MSCI Small Cap Index and 0.2% of the MSCI World Index. It is fortunate that it makes up a meaningful part of the Microcap universe as it clearly deserves more attention from investors.

At a sector level, it was materials that led the charge in June, up 6.2%. Gold was the main driver, up 13.9% and this industry represents a meaningful 2.7% of the Microcap Kokusai index. The Fund currently owns two gold stocks, one in Australia and one in Canada, which have both performed well. As is a Spheria prerequisite, both have strong balance sheets, generate free cash flow and have valuation upside. We are not interested in buying explorers or investing in asset plays that are not yet producing.

Consumer discretionary stocks were also relatively strong as economic data suggests that consumers have opened their wallets faster than anticipated. The best industries were leisure products, specialty stores and home furnishings. The Fund is overweight many of these areas.

While consumers were keen to open their wallets, it was mostly from the safety of their own home as leisure facilities were among the worst-performing stocks.

Fund Performance

The Fund's largest contributor for June encapsulates the type of undiscovered company the Fund is searching for. This US company, with a market capitalisation of only US$325 million (even after its appreciation) has no research coverage on Bloomberg. For those in the business, it is well recognised, but for the rest of us it is not a household name. The niche industries it serves are growing, and this growth is underpinned by increasing e-commerce in the industry where this company's services are critical to ensure parties can transact with each other on a trusted basis.

In one of its segments, it is the leader but shares the market with another established player. In its other segment, the company has a quasi monopoly. Barriers to entry are high, and hence returns are stunning, with ROIC of 51%. Negative working capital (meaning customers pay upfront) sweeten the metrics further. Free cash flow conversion has averaged 90%, and the company has a net cash balance sheet. Please excuse us for not naming names. We would prefer to keep this one to ourselves since we continue to see valuation upside.

The Fund's most significant position also had a good month as its old private equity owners finally sold the last of their stake. Investors now see the company as ripe for a takeover from a larger firm such as Apple. While speculation has driven the share price higher, we think the company is still fundamentally under-valued given the margin upside and revenue growth we forecast for the business.

Continued on the next page...

It was a UK based company that detracted the most value for the Fund in June. The company can find no love despite offering a trailing free cash flow yield of 12.4% and a dividend yield of 6.1%. The firm has a net cash balance sheet, ROIC of 55.6% and historical free cash flow conversion that has averaged 111% over the past five years. See where we're going with this? Furthermore, the company's clients are UK convenience stores, a segment of the economy that has held up relatively well during COVID given the essential services they provide (e.g., toilet paper).

Yes, there is cause for concern. Much of the company's revenue comes from the cash payments of bills, akin to visiting the post office. COVID-19 has forced many people to embrace online tools, and in so far as the cash economy drives in-person bill payments, this too is depressed as consumers shun "dirty" cash. One of the key growth avenues for the company is facilitating agreements between convenience stores and delivery companies such as Yodel to use the convenience store network as a parcel collection point. However, COVID-19 has meant people are home to take delivery of their parcels, impacting near-term growth.

While these issues are real, they are mostly short-term, and certainly don't warrant shunning such a cash cow of a business. We think the market simply overlooks this stock as too pedestrian as it lacks the type of growth the market is currently fixated on. However, as an addition to the portfolio, it provides a defensive growth exposure with significant valuation upside. For this reason, we continue to maintain a reasonable position in the company.

More generally March's heroes are June's villains. However, we are not ready to abandon these relatively defensive positions given a) they continue to track our investment thesis and offer valuation upside b) they will shield the portfolio if there is another draw-down in the market c) their earnings are far more predictable than most companies and hence we have a greater conviction in our valuation.

So far this pandemic has played out incredibly close to many leading epidemiologists predictions back in February and March. That is, this virus will become the new normal until we find a vaccine or we reach herd immunity. On the vaccine front, we are not overly optimistic, particularly given how stringent recent guidelines from the FDA are on trial design. Nor is herd immunity close, with even heavily impacted areas showing infection rates well below the levels required to slow the virus.

