Financial Year in Review

Compared to recent years, global share market returns[1] were relatively subdued across FY2019, rising by 5.7%[2] in US dollar terms. What this benign headline return figure hides however, is just how badly all financial markets were punctured during the December quarter of 2018. At its September 2018 meeting, the US Federal Reserve raised interest rates for the third time in 2018 and, crucially, guided that it expected to raise rates both for a fourth time in December, and then a further three times during 2019. Having already digested seven interest rate hikes over the previous twenty-two months and facing a further four rate hikes in the months to come, financial markets – supported for years by low rates and easy money - capitulated. From the end of September through to Christmas eve, global share markets fell by 16.2% in US dollar terms. Higher risk and growth sensitive assets classes fared the worst over this period. In the US, small cap stocks fell by 25.1%, while the 'FAANG' basket of technology stocks, a key driver of overall market returns in recent years, fell by 25.5%.

In the face of collapsing markets, vocal criticism from President Trump, and some signs of weakness in the future economic outlook, the US Fed pivoted substantially at its December meeting. While it raised interest rates as previously indicated, it adopted a much more dovish tone regarding the outlook. This swing in the Fed's future positioning was the catalyst for a sharp market rebound. Further, as 2019 has progressed, this dovish tone from the US Fed has become accompanied by a more broad-based darkening of the global growth outlook. In the US, growth had already begun to slow back towards more sustainable levels, with the effects of the one-time stimulus boost from the Trump administration's tax cuts fading. Outside of the US however, global growth in 2019 has begun to slow noticeably. In the European Union, growth rates, already falling over 2018, have slowed markedly as 2019 has progressed. Having recorded a brisk (for EU standards) growth rate of 2.4% in 2017, growth fell to 1.9% in 2018 and is projected to now fall to just 1.4% in 2019. Worryingly, much of the slow-down in the EU this year is attributed to a stalling German economy, with Germany historically acting as the key growth powerhouse for the region. In Asia, though expected, Chinese economic growth rates continue to fall, hitting a 27 year low in the June quarter of 2019. While in Japan - an economy heavily reliant on exports – the incoming data has shown exports falling every month of 2019 so far.

In the face of a worsening economic outlook, financial markets have primed themselves for considerable monetary easing over the second half of 2019. Between September 2018 and June 2019, the US Fed's original guidance of three interest rate hikes during 2019 was completely unwound, with the Fed delivering a 0.25% cut at its July meeting and markets now anticipating two more cuts before year end. Likewise, markets currently expect both further interest rate cuts and/or additional rounds of quantitative easing in both the EU and Japan.

Thus, having capitulated in the face of rising interest rates at the end of 2018, risk assets staged a stunning rebound in 2019, propelled higher by the prospect of falling interest rates, and potentially, further quantitative easing. The deteriorating global economy has therefore re-ignited a version of the 'Goldilocks' narrative that has made frequent market appearances in recent years. The current version of the 'Goldilocks' theme is one where bad economic news equates to good market news and it runs along the following lines: as inflation continues to run well below target, central banks have latitude to cut interest rates and/or engage in further rounds of quantitative easing. Further, while the growth outlook has begun to deteriorate, it has not yet become bad enough to be truly concerning. Markets can thus enjoy the sugar-rush of lower interest rates today, without having to worry too greatly about the more troubling scenario of a future economic recession.

Absent the risk of recession, further rounds of monetary policy easing should, in the near-term, continue to create a supportive backdrop for risker assets like shares. It should be remembered however, that the reasons that central banks are poised to once again embark on more rounds of monetary easing are hardly positive when looking out over the longer-term. They are based on a bleak assessment of the prospects for heavily indebted rich-world economies in a low growth, low inflationary world.

Performance of the Portfolio

The foundation of the Global Value Fund is to invest into a diversified global portfolio of financial assets, all purchased at attractive discounts to their intrinsic value. This approach is then paired with an active strategy designed to capture the value presented by these discounts. In doing so, GVF aims to offer investors two sources of return: the see-through investment return

[1] Global share market returns refer to the MSCI All Country World Index.
[2] All market returns quoted are total returns, including net dividends. Source: Bloomberg LLP.

from a lower-risk portfolio of financial assets, and then an additional source of return from the successful application of the Company's discount capture strategy.

