

## Performance as at 31st January 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a <sup>3</sup>
Fund <sup>1</sup>	-5.5%	-3.5%	17.9%	14.1%	12.8%	12.0%
Benchmark <sup>2</sup>	-8.8%	-5.8%	9.3%	12.5%	11.0%	10.4%
Difference	3.3%	2.3%	8.6%	1.6%	1.8%	1.6%

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

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

<sup>3</sup> 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.



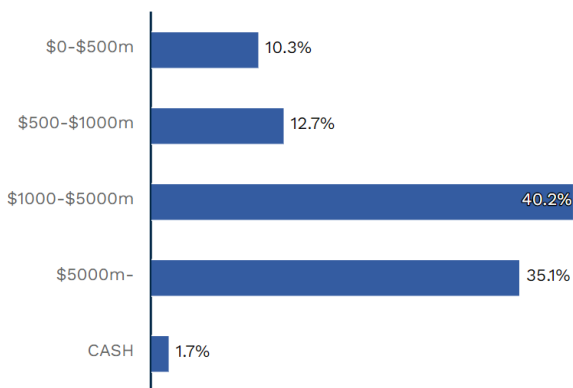
### Overall Commentary

The Spheria Opportunities Fund returned -5.5% (after fees) during the month of January, strongly outperforming the ASX Mid-Small Accumulation Index by 3.3%.

### Top 5 Holdings

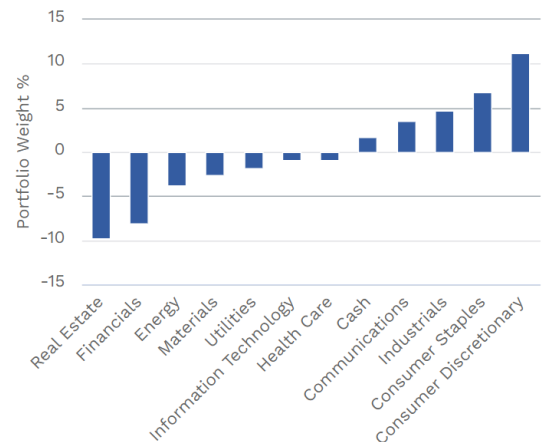
Company Name	% Portfolio
Crown Resorts Limited	6.6
Alumina Limited	5.8
Atlas Arteria	5.1
Incitec Pivot Limited	4.9
Michael Hill International Limited	4.9
<b>Top 5</b>	<b>27.3</b>

### Market Cap Bands



Source: Spheria Asset Management

### Active Sector Exposure



Source: Spheria Asset Management

## Markets

The local small and midcap indices were both materially lower over January – down close to 9% – as the market absorbed the continued newsflow around inflation and the reasonably material adjustment to interest rate outlooks by Central Bankers. As children who lived through the 80's, we had been suggesting that inflationary pressures were more than just transitory impacts of a post Covid crisis. Watching cafés raise prices 5-15%, cleaners readjust prices over 10% and seeing unions striking for better pay conditions, all suggested to us that cost increases were broad based and that labour rates were heading higher. It is somewhat ironic that inflation is precisely what Central Banks have been trying to engender for some time via the consistent debasement of currencies. This deflates the real value of the debt balloons which Governments around the world have taken on and sold predominantly to their own Central Banks. As rates rise, the value of bonds falls. This doesn't bode especially well for the balance sheets of Central Banks, all of which are now bloated with super low yielding bonds and all of which are now decreasing in nominal (and real) value as longer-term bond rates tick upwards.

In a falling rate environment, momentum is your friend. The longer the duration, the growthier the company the more the stock can rise. If you use spot rates in your valuations even small decreases on a very small discount rate base can see sharp upward re-valuations in companies. This had led to quite a few smaller companies that we felt were – to put it mildly – trading significantly above intrinsic value. You could easily use a harsher description. The list of some of the worst hit stocks in January reads like an honor roll of companies with large market caps on small revenue bases, with even smaller earnings bases. On the other side of the ledger, valuation almost became a fashionable word. This is what makes investing in smaller companies generally an enjoyable occupation with volatility often creating some great opportunities.

