

Performance as at 31st December 2021

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a. ³
Fund ¹	2.7%	5.1%	23.6%	17.9%	13.9%	13.3%
Benchmark ²	2.8%	3.9%	19.1%	18.0%	12.8%	12.4%
Difference	-0.1%	1.2%	4.6%	0.0%	1.0%	0.9%

¹ Spheria Opportunities Fund. Returns of the Fund are net of applicable fees, costs and taxes.

² Benchmark is the S&P/ASX Mid-Small Accumulation Index.

³ Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.



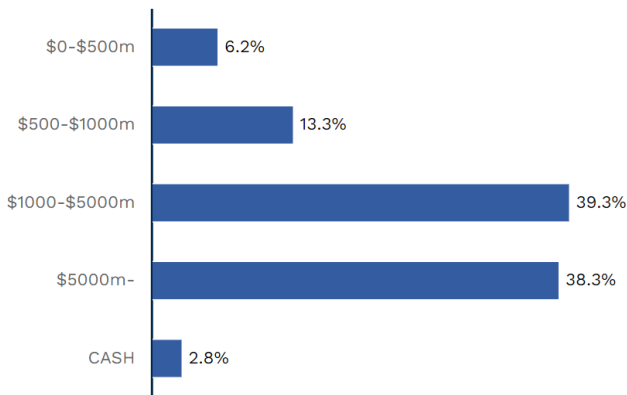
Overall Commentary

The Spheria Opportunities Fund returned 2.7% (after fees) during the month of December, very modestly underperforming the ASX Mid-Small Accumulation Index by 0.1%.

Top 5 Holdings

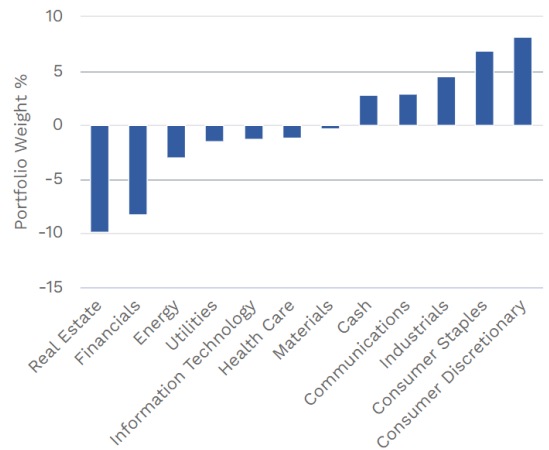
Company Name	% Portfolio
Crown Resorts Limited	7.1
Orora Limited	6.5
Alumina Limited	5.3
Incitec Pivot Limited	5.1
Atlas Arteria	5.0
Top 5	29.1

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

The local small and midcap indices were both higher over December despite a significant pull back in the small cap tech sector driven by concerns about rising interest rates and the resulting implications for valuations. Resource stocks outperformed industrials over the month as commodities were largely higher across the board with lithium, iron ore and oil in particular being standouts. Despite the concerns about rising interest rates gold rose 3% over the month and gold equities performed reasonably well. Property names also outperformed despite concerns about rising yields for Government debt, perhaps showing that investors believe they could be effective hedges against rising inflationary expectations. The losers during the month were dominated by expensive technology stocks, particularly those that have yet to demonstrate sustained profitability with Imugene (IMU.ASX), Sezzle (SZL.ASX), Dubber Corp (DUB.ASX), Novonix (NVX.ASX), Australian Strategic Materials (ASM.ASX), Life360 (360.ASX), Mesoblast (MSB.ASX), Zip Co (Z1P.ASX) and PPK Group (PPK.ASX) all down > 15% over the month as the market became concerned about the impact of rising discount rates on their long dated (potential) cashflows. Surprisingly perhaps given the local newsflow, most re-opening trades were fairly flat for the month after falling over the back part of November on the emergence of the Omicron strain.

M&A activity was once again elevated during the month with BGH bidding for IVF provider Virtus Group (VRT.ASX) and IGO Group (IGO.ASX) finally making a cash offer for nickel miner Western Areas (WSA.ASX) after stalking it for some time. Meanwhile Humm Group (HUM.ASX) announced it had received proposals to acquire all or parts of its business and lithium developer Prospect Resources (PSC.ASX) announced the divestiture of its flagship Arcadia hard rock lithium project in Zimbabwe to lithium-ion battery producer Zhejiang Huayou Cobalt Co. Finally, Helloworld (HLO.ASX) sold its interest in its Australia and NZ focused corporate travel business to specialist global player Corporate Travel Management (CTD.ASX) for a combination of cash and scrip.

