December 2022 half-year review by the Portfolio Manager

The driving force across financial markets for the past 18-months, has been the reappearance of worryingly high levels of inflation throughout developed world economies. Having spent the decade between the global financial crisis and the pandemic dealing with inflation that was too low, central bankers have, with very little warning, been presented with the opposite problem. At stake in confronting this is not just the mundane sounding problem of 'maintaining price stability', but the hard-won inflation fighting credibility of central banks themselves.

Having initially been too slow to respond during the latter part of 2021, policy makers spent most of 2022 trying to get out ahead of the problem. The result was one of the fastest policy tightening cycles on record. From a financial markets' perspective, most of the pain from this was felt during the first half of calendar 2022. From the end of December 2021 to the end of June 2022, global equity[1] and bond[2] markets fell considerably - in US$ terms, by 20.2% and 15.6% respectively. What was striking about these falls was both their magnitude, and the fact that both asset classes recorded such steep falls at the same time. Conventional asset management theory typically seeks to create portfolios that combine both asset classes, under the assumption that they rarely move in the same direction at the same time. Sadly, holding bonds and shares together during the first half of 2022 greatly amplified investment risk instead of ameliorating it.

Turning to the December half of 2022, and the 6-month period of our review, what is noteworthy is that, by and large, market forces had normalised. That might seem an odd thing to say with inflation rates near double digits in many countries, central banks continuing to tighten policy, and a lot of hyperbole around this from market commentators. However, by the middle of 2022, most of the painful adjustments that central banks needed to deliver were done, both in terms of the actual tightening of monetary policy, and in terms of setting the markets expectations around the relatively modest amounts of tightening that was still to come. It is true that the investment landscape we are confronted with today looks very different to the one we have been used to for many years: in the US, short term interest rates have rarely been much above zero for the past 14 years, yet today they sit at 4.5%. Nevertheless, for the forward-looking market, by July of 2022 the necessary adjustment to this 'new normal' was largely complete.

Over the December half-year period, financial markets were largely range-bound, a feature of the fact that while we don't know exactly when the current tightening cycle will end, the finish line is now clearly in sight. The arguments today are whether the US Fed is going to raise interest rates by a final 0.25% or 0.5%, not whether there is a further 2% or 4% of tightening to come. In US$ terms, global share markets eked out a 2.3% gain during the December half, while global bond markets fell 1.6%. Most major currencies were also little changed against the US$ over the period, as were key commodities such as Oil, Gold, and Copper (a notable exception to this was Iron Ore, which rose by 15.7% over the period). Indeed, given the volatility of asset classes like Oil and global share markets, what is most striking is how little prices moved over a 6-month window.

In Australian dollar terms, which is the base currency from which GVF invests internationally, global share markets rose 3.6% and global bond markets fell 0.3%. In comparison, GVF generated adjusted NTA returns[3] of 8.1% over the period, while shareholder total returns were 6.1%. For calendar year 2022, which includes the large market correction that took place in the first half of the year, GVF's adjusted NTA returns, and shareholder total returns were both +0.4%, which compares very favourably to global share and bond market returns of -13.0% and -11.5%, when measured in Australian dollar terms.

[1] Global share markets refer to the total return (price and dividends) of the MSCI All Country World Equity Index
[2] Global bond markets refer to the Bloomberg Barclays Global Credit Total Return Index
[3] Adjusted NTA returns are net of all fees and expenses. NTA adjusted for dividend and tax payments and the effects of capital management initiatives. Source: Staude Capital Ltd

Our recent investment performance hopefully demonstrates the value of holding GVF as part of a wider investment portfolio. While we are not immune to broader financial market conditions, we strive to generate healthy returns regardless of the prevailing market weather. In doing so, we hope to provide both an attractive investment return to our shareholders, *and* an important diversifying tool for investors to use in their portfolios. To that end, the GVF investment portfolio typically generates most of its returns from identifying compelling market opportunities around the world, or from constructively unlocking the value embedded within its portfolio holdings. Which is to say, we generate most of our returns from places that are unrelated to what broader markets are doing. True to form, the top three contributors to performance during the half were all investment stories that were largely agnostic to developments in financial markets. Those were our holdings Amedeo Air Four Plus (AA4), New Energy Solar (NEW) and Trian Investors 1 (TI1). We have discussed our success at each of these holdings in our recently monthly reports, which can be found here, here, and here respectively. In aggregate, these three holdings contributed 3.7% to GVF's investment returns during the period. At this time, we will not list our three largest negative contributors to performance over the half-year. We are still actively adding to these holdings and each name is relatively thinly traded where competition for stock is high. What we can highlight, however, is the continuation of the considerable positive skew we typically see in our performance. By this we mean that our successful trades usually generate far more for us in positive performance than our detractors cost us in negative returns. As stated above, our three largest contributors to returns generated +3.7% collectively to performance over the half. By comparison, our three biggest detractors combined only contributed -1.1% in returns.