## Major Contributors for the Month

**Crown Resorts Ltd (CWN.ASX)** rose modestly (1%) over the month as the stock remains under takeover offer from Blackstone at \$13.10 a share. With a likely recovery in tourism and travel on the cards, an apparent willingness to sell from the largest shareholder and a valuation strongly supported by significant property holdings, we see the takeover proceeding as a reasonably high chance event. The time value of money and the possibility of the deal not proceeding are likely to mean that the shares continue to trade at a discount until the deal is finally approved.

**Santos (STO.ASX)** was acquired as part of STO's merger with Oil Search (OSH.ASX) which was completed late December 2021. STO had offered 0.6275 shares in STO for each OSH share in September 2021. The merger was designed to combine STO's strong cashflows with the development potential within OSH, which is typically capex heavy. Over January the WTI price surged a further 15%, which has supported the share prices of Oil and Gas companies including STO which increased 13%. With current oil prices flowing through earnings and cashflows, STO will be generating prodigious levels of operating cash flow enabling a rapid de-gearing of the combined balance sheets. The company has indicated US\$90-115 of synergies should be available from the merger adding a further 5% to forecast combined group EBIT.

**Alumina Ltd (AWC.ASX)** increased a modest 1%, which represented a solid result in a weakening market. Alcoa (60% owner of the AWAC JV) reported their Q4 results which contained key information on the AWAC JV. Overall, this looks to have been a solid result for AWC although management were flagging cost increases from energy and caustic soda into the second half for AWAC.

## Major Detractors for the Month

**AGL (AGL.ASX – not owned)** AGL which is in the process of de-merging itself into two companies (Accell Energy – focused on generation and AGL focused on power retailing) rose 15% over January. The main driver of the share price appears to be an increase in forward power prices which in turn are partly being driven by rising thermal coal prices. AGL carries a significant debt burden and has had a volatile earnings history in addition to significant ESG issues. The Fund does not hold shares in the company.

**Vista Group (VGL.ASX)** detracted from performance as the share price declined 15%. We have spoken about VGL before and its strength in the cinema market as the leading provider of ERP software to cinema exhibitors. Whilst Omicron has tempered investors views on the speed of re-openings across Europe, we are of the view that appetites for sustained lockdowns amongst countries is rapidly waning and that VGL will see a dramatic improvement in prospects this year. The business remains in a strong position with a net cash balance sheet and is trading on around 14x recovered EV/EBIT.

**Brainchip Holdings (BRC.ASX – not owned)** surged 110% over January on news that it had been granted a US patent for its AI neuromorphic chip. BRC makes a low powered AI chip that could have applications in the aerospace and automobile industries. At present BRN has virtually no revenue, a skinny balance sheet (US\$23m net cash as at September 2021) and is losing a significant amount of earnings and cash flow. Whilst the ultimate product may be a success, with an enterprise value approaching \$3.0 billion we continue to believe there is better investment alternatives elsewhere.

## Outlook & Strategy

Periods like the market sell off in January serve as a useful reminder that the 'animal spirits' of investing need to be grounded by logic, reasoning, and fundamentals. The market is re-appraising the medium-term interest rate outlook in the absence of Central Bank QE and is waking up to the prospect that this will see 10-year bond yields rise from their all-time lows plumbed in CY2021. Whilst volatility seems unpleasant in the short term, rotations like the ones we have just seen tend to provide opportunities for our style of investing and should see a more rational approach to capital allocation in the smaller companies space. We have long argued that very low interest rates for a sustained period can lead to misallocation of capital. The funding of loss-making new enterprises against legitimate incumbent businesses for example, should come to an end if there is no reasonable prospect of them turning a profit. The market has been fixated by the idea of new technologies and business models for the past few years and been willing to fund ever expanding losses with a dim future prospect of earnings and cash flows. With rates on the rise this exuberance is likely to be tempered favouring strong existing business models on attractive valuations.

## 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](mailto:distribution@pinnacleinvestment.com)

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