Our approach allows us to aim to generate equity market like returns over the long run, but with a portfolio that offers a much greater level of downside protection than a typical portfolio of global shares. GVF thus has two equally important aims for its investors. To generate healthy investment returns over the long-term, *and* to preserve shareholder capital come what may in financial markets.

We have stated for some time now that, after a ten-year equity bull market, our conviction that compelling risk-adjusted returns can be readily found in share markets today is low. While we have never pretended to be able to call what broader markets will do next, given the building risks in markets today, we have, in recent times, believed it prudent to focus our attention on unlocking value from lower-risk asset classes. In doing so, the absolute returns generated by the fund have relied more heavily on the successful application of our discount capture strategy than the see-through returns from the Company's investment portfolio. In line with this approach the fund's see-through equity market exposure averaged 28%[3] during FY2019, towards the lower end of the range the fund has run with since its launch in 2014.

Our focus on risk-management and a lower risk portfolio of assets served the Company well through the dramatic market sell-off in the December quarter of 2018. From the end of September, through to the market low on the 24th of December, global share markets fell by 14% in Australian dollar terms. Over this same period the GVF investment portfolio fell by 4.0%[3].

While we were pleased with our success in protecting shareholder capital during one of the largest market sell-offs in recent years, our absolute investment returns did not participate in the dramatic rebound in higher-risk asset classes that followed. Financial markets this calendar year have been propelled higher by the world's major central banks guiding that substantial amounts of monetary stimulus are once again in the works. This is the 'bad news is good news' narrative discussed earlier, with a weaker economic outlook prompting central banks to cut interest rates (the US) and/or embark on further rounds of Quantitative Easing (EU and Japan).

Over FY2019, the Company's adjusted pre-tax NTA increased by 3.2%[3] with the successful application of our discount capture strategy adding 2.1%[3] (gross) to performance. Positive returns from this strategy represent outperformance (or alpha) over the fund's underlying market and currency exposures. While it is pleasing to report a fifth consecutive year of positive returns from our discount capture strategy, in absolute terms FY2019's performance was below the targets that we set for ourselves, and our historical success in pursing this approach.

Notable winners and detractors in FY2019

One of the inherently attractive features of the Company's investment strategy is the margin of safety that typically comes from investing into assets which are trading below their intrinsic value. Historically, this combination of a margin of safety - and our hands-on approach to unlocking discounts - has enabled the Company to achieve a very high win versus loss ratio across the investment portfolio. Since inception, through to the end of June 2019, GVF has generated positive returns on 84%[3,4] of all the investments it has made. While FY2019 still benefited from a very favorable ratio, 76% of investments held over the year generated positive returns, several high-conviction holdings detracted from performance during the year which merit discussion.

In our FY2018 review we quipped that GVF 'strives to be a to be an all-weather investment proposition'. There is therefore a degree of poetic justice that adverse weather events were one of the notable detractors to the Company's returns in FY2019. We wrote about our investment in Blue Capital Alternative Income Fund in our January 2019 monthly update. Blue Capital held a portfolio of weather-related reinsurance investments, and we had accumulated our position in this fund at an average discount to asset value of 11.4%. After running a hard-fought public activist campaign during the first half of calendar 2018, the fund was put into liquidation ahead of a return of capital to shareholders, scheduled for 2019. However, the six-month period between the end of our activist campaign, and the return of shareholder capital, proved to be one of the worst periods on record for weather-

[3] Source: Staude Capital Limited.
[4] This win versus loss ratio refers to active investments the Company has made, including, where relevant, market hedges. This metric excludes the impact of the Company's underlying currency exposures.

related natural disasters. These events, notably a series of hurricanes through the Gulf of Mexico, weighed heavily on the reinsurance industry and resulted in a 23% write-down in the carry value of Blue Capital's investment portfolio. Having run a successful activist campaign that unlocked value, it was frustrating to shoulder a fall in asset value that was greater than the 11.4% margin of safety we enjoyed from buying these assets at a discount.