Investors that are confident future lockdowns are unlikely may be right, but they forget the fact that companies and consumers will take matters in their own hands if authorities fail to act. Apple were not ordered to close stores. Sweden is a case study in what happens during a more liberal policy setting. The economy is not spared.

Outlook

What a horrid time active fund managers have had in recent years. The table (see page 4) shows S&P's SPIVA analysis which tallies the proportion of fund managers who were unable to beat the index in any given year.

Continued on the next page…

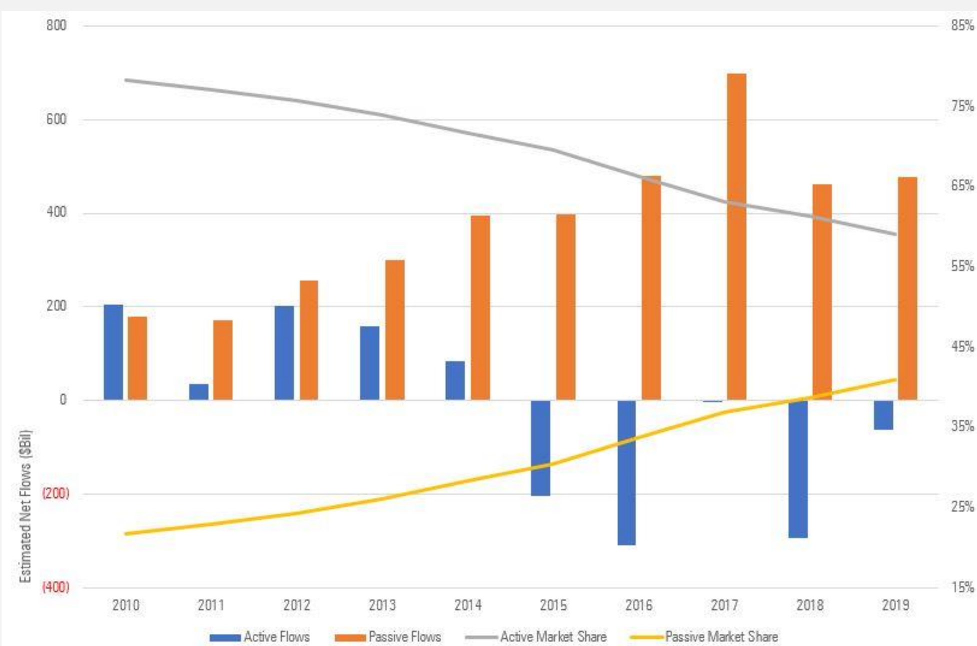
Exhibit 2a: Percentage of U.S. Equity Funds Underperforming Benchmarks Each Year