The Fund very modestly underperformed as the drag from an underweight to the expensive but high momentum battery material names outweighed strong performance from low multiple consumer names like HT&E (HT1.ASX) and Michael Hill (MHJ.ASX).

Major Contributors for the Month

Michael Hill International (MHJ.ASX) was the largest contributor as the stock returned 15% over the month. The retailer of fine jewellery in Australia, New Zealand and Canada provided a strong earnings update just prior to the end of the month flagging an EBIT result “well above” that achieved last year (excluding the one off jobkeeper subsidy) despite a significant impact from the delta lockdown over July through October in its key NSW and Victorian markets. While the Omicron outbreak and people reducing exposure on a voluntary basis may impact second half trading, we are hopeful there should be less disruption over the key Valentines and Mother’s Day trading periods and would note that the business is cycling a very harsh lockdown of its Canadian operations over much of the 2H21 period. While there is some noise in the data, it is clear management of Michael Hill have presided over an extremely impressive turnaround of performance since the MD joined the business at the end of 2018 that is only now starting to be somewhat appreciated by the market. We see the firm as well placed to leverage its strong existing market position, robust profitability and cashflows and strongly net cash positive balance sheet to pursue growth opportunities not discounted by the current share price.

HT&E (HT1.ASX) contributed as the stock rose 18% during the month. HT&E completed the previously mooted liquidation of part of its holding in online travel provider Luxe Group (owner of the Luxury Escapes brand) demonstrating the value in some of its smaller and less well understood assets. We still see significant valuation upside in the stock on a sum of the parts basis. In our view the market is either ascribing a much lower than average through the cycle multiple to the core audio franchise or assuming a level of permanent earnings impairment that is at odds with evidence from international audio markets.

Crown Resorts (CWN.ASX) contributed as the owner of integrated resorts in Melbourne, Perth and Sydney rallied 9% over the month as the market looked through the spread of the Omicron variant and started discounting a potential increase to Blackstone’s November \$12.50 non-binding proposal to acquire the firm. Subsequent to year end, an increase to Blackstone’s proposal was in fact forthcoming with the private equity operator indicating its willingness to pay up to \$13.10 in cash subject to further due diligence, entry into a binding scheme implementation agreement and unanimous recommendation by the board and regulatory approval from State gaming regulators in Victoria, Western Australia and New South Wales. We believe this outcome, despite the significant impacts of the pandemic and the well publicised issues revealed at the inquiries into Crown’s historical conduct, is a testament to the quality of the assets of the group.

Major Detractors for the Month

A2 Milk (A2M.ASX) was the largest detractor as the stock fell 8% over the month of December. While there was no stock specific news in the month the slide in the share price may have been driven by the emergence of the Omicron variant which is likely to extend the disruption from COVID-19 in the daigou trade that sees the A2 brand introduced to many new Chinese consumers and potentially to Chinese birth rates which have been impacted since the start of the pandemic. While we acknowledge that the firm’s FY22 result is likely to be well below trend we think the combination of a very strong balance sheet, excellent brand and highly qualified executive team puts A2 in a good position to significantly improve its top and bottom-line results from the more recent disappointing outcomes.

Mineral Resources (MIN.ASX – Not owned) detracted as the mining services firm and producer of iron ore and lithium rallied 24% during the month. Mineral Resources had been sold off aggressively as the market became concerned that its low grade and high-cost iron ore operations would become marginal as the iron ore price fell over 60% from its July 2021 highs before recovering in early November to be up c50% from its recent bottom. Additionally, the lithium price which Mineral Resources has exposure to from its Mt Marion (50% owned) and Wodgina (40% owned) operations (once the latter is restarted) continued to rise throughout the month of December to record highs.