Events like Blue Capital are, thankfully, relatively rare for the Company. Typically, when positions go against us, the value we are seeking to unlock remains intact and is just stored for another day. In such cases the near-term loss can represent a longer-term opportunity, allowing us to add to a high-conviction name at more favorable levels.

Two examples like this from FY2019 are worth discussing. The first is Third Point Offshore Investors Limited (TPOU), a London-listed hedge-fund with an impressive long-term track record. While the discount on this fund widened over FY2019, detracting from GVF's returns, our belief that the underlying value within this fund will ultimately be realized was strengthened greatly over the course of the year. A number of TPOU shareholders, including GVF, have been actively engaged with the fund. In response, the Board has brought forward several major initiatives, which we believe will be greatly beneficial in unlocking value for shareholders. Probably the most important of these was the appointment of a new independent Chairman, Steve Bates, in February 2019. Steve is a robust independent director who understands the existential problem that the fund's current excessive discount represents, and who appears determined to tackle this head-on. In addition to a new independent Chairman, the Board has also renegotiated lower the management fees being paid to Third Point and has begun an aggressive capital management program. This program has seen over 15% of the outstanding shares on issue bought back and cancelled since December of last year. It has also added 4% to the fund's returns due to the accretion of buying back shares so cheaply. The fund ended FY2019 trading on a 25% discount to asset value and GVF added to its position during the year at these new cheaper levels. Fundamentally, we believe the current discount is unsustainable over the long-run.

The second example of 'stored value' that we believe FY2019 generated for us was our investment in VPC Specialty Lending Investments (VSL), a London listed closed-end fund that lends to middle-market financial companies, mainly in the USA. VSL was originally a turn-around story for GVF. The managers investment strategy, while still generating positive returns, hadn't lived up to its stated targets during 2016 and 2017. 2018 heralded a re-focusing on the managers very attractive core lending business and the divestment of a newer, less successful, lending book. After undertaking extensive due-diligence on the new re-focused approach, GVF built a position in the fund at an attractive discount to asset backing. Our thesis being that a significant turn-around in investment performance would re-rate the shares. Pleasingly, the re-focused investment strategy has been a great success, with the fund's underlying lending portfolio generating net returns of 10.9% over FY2019, by far its best year on record, and representing a new sustainable run-rate for the company, in our view. While our original investment thesis was proved, unfortunately in the final months of FY2019, VSL's share came under significant selling pressure for reasons unrelated to the medium-term value story we see. The first of these was that one of its largest shareholders was Woodford Investment Management. The fall from grace of Neil Woodford, one of most famous investment managers in Britain, has dominated the financial press this year. Sadly, his travails have forced the gating of his main investment funds and large scale forced-selling across many of his holdings. In the case of VSL, this meant that the final months of FY2019 saw considerable selling as Woodford offloaded its 18% stake in the fund. Further adding to this selling pressure dynamic, VSL was also erroneously removed from the important FTSE All-Share Index in June 2019, resulting in a considerable amount of technical selling pressure, as index funds removed it from their holdings. GVF took advantage of these market dynamics, adding to its position at highly attractive levels. Notably in July, the FTSE index service announced that it had incorrectly removed VSL from the All-Share Index and re-instated the company. This resulted in considerable index buying during July, which has helped re-rate the share price since year-end.

Away from the short-term market related noise, we remain very constructive on our holding in VSL, which we have carried into FY2020 at a 20% discount to asset value. We are actively engaged with both the manager and the Board and believe that the actions they are taking will serve to greatly reduce the discount during the year ahead. Failing this, the fund is subject to a continuation vote in 2020, at which point shareholders will have the right to vote to put the company into liquidation. Further, the improved investment performance and deep discount means that GVF is currently earning a running yield of over 10% pa while we work to see the underlying value unlocked.