FUND CATEGORY	COMPARISON INDEX	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
All Domestic Funds	S&P Composite 1500	42.3	68.0	48.9	64.9	40.7	48.3	84.6	64.9	43.3	86.9	74.0	60.5	63.4	68.8	70.0
All Large-Cap Funds	S&P 500	48.8	68.4	44.6	56.0	48.4	65.9	82.2	62.7	54.6	86.7	65.4	66.0	63.1	64.5	71.0
All Mid-Cap Funds	S&P MidCap 400	73.6	44.8	45.8	75.7	55.7	73.3	68.6	79.8	37.1	66.1	57.2	89.4	44.4	45.6	31.7
All Small-Cap Funds	S&P SmallCap 600	61.0	62.5	46.0	83.3	30.7	54.0	85.8	66.3	67.8	72.0	71.8	85.5	47.7	68.5	38.5
All Multi-Cap Funds	S&P Composite 1500	37.1	68.8	46.0	70.1	39.3	60.4	83.9	65.2	46.8	81.6	70.1	74.9	56.5	66.8	69.2
Large-Cap Growth Funds	S&P 500 Growth	38.0	93.9	27.1	90.7	36.8	51.0	95.9	45.6	41.1	95.6	47.6	89.8	32.9	60.3	33.3
Large-Cap Core Funds	S&P 500	56.2	81.1	43.5	52.3	50.5	76.6	83.2	66.6	57.7	80.4	73.7	74.6	69.0	75.8	69.5
Large-Cap Value Funds	S&P 500 Value	54.1	80.3	45.8	24.5	45.7	70.6	54.3	85.0	64.9	77.8	61.5	78.0	46.9	46.3	97.2
Mid-Cap Growth Funds	S&P MidCap 400 Growth	79.7	28.0	42.0	91.0	54.0	84.1	76.5	86.8	34.5	55.4	79.7	94.6	18.0	15.2	9.3
Mid-Cap Core Funds	S&P MidCap 400	66.3	32.0	60.8	60.2	70.7	86.5	65.7	78.6	43.0	58.6	68.2	90.6	61.7	62.2	40.5
Mid-Cap Value Funds	S&P MidCap 400 Value	69.1	36.9	57.8	68.0	47.3	57.1	67.6	73.5	40.8	71.4	34.4	96.8	43.1	72.2	65.0
Small-Cap Growth Funds	S&P SmallCap 600 Growth	78.1	50.8	40.8	94.8	31.3	62.2	94.1	62.9	55.3	64.0	87.5	96.0	15.1	61.5	13.8
Small-Cap Core Funds	S&P SmallCap 600	58.3	56.3	55.5	82.1	33.2	58.6	86.0	68.7	77.7	66.9	77.5	89.5	58.6	87.5	41.4
Small-Cap Value Funds	S&P SmallCap 600 Value	45.2	71.3	39.4	72.1	25.2	42.0	81.8	61.5	78.8	94.1	45.0	88.9	74.1	83.3	80.0
Multi-Cap Growth Funds	S&P Composite 1500 Growth	17.7	73.2	29.8	88.3	42.0	45.7	94.8	51.6	38.8	87.4	65.5	85.3	46.3	65.9	45.2
Multi-Cap Core Funds	S&P Composite 1500	38.1	77.4	45.2	65.8	39.2	66.1	82.9	68.2	53.3	84.1	83.9	74.5	68.8	81.7	74.4
Multi-Cap Value Funds	S&P Composite 1500 Value	72.0	84.0	58.1	48.4	35.8	68.2	66.7	72.6	47.9	67.3	55.6	71.2	49.6	74.8	91.8
Real Estate Funds	S&P United States REIT	43.6	68.4	45.3	72.9	38.3	66.7	66.3	62.0	64.8	67.8	43.0	84.0	36.9	88.9	26.6

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

Source: https://us.spindices.com/indexology/core/spiva-us-year-end-2019

With these numbers it is no surprise that investors are turning to passive funds as an alternative low-cost way to gain exposure to equities. The shift has been dramatic. Morningstar data below shows that since 2015 active funds have been in net outflow while passive funds have continued to attract new money.

