Clime International Fund

Monthly Report February 2020

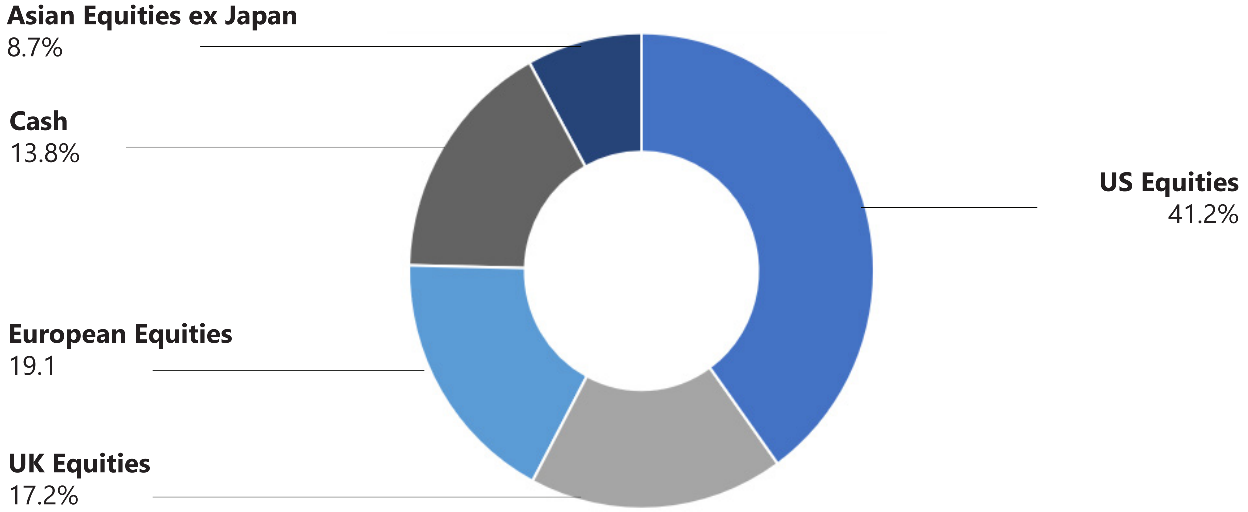
The Clime International Fund (CIF) aims to provide consistent capital growth and income over the long term (5-7 years) by investing in international securities. The Fund is intended to be a medium to high-risk fund, however the ability of the Fund to hold a significant cash position allows for capital preservation and the delivery of a smoother return profile. The Fund seeks to deliver a return in excess of the MSCI World Index.

1 Month Net Return (Wholesale)*	1 - Year Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)*	Total Fund Size
-5.3%	11.2%	9.1%	$104.4m

	1 month	3 months	6 months	1 year	3 years*	5 years*	Inception*
Fund Net Return (Wholesale)*	-5.3%	-1.8%	2.4%	11.2%	10.9%	8.0%	9.1%
Benchmark^	-4.9%	-1.7%	5.4%	11.6%	10.5%	10.3%	10.3%
Excess Return	-0.3%	-0.1%	-3.0%	-0.4%	0.4%	-2.3%	-1.2%

Inception: Wholesale Units: 4 March 2014. Retail Units: 11 March 2015.
*Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Performance figures compare unit price to unit price for the given period.
^10%p.a. from 4 March 2014 and then MSCI World Net Total Return Index in AUD from 1 July 2019.

Asset Allocation



Fund Facts

Portfolio Manager	Pieter Fourie
Fund Inception	March 2014
Fund Size	$104.4m
Cash Distributions	Annually
Eligibility	Wholesale & Retail

Top 5 Holdings

Company	Weight %
Booking Holdings	4.7%
Tencent	4.7%
Alphabet	4.7%
Reckitt Benckiser	4.6%
Intercontinental Hotels Group	4.6%

Portfolio Commentary

The world has been coming to terms with the implications of the coronavirus for some weeks now, but it was only towards the end of last month that we experienced the level of volatility we would expect in equity markets given a crisis of this scale. So why were equities complacent in the face of a potential pandemic, why have they suddenly woken up to the threat, and what is the longer-term outlook as a result?