Moving away from those investments that have not yet panned out as expected, the Company also recorded several notable successes during FY2019. One of GVF's largest positions throughout the year was its holding in Pershing Square Holdings, a

Dutch listed closed-end fund managed by Bill Ackman, a famous wall-street activist investor. Our investment thesis with Pershing was relatively straight-forward, after several years of poor performance the fund had begun trading on a very wide discount to its underlying asset backing, enabling GVF to accumulate a position at a 23.5% discount to NTA. In the coming years our belief was that either Bill's investment performance would improve, or that investors in his fund (including ourselves) would demand action to address such a wide and unjustifiable discount to asset backing. Pleasingly, the former of these outcomes prevailed. The Pershing investment portfolio increased by 21.6% over FY2019, greatly outpacing general share market returns and thus meaningfully contributing to GVF's total investment performance over the year.

Another of GVF's larger holdings in FY2019 was its position in Carador Income Fund Plc (CIFU). CIFU is a closed-end investment company domiciled in Ireland and listed on the London Stock Exchange. It primarily invests into the equity and mezzanine tranches of collateralised loan obligations (CLOs), which are debt securities backed by diversified pools of bank loans. The CIFU investment portfolio is managed by GSO/Blackstone, one the largest alternative asset managers in the world.

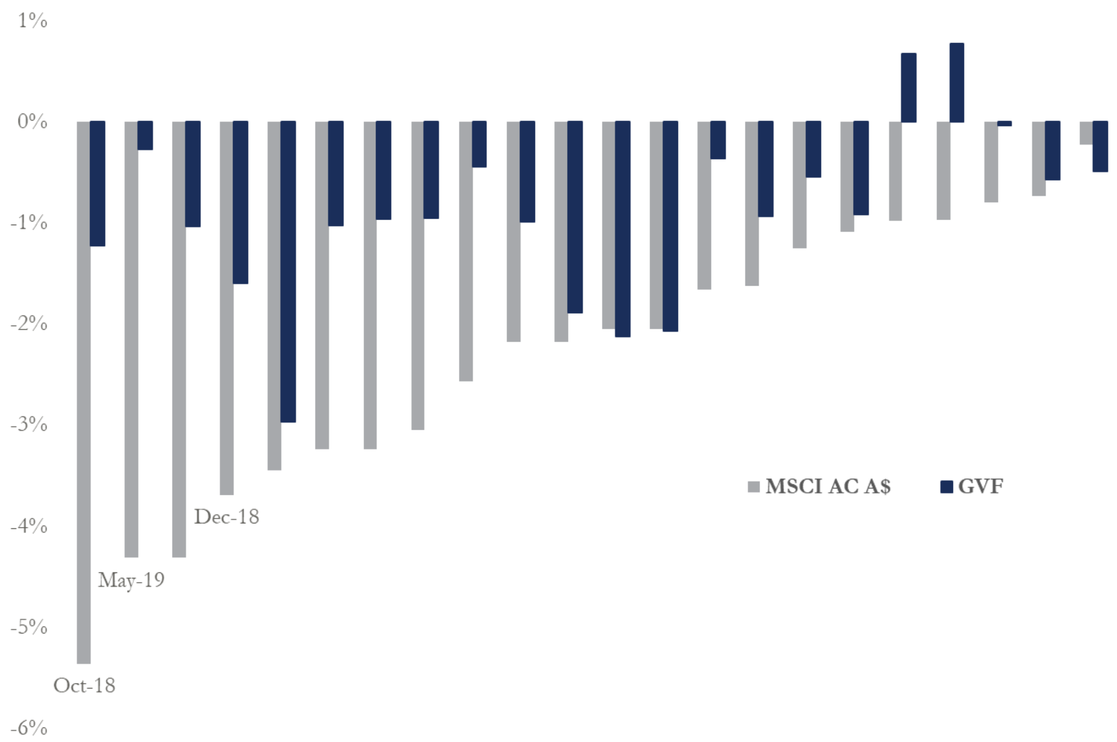
CLOs are an often-misunderstood asset class, resulting perhaps from being too easily confused with 'CDOs', a much broader form of debt securitisation. Infamously, CDOs were used to finance the excesses of the US mortgage market in the run-up to the 2008 financial crisis. CLOs in contrast are backed by corporate credit in the heavily regulated bank loan market. For this reason, CLOs, unlike CDOs, have exhibited very low levels of default.

