STAUDE CAPITAL

GLOBAL VALUE FUND

December 2021 half-year review by the Portfolio Manager

"I used to think that if there was reincarnation, I wanted to come back as the President or the Pope, or as a .400 baseball hitter. But now I would like to come back as the bond market. You can intimidate everybody." - James Carville

Before writing these periodic reviews for shareholders, I always start by reading the market commentaries we penned in our monthly updates throughout the period. A reading of these from July to December 2021 comes across like something from the plotline of a cheap paperback thriller. The half-year begins following one of the most profitable investing periods in modern history. Virtually every asset class is enjoying extraordinary gains, the bulls are in ascendance in most market debates, for investors life couldn't be better. As you watch the six months unfold, however, the spectre of a terrifying villain starts to appear on the pages. At first the inflation prints markets are compelled to pay attention to seem almost quaint, a throwback to another era when rising inflation was something investors actually needed to worry about. Slowly, however, the inflation prints start to build. As the months go by, markets rise and fall as a new debate rages – are these increasingly disturbing inflation numbers going to be a temporary phenomenon or, heaven forfend, a new permanent feature of the landscape?

Like any good thriller, the plotline weaves in unexcepted twists. Just as the inflation numbers start to really scare us, the arrival of a new Covid variant, Omicron, placates market fears briefly. Surely more bad news on Covid means more government stimulus, and more central bank market support? While it might have seemed like a perverse logic, these are the two currents that have carried everything higher over the past 18-months. And for a brief window it seems this logic prevails. By late December though, the market narrative on inflation, and thus the risk of rising interest rates, finally capitulates. Looking at the US, year-on-year monthly inflation prints increased from 1.4% in January 2021, to a whopping 7% by December. The villain had become very real, and he was menacing the serene existence investors had become accustomed to.

In August of last year, markets were pricing in the first interest rate rise from the US Federal reserve in April 2023. Four months later, this had moved forward to March 2022, with a further two or three rate rises expected to follow this in quick succession. For markets that had been conditioned to think about money as essentially costless, such a quick repricing of interest rates presented significant risks, most notably for the high-growth technology companies whose market valuations have benefited the most as interest rates have fallen.

As it transpired, markets managed to limp through to January before recording a significant fallout from the shifting paradigm on inflation and interest rate risks. And while January saw a significant market correction, one that affected high-growth FANG stocks the most, over the December half-year we are reviewing, most asset classes still enjoyed a period of healthy gains.

In US$ terms, global share markets[1] rose by 5.6%[2] over the half-year, with a noticeable divergence between the fortunes of share markets in the developed world[3], and those in emerging markets[4]. The former rose by 7.8% over the period, while the latter fell 9.3%. For comparison, the Australian local share market rose by 3.8%.

In contrast to the gains seen in most developed share markets, debt investors had a more challenging time. Both the investment grade[5] and high-yield bond[6] markets were 1.3% lower over the period, while leveraged loans (floating rate debt) rose by 1.9%[7].

For Australian dollar investors like GVF, a 3.1% depreciation in the Australian dollar over the period correspondingly boosts all the returns above. For the December half, global shares markets rose by 9.0% and global debt markets by 1.9%, when both are measured in Australian dollars terms.

---

[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.

[3] As measured by the MSCI Developed World Index.

[4] As measured by the MSCI Emerging Markets Index.

[5] As measured by the Bloomberg Barclays Global Credit index.

[6] As measured by the Bloomberg Barclays High-Yield index.

[7] As measured by the S&P US and European Leveraged Loan indices.

Performance of the portfolio (continued)

For the half-year ended 31 December 2021, the Company's adjusted pre-tax NTA increased by 10.7%[8]. Pleasingly, GVF's investment returns for the period outperformed those of global equity markets, despite the fund running with a see-through equity market exposure of just 39%. For reference, our second largest exposure over the period was to debt securities (predominantly floating rate instruments), which comprised 22% of the portfolio on a see-through basis.

In terms of the attribution of our returns, the Company's discount capture strategy was the largest driver of performance, generating gross (pre-costs) returns of 9.2% over the half. As a reminder for investors, the returns we quote from our discount capture strategy essentially measure the amount of value we have unlocked from the underlying investments the Company has made around the world. As such, we believe it is the most relevant measure of any outperformance or underperformance from our approach. The 9.2% generated over the December half reflects another strong result from our core investment strategy. In addition to these returns, the fund also receives a second source of performance which comes from the underlying assets it has bought at a discount.

The most significant driver of returns during the period was a thematic we have discussed in depth in recent presentations and monthly reports – namely, a 'lag effect' in listed private equity funds. Put simply, we believed this 'lag effect' could see listed private equity funds trade at discounts to asset backing that are far larger than the official headline figures suggest. In effect it presented an opportunity to invest into global equity markets today at yesterday's (much cheaper) prices.

In early 2021, we identified several London-listed funds that we believed were trading at extremely large discounts to asset backing. These included Harbourvest Global Private Equity (HVPE), Pantheon International Participations (PIN) and NB Private Equity Partners (NBPE). Our thesis had been that the NTAs of these listed vehicles would eventually 'catch up' with earlier share market performance, making the true discounts clear.