Outlook

Looking ahead, to say that market forces have normalised again is not to say that there is any certainty about the outlook, or a consensus on where we end up. Rather, it just means that the daily arm-wrestle between the market optimists and pessimists is now more evenly balanced. Assessing what is known today, it is likely that rates of inflation have peaked, and thus we are drawing to the end of the current monetary policy tightening cycle in most rich-world countries. We also know that it is likely, but not certain, that key economies like the US and Europe will endure a recession sometime during 2023. Finally, there is the recent ending of China's "zero-covid" policy and its reopening to the world, a development that is likely to boost global demand and growth. The optimists see all those facts and divine a "soft landing" ahead, perhaps even the avoidance of a recession, while contending that falling rates of inflation and economic growth will provide policy makers scope to cut interest rates later this year, boosting asset prices once again. The pessimists fret that the market has not yet appreciated the depth to the falls in company earnings that lie ahead, while arguing that it is far too soon for central banks to turn around and start cutting interest rates once more. Finally, while a reopening of China will undoubtedly boost aggregate global demand, whether this is a good thing, or a bad thing, remains to be seen at time when policy makers are frantically trying to get inflation back under control. Indeed, given the precarious situation Europe faces in terms of its energy supplies, the reappearance of considerable Chinse natural gas demand should be a cause for concern.

There are thus two healthy and competing narratives about the direction of travel for the year ahead. As ever, we see little utility in trying to predict which will prevail in the near-term. That said, if we had to pick a camp, it does seem premature to us to assume the Fed will pivot to cutting interest rates again this year. Having initially been behind the curve, US policy makers have been at pains to highlight that they see more work to be done before inflation is back under control, and that they are likely to err on the side of caution until they have clearly won. Irrespective of which way the near-term plays out, however, we must confess to being more optimistic about the longer-term outlook than we have been for some time. Following a large sell-off in markets, and a large lift in interest rates, longer-term return expectations across most assets classes have improved considerably. At the end of December 2021, global share markets traded on a price to earnings (P/E) ratio of 19.2 times, while a ten-year US government bond yielded a paltry 1.5%. By the end of 2022, global share markets were trading on a P/E ratio of 15 times, while ten-year US bond yields had reached 3.9%. To our mind that represents a very healthy resetting in the market, and a much more constructive backdrop to be investing from.

Importantly, regardless of how the big picture does unfold, GVF will continue to focus on building investment portfolios that should perform well under most scenarios. Our aim is to generate the bulk of our returns from our discount capture strategy, and not broader market movements. That means that if the optimists are right in the near-term, our lower risk strategy will probably underperform the riskier parts of the market for a little while. However, over the long run, we believe our focus on risk management and less correlated investment returns will continue to serve shareholders very well.

Adjusted NTA Returns[1]

Financial Year	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD[2]
FY2023	1.5%	2.3%	-0.5%	2.5%	1.0%	1.1%							**8.1%**
FY2022	2.8%	2.4%	0.5%	0.0%	2.7%	1.9%	-0.6%	-2.3%	-1.7%	1.3%	-1.7%	-2.2%	**2.8%**
FY2021	1.6%	1.4%	3.2%	2.7%	5.4%	1.4%	2.7%	0.7%	0.4%	2.9%	2.0%	1.8%	**29.3%**
FY2020	2.7%	0.2%	1.4%	-0.3%	2.4%	-0.5%	3.7%	-3.5%	-13.5%	2.4%	6.0%	0.8%	**0.2%**
FY2019	0.8%	2.3%	-0.5%	-1.2%	-2.1%	-1.6%	0.2%	3.2%	-0.4%	1.9%	-0.3%	0.9%	**3.2%**
FY2018	-0.9%	0.4%	1.3%	2.3%	1.7%	-0.9%	0.7%	0.8%	0.0%	1.6%	-0.5%	2.2%	**9.1%**
FY2017	2.0%	1.9%	-0.5%	0.7%	2.7%	3.1%	-2.1%	1.1%	1.8%	2.0%	2.1%	-1.0%	**14.5%**
FY2016	4.6%	-1.0%	-1.0%	2.3%	-1.9%	-0.4%	-1.0%	-0.4%	-1.7%	2.3%	4.0%	-3.0%	**2.4%**
FY2015	0.3%	-0.3%	4.3%	-1.0%	3.1%	2.6%	3.9%	1.3%	1.8%	-0.6%	5.6%	-1.0%	**21.6%**

[1] Adjusted NTA returns are after all fees and expenses and are adjusted for the payment of taxes, dividends, and the effects of capital management initiatives. Performance data is estimated and unaudited. Source: Staude Capital Ltd.

[2] Refers to the full year returns for a given Financial Year, or the year-to-date returns in the current Financial Year.

This report is based on the half-year interim report which has been subject to an independent review by the Auditors, Deloitte. All the documents comprise the information required by Listing Rule 4.2A. This information should be read in conjunction with the 2022 Annual Financial Report.