

Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU



Performance as at 29th February 2020

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	-11.8%	-5.0%	-0.8%	8.2%	8.0%
<i>Benchmark*</i>	-9.3%	-2.5%	3.4%	8.5%	8.1%
Value added	-2.5%	-2.5%	-4.2%	-0.2%	-0.1%

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

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

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.

Top 5 Holdings

Company Name	% Portfolio
Tabcorp	5.1
TPG Telecom	5.1
Crown Resorts	4.8
Incitec Pivot	4.6
Orora	4.3
Top 5	23.8

Source: Spheria Asset Management

Commentary

The Spheria Opportunities Fund returned -11.8% (after fees) in February, underperforming its benchmark by 2.5%.

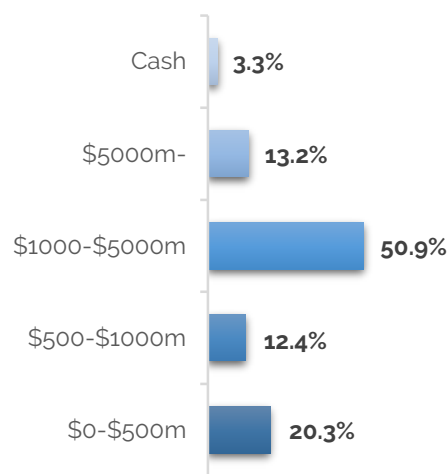
Markets

Global share markets began a steep correction in late February with the main trigger being fear surrounding COVID-19 and the follow-on economic impact of counter measures to contain the virus. We believe the ingredients for a correction were in place well before, including extremely rich valuations applied to companies that were conceptually appealing but with limited profitability and in many cases expanding losses. Thus, we positioned in companies with franchise value, some level of competitive advantage and a long-term track record of profitability in conjunction with a sustainable balance sheet - which seemed sensible. However, this did not protect us from market falls and in "actuality" we saw steeper share price declines in these stock prices in the month of February. Life is never fair and markets can be brutal and periodically irrational but we believe in the medium to long term we will be rewarded by our positioning given the valuations and financial metrics of the companies that we own, afford us some protection in a downturn versus the new and relative weaker competitors (as defined by lack of profitability) which may struggle to survive in a tighter funding environment.

Given the ongoing dramatic falls since the end of February, we believe it appropriate to provide an update on what we have been doing. Firstly, we have been analysing the COVID-19 statistics particularly the early figures from Australia versus other countries where it is more advanced. Whilst we are not infectious diseases experts, we do have statistical backgrounds that provides objectivity. From our perspective, whilst it is early days, we are hopeful that Australia's more pro-active approach to testing relative to many European nations and the recent significant tightening of international travel restrictions and social distancing measures should significantly reduce the chance of the viral spread becoming exponential in the community (given the preponderance of new cases continue to be imported cases).

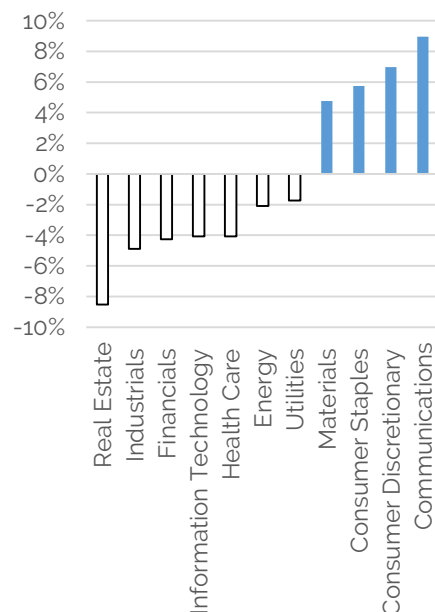
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Market Cap Bands



Source: Spheria Asset Management

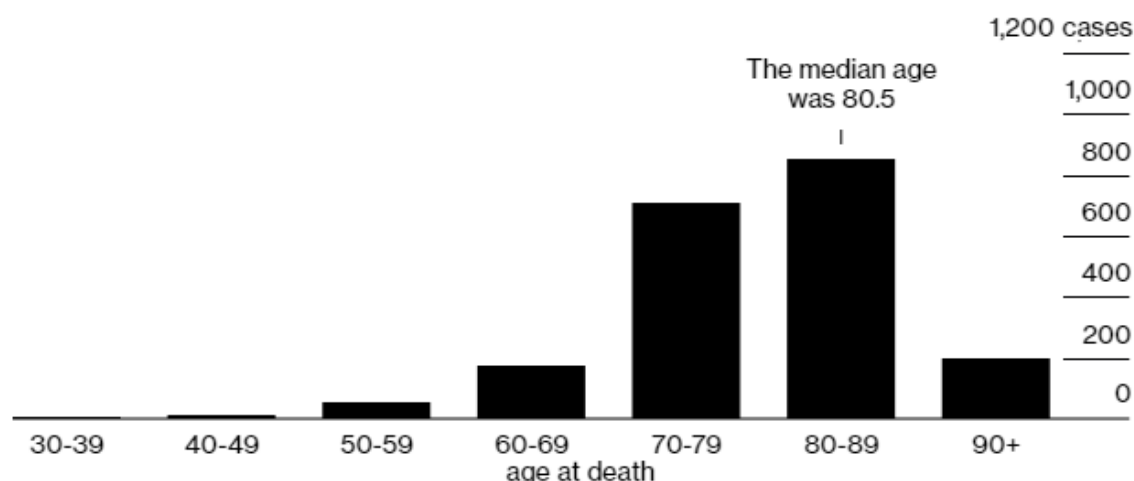
Active Sector Exposure



Source: Spheria Asset Management

This effort to 'flatten the curve' should spread the extreme pressure that could have been placed on the health care system in the absence of such measures and help reduce excess mortality from substandard care. Additionally, every day that passes without significant community spread is a day closer to the introduction of better diagnostic capability, repurposed or novel treatments that can reduce the case fatality rate, or even a much hoped for vaccine (noting that one has begun safety trials and a second is due to start imminently). It should be noted that China, Singapore, Hong Kong, Taiwan and even South Korea now appear to have slowed the viral spread to one well within their health care systems capacity to handle and where almost all new cases are imported cases.