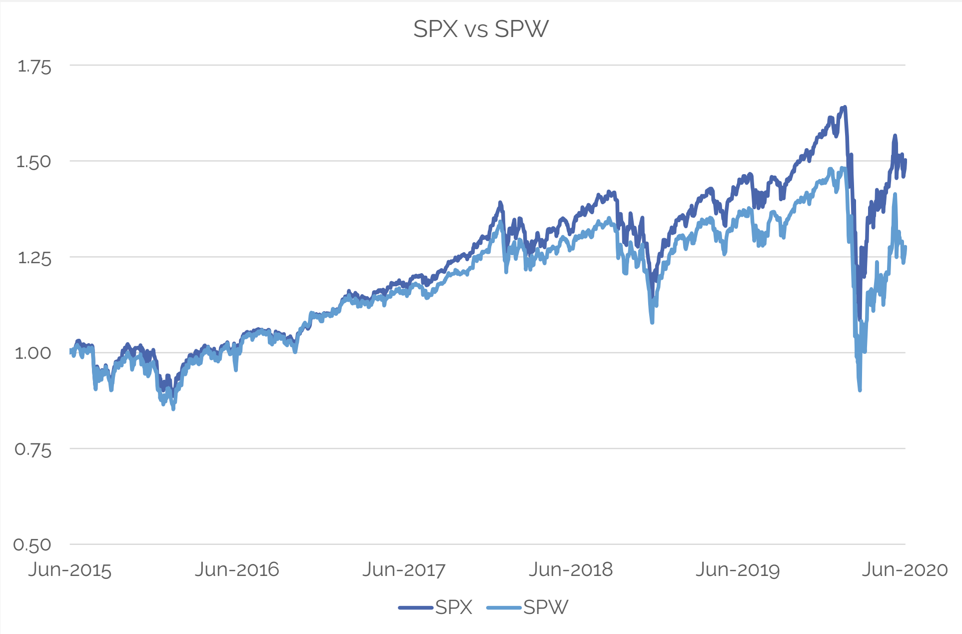


Source: https://www.morningstar.com/insights/2020/01/29/fund-flows-recap

Continued on the next page…

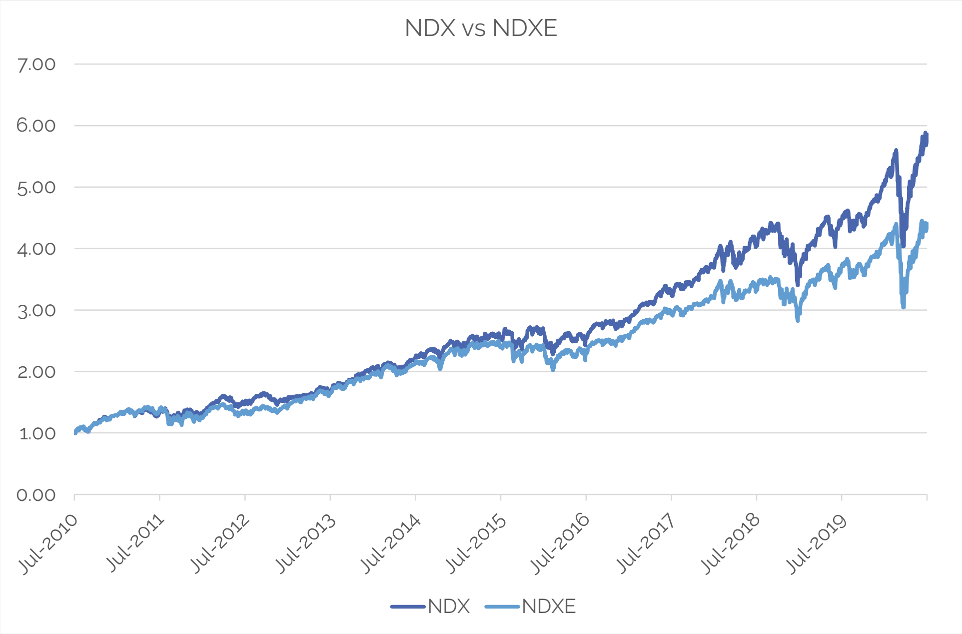
The impact of this can be seen by the simple exercise of comparing an index (that is typically market cap weighted with the exception of the Dow Jones) with its equal weight equivalent. Since passive funds will buy more of the index's largest stocks, these inflows should open up a discrepancy between the two methods of calculating an index.

The below chart compares the S&P500 (SPX) with the equal weight S&P500 equivalent (SPW). Over the past five years the gap is a return of 23%. Much of this occurred in the last couple of years. Another way to put it is that the market cap weighted index has added $3.9 trillion of value over the equal weight index.



Source: Bloomberg, Spheria Asset Management.

The difference is more dramatic for the NASDAQ100. Below we compare the NASDAQ100 (NDX) with the equally weighted NASDAQ100 equivalent (NDXE). The difference in returns is an extra 145% for the market cap weighted index. The majority of this outperformance has taken place since 2015 when the switch to passive funds started to take hold in earnest. The market capitalisation of the NASDAQ100 is $11.6 trillion at the time of writing. So that's an additional $2.9 trillion of value for the market cap weighted index over the equal weighted index during the past five years.