Pilbara Minerals (PLS.ASX – Not owned) detracted as the lithium hard rock producer rose another 23% -despite a near 15% production downgrade announced during the month – as the price of its spodumene concentrate continued to rise with that of the battery material inputs of lithium carbonate and lithium hydroxide (both now at record highs). While we acknowledge the demand profile of lithium is very strong due to the rise of EVs, we see PLS.ASX’s share price as unsupported by the through the cycle fundamentals. Firstly, we note the near non-existent cost of capital for lithium miners, developers and explorers is baking in a very substantial supply response from both existing and new producers. We also note that the surging price of

lithium carbonate and other battery inputs (cobalt, nickel, copper and aluminium are all up materially year on year) is now seeing material increases in battery prices by suppliers to their EV manufacturer customers. This raises the prospect of slower demand growth than the market may be assuming as consumers defer purchases, purchase vehicles with smaller battery packs or purchase plug in hybrids rather than full BEVs (e.g., China's BYD is growing its PHEV sales several times faster than its BEV sales). Further the surge in lithium prices is giving new impetus to competing technologies that could permanently substitute out lithium from some parts of the market that it currently dominates, and which are expected to enjoy the highest growth. India's Reliance Industries (RELIANCE.NYS – US\$232bn market cap) for instance purchased sodium ion battery specialist Faradion during the month and intends to invest significant sums to accelerate commercial rollout. They join Contemporary Amperex Technology (300750.SZ – US\$213bn market cap) which is the largest lithium-ion battery manufacturer in the world and announced during 2021 that it will launch commercial production of a sodium ion battery to compete in both automotive and stationary storage applications.

Outlook & Strategy

We see the market as fairly precariously balanced with COVID-19 induced supply shortages and the pandemic induced shift of global purchasing power to goods leading to rising inflationary cost pressures. These are likely to impact margins for business models without real pricing power on the one hand and heap pressure on Central Banks to raise interest rates (at least nominal rates) on the other with negative resultant implications for the valuations of cash burning concept stocks with long dated (and by definition highly uncertain) future cashflows. The rampant spread of the Omicron variant adds to this uncertainty given its potential for reduced consumer expenditure in face-to-face channels and logistical bottlenecks in supply chains as workers convalesce upon a positive diagnosis or isolate upon exposure to confirmed positive cases. Nevertheless, the experience of South Africa shows there is light at the end of the Omicron tunnel with cases, hospitalisations and even deaths all now well down from their peak in the first impacted province of Gauteng (home to the Capitol Pretoria and the major commercial hub Johannesburg). We remain confident that services will eventually trend back towards their historical share of consumption and GDP. We therefore remain constructive towards businesses with a track record of profitability and cash conversion (alongside a solid balance sheet) even where they have been hurt by the pandemic. On the flip side, we continue to avoid capitalising profits of companies that have been boosted above a sustainable baseline by COVID-19 induced behaviours.

We would expect a significant number of short-term earnings downgrades from Omicron and hope to selectively take advantage of these where the market is capitalising a more negative long-term outlook than we feel is reasonable. We continue to be positioned in stocks with significant valuation support, proven business models and good balance sheets as we expect M&A activity to remain robust given the procyclical nature of boards, corporate balance sheets being well cashed up and equity and debt capital remaining cheap and readily available. There continues to be pockets of the market (those leveraged to popular thematic) that appear well and truly overvalued. We continue to avoid these given a market that is inherently inefficient and regularly presents us with opportunities for rotation into names that satisfy our requirements on cashflow, balance sheet strength and valuation.

Platform Availability List

If a fund is not available on your preferred platform, please contact us.

Please check with your platform for minimum investment requirements and fees.

[FNZ Group](#)

[HUB24](#)

[mFund](#)

[Praemium](#)

[Macquarie Wrap](#)

Spheria Opportunities Fund	
Benchmark	S&P/ASX Mid-Small Accumulation Index
Investment Objective	Outperform the S&P/ASX Mid-Small Accumulation Index over the medium to long term
Investing Universe	Primarily listed companies outside the top ASX 50 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Holdings	Generally 20-65 stocks
Distributions	Half-Yearly
Fees	0.99% p.a. Management fee & 15% performance fee of the Fund's excess return versus its benchmark, net of management fee.
Cash	Up to 20% cash, typically 5% - 10%
Expected Turnover	30% - 40%
Style	Long only, risk aware
APIR	WHT0025AU
Minimum Initial Investment	\$25,000

Fund Ratings



Further Information

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311 or email distribution@pinnacleinvestment.com

Disclaimer

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