The fact that equities were slow to react to the potential threat of coronavirus could have been because investors were struggling to find value and safety in bond markets – traditionally the place to shelter from volatility in equity markets. The absence of a suitable, less risky alternative investment was forcing investors to adopt a 'wait and see' approach.

But underestimating the coronavirus was always going to be a risky strategy. Given that one of the world's largest and most important manufacturing economies (China) has practically ground to a halt, it stands to reason this will ultimately feed through to global quarterly business results. Companies less able to cope with changes in supply and demand could well fall victim to this crisis, and there are highly indebted businesses (thanks to years of cheap lending) that rely on a buoyant economy to maintain their balance sheet. We've not yet felt the full impact of the coronavirus, but we will, and we need to be prepared for it. As businesses report their earnings in the coming weeks, it could make for some testing times.

A global health crisis reminds us that the economy is susceptible to forces outside of normal economic cycles and government interventions. We've been constantly re-evaluating our exposures to every company, country and sector since this virus surfaced, and we will continue to do so. Our focus is on resilient businesses with strong balance sheets that are well positioned to cope with an economic downturn and/or an inflation shock.

Of course, all companies can be swept along with short-term negative sentiment, but we're confident in the longer-term outlook of our portfolios and the fact we're well positioned to take advantage of any volatility and opportunities as they arise.

The coronavirus clouds what is otherwise a positive economic outlook. We expect around six months of weak and possibly negative economic growth in some regions. But a recovery should follow, bringing high levels of employment and consumer confidence.

During February we added to our positions in General Dynamics, Booking Holdings, Anheuser-Busch Inbev and Yum! Brands. We exited our position in SPDR Gold and initiated a position in Heineken.

Pieter Fourie
Portfolio Manager

Market Commentary

With February 2020 came the first half reporting season and a significant equity market correction, reflecting growing global fears pertaining to the spread of the coronavirus (COVID-19). When coupled with a somewhat elevated level of equity pricing, the scene was set for a swift reassessment of risk asset exposure. Key indices delivered the following returns for the month:

- S&P/ASX200 Accumulation Index: -7.7%
- All Ordinaries Accumulation Index: -8.1%
- S&P 500 Index (US): -8.2%
- Small Ordinaries Accumulation Index: -8.7%
- FTSE 100 Index (UK): -9.0%
- Emerging Companies Accumulation Index: -14.1%

Many global indices, including those in Australia and the US, corrected in the space of just five days in the final week of February (a correction being a greater than 10% fall). This was the first such occurrence since October 2008 during the depths of the Global Financial Crisis (GFC). It has been an unusual time to say the least!

With the rolling news cycle omnipresent these days, you would be hard pressed to go a day without hearing anything of COVID-19. News of the virus' spread well beyond Chinese borders saw global markets sell off sharply and bond yields collapse, in turn reflecting expectations for a significant slowdown in global growth. While yet to flow through in many datasets, the first insight was provided via China's PMI (Purchasing Managers' Index, a measure of manufacturing trends) release.China's official PMI fell to a record low of 35.7 in February, from 50 in January. Incredibly this was the fastest pace of contraction on record for the survey, surpassing the decline registered during the GFC. Non-manufacturing PMI came in at 29.6, versus the prior reading of 54.1, also the lowest on record. We note that 50 is the level that separates expansion from contraction.

The Current Situation in Context and the Outlook for 2020

Clime's investment strategist Paul Zwi recently noted 'As investors, we are required to deal with probabilities rather than certainties.' While evergreen in nature, this statement is particularly relevant when assessing the degree of social and economic dislocation to be felt in 2020.

We are obviously not epidemiologists, but what happens in the near term will likely depend on several factors, including the tenure of the pandemic, its geographic spread, when a vaccine is prepared for human use and whether the arrival of the northern hemisphere summer provides a degree of abatement. We can observe that all major outbreaks to date (Wuhan, South Korea, northern Italy and Iran) have occurred in geographies with an average maximum February temperature of no more than 11 degrees Celsius.