Source: Bloomberg, Spheria Asset Management.

Continued on the next page...

This dollar difference between equal weight and market-cap weighted indices is in the vicinity of the money that has poured into passive funds at the expense of active funds. They are large numbers, and the switch to passive has become mainstream.

What worries us is that passive investing is akin to avoiding vaccinations. If a small proportion of the population stops getting vaccinated, they are likely to be protected by the herd's immunity. However, if a large portion of the population stops getting vaccinated, they become vulnerable to the virus. Likewise, in passive, it works so long as the majority of money is in active management, keeping the market rational and capital allocation efficient. However, if enough people switch into passive, fundamentals and rational capital allocation is no longer the dominant driver of stock prices. What will protect these passive investors from capital misallocation and future losses? What happens if we begin to see outflows from passive funds? Wouldn't we expect the Index to under-perform an equally weighted equivalent just as it outperformed with inflows?

In our opinion this experiment in passive investing may be neglecting the following facts:

1) **Markets don't always go up.** Periods where you would have been waiting some time to recoup your initial investment in the S&P500 include 1929-1953, 1965-1978, and of course 1999-2012. I'm ignoring the effects of inflation and the time value of money for simplicity. While the market may have gone sideways for extended periods of time, there is still opportunity for alpha generation (outperformance). Philosophically, We also refuse to believe that Mr Market is likely to make a person wealthy for doing something as simple as buying the largest companies available at the time. Parallels can be drawn with the Nifty-50 phenomenon of the 60s and 70s. That experiment did not end well for investors.

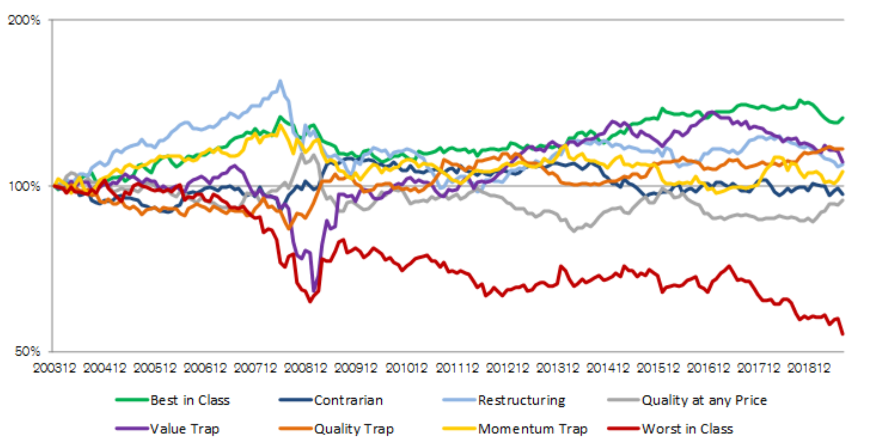
2) **Active investors tend to add value during market turning points such as the dotcom collapse and GFC.** Had you been invested in passive funds leading into the GFC your portfolio's largest positions would have likely included Citigroup, Bank of America and AIG. The table below shows the S&P's largest stocks before and after the dot-com crash and GFC, highlighting the risks of simply investing in the largest stocks at any given point in time.

1999	2002
Microsoft	Microsoft
GE	GE
Cisco	Exxon
Wal-Mart	Wal-Mart
Exxon	Pfizer
Intel	Citigroup
Lucent Technologies	J&J
IBM	AIG
Citigroup	IBM
AOL	Merck & Co

2006	2010
Exxon	Exxon
GE	Apple
Microsoft	Microsoft
Citigroup	Berkshire Hathaway
Bank of America	GE
Procter & Gamble	Wal-Mart
Wal-Mart	Google
J&J	Chevron
Pfizer	IBM
AIG	Procter & Gamble

3) **Data from Credit Suisse's HOLT system shows that an investment style that incorporates factors other than price momentum (or passive investing) such as operational quality (cash flow return on investment) and valuation provide superior risk-adjusted returns through the cycle.** The data below shows the difference between an investment style that includes these qualities in the green line, as opposed to momentum strategies labelled by HOLT as "momentum trap" and "quality at any price". Passive investing is just one narrow and straightforward strategy which is unlikely to perform throughout various market cycles.