Looking at overseas statistics, unfortunately, it appears the over 60 age group will be where mortality will be concentrated. Hopefully we are wrong on this front, but we need to be prepared for this eventuality. To put things in perspective, dementia* was the cause of nearly 14,000 deaths in Australia in 2016 and was the leading cause of death for Australian women, yet it receives little media attention. In contrast there have only been 6 deaths relating to COVID-19 so far (all over the age of 77). Those following the Italian experience which at face value appears catastrophic should note that it has the second oldest population in the world with over 23% of the population over 65 years of age. It also has a smoking rate of 23.7% vs. Australia's at 14.7% (smoking being a leading cause of hypertension and heart disease). A recent study by the country's national health authority (extract from Bloomberg) notes that more than 99% of Italy's COVID-19 fatalities were people who suffered from at least one pre-existing medical condition (with many suffering from multiple co-morbidities). More than 75% had high blood pressure, about 35% had diabetes and a third suffered from heart disease. The average age of those who died from the virus in Italy is 79.5 years (median 80.5) and only 17 people under the age of 50 have died from the disease and all those under 40 had serious existing medical conditions.



Source: ISS Italy National Health institute, March 17 sample

Clearly, shutting down meaningful chunks of the Australian and global economies - however temporarily - is having dire consequences on directly affected sectors and a significant flow on impact to a much broader segment of the market due to the sentiment hit the measures are having on consumers and the corporate sector. This will provide opportunities to buy companies where valuations have become irrelevant and solvency is now the key issue.

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We believe the government will intervene where companies are deemed too big to fail or too critical for the economy, this could be conducted via a TARP (Troubled Asset Relief Program) type vehicle that we saw the US Government employ during the GFC. They might also urge banks to provide relief to smaller businesses by providing repayment holidays. Tax relief for individuals is also a must. These will all counter the potential for mass bankruptcies caused by government measures to fight COVID-19 and the potential for a catastrophic increase in unemployment and bad debts that would have dire consequences for the banking system.

Fund Performance

Recently, we have been rotating our portfolios from a few defensive names that have held up well including Coca Cola Amatil (CCL) and TPG Telecom (TPM) into companies that have underperformed significantly where the valuations are now much more attractive. Some of the notable additions to the portfolio ALS Labs (ALQ) and NIB Health (NHF). We have also increased weightings in REA and Orora Packaging (ORA). The common thread to these companies is the balance sheets are strong and the free cash flows/returns in a normal environment are solid. Our valuations are not based on the next 6 months earnings but are based on mid-cycle averages, which coalesce in a DCF. The market is too obsessed with short term earnings which has concerned us for some time. Hopefully, this crash in share prices cleans out this element of the market as those participants will be lost given most of the market will be in a downgrade phase for the next few months at least. Value or valuation-based investing may come back in vogue which we think is a good dynamic for equity market stability.

Outlook

Going to cash is not an option, in our view, as Central Banks around the world will continue to debase this via ever more negative real interest rates and QE, particularly given Governments will have injected substantial stimulus in their efforts to fight the virus and its economic impacts. The period directly after WWII is instructive here in our humble opinion. Governments had massively leveraged themselves during the War (US debt to GDP soared from 50% to 120%) with US deficits peaking at a staggering 27% of GDP in 1945. What followed however was a 35 year period of financial repression to debase that debt that saw real assets (shares and property) spectacularly outperform bonds and cash. The beneficiary once a light emerges at the end of the tunnel will be equities and asset inflation more generally. Whilst we are conscious that COVID-19 will take lives and counter measures have sharply reduced economic activity, we believe that human race is more resilient and in a better position to deal with this now than at any time in the past. Historically, panics in share markets have been great buying opportunities for long term investors. We believe this will be no different and global coordinated stimulus will once again be effective, even though now it is being shunted into the background by fear. The rally we suspect will be unexpected and violent when the realisation dawns that the virus will be defeated and that cash is a poor long-term investment particularly when it is constantly debased by monetary authorities. Those that sold during the GFC felt good for a while but missed out on huge returns that ensued.

We urge clients not to overreact to the market panic. The world economies will recover in time. Balance sheets for the vast majority of our portfolio companies are strong such that the companies will weather the storm and will come out the other side in a better position. Though painful and frightening, the path beyond a stock market crash tends to be a very profitable journey for people that can remain calm and objective.

** In June 2019 a partnership was initiated between Spheria Asset Management and the Pinnacle Charitable Foundation with the Perth based Australian Alzheimer's Research Foundation (AARF), supporting the charity's work to help find a cure for this debilitating disease - which strikes randomly, is incurable and is currently the second leading cause of death in Australia.*

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	Spheria Opportunities Fund
Benchmark (universe)	S&P/ASX Mid-Small Accumulation Index
Investment objective	The Fund aims to outperform the S&P/ASX Mid-Small Accumulation Index over the medium to long term
Investing universe	Primarily listed companies outside the top 50 ASX listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Distributions	Half yearly
Fees	0.99% p.a. management fee & 15% performance fee of the Fund's excess return versus its benchmark, net of the management fee
Cash	<ul style="list-style-type: none">• Up to 20% cash• Typically 5% - 10%
Expected turnover	30-40%
Style	Long only, risk aware
APIR	WHT0025AU
Minimum Investment	\$25,000

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