Travel

In terms of first order effects, we expect the near-term restrictions imposed on travel to adversely impact all travel and tourism related businesses. In the past week alone, leading Australian companies including Lendlease, Telstra, the major banks, and IAG (to name a few) have all banned staff from international travel for work.

Our recent investment management meetings with travel focused businesses suggest a significant curtailment of forward bookings, with employees being requested to use all annual leave and/or cut back to part time for the next few months. We also perceive some risk to the collection of receivables, so balance sheet strength in this sector will never be more important for those exposed.

Education

The education sector forms a significant backbone of Australia's services sector and still represents a fantastic long term opportunity for our country and its plethora of well-respected tertiary institutions. With the imposition of travel bans and a general reluctance to travel, we expect this sector to also be directly impacted.

Manufacturing & Retail

From various recent management meetings and company outlook statements, it is clear that manufacturing and broader supply chains are being directly impacted. Even if goods are not being manufactured in China, significant amounts of componentry are sourced from within China. Some retailers and hardware technology businesses that we have spoken to added inventory prior to the Chinese New Year, so are fortuitously better placed to ride out short term impacts to supply chains. We expect retail more broadly to be impacted by soft consumer sentiment, itself already under pressure from Australia's tragic bushfire season.

Commodities

While the outlook for commodities appears to wax and wane on an almost daily basis, with ongoing monetary support soon to be coupled with significant fiscal stimulation, we remain constructive on exposures to dominant low cost producers with strong balance sheets and healthy cash flows, most notably BHP Group (BHP) and Rio Tinto (RIO).

Concluding Thoughts

The maintenance of focus on investing in quality companies with strong valuation discipline, which when given time allows the wonders of compounding to take place, has to remain the cornerstone of successful long term investment (as opposed to speculation).

We are not seeking to downplay COVID-19 and the likely flow on effects for the global economy in the near term. This will be an especially difficult period for economies and markets. Some counterbalance may be provided by further central bank support (globally co-ordinated) and fiscal stimulus.

Borrowing from Clime Director John Abernethy's recent note in 'The View' (available to Clime Direct subscribers), in Australia, we note that the Government has relented on its promise to produce a budget surplus in FY20. We predict that if the coronavirus continues to affect the Australian economy into the June quarter, substantial tax payment relief will be given to small and midsized businesses. This would help business cashflows at a time when stock levels are falling, and consumer sentiment is challenged.

There is much that can be done by sensible fiscal governance and there is little that the RBA through monetary policy can do other than ensure liquidity is plentiful in financial market and that banks do not restrict essential credit. It will be an interesting few weeks and possibly months for markets. The coronavirus, the US election and the US China trade deal are amongst many other unknowns, but the likely behaviour or responses of central banks and governments is more predictable.

Is that a reason to be bullish in the short term? No. But it is a reason to remain calm, not panic and invest logically at a time when markets are being driven by wild speculation. The long term outlook for world growth looks good and that is what investors (not speculators) need to focus upon.

Specific to asset allocation, we remind investors that tilting asset allocation both across and inside of asset classes will act to build portfolio resilience. Further strategies to bolster resilience include diversifying across asset classes, including cash (even if the return from cash is only marginal); ensuring asset allocations are fit for purpose; focusing on high quality companies; and maintaining a focus on sustainable yield. These strategies have stood the test of time and will continue to do so in the future.

At a portfolio level, we look across our Australian All Cap, Small Cap and International equity portfolios and are excited about the long term opportunity sets for each of these businesses, many of which are executing well on a global scale. When coupled with strong balance sheets and capable management, we anticipate that in aggregate, earnings, dividends and ultimately valuations will be far higher in five to ten years' time. Of course, we remain vigilant and aware of new information but are determined to stay the course, remaining focused on long term objectives.

Thank you for investing alongside us and for your ongoing support of Clime.

Adrian Ezquerro
Head of Investments