Continued on the next page...



Yearly Excess Returns:

	Universe	Best in Class	Contrarian	Restructuring	Qualty at any Price	Value Trap	Quality Trap	Momentum Trap	Worst in Class
2004	16.8%	0.7%	-6.8%	10.6%	2.1%	1.1%	-8.0%	4.1%	3.0%
2005	10.9%	10.0%	-3.3%	8.7%	-2.1%	1.3%	-2.1%	8.1%	-4.7%
2006	16.1%	4.7%	9.9%	9.2%	-6.7%	1.4%	0.0%	4.1%	-4.8%
2007	7.8%	12.4%	-4.0%	10.9%	3.7%	-7.7%	-0.4%	9.3%	-7.9%
2008	-42.1%	-1.6%	3.9%	-4.4%	7.6%	-11.7%	-2.4%	-4.4%	-15.2%
2009	39.1%	-11.9%	12.7%	-19.5%	-21.7%	31.6%	21.7%	-11.7%	27.9%
2010	23.0%	-0.2%	-4.8%	6.6%	2.6%	11.8%	-2.4%	6.9%	-8.7%
2011	-1.3%	2.8%	-1.0%	-11.6%	1.4%	-4.2%	10.7%	-8.2%	-3.3%
2012	17.7%	0.8%	0.4%	1.1%	-3.5%	12.5%	4.9%	8.6%	-7.8%
2013	35.8%	1.6%	4.6%	14.0%	-6.8%	12.1%	-12.2%	4.3%	3.5%
2014	13.4%	2.2%	-6.3%	5.1%	1.5%	8.5%	-1.8%	-5.5%	2.4%
2015	-1.4%	9.5%	-6.6%	-2.6%	6.2%	-5.6%	7.0%	-0.1%	1.4%
2016	12.4%	0.3%	5.3%	-2.5%	-7.8%	14.5%	-1.8%	-9.5%	-7.5%
2017	21.4%	5.5%	0.9%	9.2%	-3.0%	-7.2%	2.1%	2.3%	-1.3%
2018	-7.7%	2.0%	-3.4%	-3.5%	0.6%	-6.2%	4.3%	4.6%	-8.5%
2019 YTD	20.4%	-7.4%	-2.0%	-9.2%	9.3%	-8.9%	2.4%	1.0%	-7.9%

Spheria Global Microcap Fund was designed to give investors a choice. The choice between stocks that have the attention of millions of investors, are trying to grow from an already large revenue base, and whose prices have been inflated by trillions of dollars of passive funds flow.

Or, a universe of undiscovered companies, in an embryonic stage with long growth runways whose current prices are free from the direct distortion of passive investing. In fact, for the Spheria Global Microcap Fund, 81% of the Fund's holdings (excluding cash) aren't even found in the MSCI Microcap Kokusai index.

For now, as the table below shows, the Microcap universe is still tethered to fundamentals. The only areas it does not trump its larger index peers is in free cash flow and gearing, hallmarks of the Spheria process. The Global Microcap Fund has a free cash flow yield of 5.9% and gearing of -1.0x (i.e. companies in the Fund have a weighted average net cash position). In our opinion, this undiscovered asset class remains the most attractive part of the equity market for investors with a long-term investment horizon.

Metric	Kokusai Microcap	MSCI World Smalls	S&P 500
PE	20.5	24.2	29.0
EV/EBIT	18.6	22.7	26.7
Price/Book	3.2	4.1	8.6
FCF Yield %	-0.7%	3.1%	4.4%
Div. Yield %	1.6%	1.6%	1.7%
Gearing	1.87	2.10	0.98
EPS Growth %	-1.7%	-12.6%	-5.1%

Source: MSCI, Bloomberg, S&P

	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 PA turnover	20%-40%
Style	Long only
APIR	WHT6704AU
Minimum Initial Investment	$25,000