Whilst CLOs are not CDOs, they are still multifaceted debt instruments that require reasonable amounts of due diligence to fully understand. What attracted us to the CIFU investment was that, in our view, the fund had largely been sold to an investor base that did not properly appreciate the unique risk and return attributes of the underlying portfolio. As a result, the fund continually traded at an excessive discount to its asset backing. We built a meaningful position in CIFU at an attractive discount to NAV and engaged with the company. Not long after this the Board brought forward proposals to liquidate the CLO portfolio, offering investors a cash exit. The bulk of CIFU's CLO portfolio was realised progressively over the course of FY2019, at prices that were in-line with the fund's asset backing, allowing us to realise the majority of the underlying discount during the year. The resulting uplift from these cash realisations made CIFU one of GVF's best performing investments in FY2019. We currently expect to receive the small remaining balance of the CIFU investment portfolio, again at asset backing, over the course of FY2020.

The final notable success to discuss for FY2019 was GVF's investment in DW Catalyst Fund Ltd (DWCG). DWCG, listed on the London Stock Exchange, was a feeder fund into a large credit hedge fund run by DW partners. The master fund that DWCG invested into had a long-track record of delivering reasonable returns with low levels of risk and limited correlation to overall market movements. Despite this success, DWCG had suffered from a broader sector de-rating which has affected most of the London listed hedge fund universe in recent years. The fund had shrunk considerably and was continually contending with a large and persistent discount to asset backing. Like with CIFU, GVF built a large stake in DWCG at an attractive discount to NAV and began engaging with the company. Following this, the Board of DWCG brought forward plans to liquidate the fund and return capital to its shareholders. Over the course of FY2019 GVF realised its entire holding in DWCG at asset backing, thus allowing us to unlock the considerable underlying value within our investment.

Risk Management

We wrote last year that the virtue of managing risk can be easily overlooked when markets are rallying strongly. Over time however, we believe it is a practice that will ultimately benefit investors greatly. It is our belief that the drivers behind the current 'bad news is good news' narrative must, at some point, turn. Either the economic outlook will continue to deteriorate, at which point markets will begin to price in the building risks of a rich-world recession. Or, alternatively, an improving economic outlook must turn the 'bad is good' logic back on its head, with central banks needing to move once again towards a tightening bias. After being carried higher for a decade on the back of extraordinary levels of central bank monetary support, the December quarter of 2018 illustrates well how sensitive higher-risk assets are today to even modest levels of future tightening.
The chart below shows the draw-down history of the investment portfolio since the Company's IPO. The first column in grey shows months where global equity markets[1] have fallen in Australian dollar terms, with the three worst months of FY2019 annotated on the chart. Beside the grey, in blue, is the corresponding net investment return of the Global Value Fund portfolio in the same month.



Despite managing a significantly lower risk portfolio than one invested solely in international share markets, the fund has generated annualised adjusted NTA returns of 9.6%[3] since IPO.

Outlook

It is said that happiness equals outcome minus expectation. In US dollar terms, global share markets rallied 17% over the first six months of 2019. This rally has come in the face of a deteriorating growth outlook and falling 2019 company earnings estimates in the US, Europe, Japan and China. Accordingly, much is riding on the delivery of the significant levels of central bank easing that markets are anticipating over the second half of this calendar year. Somewhat perversely therefore, any brightening of the economic outlook in the near-term is likely to weigh heavily on share markets, given the risk that this would lead to less than expected levels of future easing.

Regardless of how the current iteration of the Goldilocks thesis unfolds, GVF will continue to keep its head below the parapet and focus on unlocking value across a range of different asset classes. One of the consequences of releasing less value than we hoped for from our portfolio in FY2019, is that the Company begins FY2020 with higher than usual targets across many of the positions in the fund. Importantly, our ability to unlock this value is independent of what broader markets might do, while the lower risk nature of our portfolio should offer an important level of protection against any significant market corrections ahead.

The team and I would like to thank all our shareholders for their continuing support throughout FY2019 and especially for the many kind messages that we received during the year.

Miles Staude
Director and Portfolio Manager
29 August 2019