Pleasingly, we saw this dynamic play out during the six-month period, with these funds enjoying very strong share price gains on the back of strong reported NTA growth, as well as a narrowing of the discounts to asset backing at which they trade. As such, HVPE was GVF's strongest contributor during the period, with PIN and NBPE also adding significantly to our returns. Another listed private equity fund also was a significant contributor, albeit for more idiosyncratic reasons. JPEL Private Equity Limited (JPEL), which is now several years into an orderly wind-down, reported a sale of its largest holding at a 19% premium to carrying value. This helped fund a redemption of approximately 50% of shares at asset backing, which represented a significant premium to the prevailing share price at the time.

Another significant contributor to half-year performance was Amedeo Air Four Plus (AA4) — an investment we discussed in the 2021 Annual Report, when it had been one of the few detractors from performance (albeit a modest one).

AA4 is a complicated and deeply discounted opportunity that we felt offered a compelling risk/reward opportunity due to: a large amount of surplus cash on the balance sheet; long-term Emirates leases that were paid in-full throughout the pandemic, which we believed on their own could fund an extremely attractive dividend yield; and, finally, potential upside from the eventual sale of assets above our conservative assumptions. Consistent with our growing conviction in the investment, GVF added to its holding during the period, most notably in July, when we took advantage of a large block transaction to purchase stock at a double-digit discount to the market price.

---

[8] Adjusted NTA returns are net of all fees and expenses. NTA adjusted for tax payments and the effects of capital management. Source: Staude Capital Ltd.

Performance of the portfolio (continued)

Towards the end of the period, the near-term positive catalysts we had been expecting played out as hoped. A key event was the signing of a restructured lease with Thai. While we had long since placed no value on the leases to Thai (which is currently emerging from a rehabilitation process) this restructuring was an important milestone which, we felt, would allow the board to reinstate a regular quarterly dividend. It also freed up some of the surplus cash that had been held back in case AA4 needed to repossess, maintain, and remarket these aircraft – surplus cash that could be returned to shareholders.

AA4 ended the calendar year announcing it would return £30M of capital, equivalent to 30% of the end-November market capitalisation, via a mandatory redemption. Through this redemption, GVF exited one-fifth of its investment approximately 50% above the pre-announcement share price, and c.65% above where it had acquired the block of stock in July.

GVF's remaining holding in AA4 also performed strongly as the company announced a reinstated dividend, the first instalment of which was paid in January 2022. While this dividend put the shares on an attractive high-teens yield, the board of AA4 has highlighted the possibility of increasing it in future, if prudent. We also believe there is the prospect of further distributions of surplus cash if and when international air travel normalises. As such, AA4 continues to remain a core holding in GVF, despite the share price performance over the December half.

Outlook

Looking ahead, the key driver of asset price returns over coming year will be how inflation, and thus interest rates, progresses from here. With current CPI prints of 7% and 5% in the US and Europe respectively, it is unsurprising to see some commentators beginning to make parallels to the 1970s, and the terrible toll runaway inflation took during that era. While such comparisons are attention grabbing, they seem to be poorly grounded arguments given what we know today. For one, it is clearly the case that much of the rapid rise in inflation we are seeing has come about from a base effect. Headline inflation prints are measures of inflation rates today versus this time a year ago, a time when the pandemic had greatly depressed economic activity. As prior year comparisons start to look more normal, it is highly likely that the prints we are seeing today will noticeably fall.

More relevantly, prior to the pandemic, the Gordian knot facing policy makers was the idea of 'secular stagnation'. Economic growth had consistently disappointed in the decade following the Global Financial Crisis (GFC), and with this, inflation had been running at levels that were far too low for central bankers' comfort. The drivers of secular stagnation are not completely understood, but they include powerful forces such as the ageing of rich-world societies, and technological innovations that are disrupting entire industries. Whether a global pandemic has suddenly wiped away the forces that have depressed inflation and growth for so long is a question that lands well above our paygrade. More important than the question itself, we believe, is how much uncertainty comes with any attempt to answer it. Today, the market is forecasting that inflation will fall back down almost as quickly as it has shot up. Yet it is still expected to settle roughly 0.5% to 1% higher than it was during the decade between the GFC and the Covid pandemic. If this turns out to be the case, then the gentle lift in interest rates that will follow may prove to be nothing more than a frustrating headwind that high-risk asset classes must work their way through. It should not spell disaster, rather, a more subdued level of future returns than investors have been accustomed to recently.

The more troubling alternative to this future path is one where inflation does not slow as quickly or as much as is currently priced in. This could readily become the case if the current very high inflation numbers we are seeing begin to get baked into future inflation expectations, notably through higher wage demands. Under this scenario the outlook becomes much more fraught. Historically, central banks attempt to curb such inflationary cycles tend to end in recessions. At the very least it would imply far higher interest rates than what are expected today, and with this a significant derating of valuations across many asset classes.

Outlook (continued)

Fortunately, we believe GVF will be well placed to perform under either of these future scenarios. Our focus on generating returns from our discount capture strategy - and not broader market movements - means we are reasonably isolated from these bigger picture debates. Said more simply, our aim remains to generate reasonable investment returns for shareholders regardless of the prevailing market weather. Indeed, in recent years, our biggest challenge has been to keep pace with the extraordinarily high returns share markets have enjoyed in an ultra-low interest rate environment, given the lower risk underlying portfolio we run with. If future returns in high-risk asset classes are to become more subdued in the years ahead, a scenario that we think is most likely, then we believe GVF should offer a compelling alternative to the more traditional asset classes available to investors.

Adjusted NTA Returns[8]

Financial Year	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD[7]
FY2022	2.8%	2.4%	0.5%	0.0%	2.7%	1.9%							**10.7%**
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%**

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 2021 Annual Financial Report.